農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

2019
Economic Outlook & Investment Strategy

Clarity amid Cacophony

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Global Economic Outlook

Andy Yao, Economist

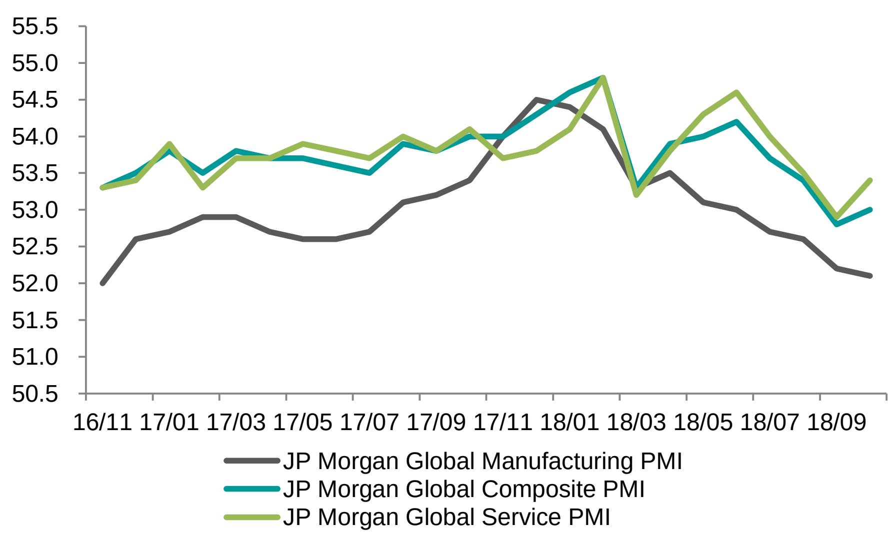
2019 Global Economic Outlook

- The pace of global economic recovery has slowed since the start of 2018, with major central banks tightening monetary policy and trade frictions heating up. Among the major economies, only the US has shown an upward momentum
- Global inflation has ticked up since the start of 2018 on rising energy prices. However, core inflation, excluding food and energy prices, has remained muted on weak wage growth
- Global economic growth is expected to slow in 2019, mainly driven by escalating trade disputes, a reversal of capital flows to emerging market economies, and heightened uncertainty on economic and political policies
- We expect economies in the US, China, Eurozone, Japan and UK to grow by 2.9%, 6.6%, 2.0%, 0.9% and 1.3% in 2018E and 2.4%, 6.3%, 1.7%, 0.8% and 1.3% in 2019E, respectively, compared with 2.2%, 6.9%, 2.4%, 1.7% and 1.7% in 2017

Global growth momentum has already weakened

The pace of global economic recovery has slowed since the start of 2018 with the tightening of monetary policy by major central banks and trade frictions escalating. As shown in Exhibit 1, both the JP Morgan global manufacturing PMI and service PMI moderated in 10M18, pointing to a slowing economic expansion. In response to the abating impetus, investors in the capital markets have been reducing their risky capital holdings. Major stock markets, except that of the US, have declined since the start of 2018.

Exhibit 1: JP Morgan Global PMIs (%)



Source(s): Bloomberg, ABCI Securities

Global trade softened on weaker growth in global manufacturing activity, with the World Trade Outlook Indicator released by WTO falling to 100.3 in Aug and just above the baseline value of 100 for the index. The sub-indicator export order index tumbled to a contraction level of 97.2 in Aug, suggesting trade growth may ease in 2019.

Year to date, global major economies have displayed a trend of differentiation. The US economy has managed to accelerate. In 9M18, the US economy expanded by 2.8%[1] on fiscal stimulus package, which includes tax cuts, compared to 2.2% in 2017 (Exhibit 2). Real GDP in Eurozone, UK, and Japan expanded by 2.1%, 1.3%, and 0.9% in 9M18, respectively, down from 2.4%, 1.7% and 1.7% in 2017. Recent data pointed to a slower growth of 6.7% in China's economy in 9M18, compared with 6.9% in 2017.

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

Real GDP Growth (YoY)	2016	2017	9M18
U.S.	1.6	2.2	2.8
China	6.7	6.9	6.7
Eurozone	1.9	2.4	2.1
Japan.	1.0	1.7	0.9
U.K.	1.8	1.7	1.3

Source(s): Bloomberg, ABCI Securities

Global inflation has ticked up since the start of 2018 on rising energy prices. With OPEC's joint production cuts and rising geopolitical risks in the Middle East, international oil price has been climbing though significant moderation has been observed since early Oct. Inflation in major developed countries has generally gone up, especially in the US and Eurozone. CPI in the US increased from 2.1% in Jan to 2.5% in Oct, while CPI in Eurozone rose from 1.3% to 2.2% during the same period. CPI in China also advanced from 1.5% in Jan to 2.5% in Oct. However, core inflation, excluding food and energy prices, has remained muted on anemic wage growth. In most advanced economies except the US, core inflation has failed to meet central bank targets despite substantial reduction in unemployment rate.

Monetary policies of major central banks have diverged as their economic situations differ. The Fed raised interest rates thrice up till Oct in 2018; and expected another rate hike in Dec 2018, which will be followed by three more in 2019 amid improving economy and rising inflation. At its Aug meeting, BOE raised its policy rate from 0.50% to 0.75%. ECB and BOJ hold firm to their stances of a loose monetary policy, while PBOC has adjusted its neutral monetary policy with a tightening bias to a more loosened one. Moreover, tightening of global liquidity, the rising USD, and the return of capital flow to the US have sent some emerging markets into financial turmoil. Since Apr 2018, currencies in Argentina, Turkey, Brazil and Indonesia have depreciated at an alarming rate. These central banks were forced to raise their policy rates sharply to stabilize their currencies and prevent capital outflows.

[1] All growth rates in the "Global Economic Outlook" section are year-on-year except specified otherwise

Global growth is likely to slow in 2019

Global economic growth is expected to slow in 2019, mainly driven by escalating trade disputes, a reversal of capital flows to emerging market economies and heightened uncertainty on economic and political policies. Moreover, central banks in the US, some emerging markets and developing economies are tightening their monetary policies. Given the heightening trade tensions and tighter credit market conditions in important markets, WTO forecasts merchandise trade volume to grow by 3.9% in 2018E, with trade expansion slowing further to 3.7% in 2019E, down from 4.7% in 2017. According to the latest World Economic Outlook released by IMF in Oct 2018, global economic growth is projected at 3.7% for 2018E and 2019E, 0.2ppt below the World Economic Outlook in Apr 2018 (Exhibit 3). Given that we expect the growth for major economies to slow in 2019, we believe that the 2019 forecast for global growth by IMF is likely to be revised down in the next World Economic Outlook. In OECD's latest Economic Outlook released in Nov 2018, the global economic growth forecast for 2019 is revised down to 3.5% from 3.7% in the May version.

We expect the US economy to expand by 2.4% in 2019E, down from our estimate of 2.9% in 2018E due to fading impact of fiscal stimulus, Sino-US trade disputes, and tighter financial conditions. With the Democrats taking control of House of Representatives in 2019, the Trump government's fiscal stimulus package, including further tax cuts and investments in infrastructure programs, is likely encounter challenges. On the monetary front, we forecast the US interest rate will be raised twice in 2019E, instead of thrice as estimated by the Fed. The reason is that the spread between long and short interest rates in the US government bonds have been narrowing consistently and inflation is likely to remain mild with the global oil price moderation, property price easing, and economic slowdown. If Fed raises the interest rate frequently, the yield curve is likely to become inverted and the US economy is likely to enter a recession. Meanwhile, we estimate the Fed to trim down its balance sheet by US$ 420bn and US$ 600bn in 2018E and 2019E.

In China, escalating tension with the US, housing market restriction, and weak growth in consumption would weigh on economic growth. We maintain our 6.6% and 6.3% GDP growth forecasts for 2018E and 2019E. China is expected to maintain a neutral monetary policy with a loosening bias and proactive fiscal policy to support growth. PBOC is likely to keep the benchmark interest rates steady. We expect targeted RRR to be slashed once in Dec 2018 and thrice in 2019 given the mild inflationary pressure and softening economy.

We project the Eurozone economy to expand by 1.7% in 2019E, down from estimated 2.0% in 2018E, due to trade friction with the US, falling external demand, and uncertainty surrounding domestic politics. Political risks remain elevated in the form of a potential no-deal Brexit, a populist government in Italy, and weakened German leadership. On the monetary front, according to ECB's monetary meeting in Oct, we expect QE to be halted by end-Dec 2018. With a weakening economy, we believe interest rates would remain unchanged for the rest of 2018 and 1H19 before a hike can be considered in 2H19. Meanwhile, we expect the UK economy to grow by 1.3% both in 2018E and 2019E, down from 1.7% in 2017.

We forecast Japan's economic growth to slow from 1.7% in 2017 to 0.9% in 2018E and 0.8% in 2019E due to frail external demand, rising trade protectionism, and weaker business fixed investment. The sales tax hike scheduled in Oct 2019 would weigh on growth. With inflation outlook remaining low and far below the 2% target set by BOJ, we expect the country's ultra-loose monetary stance would be held firmly in place for the rest of 2018 and 2019.

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

Real GDP Growth (YoY)	2017	2018E	2019E
U.S.	2.2	2.9	2.4
China	6.9	6.6	6.3
Euro zone	2.4	2.0	1.7
Japan	1.7	0.9	0.8
U.K.	1.7	1.3	1.3
World (IMF)	3.7*	3.7*	3.7*
World (OECD)	3.6#	3.7#	3.5#

Source(s): IMF, OECD, Bloomberg, ABCI Securities estimates

*Denotes IMF estimates and forecasts

#Denotes OECD estimates and forecasts

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China Economic Outlook

Andy Yao, Economist

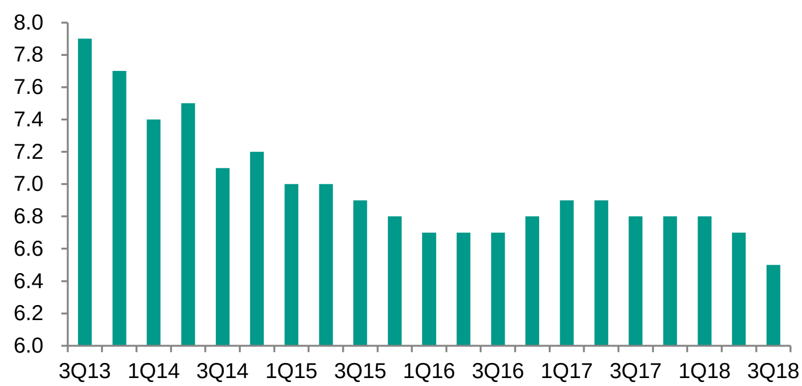
2019 China Economic Outlook

- China's economic growth has slowed slightly since the start of 2018 on weak domestic demand, tightening financial regulatory measures, and rising trade tensions with the US. Official figures show the world's second-largest economy expanded by 6.7% in the first three quarters of 2018, down from 6.9% in the same period last year
- Looking ahead, we expect China's economic growth to slow in 2019 due to the ongoing Sino-US trade frictions, weakening consumption growth, housing market restrictions, and rising credit defaults. However, a looser fiscal stance and a more accommodative monetary policy would prevent sharp economic downturn. We expect China's economy to grow by 6.3% for 2019E, slightly slower than the 6.6% for 2018E
- PBOC is expected to maintain a neutral monetary policy with a loosening bias to support economic growth. It will keep liquidity abundant to support loan growth for private firms and SMEs. Targeted RRR would be slashed thrice or by 2ppt in total in 2019E given the mild inflationary pressure and increasing economic slowdown
- The central government is expected to adopt a more proactive fiscal policy in 2019 to support economic growth through tax and fee reductions, funding support for private sectors, and infrastructure investment projects. We expect fiscal deficit ratio to approach to ~3.5% of GDP in 2019E.

China's economic growth slowed slightly in 10M18

China economic growth has slowed slightly since the start of 2018 on weak domestic demand, tightening financial regulatory measures and rising trade tensions with the US. Official figures show the world's second-largest economy has expanded by 6.7% in the first three quarters of 2018, down from 6.9% for the same period last year (Exhibit 1). A breakdown of the GDP components shows consumption was still the key growth driver, contributing to 5.2ppt to the economic growth in the first three quarters of 2018. Investment only added 2.1ppt to overall growth, while net exports of goods and services reduced growth by 0.6ppt.

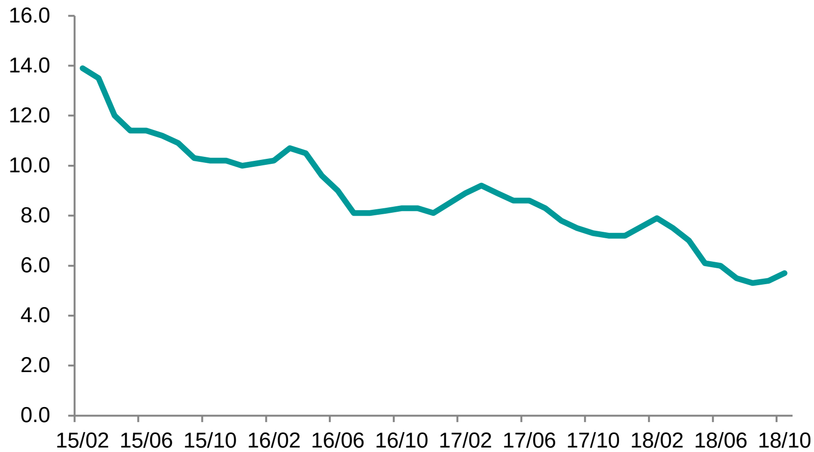
Exhibit 1: China's GDP growth (%)



Source(s): NBS, ABCI Securities

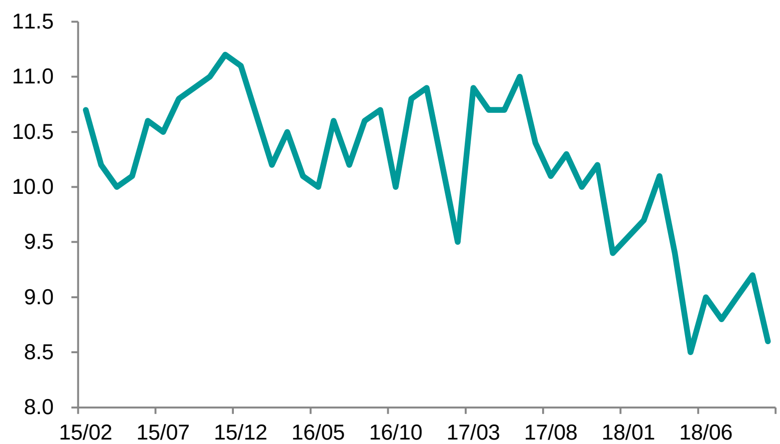
Compared with 2017, domestic demand showed weakness, with both investment and retail sales growth declining in 10M18. FAI growth in urban areas retracted to 5.7% in 10M18 from 7.2% in 2017, which we believe is a result of the slowdown in infrastructure investment amid tightened fiscal spending (Exhibit 2). Retail sales growth also decelerated to 9.2% in 10M18 from 10.2% in 2017, mainly attributable to consumption being squeezed by a surge in residential home loans and weak car sales due to tax rebate phasing out (Exhibit 3). On the production side, the real growth of industrial output slowed to 6.4% in 10M18, compared with 6.6% in 2017.

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



Source(s): NBS, ABCI Securities

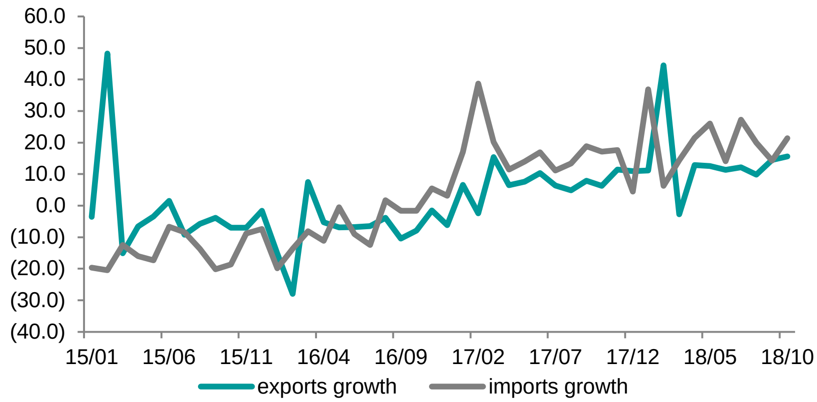
Exhibit 3: China's retail sales growth (%)



Source(s): NBS, ABCI Securities

On the external front, both exports and imports rebounded significantly in 10M18 despite the Sino-US trade disputes since Mar 2018 (Exhibit 4). The USD value of China's exports grew by 12.6% in 10M18 on the back of RMB depreciation and export rush effect, well above the 7.9% increment in 2017. Imports climbed 20.3% in 10M18, compared with the 15.9% increase last year. With the substantial import growth, trade balance narrowed to US$ 254.2bn in 10M18 from US$ 334.8bn in 10M17.

Exhibit 4: China's export and import growth (%)



Source(s): NBS, ABCI Securities

Inflation diverged in 10M18. CPI inched up to 2.1% in 10M18 from 1.6% in 2017, driven by risen food prices. However, PPI eased significantly to 3.9% in from 6.3% during the same period due to weak domestic demand and high base effect.

On the monetary front, PBOC has adopted a neutral monetary policy with a loosening bias since the start of 2018. It slashed targeted RRR four times in 10M18 to lower financing costs. We still expect to have another RRR cut before the end of 2018. Although the benchmark interest rates set by PBOC has stayed unchanged, yields of the government bonds and seven-day repurchase rate, which measures market interest rates, trended downwards. On the other hand, PBOC and CBIRC strengthened financial regulations, particularly in the area of shadow banking system. M2 growth decelerated to 8.0% in Oct 2018 from 8.8% in the same month last year, while new social financing, a comprehensive measure of all types of financing for the real economy, fell to RMB 14.6tn in 10M18 from RMB 16.8tn in 10M17

Economic growth is set to slow for 2019

Looking ahead, we expect China's economic growth to slow in 2019 due to the ongoing Sino-US trade frictions, weakening consumption growth, housing market restrictions and rising credit defaults. In our view, a looser fiscal stance and a more accommodative monetary policy would prevent sharp economic downturn.

Domestically, infrastructure investment is expected to pick up in 2019 as the issuance pace of local government bonds quickens and fiscal spending accelerates. Property regulation will remain tight, and property investment is likely to fall back slightly as land auction failure has increased since July and property sales have slowed since 3Q18. Manufacturing investment will remain steady amid lower tax and financing costs. Overall, we predict total FAI growth to slow to 5.5% in 2019E from our estimated 5.8% in 2018E. Retail sales are expected to remain weak in 2019 on the sluggish income growth, though personal income tax reform would help underpin consumer spending. We expect retail sales growth to slow to 9.0% in 2019E from our estimated 9.2% in 2018E. Externally, frictions over trade between the US and China cast uncertainties on trade growth in 2019, though leaders of both countries at the post-G20 Summit meeting agreed to put additional tariffs on hold for 90 days and intensify their further bilateral negotiations. We forecast the growth of exports and imports to ease to 7.0% and 12.0% in 2019E respectively from our estimated 12.0% and 20.0% in 2018E. On the whole, we expect China's economy to grow by 6.3% for 2019E, slightly slower than the estimated 6.6% for 2018E (Exhibit 5).

Exhibit 5: Economic forecasts

Economic indicators	2017	2018E	2019E
Real GDP growth, %	6.9	6.6	6.3
FAI growth, %	7.2	5.8	5.5
Retail Sales growth, %	10.2	9.2	9.0
Export growth in USD terms, %	7.9	12.0	7.0
Import growth in USD terms, %	15.9	20.0	12.0
Industrial Production growth, %	6.6	6.5	6.2
CPI, %	1.6	2.2	2.0
PPI, %	6.3	3.5	2.5
M2 growth, %	8.2	8.5	8.5
Aggregate Financing, RMB bn	22,397	18,000	20,000
New Yuan Loans, RMB bn	13,523	15,500	17,000
Spot CNY per USD, End-year	6.5068	6.9000	7.0000

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

CPI inflation is expected to ease slightly to 2.0% in 2019E from the estimated 2.2% in 2018E due to lower oil price and easing property price. We forecast PPI inflation to ease to 2.5% in 2019E from the 3.5% for 2018E with commodity prices moderating and domestic demand softening. We believe the direction of macro policy will not be constrained by inflation in 2019.

On the monetary front, PBOC is expected to maintain a neutral monetary policy with a loosening bias to support economic growth. PBOC is likely to keep liquidity abundant to support loan growth for private firms and SMEs. We predict new RMB-denominated loans and new aggregate financing to increase by 9.7% and 11.1% to ~RMB 17.0tr and ~RMB 20.0tr in 2019E. Meanwhile, we expect the authority to lower interest rates of open market operations and various instruments such as SLF, MLF and more, though it will keep the benchmark interest rates steady in 2019E. Targeted RRR would be slashed thrice in 2019E given the mild inflationary pressure and increasing economic slowdown. We expect RRR for large financial institutions to be 12.0% and RRR for medium and small financial institutions to be 10.0% for end-2019E. Broad money supply (M2) is set to grow by about 8.5% in 2019E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 7.0000 by end-2019E with the rising US interest rates, as compared to the estimated 6.9000 for end-2018E.

The central government is expected to adopt a more proactive fiscal policy in 2019 to support economic growth through tax and fee reductions, funding support for private sectors, and infrastructure investment projects acceleration. The Minister of Finance released a detailed draft plan for personal income tax cuts, while the enterprise income tax and VAT cuts are on the cards in 2019. The State Council issued a policy report requesting support for reasonable financing requirements for infrastructure investment. We expect faster growth in fiscal expenditure than fiscal revenue to result in another fiscal deficit in 2019, with the headline ratio approaching to about 3.5% of GDP.

Investment Strategy

Philip Chan, Head of Research

2019 Investment Strategy
Identifying major trends in a noisy environment

Looking forward, we expect potential adverse externalities caused by the Sino-US conflict, the NATO-Russia confrontation, Brexit, as well as financial instability of some Eurozone and emerging countries to persist in 2019-20. Nonetheless, China will continue to proceed with the regional development strategies such as the Belt & Road Initiative, Guangdong-HK-Macau Greater Bay Area Development, Yangtze River Belt Development, and Beijing-Tianjin- Hubei Development. To stabilize and sustain economic growth, China will continue to implement supply-side structural reform to increase effective supply and enhance efficiency of resources allocation, revitalize rural area to narrow rural-urban income gap, and effectuate the China 2025 industrial strategy to elevate the global competitiveness of the country's products in the long run. We have identified a few major trends that form the basis of our investment opinions.

- Major central banks are slowing asset growth, depressing prices of risky assets
- The US will raise real interest rate, suppressing consumption and investment
- China will lower real interest rates, boosting consumption and investment
- New Sino-US relationship will support market diversification as an investment theme
- Investment return outlook: a falling Sharpe ratio
- Demographic trend and IT trend will determine investment cycle
- Hang Seng Index(HSI) in 2019: 23,000-31,700

Central banks are constraining or reversing balance sheet growth

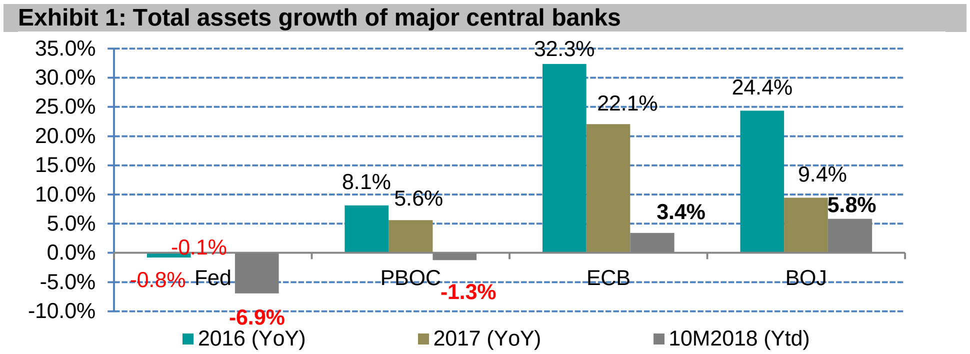
The Fed contracted its balance sheet by ~7% YTD in 10M18; PBOC, ECB and BOJ have also suppressed growth in their balance sheets in 2018. The PBOC downsized its balance sheet by 1.3% YTD in 10M18 after the 8.1% YoY expansion in 2016 and 5.6% YoY increase in 2017. Balance sheet growth of ECB slowed down from 22% YoY in 2017 to 3.4% YTD in 10M18. BOJ also sharply constrains its balance sheet growth to 5.8%YTD in 10M18 from 9.4% YoY in 2017. We expect the downsizing trend to continue for the four major banks in 2019-20.

A loosened fiscal policy is employed to cushion the adverse impacts of central banks' balance sheet tightening. Hence, risk-free rate is going up, as supply of liquidity is contracting or slowing while the supply of government debts is increasing.

As major central banks continue to slash their balance sheets, downward adjustments of global asset prices will accelerate.

Industry consolidation will become an inevitable trend in coming years due to the crowding out effect.

Exhibit 1: Total assets growth of major central banks



Source(s): The Fed, PBOC, ECB, BOJ, Bloomberg, ABCI Securities

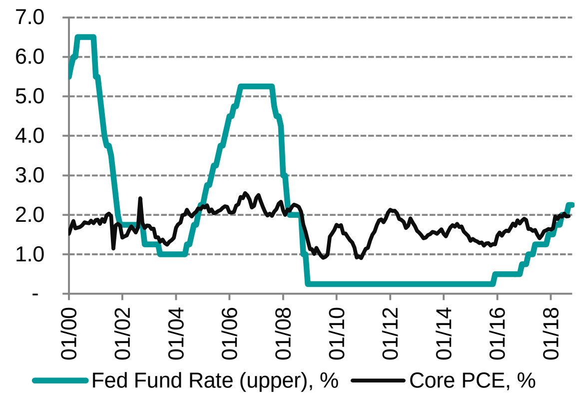
Ripple effect of positive real interest rate in the US will spread in 2019-20

The Fed has formed an increasingly positive real interest rate environment in 2018. After the three rate hikes in 10M18, the Fed Fund rate has climbed above core PCE, the first time since early 2008. A positive real interest rate environment has been formed. The real interest rate is likely to rise further in 2019 with the market anticipating the Fed to raise rate again in Dec 2018, to be followed by one to two hikes in 2019E.

Consumption and investment growth in the US will be suppressed in 2019-20 when real interest rate is edging higher in 2019. Adverse impacts will spill over to other countries exporting to the US in 2019-20.

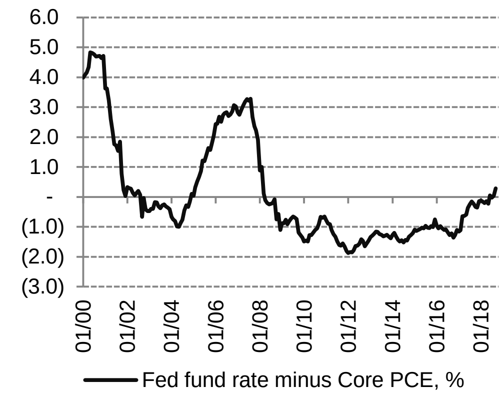
The ripple effect will spread to China, Mexico, and Germany since they are major trading partners of the US.

Exhibit 2: US Fed fund rate vs. personal consumption expenditure core price index



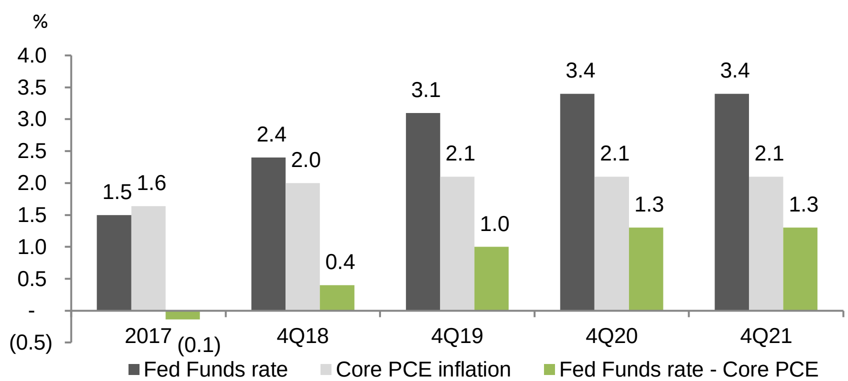
Source(s): The Fed, Bureau of Economic Analysis, Bloomberg, ABCI Securities

Exhibit 3: Fed fund rate minus Core PCE (%) : positive real interest rate environment is forming



Source(s): The Fed, Bureau of Economic Analysis, Bloomberg, ABCI Securities

Exhibit 4: The Fed expects gap between Fed funds rate and Core PCE to enlarge further in 2019-20



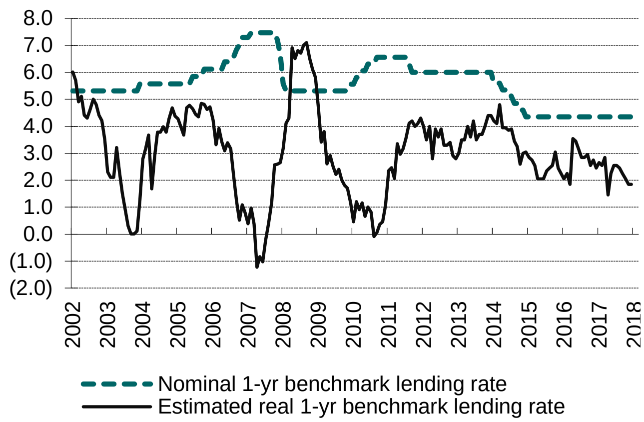
Note(s): Projection from 4Q18 to 4Q21 was released by the Fed in Sep 2018
Source(s): The Fed, ABCI Securities

China will need to maintain a low real interest rates environment to boost consumption and investments

To stabilize economic growth and facilitate structural change in economic growth, China needs to maintain a negative real interest rate environment in 2019-20 to boost consumption and investments. Frequent deployment of counter-cyclical measures can be expected.

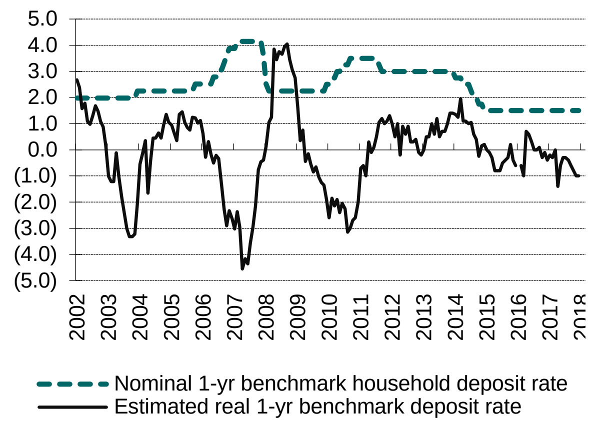
During the three major economic crises (SARS in 2003, US subprime debt crisis in 2008 and Europe sovereignty debt crisis in 2010), China's real lending interest or deposit rates fell to the negative territory. Since real lending rates at present remain high, we believe the option of lowering real lending rates to support investment and consumption growth in 2019 becomes increasingly viable.

Exhibit 5: China Nominal & Real 1-Year Benchmark Lending Rate (%)



Source(s): PBOC, NBSC, ABCI Securities

Exhibit 6: China Nominal & Real 1-Year Benchmark Deposit Rate (%)



Source(s): PBOC, NBSC, ABCI Securities

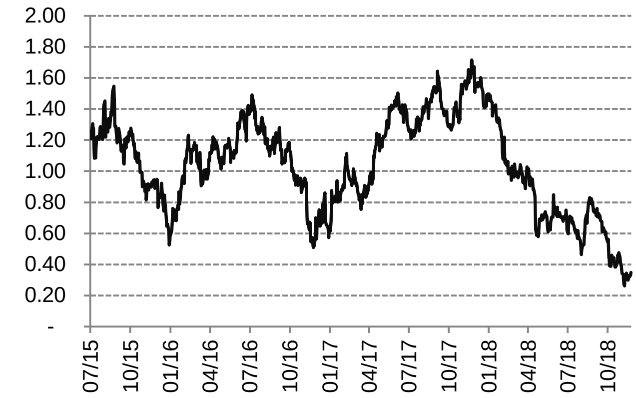
Investment implications of new Sino-US relationship

Escalation of Sino-US confrontations will significantly lower the degree of synchronization of economic cycles in the medium to long term. Low-beta or negative-beta investment diversification becomes necessary. With the de-synchronization of economic cycles, market diversification strategy turns increasingly meaningful. In the long run, global investors will have more low-correlation choices.

RMB exchange rates have become more market-driven in recent years and the government has increased channels to facilitate the capital flow. Subsequently, China has been gaining more control over the local interest rate cycle, reducing the need to strictly follow the US one.

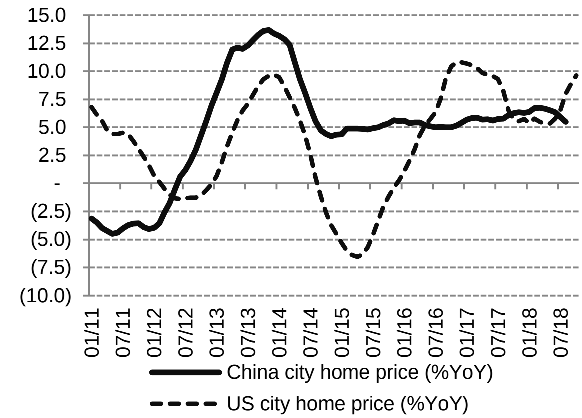
Property cycles in China and the US have de-synchronized since 2016. The increasing difference in China and US interest rate cycles has also resulted in higher volatility of RMB exchange rate. The falling yield gap between China and the US is one of leading causes behind RMB's devaluation against the USD in 2018. Offshore investors keen on bargain hunting have been accumulating RMB-denominated assets in China. We estimate offshore investors or institutions have net bought RMB 227bn of A-shares in 11M18 via the northbound of China-HK Stock Connect and RMB 53bn onshore bonds in 10M18.

Exhibit 7: China -US 10 yrs treasury yield gap (ppt)



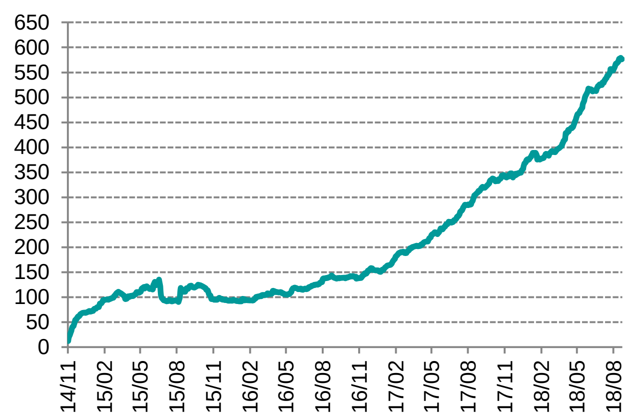
Source(s): Bloomberg, ABCI Securities

Exhibit 8: China , US home price change (%YoY)



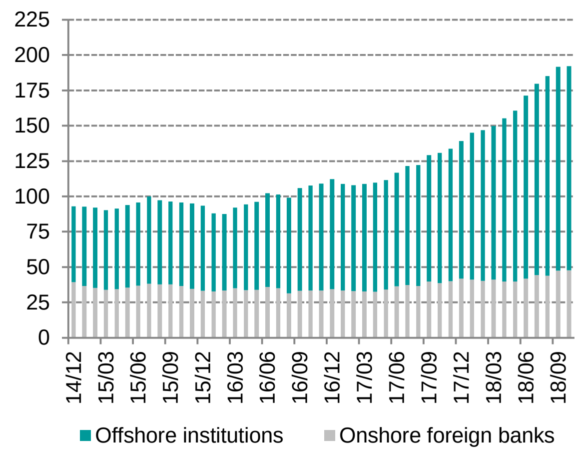
Source(s): S&P/Case-Shiller, NBSC, Bloomberg, ABCI Securities

Exhibit 9: SH-HK and SZ-HK Connect: Northbound cumulative net buy A shares (RMB bn)



Source(s): HKEX, Bloomberg, ABCI Securities

Exhibit 10: Onshore bonds holding (RMB bn)



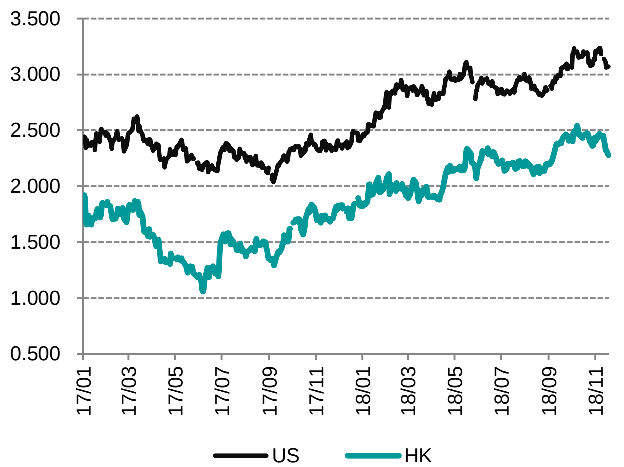
Source(s): SAFE, ABCI Securities

Investment return outlook: falling Sharpe ratio

Sharpe ratio will fall due to higher return on risk-free assets and higher expected price risk.

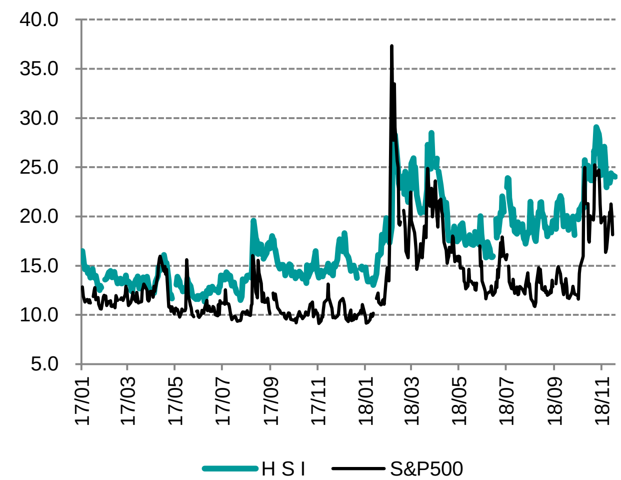
Dwindling Sino-US relationship has elevated systematic risk. The increase in volatility index indicates investors have to bear higher market risks. Meanwhile, the increase in US treasury yields suggests the extra investment return from investment (ROI minus risk-free rate) is likely to diminish. The risk-return profile is weighed on the risk side. Investors should consider allocating a relatively high proportion of funds in cash position in their portfolio.

Exhibit 11: 10-year government bond yields (%) are trending up



Source(s): Bloomberg, ABCI Securities

Exhibit 12: Volatility indices of Hang Seng Index and S&P500 are trending up



Source(s): Bloomberg, ABCI Securities

Industries in an uptrend cycle

2019 - 2020 up-cycle industry:

(1) IoT services - cloud computing and artificial intelligence services

- Alibaba (BABA US): Cloud computing segment is one of the fastest growth businesses in Alibaba. The segment's revenue jumped 101%YoY/ 93%YoY/ 90%YoY to RMB13.4 bn/ RMB4.7bn/ RMB 5.7bn in FY3/18, 1QFY19 and 2QFY19. EBITDA loss margin reduced from 6% in FY3/18 and 10% in 1QFY19 to 4% in 2QFY19.

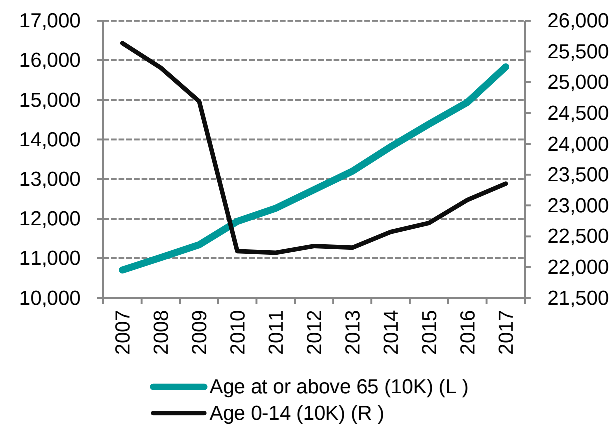
- Tencent (700 HK): Cloud services revenue doubled in 9M18 to over RMB 6bn. It plans to integrate its proprietary technologies into cloud-based solutions. Healthcare and transportation are two major ecosystems with the applications of cloud computing, AI and big-data analytics capabilities.

- Microsoft (MSFT US): Its intelligent cloud business segment contributed 32.5% and 32.9% of total revenue and total operating income in FY18, implying FY14-18 CAGRs of 10.3% and 8.1%.

- We believe the commercialization of 5G telecom services in 2020 will accelerate the applications of IoT services, boosting demand for clouding computing and AI.

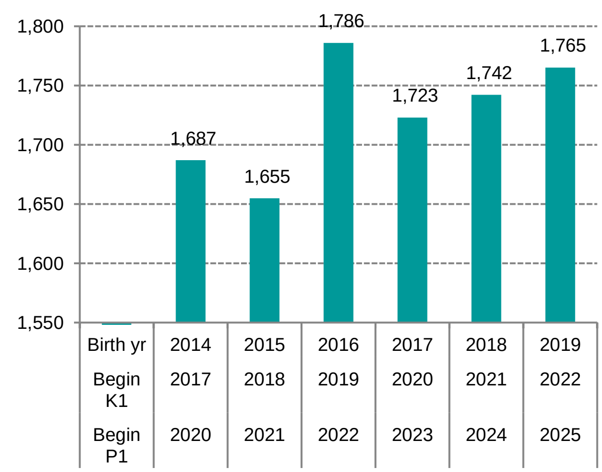
(2) Living standard services: Demographic profile of China will continue to drive demand for healthcare, education, tourism, environmental protection and clean energy.

Exhibit 13: Growing population of seniors and children



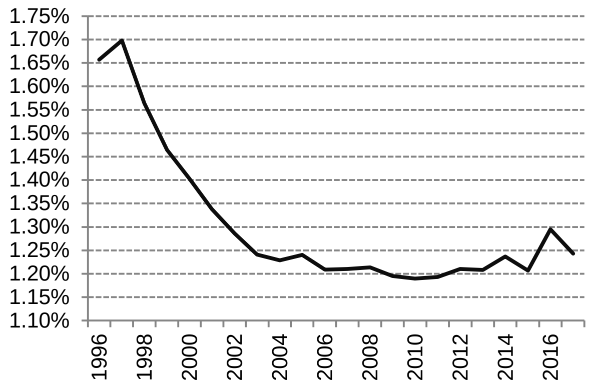
Source(s): NBSC, ABCI Securities

Exhibit 14: Newborns (10,000) in 2016 will enroll in kindergartens in 2019E-20E



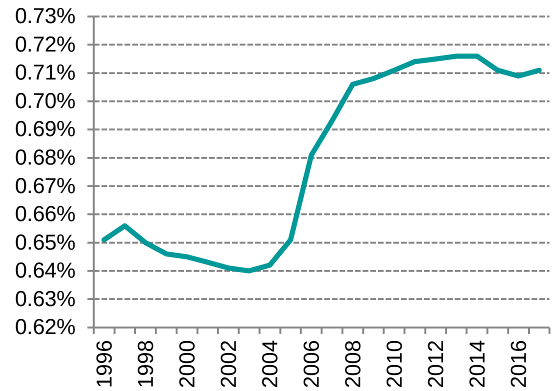
Source(s): NBSC , ABCI Securities estimates

Exhibit 15: Rebounding birth ratio to drive up demand for education resources



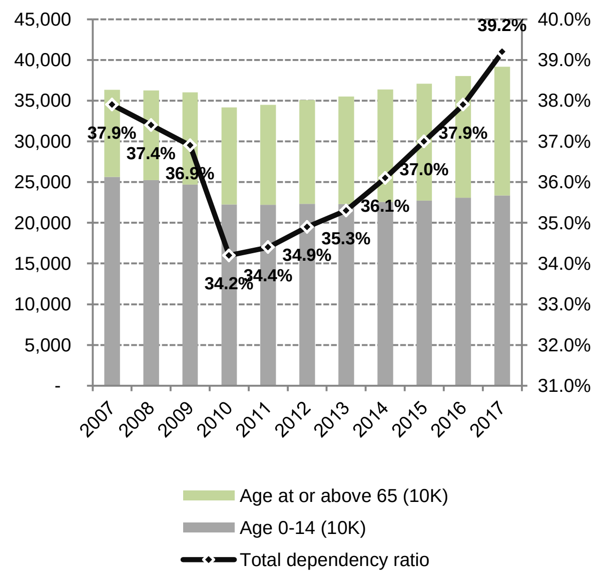
Birth rate: new born / avg.population
Source(s): NBSC, ABCI Securities

Exhibit 16: Surging mortality ratio raises concerns of environmental protection issue



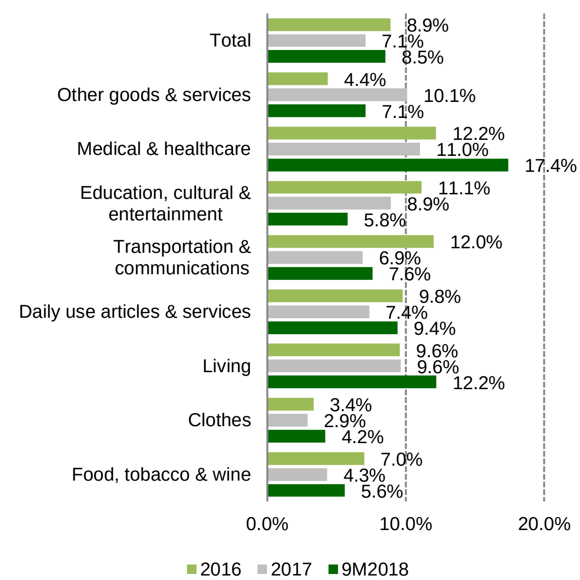
Mortality rate: # of death / avg.population
Source(s): NBSC, ABCI Securities

Exhibit 17: Increasing dependency ratio will alter consumption and saving behaviors in coming years



Dependency ratio: (Population of age <15 & >64)/ population of age 15-64
Source(s): NBSC, ABCI Securities

Exhibit 18: Increasing per capita spending (%YoY) on healthcare and living will suppress consumption growth in other categories

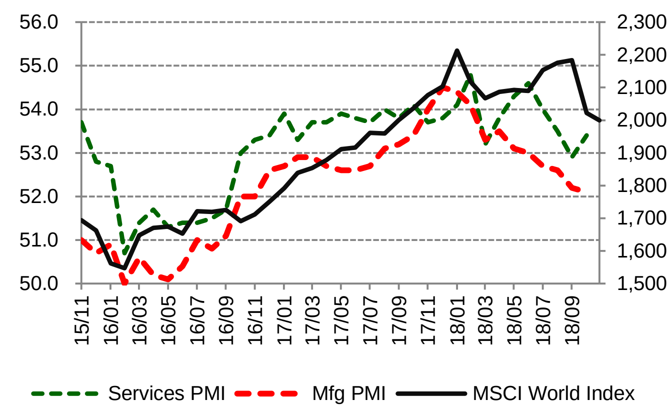


Sources: NBSC, ABCI Securities

MSCI World Index has been weakening. Earnings growth is temporarily boosted by fiscal stimulus, but momentum is unlikely to sustain in 2019

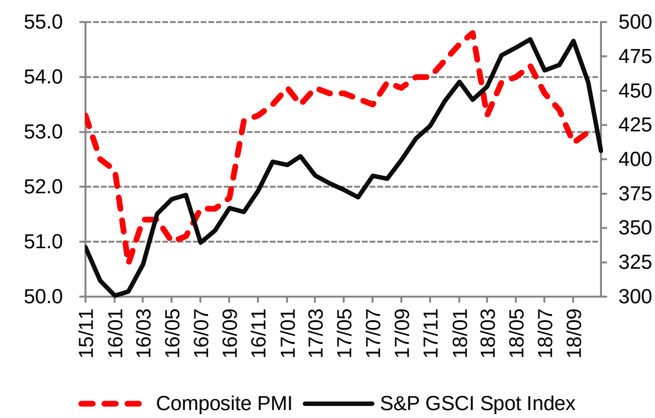
Global major stock market indices in 2018 weaken on expected slowdown in corporate profit growth on reduced momentum in economic activities. Slowing growth in global manufacturing and services activities, as indicated by the PMI data, has quelled the stock market and triggered selling of commodities in 2018.

Exhibit 19: JPM Global Services and Mfg PMI (L) vs. MSCI World Index (R) – slowdown in expansion of global economies since early 2018



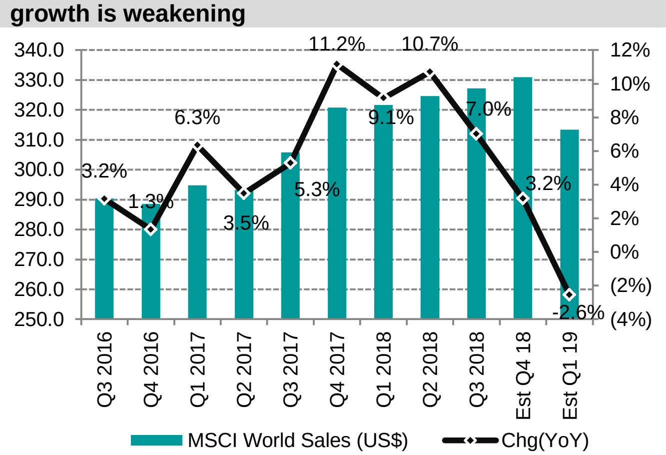
Source(s): Markit, Bloomberg, ABCI Securities

Exhibit 20: JPM Global Composite PMI (L) vs. S&P GSCI Spot Index (R) – investment demand in commodity market has been contracting in 2H18



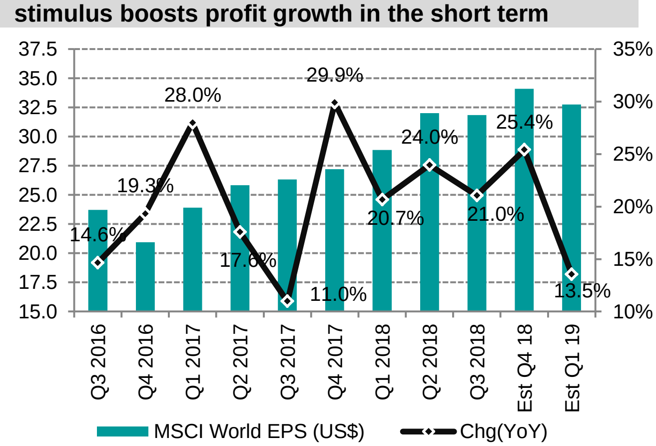
Source(s): Markit, Bloomberg, ABCI Securities

Exhibit 21: MSCI World Index Sales (US$) – top line growth is weakening



Source(s): Bloomberg, ABCI Securities

Exhibit 22: MSCI World Index EPS (US$) – fiscal stimulus boosts profit growth in the short term



Source(s): Bloomberg, ABCI Securities

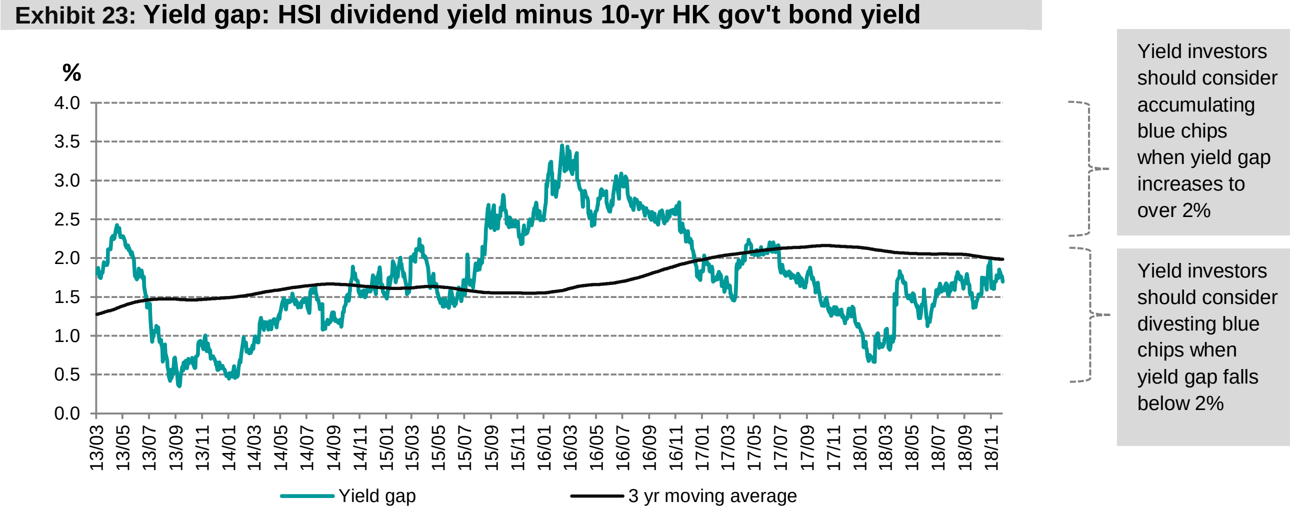
Hong Kong Stock Market

- Reduce weight of growth stocks or risky assets; increase weight of value stocks and cash positions
- Adjust the return on investment expectations
- Divest low-return assets to reduce leverage and optimize return on investment
- Diversify investment markets and time the differences of economic cycles in China and the US
- Prepare for liquidity crunch as major central banks will limit balance sheet growth

Hong Kong's blue chips are not attractive unless yield gap (dividend yield minus treasury yield) expands to more than 2.0 ppt

The increase in HK treasury yield drives up the opportunity cost of value investors holding blue chips. The three-year average yield gap between HSI dividend yield and HK 10-year treasury yield is ~ 2% (with standard deviation of 0.6 ppt). Value investors should consider accumulating blue chips if the yield gap expands to expand to over 2%.

Exhibit 23: Yield gap: HSI dividend yield minus 10-yr HK gov't bond yield



Hang Seng Index 26682
Source(s): Bloomberg, ABCI Securities

HSI trading range

Taking consideration of profitability, growth momentum, payout and historical market valuations, our forecasts for the trading range of HSI in coming years are as follows:

a) 2018E trading range projection: 24,540-33,484, equivalent to 10.31x-14.06x FY18E P/E, 1.13x-1.54x FY18E P/B, or 4.07%-2.98% FY18E dividend yield

b) 2019E trading range projection: 24,488-31,637, equivalent to 9.29x-12.00x FY19E P/E, 1.05x-1.36x FY19E P/B, or 4.39%-3.39% FY19E dividend yield

c) 2020E trading range projection: 25,169-34,779, equivalent to 8.68x-12.00x FY20E P/E, 1.00x-1.38x FY20E P/B, or 4.60%-3.33% FY20E dividend yield

Exhibit 24: HSI market valuation

	2014-18	2018E	2017	2016	2015	2014
Hang Seng Index						
High		33,484.08	30,199.69	24,364.00	28,588.52	25,362.98
Low		24,540.63	21,883.82	18,278.80	20,368.12	21,137.61
Index EPS YoY chg	Avg. 3.9%	(1.6%)	34.8%	(12.4%)	(14.2%)	12.7%
Index NBV YoY chg	Avg. 6.0%	(0.4%)	14.5%	1.3%	5.0%	9.82%
Index ROAE	Avg. 11.5%	10.96%	11.86%	9.50%	11.17%	13.97%
Index payout	Avg. 41.9%	41.95%	42.35%	45.32%	42.19%	37.82%
PER (x)						
High	14.06	14.06	12.48	13.57	13.95	10.62
Low	8.85	10.31	9.04	10.18	9.94	8.85
P/B (x)						
High	1.54	1.54	1.39	1.28	1.52	1.42
Low	0.96	1.13	1.00	0.96	1.08	1.18
Yield						
Low	2.98%	2.98%	3.39%	3.34%	3.02%	3.56%
High	4.68%	4.07%	4.68%	4.45%	4.24%	4.27%

Notes: 2018 data up to Nov 28
Source(s): Bloomberg, ABCI Securities

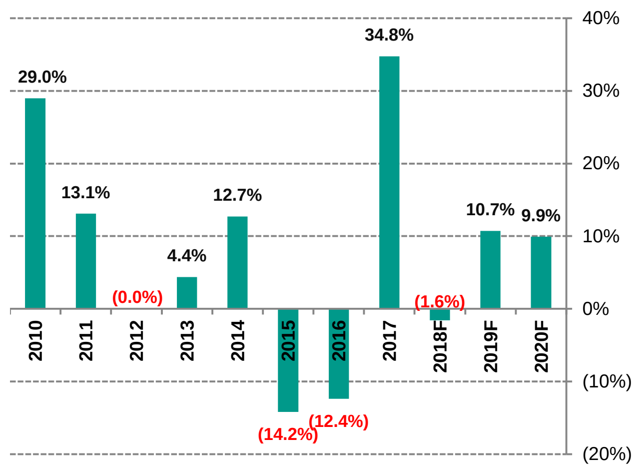
Exhibit 25: HSI projections for 2019E-20E

Period: 2019	High	Low	Year end
Index	31,637	24,488	30,319
Implied 2019 P/E	12.00	9.29	11.50
Implied 2019 P/B	1.36	1.05	1.30
Implied 2019 yield	3.39%	4.39%	3.54%
Period: 2020	**High**	**Low**	**Year end**
Index	34,779	25,169	31,880
Implied 2020 P/E	12.00	8.68	11.00
Implied 2020 P/B	1.38	1.00	1.27
Implied 2020 yield	3.33%	4.60%	3.63%

Source(s): Bloomberg, ABCI Securities

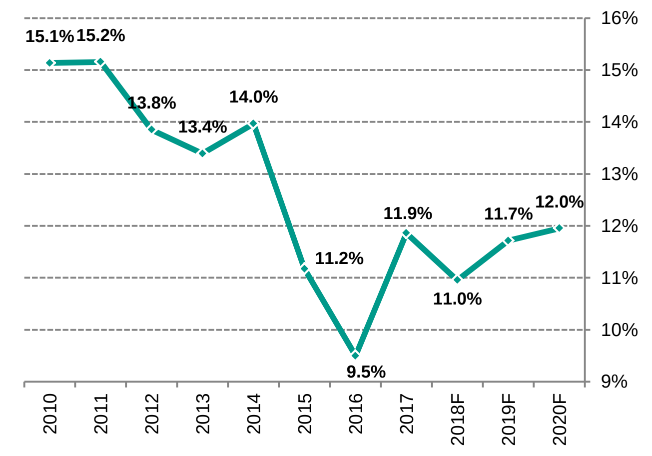
HK Blue Chips

Exhibit 26: HSI EPS chg (YoY)



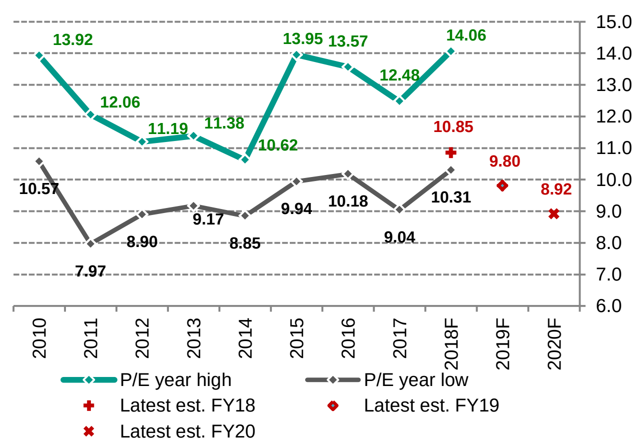
Source(s): Bloomberg, ABCI Securities

Exhibit 27: HSI ROAE



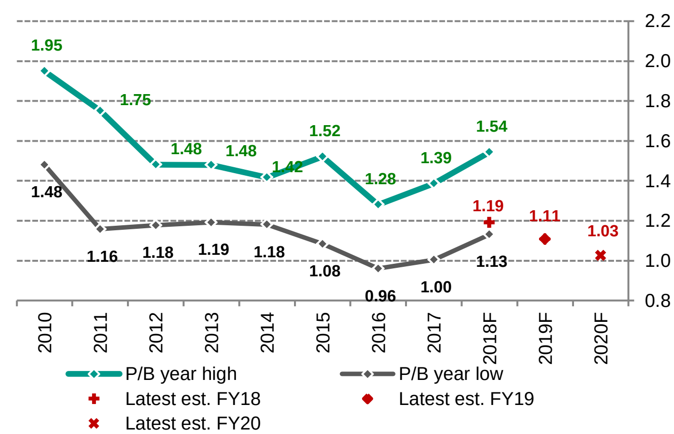
Source(s): Bloomberg, ABCI Securities

Exhibit 28: HSI P/E (x)



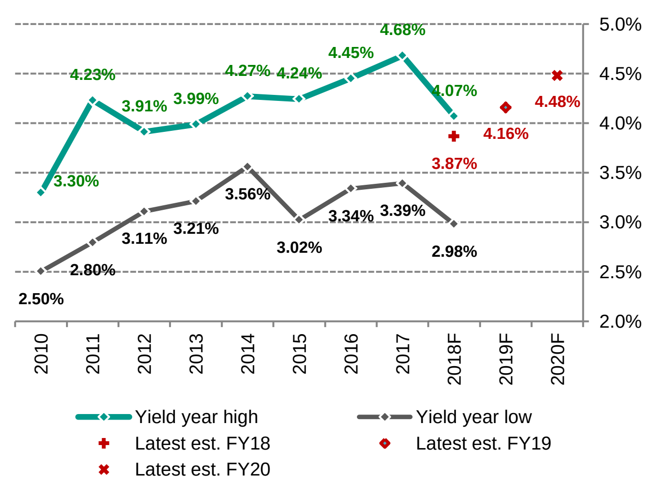
Index (11/28/2018): 26682.56
Source(s): Bloomberg, ABCI Securities

Exhibit 29: HSI P/B (x)



Index (11/28/2018): 26682.56
Source(s): Bloomberg, ABCI Securities

Exhibit 30: HSI dividend yield (%)



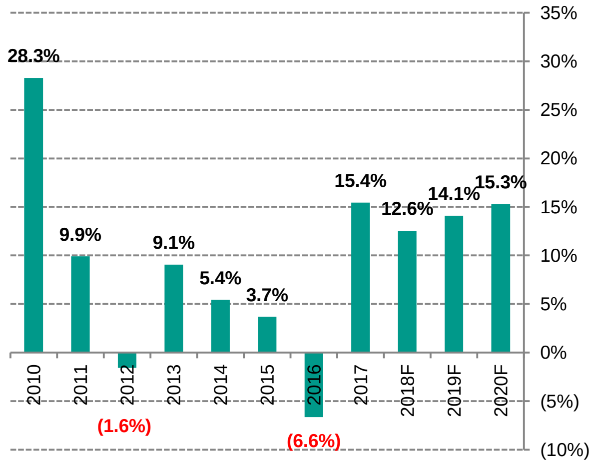
Index (11/28/2018): 26,682.56
Source(s): Bloomberg, ABCI Securities

Outlook for 2019

- Risk of downward earnings revision exists; EPS growth could be softer than currently expected
- Floor of market valuation range will go lower
- HSI trading range estimates at 24,500-31,600, representing FY19E P/E range of 9.3x-12.0x or FY19E P/B range of 1.05x-1.36x

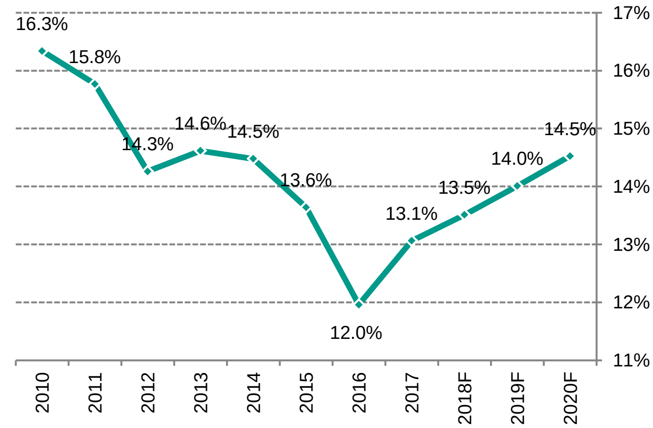
China Blue Chips

Exhibit 31: CSI 300 Index EPS chg (YoY)



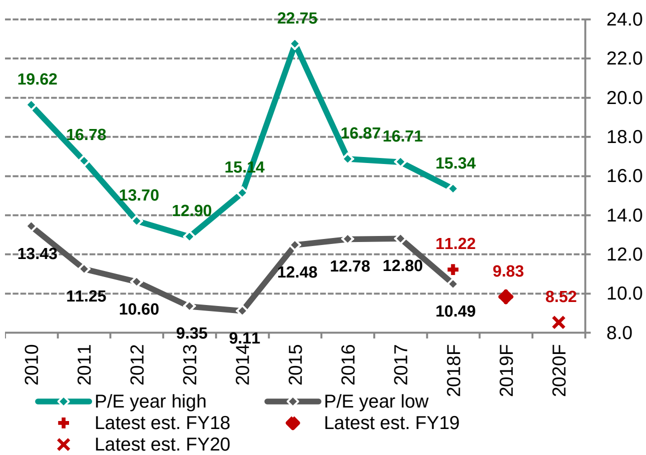
Source(s): Bloomberg, ABCI Securities

Exhibit 32: CSI 300 Index ROAE



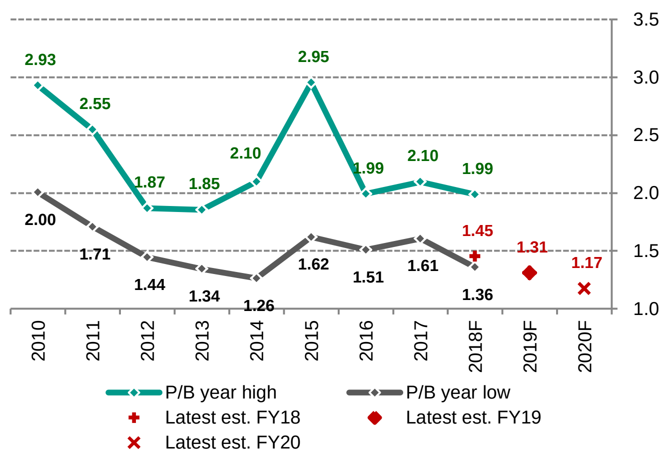
Source(s): Bloomberg, ABCI Securities

Exhibit 33: CSI 300 Index PER (x)



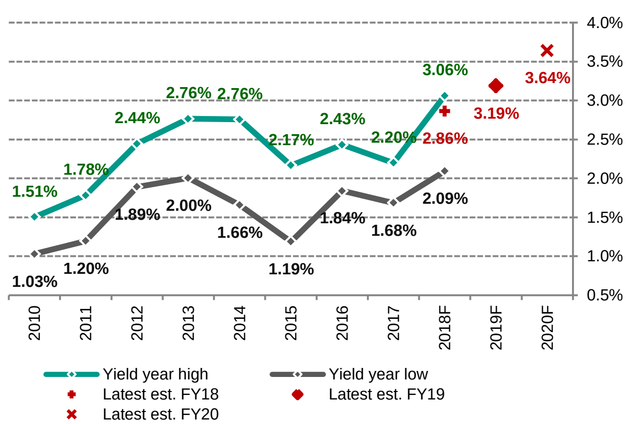
Index (11/28/2018): 3218.41
Source(s): Bloomberg, ABCI Securities

Exhibit 34: CSI 300 Index P/B (x)



Index (11/28/2018): 3218.41
Source(s): Bloomberg, ABCI Securities

Exhibit 35: CSI300 Index dividend yield (%)



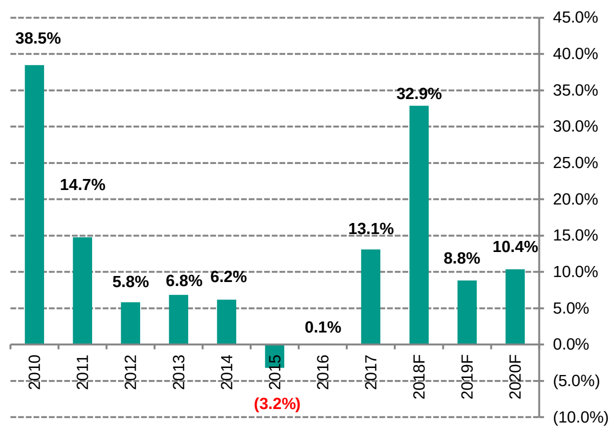
Index (11/28/2018): 3218.41
Source(s): Bloomberg, ABCI Securities

Outlook for 2019

- Risk of downward earnings revision exists; EPS growth could be softer than currently expected
- Floor of market valuation range will go lower
- CSI 300 Index range at 3,100-4,260, representing FY19E P/E range of 9.4x-13.0x or FY19E P/B range of 1.26x-1.73x

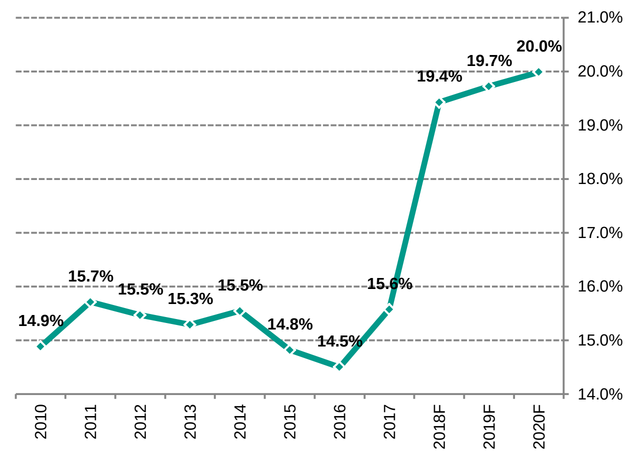
US Blue Chips

Exhibit 36: S&P 500 Index EPS chg (YoY)



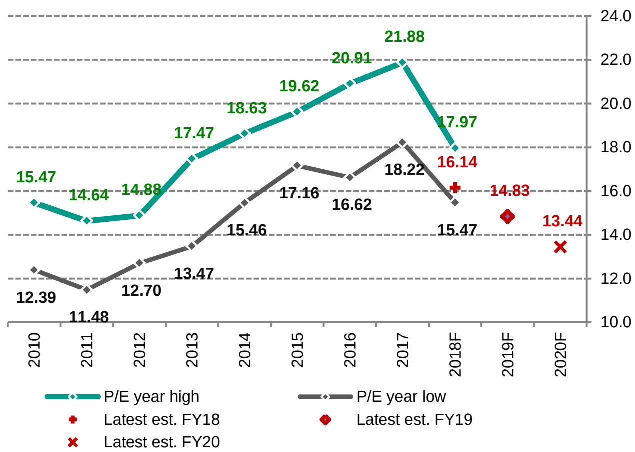
Source(s): Bloomberg, ABCI Securities

Exhibit 37: S&P 500 Index ROAE



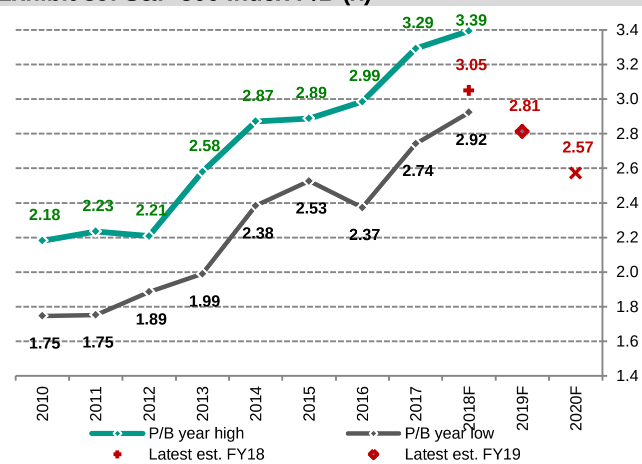
Source(s): Bloomberg, ABCI Securities

Exhibit 38: S&P 500 Index P/E (x)



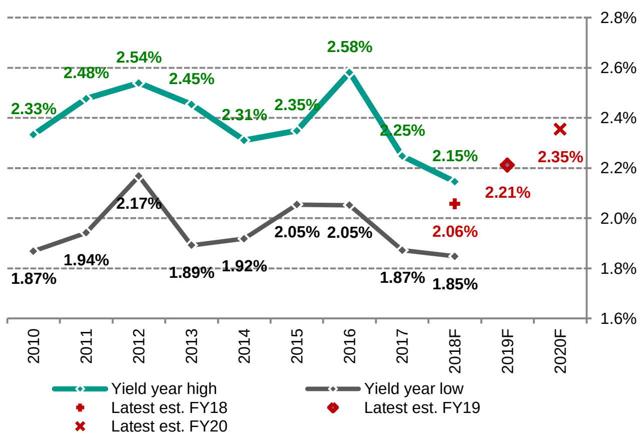
Index (11/28/2018): 2641.89
Source(s): Bloomberg, ABCI Securities

Exhibit 39: S&P 500 Index P/B (x)



Index (11/28/2018): 2641.89
Source(s): Bloomberg, ABCI Securities

Exhibit 40: S&P 500 Index dividend yield (%)



Index (11/28/2018): 2,641.89
Source(s): Bloomberg, ABCI Securities

Outlook for 2019

- Fiscal stimulus helps elevate ROAE, but its effect on EPS growth is diminishing
- EPS growth momentum is weakening, P/E valuation range is trending lower
- S&P 500 Index range at 2,400-3,200, representing FY19E P/E range on 13.5x-18.0x or FY19E P/B range of 2.56x-3.40x

Exhibit 41: Hang Seng Index market valuation

			2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E	2019E	2018E	2018E	2018E	2018E
		Price	P/E	PEG*	P/B	Yield	ROAE	P/E	PEG*	P/B	Yield	ROAE	P/E	P/B	Yield	ROAE
Code	**Stock**	**(HK$)**	**(x)**	**(x)**	**(x)**	**(%)**	**(%)**	**(x)**	**(x)**	**(x)**	**(%)**	**(%)**	**(x)**	**(x)**	**(%)**	**(%)**
2	CLP Holdings	88.05	16.58	(4.16)	1.72	3.11	10.6	17.18	(4.31)	1.81	3.00	10.8	15.29	1.89	3.38	12.9
3	HK China Gas	15.92	25.35	4.75	3.43	2.35	13.7	26.80	5.02	3.54	2.22	13.5	28.13	3.69	2.12	14.6
6	Power Assets	52.55	13.96	11.73	1.30	5.14	9.4	14.30	12.02	1.33	5.02	9.4	14.30	1.35	5.02	8.8
836	China Res Power	14.96	7.22	0.33	0.80	12.50	11.6	8.57	0.39	0.87	10.52	10.4	10.70	0.92	8.43	8.8
1038	CKI Holdings	59.00	12.05	2.37	1.23	4.85	10.4	12.59	2.48	1.28	4.65	10.4	13.31	1.33	4.39	10.4
1113	CK Asset Holding	56.75	7.96	2.96	0.59	2.65	7.6	7.99	2.98	0.62	2.64	7.9	8.39	0.65	2.51	8.2
101	Hang Lung PPT	15.58	15.50	(6.00)	0.50	2.67	3.2	15.55	(6.02)	0.50	2.66	3.2	14.71	0.51	2.82	3.5
12	Henderson Land D	40.00	11.30	1.10	0.57	1.99	5.0	10.97	1.07	0.57	2.05	5.3	13.75	0.58	1.63	4.3
16	SHK PPT	113.00	8.77	1.33	0.54	3.24	6.3	9.32	1.42	0.56	3.05	6.1	9.96	0.58	2.85	6.2
17	New World Dev	10.68	9.89	1.33	0.48	5.81	4.9	11.52	1.55	0.48	4.99	4.3	11.41	0.50	5.04	4.6
1997	Wharf	49.60	14.56	4.09	0.69	1.15	4.8	14.85	4.17	0.70	1.13	4.7	15.61	0.71	1.07	4.6
823	Link REIT	77.00	23.68	2.29	0.89	1.22	3.8	26.03	2.52	0.89	1.11	3.5	28.83	0.91	1.00	3.2
83	Sino Land	13.90	7.99	0.17	0.58	5.58	7.5	16.83	0.35	0.62	2.65	3.7	17.53	0.63	2.54	3.7
2007	Country Garden	9.67	3.56	0.16	0.96	9.14	29.7	4.12	0.19	1.18	7.89	32.0	5.29	1.49	6.15	31.8
688	China Overseas	26.90	5.33	0.33	0.78	4.04	15.5	6.13	0.37	0.88	3.51	15.2	7.22	0.99	2.98	14.5
1109	China Res Land	29.60	6.15	0.40	1.04	4.74	17.9	7.01	0.46	1.17	4.15	17.6	8.19	1.31	3.56	15.7
1398	ICBC-H	5.69	5.05	0.62	0.65	6.03	13.5	5.47	0.67	0.72	5.57	13.7	5.91	0.79	5.16	14.0
939	CCB-H	6.71	4.83	0.56	0.65	6.27	14.0	5.26	0.61	0.71	5.76	14.2	5.70	0.78	5.32	14.5
3328	Bank Comm-H	6.01	4.84	0.65	0.51	6.49	10.9	5.24	0.71	0.55	5.99	10.9	5.58	0.59	5.62	11.1
3988	Bank Of China-H	3.44	4.34	0.57	0.49	7.24	11.9	4.69	0.62	0.54	6.70	11.9	5.03	0.59	6.25	12.1
11	Hang Seng Bank	183.20	12.86	1.63	1.98	5.08	15.8	13.77	1.75	2.10	4.74	15.7	14.96	2.23	4.36	15.5
2388	BOC Hong Kong	30.85	8.71	1.10	1.08	5.09	12.9	9.49	1.20	1.17	4.67	12.7	10.14	1.25	4.37	12.8
5	HSBC	66.30	10.66	1.77	0.96	9.96	9.2	11.32	1.88	1.01	9.39	9.0	11.99	1.03	8.86	8.5
2318	Ping An-H	77.50	8.79	0.48	1.59	3.42	19.7	10.13	0.55	1.90	2.97	20.3	12.30	2.24	2.44	19.6
2628	China Life-H	17.32	9.45	0.42	1.09	3.74	12.0	10.81	0.48	1.18	3.27	11.4	14.15	1.29	2.50	9.3
1299	AIA	64.80	13.60	0.61	1.89	1.84	14.6	15.77	0.71	2.09	1.59	13.9	20.33	2.30	1.23	11.5
388	HKEX	235.80	24.98	2.17	6.83	3.59	27.8	28.37	2.47	7.07	3.16	25.5	31.05	7.40	2.88	24.5

(Continue on next page)

			2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E	2019E	2018E	2018E	2018E	2018E
		Price	P/E	PEG*	P/B	Yield	ROAE	P/E	PEG*	P/B	Yield	ROAE	P/E	P/B	Yield	ROAE
Code	**Stock**	**(HK$)**	**(x)**	**(x)**	**(x)**	**(%)**	**(%)**	**(x)**	**(x)**	**(x)**	**(%)**	**(%)**	**(x)**	**(x)**	**(%)**	**(%)**
762	China Unicom	8.97	13.11	0.28	0.69	5.67	5.4	17.95	0.39	0.72	4.14	4.1	28.14	0.74	2.64	2.7
941	China Mobile	76.15	11.37	4.91	1.15	4.30	10.4	11.82	5.11	1.22	4.14	10.7	11.91	1.31	4.11	11.3
700	Tencent	321.00	22.04	0.92	4.99	0.42	25.3	28.28	1.18	6.30	0.33	24.9	33.89	7.95	0.28	26.7
2018	AAC Technologies	54.60	10.24	0.65	2.17	3.81	22.7	11.93	0.76	2.50	3.27	22.5	13.73	2.89	2.84	22.6
2382	Sunny Optical	74.00	12.55	0.35	4.01	1.97	36.5	16.25	0.46	5.34	1.52	37.7	23.02	7.18	1.08	35.6
386	Sinopec Corp-H	6.72	9.11	58.89	0.90	12.98	10.1	9.14	59.07	0.93	12.94	10.4	9.14	0.96	12.94	10.7
857	PetroChina-H	5.55	12.01	1.81	0.68	3.89	5.7	12.04	1.81	0.70	3.88	5.9	13.65	0.72	3.42	5.4
883	CNOOC	13.32	8.58	2.80	1.11	8.75	13.4	8.13	2.65	1.18	9.23	15.1	9.11	1.28	8.24	14.5
1088	China Shenhua-H	17.58	6.92	(4.93)	0.80	5.47	11.9	6.96	(4.96)	0.85	5.44	12.7	6.73	0.92	5.63	14.3
1093	CSPC Pharma	16.16	17.17	0.64	3.95	1.92	25.1	21.58		4.75	1.53	23.9	27.62	5.65	1.19	22.0
1177	Sino Biopharm	6.95	18.33	0.99	3.54	1.22	21.1	21.72	1.17	4.25	1.03	21.5	25.76	5.16	0.87	21.8
66	MTR Corp	40.85	18.88	1.87	1.36	2.10	7.3	21.41	2.12	1.40	1.85	6.6	22.89	1.43	1.73	6.4
175	Geely Automobile	15.08	6.20	0.31	1.62	3.26	29.1	7.27	0.37	2.03	2.79	31.6	8.88	2.63	2.28	33.6
1928	Sands China Ltd	36.90	15.05	1.49	7.94	8.50	54.0	16.81	1.66	8.30	7.61	49.6	18.24	8.36	7.01	46.0
27	Galaxy Entertain	51.90	13.83	1.35	2.59	-	20.1	15.76	1.54	2.98	-	20.3	16.81	3.45	-	22.1
151	Want Want China	5.92	16.10	2.02	3.25	0.42	21.3	17.75	2.22	3.64	0.38	21.6	18.77	4.05	0.36	22.6
2319	Mengniu Dairy	24.80	17.78	0.72	2.65	1.28	15.8	21.63	0.87	2.99	1.05	14.7	27.68	3.37	0.82	12.9
288	WH Group Ltd	6.34	9.22	0.94	1.25	4.79	14.1	10.02	1.02	1.37	4.41	14.2	11.12	1.48	3.97	13.8
1044	Hengan Intl	64.35	14.80	1.87	3.29	4.51	23.1	15.91	2.01	3.56	4.19	23.3	17.24	3.87	3.87	21.4
2313	Shenzhou	98.60	19.41	0.99	4.22	2.37	23.3	23.06	1.18	4.90	1.99	22.7	27.76	5.63	1.66	20.1
1	CKH Holdings	80.65	6.88	0.78	0.59	4.55	8.8	7.39	0.83	0.62	4.24	8.7	8.15	0.66	3.84	8.5
19	Swire Pacific-A	84.00	12.26	0.46	0.47	0.99	3.9	14.02	0.53	0.48	0.86	3.4	19.65	0.49	0.62	2.5
267	Citic	12.70	6.20	0.69	0.56	3.85	9.4	6.84	0.76	0.60	3.49	9.1	7.36	0.64	3.24	9.0

Priced on Dec 5, 2018
RMB 0.8783/HK$1.00; HK$ 7.8109/US$ 1.00
PEG = P/E / EPS CAGR in 2018-20
Source(s): Bloomberg, ABCI Securities

Exhibit 42: Hang Seng China Enterprises Index market valuation

			2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E	2019E	2018E	2018E	2018E	2018E
		Price	P/E	PEG*	P/B	Yield	ROAE	P/E	PEG*	P/B	Yield	ROAE	P/E	P/B	Yield	ROAE
Code	Stock	(HK$)	(x)	(x)	(x)	(%)	(%)	(x)	(x)	(x)	(%)	(%)	(x)	(x)	(%)	(%)
1398	ICBC-H	5.69	5.05	0.62	0.71	6.03	14.9	5.47	0.67	0.79	5.57	15.3	5.91	0.89	5.16	14.9
939	CCB-H	6.71	4.83	0.56	0.73	6.27	15.9	5.26	0.61	0.82	5.76	16.4	5.70	0.92	5.32	15.6
1288	ABC-H	3.57	4.39	0.51	0.64	7.01	15.4	4.86	0.57	0.72	6.32	15.5	5.17	0.80	5.95	15.1
3988	BANK OF CHINA-H	3.44	4.34	0.57	0.52	7.24	12.4	4.69	0.62	0.57	6.70	12.6	5.03	0.62	6.25	12.5
3328	BANKCOMM-H	6.01	4.84	0.65	0.58	6.49	12.4	5.24	0.71	0.63	5.99	12.5	5.58	0.69	5.62	11.9
1658	POSTAL SAVINGS-H	4.62	4.67	0.35	0.69	5.33	15.6	5.33	0.40	0.78	4.68	15.5	6.01	0.88	4.15	14.4
3968	CM BANK-H	33.60	7.27	0.55	1.32	4.16	19.4	8.17	0.62	1.52	3.70	20.0	9.31	1.76	3.25	18.4
998	CITIC BANK-H	4.97	4.13	0.47	0.51	7.26	12.8	4.57	0.52	0.56	6.56	12.7	4.89	0.61	6.14	12.2
1988	CHINA MINSHENG-H	5.84	3.75	0.94	0.50	4.15	14.2	4.02	1.01	0.57	3.87	15.0	4.05	0.65	3.84	15.2
2628	CHINA LIFE-H	17.32	9.45	0.42	1.07	3.74	11.8	10.81	0.48	1.16	3.27	11.2	14.15	1.26	2.50	9.2
2318	PING AN	77.50	8.79	0.48	2.00	3.42	24.8	10.13	0.55	2.40	2.97	26.0	12.30	2.92	2.44	22.5
1339	PICC GROUP-H	3.37	5.97	0.48	0.75	1.74	13.3	6.59	0.53	0.85	1.57	13.6	7.53	0.96	1.38	12.4
2601	CHINA PACIFIC-H	28.25	8.76	0.40	1.32	5.63	15.8	10.16	0.46	1.45	4.86	14.9	13.06	1.59	3.78	12.3
1336	NEW CHINA LIFE-H	34.95	8.50	0.60	1.18	3.54	14.6	9.58	0.68	1.31	3.14	14.4	11.06	1.46	2.72	13.4
2328	PICC P&C-H	8.18	5.97	0.52	0.97	4.24	17.3	6.69	0.58	1.11	3.78	17.7	7.42	1.27	3.41	16.6
6060	ZHONGAN ONLINE-H	33.50	60.79	-	2.68	-	4.5	(72.65)	-	2.80	-	(3.8)	(38.11)	2.70	-	(6.8)
6030	CITIC SEC-H	15.02	10.99	0.77	0.99	3.87	9.3	12.77	0.89	1.05	3.33	8.5	14.37	1.11	2.96	7.6
6837	HAITONG SECURI-H	9.05	9.47	0.46	0.75	3.24	8.2	11.12	0.54	0.80	2.76	7.4	13.80	0.84	2.22	5.9
6886	HUATAI SECURIT-H	13.66	10.17	0.59	0.88	1.97	9.0	11.99	0.70	0.95	1.67	8.2	13.95	1.03	1.43	7.2
1776	GF SECURITIES-H	12.06	9.46	0.54	0.91	3.74	10.0	10.92	0.62	0.97	3.24	9.2	13.06	1.04	2.71	7.6
1359	CHINA CINDA-H	2.14	3.44	0.41	0.48	9.18	14.7	3.60	0.43	0.53	8.76	15.6	4.04	0.60	7.81	14.3
2799	CHINA HUARONG -H	1.63	3.26	0.12	0.42	9.25	13.5	3.76	0.14	0.46	8.03	13.0	5.28	0.51	5.71	8.9
267	CITIC LTD	12.70	6.20	0.69	0.69	3.85	11.7	6.84	0.76	0.76	3.49	11.6	7.36	0.83	3.24	11.2
1088	CHINA SHENHUA-H	17.58	6.92	(4.93)	0.78	5.47	11.7	6.96	(4.96)	0.84	5.44	12.6	6.73	0.91	5.63	14.2
857	PETROCHINA-H	5.55	12.01	1.81	0.68	3.89	5.7	12.04	1.81	0.70	3.88	5.9	13.65	0.73	3.42	5.4
386	SINOPEC CORP-H	6.72	9.11	58.89	0.95	7.14	10.7	9.14	59.07	0.99	7.11	10.7	9.14	0.97	7.11	10.7
883	CNOOC	13.32	8.58	2.80	1.14	8.75	13.5	8.13	2.65	1.17	9.23	14.8	9.11	1.23	8.24	14.2

(Continue on next page)

Code	Stock	Price (HK$)	2020E P/E (x)	2020E PEG* (x)	2020E P/B (x)	2020E Yield (%)	2020E ROAE (%)	2019E P/E (x)	2019E PEG* (x)	2019E P/B (x)	2019E Yield (%)	2019E ROAE (%)	2018E P/E (x)	2018E P/B (x)	2018E Yield (%)	2018E ROAE (%)
384	CHINA GAS HOLDIN	28.35	11.64	0.67	3.40	2.53	32.8	13.71	0.79	4.35	2.14	36.0	16.01	5.70	1.84	38.7
902	HUANENG POWER-H	5.07	9.20	0.19	0.79	9.88	8.8	12.17	0.25	0.82	7.47	6.8	20.33	0.84	4.47	4.4
1816	CGN POWER-H	1.94	7.61	0.76	0.96	4.28	13.1	8.39	0.84	1.05	3.88	13.1	9.21	1.15	3.53	12.6
270	GUANGDONG INVEST	14.56	16.89	2.63	2.64	3.26	16.3	17.82	2.77	2.86	3.09	16.7	19.13	3.10	2.88	15.5
390	CHINA RAIL GR-H	7.20	6.12	0.38	0.84	2.63	14.6	6.99	0.44	0.95	2.30	14.5	8.22	1.08	1.95	12.7
1800	CHINA COM CONS-H	7.75	4.36	0.37	0.54	4.28	13.1	4.91	0.41	0.60	3.80	12.9	5.46	0.67	3.42	11.7
1766	CRRC CORP LTD -H	7.32	11.18	0.67	1.42	3.53	13.2	12.83	0.77	1.55	3.08	12.6	15.24	1.68	2.59	10.5
1211	BYD CO LTD-H	57.35	26.94	1.06	3.12	0.37	12.2	31.21	1.23	3.49	0.32	11.8	42.33	3.89	0.24	7.5
489	DONGFENG MOTOR-H	7.33	3.76	4.24	0.46	5.70	12.9	3.81	4.29	0.51	5.63	14.1	3.83	0.57	5.60	14.1
2238	GUANGZHOU AUTO-H	7.94	4.71	0.48	0.94	6.70	21.5	5.13	0.53	1.10	6.15	23.2	5.67	1.30	5.56	20.2
2333	GREAT WALL MOT-H	5.06	6.84	0.99	0.83	4.52	12.6	7.47	1.09	0.90	4.14	12.6	7.81	0.99	3.96	11.5
2202	CHINA VANKE-H	27.40	5.72	0.37	1.41	6.20	27.0	6.37	0.41	1.70	5.56	29.5	7.63	2.09	4.64	26.8
1109	CHINA RES LAND	29.60	6.15	0.40	1.15	4.74	20.1	7.01	0.46	1.34	4.15	20.5	8.19	1.56	3.56	18.8
914	CONCH CEMENT-H	39.95	6.68	(4.91)	1.44	5.98	23.0	6.71	(4.93)	1.65	5.96	26.5	6.50	1.93	6.15	30.8
1099	SINOPHARM-H	38.00	12.68	0.96	2.06	2.35	17.3	14.29	1.08	2.34	2.09	17.4	16.24	2.66	1.84	16.3
1093	CSPC PHARMACEUTI	16.16	17.17	0.64	5.42	1.92	35.7	21.58	0.80	7.06	1.53	37.2	27.62	9.32	1.19	31.0
700	TENCENT	321.00	22.04	0.92	6.75	0.42	35.7	28.28	1.18	9.44	0.33	39.4	33.89	13.63	0.28	34.9
941	CHINA MOBILE	76.15	11.37	4.91	1.23	4.30	11.2	11.82	5.11	1.31	4.14	11.4	11.91	1.39	4.11	11.7
728	CHINA TELECOM-H	4.05	12.06	1.40	0.83	3.32	7.0	13.27	1.54	0.87	3.01	6.7	14.23	0.91	2.81	6.3
788	CHINA TOWER CO-H	1.19	23.23	0.32	0.98	1.29	4.3	36.04	0.49	1.02	0.83	2.9	69.68	1.05	0.43	1.5
753	AIR CHINA LTD-H	8.00	9.00	0.27	1.16	2.38	13.6	11.17	0.33	1.29	1.91	12.2	16.01	1.43	1.34	8.1
2313	SHENZHOU INTL GP	98.60	19.41	0.99	5.14	2.37	28.9	23.06	1.18	6.14	1.99	29.0	27.76	7.35	1.66	25.1
1044	HENGAN INTL	64.35	14.80	1.87	3.44	4.51	24.3	15.91	2.01	3.77	4.19	24.8	17.24	4.15	3.87	24.3

Priced on Dec 5, 2018
RMB 0.8783/HK$1.00; HK$ 7.8109/US$ 1.00
PEG = P/E / EPS CAGR in 2018-20
Source(s): Bloomberg, ABCI Securities

2019 Hong Kong IPO Market

More diversified across industries

- In 11M18, Hong Kong IPO market has raised US$ 33.5bn, with an average deal size of US$183mn. The Chinese investment banks accounted for seven of the top 10 underwriters by volume
- Hong Kong IPO market has become more diversified in terms of industry mix. The top four industries are industrial, technology, consumer discretionary, and financials, which accounted for 25%, 24%, 20%, and 18% of IPO volume respectively in 11M18
- In particular, the volume share of technology stocks has increased from just 4% in 2017 to 24% in 11M18

In 11M18, total volume of Hong Kong equity IPO amounted to US$ 33.5bn, significantly higher than the IPO volume in 2017 (US$16.5bn). A total of 183 IPOs were issued in 11M18, with an average issue size of US$ 183mn for each. In terms of underwriting volume, seven out of the top 10 underwriters were Chinese investment banks in 11M18.

In contrast to the trend in previous years where financial stocks have dominated the IPO market, Hong Kong IPO market has become more diversified across various industries in 11M18. For example, the top four industries are industrial, technology, consumer discretionary, and financials, which accounted for 25%, 24%, 20%, and 18% of IPO volume respectively in 11M18.

In particular, volume share of technology stocks has increased from just 4% in 2017 to 24% in 11M18. In our view, this is partly driven by the introduction of dual-class shares, such as **Xiaomi (1810 HK)**. Overall, the average size of technology IPOs was US$ 430mn, significantly higher than that of non-technology IPOs (US$ 161mn).

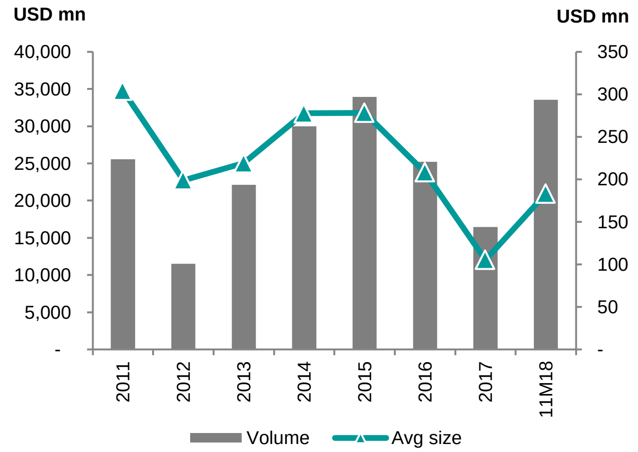
Looking ahead, we expect technology to be the major contributors of HK's IPO market in the next 1-2 years, while the number the technology/new economy stocks would continue to increase from the current level.

Exhibit 1: 11M18 HK IPO Overview

Industry	Volume (US$ mn)	Avg deal size (US$ mn)
Industrials	8,479	202
Technology	8,171	430
Consumer Discretionary	7,029	126
Financials	6,203	230
Health Care	2,275	253
Materials	1,175	147
Others	1,206	55

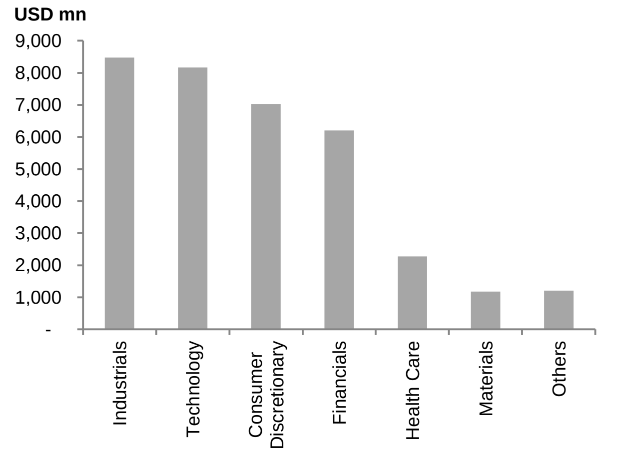
Source(s): Bloomberg, ABCI Securities

Exhibit 2: HK IPO volume and average deal size (US$ mn)



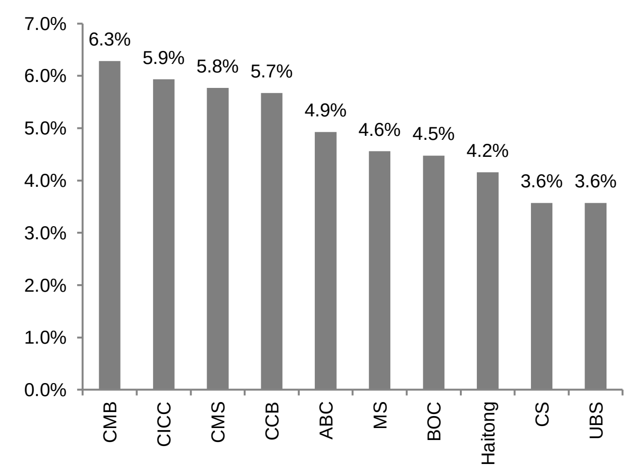
Source(s): Bloomberg, ABCI Securities

Exhibit 3: HK IPO volume by industry (11M18)



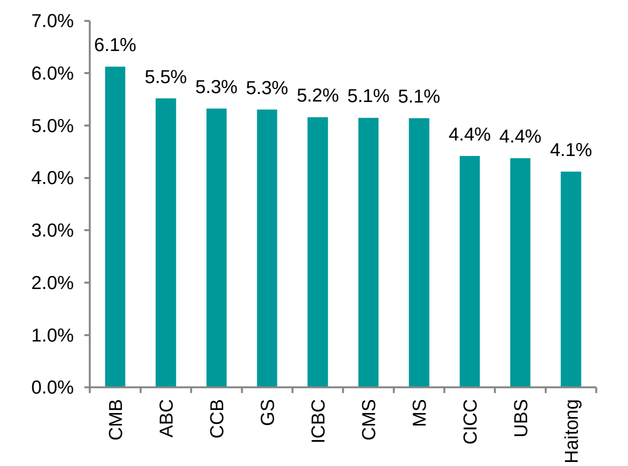
Source(s): Bloomberg, ABCI Securities

Exhibit 4 : Market share of HK IPO underwriters by volume (2017)



Source(s): Bloomberg, ABCI Securities

Exhibit 5: Market share of HK IPO underwriters by volume (11M18)



Source(s): Bloomberg, ABCI Securities

Sector Outlook

ABCI Analysts

OVERWEIGHT
China Banks Sector – Higher differentiation with improving fundamentals
Johannes Au

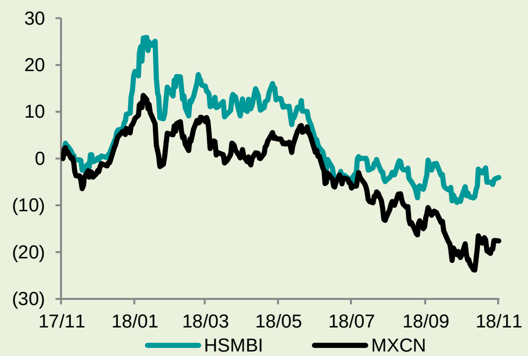
Key Data	
Avg. 19E P/E (x)	4.62
Avg. 19E P/B(x)	0.57
Avg. 19E div yield (%)	5.44

Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to MXCN)	Absolute (%)	Relative (%)
1-mth	2.08	1.30
3-mth	(0.02)	8.04
6-mth	(14.98)	7.46

Source(s):Bloomberg, ABCI Securities

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- China banks show high adaptability amid changes; greater differentiation among banks with time
- The government targets to reduce social financing cost, but robust loan demand offsets NIM pressure
- Banks build up risk buffer to counter against macro uncertainties
- Prefer big banks for defensiveness and promising dividend yield

High adaptability with widening divergence. China banks have shown high adaptability over the past decade amid policy changes and increasing complexity in operating environment. Measures to support the real economy, Sannong, inclusive finance, and private enterprises have been repeatedly emphasized since the 19th National Congress of the Communist Party of China (NCCPC) in mid-2017; avoidance of systematic risk in the financial sector has also been highlighted. We are confident that the sector will remain resilient in the face of policy changes. Over the past quarters, greater differentiation was seen among different bank categories – big banks (big 5 banks), JSBs (joint-stock banks), and district banks (city and rural commercial banks). Big banks in general are the most defensive against policy and macro changes. Their fundamentals improved in 9M18 and net fee income rebounded in 3Q18. Differentiation among JSBs has turned more obvious, with mild improvement observed for most. Fundamentals of district banks were hit hardest by policy risk; in addition, their fast growth usually implies strong capital needs. For this group, geographic location is a strong factor in determining operational results.

Stable NIM on robust loan demand and improved liquidity. Since the government aims to reduce social financing cost, we expect another RRR cut in Dec 2018 and three more in 2019E. The cuts would enhance liquidity in banks but may also escalate economic risk as perceived by investors. Traditional bank loans would remain as the core component of total social financing over 2019-20, especially when tightened policies impose further restrictions on alternative funding channels. Loan growth further accelerated in 2H18. According to PBOC, 10M18 new loans totaled RMB 13.84tr, approaching the full-year target of RMB 15.5tr for 2018E. Meanwhile, effect of policy to reduce social financing cost started to take place – average loan yield was down 3bps QoQ to 5.94% in Sep 2018, marking the start of a mild reversal of the rising lending yield, which we believe would persist over the next few quarters. The proportion of loans priced above benchmark rates also dropped by 1.48ppt QoQ to 73.76% in Sep 2018. Our base case scenario assumes benchmark rates to stay flat in 2018-19. That said, despite a mild decrease in market interest rate, we believe better liquidity environment and robust loan demand would offset NIM pressure. According to the CBIRC data, system NIM further rebounded from 2.12% in 2Q18 to 2.15% in 3Q18, supporting a system net profit growth at 4.9% YoY for the period. We forecast system NIM to stay flat or expand by 1-5bps QoQ each in 4Q18-4Q19.

Shifting focus from NPL ratio to risk buffer indicators. With banks' proactive NPL handling effort, system NPL ratio stabilized at 1.74% from 1Q16 to 1.87% in 3Q18. By category, average NPL ratio of big banks, JSBs and rural commercial banks were stable in 3Q18, while city commercial banks were subject to greater pressure with a 10bps QoQ increase. We expect overall asset quality would stay benign, with system NPL ratio remaining stable in 2H18-2019, assuming there would be no unforeseeable global factors resulting in pervasive damage to China's economy. In our view, NPL ratio alone is becoming less indicative of asset quality risk; instead, risk buffer indicators, which include provisioning ratio and provision coverage ratio, would provide a more objective assessment of the ability to counteract against asset quality risk. System provisioning ratio and provision coverage ratio gradually improved to 3.38% and 180.73% as of Sep 2018. Banks have been expending efforts in past quarters to strengthen these buffers in light of potential economic downturn. For big banks and JSBs, their average provisioning ratios increased by 2bps and 11bps QoQ in 3Q18, while average provision coverage ratio rose QoQ by 2.47ppt and 11.68ppt. We estimate the two indicators would continue to improve over 2H18-2019.

Long-term Outlook

Policy risk remains to be the largest overhang in China Banks sector. We believe a highly regulated and disciplined business environment is essential to healthy sector fundamentals. Meanwhile, we are cautious against long-term impacts of prolonged Sino-US dispute.

Short-term Outlook

Although we believe the enforcement of new policies in the sector is beneficial in the long run, uncertain timing and details of policy implementation would weigh on the sector in the near term on reduced risk appetite. This is especially true for smaller banks less defensive to policy risk. Nevertheless, promising dividend yield of big banks may draw interest from yield investors in the short term. According to our analysis, a defensive entry point would occur if 2019E dividend yield of big banks approaches ~7%.

Stock Recommendations

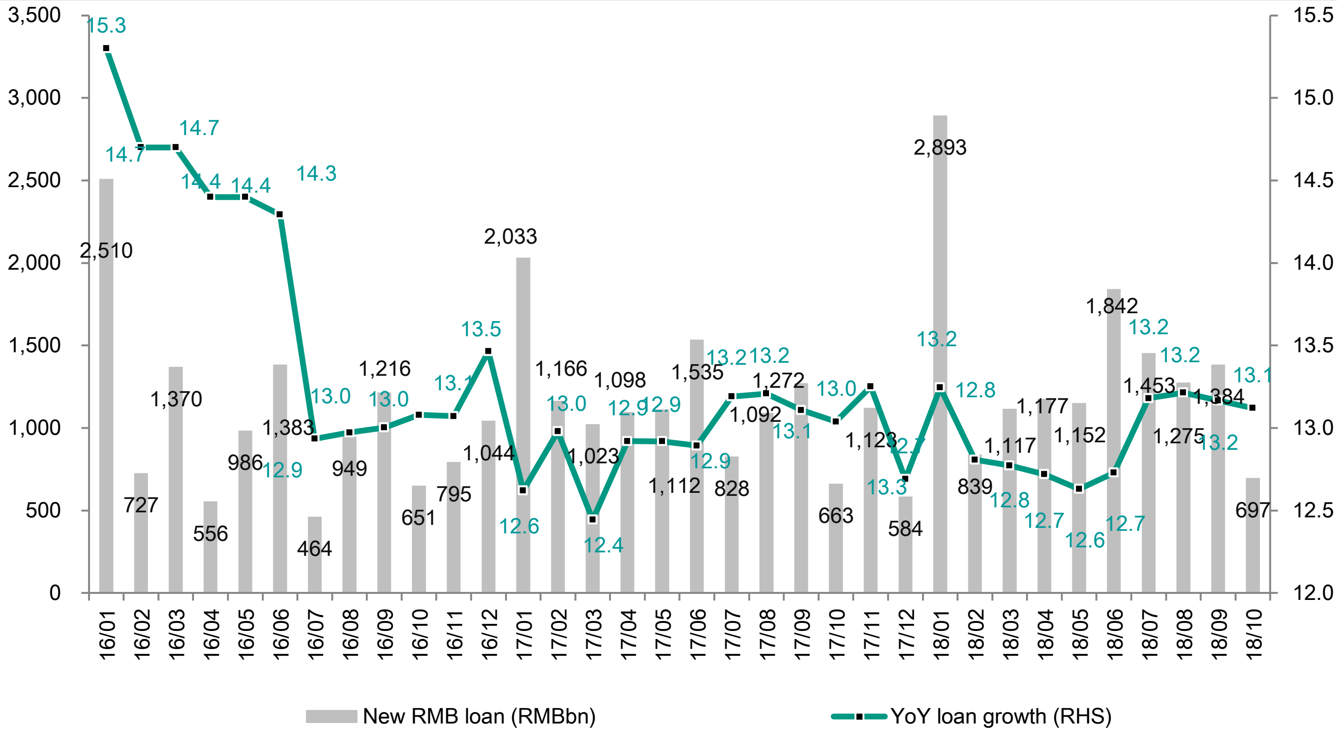
We reiterate our **OVERWEIGHT** rating for China banks sector on undemanding valuation and continuous improvement in fundamentals. Big names, with promising dividend yield and high degree of business diversification, have repeatedly demonstrated defensiveness against policy risks and high adaptability to macro changes. Our sector top picks are **ABC (1288 HK)** for its outstanding fundamental improvements and risk buffer; it is also the major beneficiary of inclusive finance and Sannong policy. We favor **CCB (939 HK)** for its prudent risk attitude and high degree of business diversification. **BOC (3988 HK),** with a relatively large offshore exposure, would benefit the most among H-share banks as onshore-offshore interest spread widens. Among the JSBs, **CMB (3968 HK)** is superior in terms of fundamentals and profitability despite expensive valuation; as a JSB, it is also subjected to higher policy risk than the big banks.

District banks, with a smaller balance sheet, have higher operational flexibility. The downside is that they are more sensitive to macro and policy impacts than other bank categories. Since regulators have decelerated the approval for A-share bank IPOs, district banks, with relatively fast growth and high capital needs, would need to explore alternative capital sources. Also, investors should be mindful of their lower trading liquidity.

Risk Factors

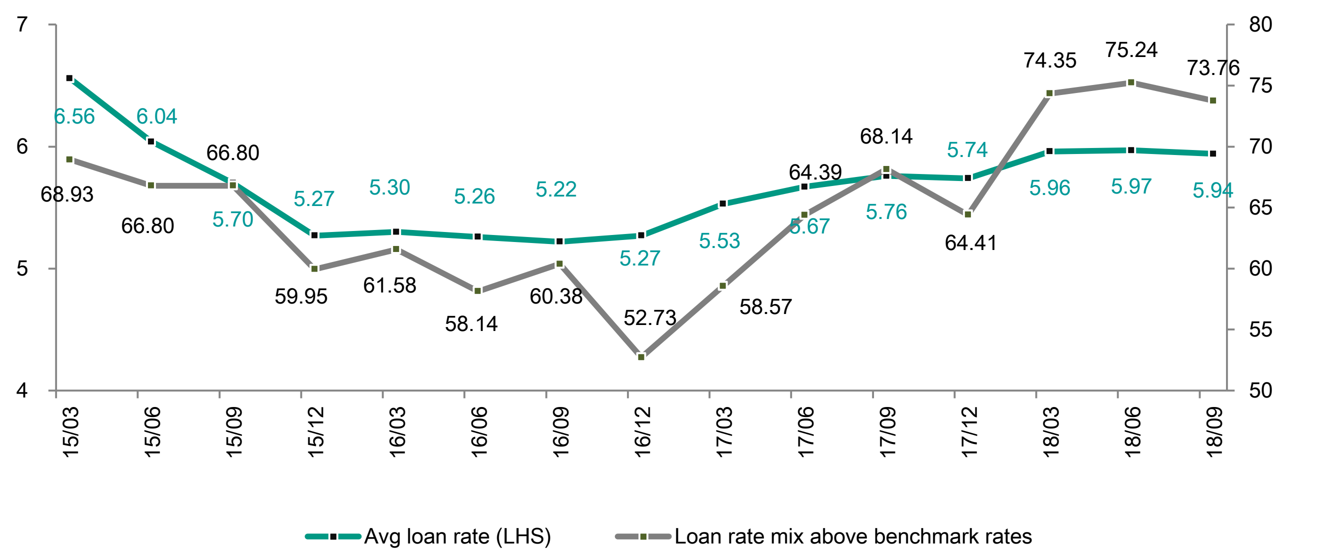
1) Radical change in business environment induced by strong supervision and policies; 2) Increasing competition from non-bank financial institutions; 3) Sharp deterioration in asset quality in specific regions; 4) Sharp decline in loan demand; 5) Increasing policy risk in new and fast-growing businesses.

Exhibit 1: Monthly new loans (RMB bn) and YoY growth (%)



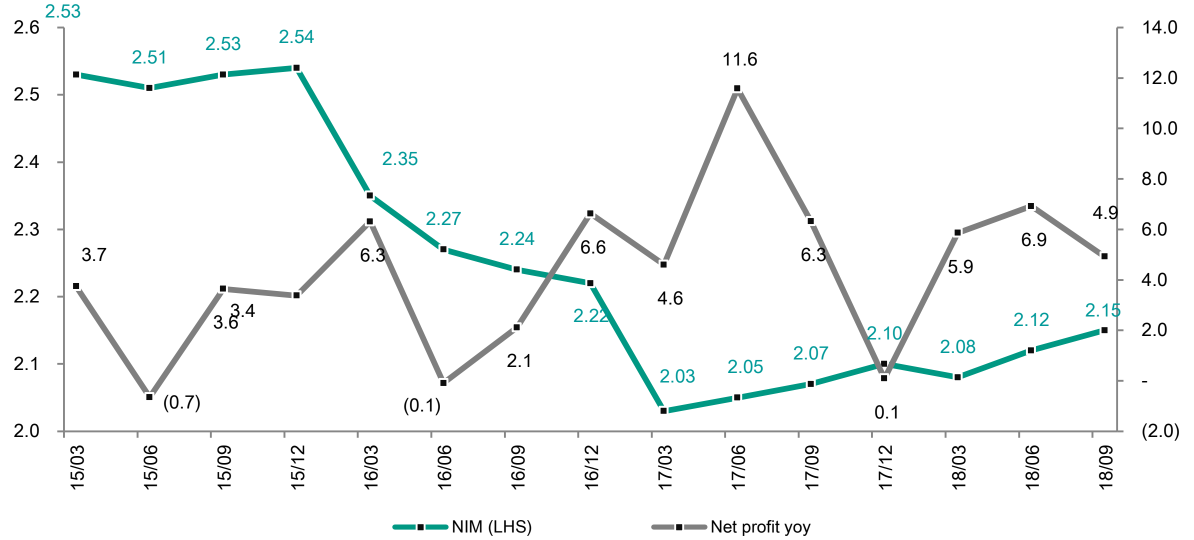
Source(s): PBOC, ABCI Securities

Exhibit 2: Average loan yield vs. proportion of loans with above-benchmark rates (%)



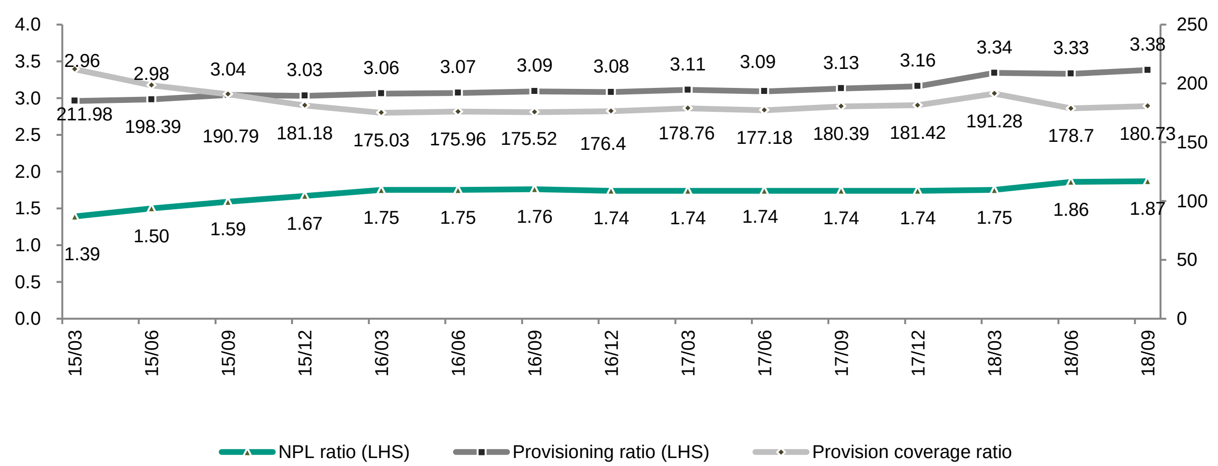
Source(s): PBOC, ABCI Securities

Exhibit 3: System NIM and system net profit YoY (%)



Source(s): CBIRC, ABCI Securities

Exhibit 4: Key asset quality indicators (%)



Source(s): CBIRC, ABCI Securities

Exhibit 5: Valuation of sector top picks (Data as of Nov 30, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)	FY18E Yield (%)	FY19E Yield (%)
ABC	1288 HK	BUY	5.28	49.15	5.13	4.67	0.71	0.64	5.85	6.49
CCB	939 HK	BUY	9.48	42.13	5.53	5.13	0.77	0.70	5.52	5.86

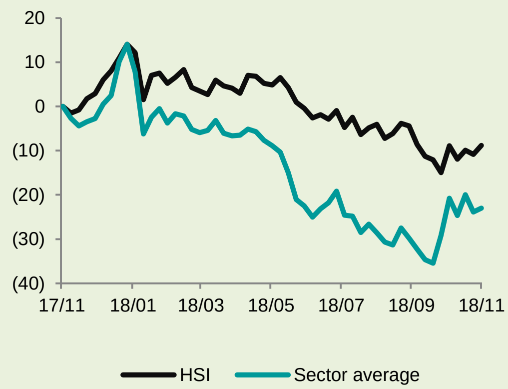
Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Securities & Brokerage Sector – Still in the woods
Steve Chow

Key Data		Sector Performance (relative to HSI/HSCEI)	Absolute (%)	Relative (%)
Avg. 19E P/E (x)	11.6	1-mth	3.8	3.8
Avg. 19E P/B(x)	0.8	3-mth	5.8	10.2
Avg. 19E div yield (%)	2.9	6-mth	(17.3)	(4.2)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Challenging operating environment might prompt the government to implement more policy support in 2019
- Overall, the government will increase the contribution of direct financing in the economy and promote product innovations such as high-yield bonds, hybrid financing, and more
- We hold a **NEUTRAL** stance on the sector as the sluggish business environment might affect shareholders' return

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Weak business environment. 10M18 A-share ADT was ~RMB 383bn, down 17% YoY. Margin financing and securities lending (MFSL) balance dropped from ~RMB 1.02trn at end-2017 to ~RMB 0.77trn at end-Oct 2018. In addition, A-share stock index tumbled in 10M18, with CSI 300 losing ~23% in 10M18 vs. a 22% gain in 2017. In our view, such weak business environment should impact brokers' earnings prospects in the near term.

Investment banking is less impacted. On a positive note, direct financing (corporate bonds and equity financing by non-financial enterprises, excluding local government special bonds) accounted for 12% of aggregate financing in the economy in 9M18, up from 6% in 2017, indicating a gradual recovery in recent months. The improvement is mainly driven by recovery in net financing of corporate bonds against the low base in 2017.

Policy support. In our view, the current challenging operating environment might prompt the government to implement additional supporting measures. E.g., the government has recently announced its decision to launch a "technology innovation board" in Shanghai Stock Exchange. In addition, SAC announced that 11 Chinese brokerages have committed RMB 25.5bn to an asset management scheme that aims to eventually raise over RMB 100bn to support listed firms with pledged share risk. The government also launched measures to encourage listed companies to buy back shares by broadening the source of repurchase funds, simplifying the implementation procedures, and encouraging listed companies to implement equity incentives or employee stock ownership plans.

Commitment to industry reform. Despite the near-term cyclical downturn, we believe the government is still committed to industry reform as outlined in the 13th FYP (2016-20). Overall, the government will increase the contribution of direct financing in the economy through the development of a diverse, multi-layered capital market. It also aims to promote product innovations such as high-yield bonds, hybrid financing, and more. In our view, such developments will be supportive to the investment banking business. Overall, direct financing only accounted for 12% of the aggregate financing in the economy in 9M18 vs. 50% in US (2015), implying ample growth opportunities.

Industry outlook. Overall, we expect A-share ADT to stabilize at ~RMB 300bn for the rest of 2018, implying a 20% YoY drop for 2018. For 2019E, we estimate a 5% YoY growth. We also expect the MFSL balance to stay at the current level of ~RMB 770bn in 2018 before improving modestly to about RMB 810bn in 2019E.

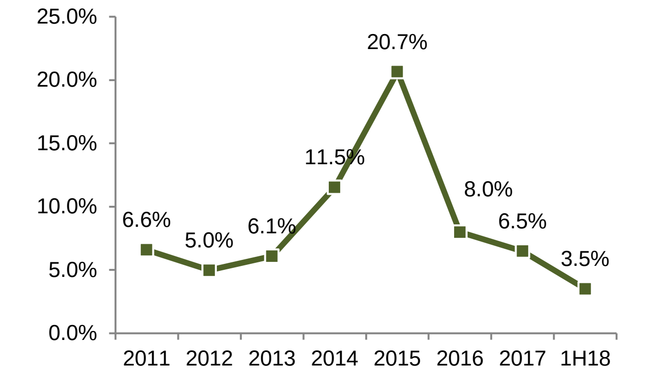
Stock Recommendations

We hold a **NEUTRAL** stance on the sector as the sluggish business environment might affect shareholders' return. Among our covered brokerage stocks, **CSC (6066 HK)** is our preferred pick as it has demonstrated strong ROAE throughout the market cycle in recent years.

Risk Factors

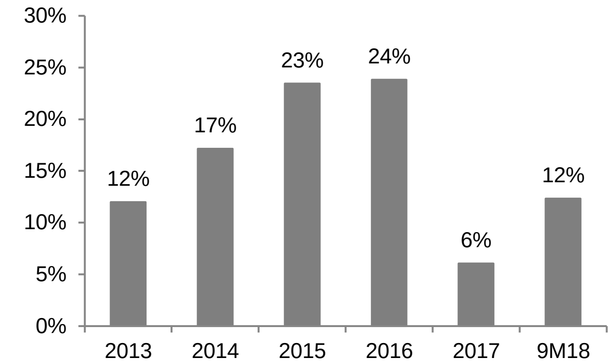
1) Market risk of financial assets; (2) Credit risk associated with bond investments and lending business; (3) Volatility in market turnover; (4) Penalties on misconduct or staff malpractice in securities firms; (5) Regulatory changes in direct financing; (6) Spill-over impact from deleveraging in the 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: Sector ROAE trend



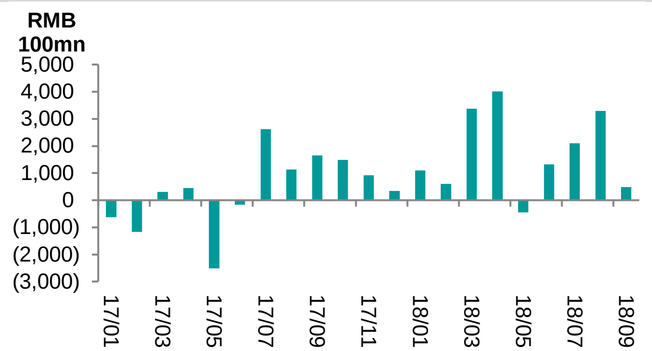
Source(s): SAC, ABCI Securities

Exhibit 2: Direct financing as a percentage of aggregate financing



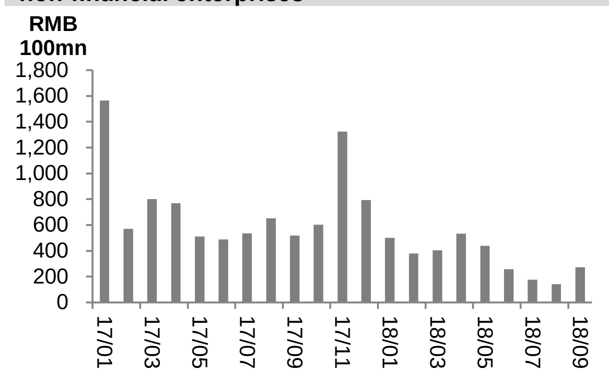
Source(s): PBOC, ABCI Securities

Exhibit 3: Net financing of corporate bonds



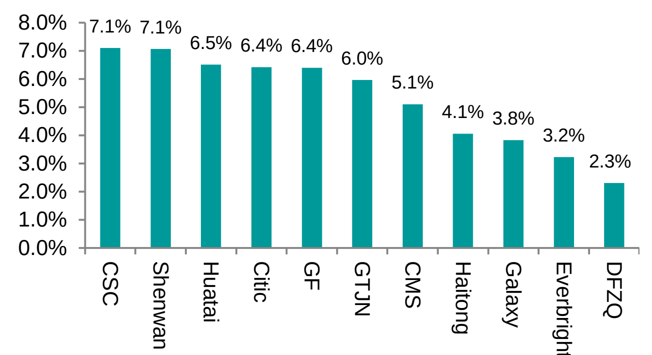
Source(s): PBOC, ABCI Securities

Exhibit 4: Equity financing on the stock market by non-financial enterprises



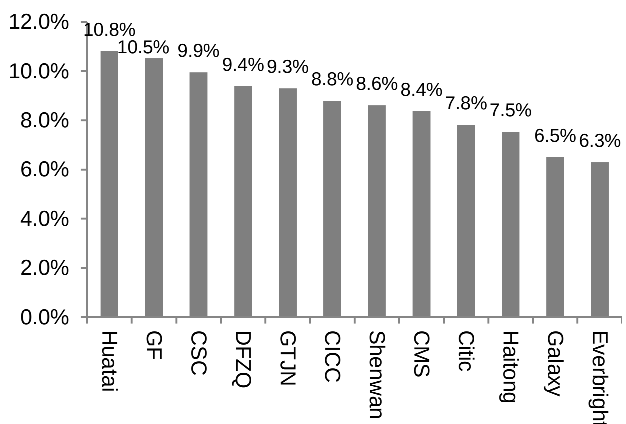
Source(s): PBOC, ABCI Securities

Exhibit 5: Annualized ROAE (9M18)



Notes: CSC –China Securities Co (6066 HK), Shenwan (000166 CH), Huatai (6837 HK), Citic (6030 HK), GF - Guangfa (1776 HK), GTJN - Guotai Junan (2611 HK), CMS-China Merchants Sec. (6099 HK). Haitong (6837 HK), Galaxy (6881 HK), Everbright (6178 HK), DFZQ - Orient Sec. (3958 HK)
Source(s): Companies, ABCI Securities

Exhibit 6: ROAE (2017)



Notes: Huatai (6837 HK), GF - Guangfa (1776 HK), CSC - China Securities Co (6066 HK), DFZQ - Orient Sec. (3958 HK), GTJN - Guotai Junan (2611 HK), CICC (3908 HK), Shenwan (000166 CH), CMS-China Merchants Sec. (6099 HK). Citic (6030 HK), Haitong (6837 HK), Galaxy (6881 HK), Everbright (6178 HK)
Source(s): Companies, ABCI Securities

Exhibit 7: Valuation of sector top pick (Data as of Nov 30, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)	FY18E Yield (%)	FY19E Yield (%)
CSC	6066 HK	BUY	7.6	55%	9.8	8.4	0.7	0.7	3.8	2.8

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

China Property Sector – Focus on property managers

Kenneth Tung

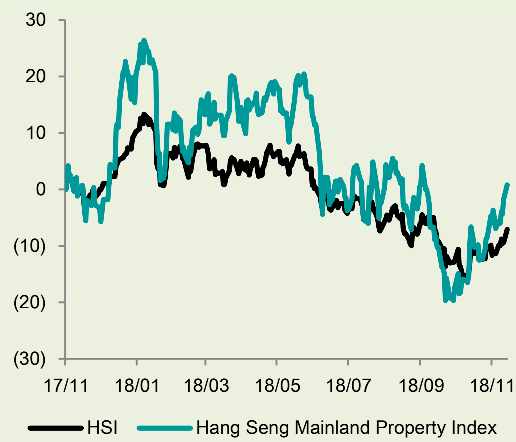
Key Data	
Avg. 19E P/E (x)	4.96
Avg. 19E P/B(x)	0.89
Avg. 19E div yield (%)	8.21

Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
1-mth	17.30	10.47
3-mth	(6.82)	(0.58)
6-mth	(0.55)	8.61

Source(s):Bloomberg, ABCI Securities

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- We believe controls are unlikely to relax in 2019. Property price in tier-1/2 cities would remain flat, while tier-3/4 cities may experience ~5% decline
- Rising interest rate is positive to the property management (PM) sector because of increased interest income
- SOE players **COLI (688 HK)** and **Jinmao (817 HK)** are our top picks among PRC developers given their lower finance cost than peers. **A-Living (3319 HK)** is our top pick in the PM sector given its above-peer growth and better margins

■ Developers:

Rising trend of finance cost continues. PBOC announced on Oct 7 to slash RRR for most commercial banks by 1ppt; nonetheless, we believe funds released by the rate cut would not be diverted to the real estate sector. With home purchase restrictions (HPR) and borrowing controls in place, banks have taken extra caution in real estate lending and personal mortgages. According to the latest data from Rong 360, the average interest rate of the first-home loan in Aug 2018 was 5.69%, equivalent to 1.161x benchmark interest rate, up 5bps MoM or 57bps YoY. Based on our statistics for 20 major developers listed in HK, average borrowing costs increased from 6.1% for FY17 to 6.5% for 1H18. RRR cuts in 2018 did little to reverse the rising interest rate in the sector. We expect more RRR cuts in 2019, but impacts will be marginal to the property sector.

Bond yield turns attractive and diverts funds from the equity side. Refinancing concerns are looming as coupon rate of USD bonds issued recently has noticeably increased. **Evergrande (3333 HK)** issued US$ 1.8bn of offshore senior notes at a coupon rate high at 11.0-13.75%; several small-mid cap developers, such as **KWG (1813 HK)** and **Agile (3383 HK),** have also issued offshore USD bonds at coupon rates of 9.5-9.85%, reflecting pressure on highly-geared developers in refinancing offshore debt. As bond yield turns attractive, stock investors may switch to bond investment given the current volatility in stock market. In particular, the bond yield of large-cap developers such as **Country Garden (2007 HK)**, Evergrande and **Sunac (1918 HK)** have reached 8.0-11.1%, similar to those of the small/mid-cap players such as **Times (1233 HK), Aoyuan (3883 HK)** and Agile. For prudent investors, bonds issued by larger developers are better investment choices than equity.

Policy is unlikely to relax in 2019 despite slowing economy. Recent tax reduction in mortgage interest may provide some relief to the property sector but policy relaxation is unlikely. According to property price data from NBS, 65 out of 70 cities registered MoM increase in Oct. The rising price means that tightening measures such as HPR and presales price control are unlikely to be removed. Tightening measures, coupled with a slowing economy, would drive down new home sales by 5% YoY in 2019E based on our estimates. Property price in tier-1/2 cities would remain flat, while tier-3/4 cities may experience ~5% decline. Contracted sales of HK-listed developers would remain flat in 2019E as sustained by increased market share.

- **PMCs:**

Rising concerns on value-added services (VAS) to non-property owners. PMC's VAS business entails a higher margin than the traditional property management (PM) business. The market preferred PMCs with higher exposure to VAS to property owners (i.e. residents) more than those focusing on VAS to non-property owners (VASNPO, services mainly provided to developers). **A-Living (3319 HK)**, with 41% of 1H18 revenue coming from VASNPO (e.g. property agency, sales assistance services and home inspection before delivery, etc.), is trading at 11.8x 2019E P/E, much lower than 17.3x 2019E P/E for **Greentown Services (2869 HK)** (VASNPO as a percentage of 1H18 revenue: 13.7%). We believe VAS to developers are subjected to higher risks because: 1) the business is highly correlated to presales, which are highly cyclical in nature due to interest rate changes and policy measures; 2) the amount of related-party transactions may increase, given the majority of such services are provided to parent developers. However, in our view, the market has overlooked the benefits of VASNPO at the same time, which includes 1) better relationship with third-party developers for future management contracts; 2) greater access to a large pool of potential homebuyers from projects under management.

Social security reform presents more M&A opportunities. Rising labor cost is another major concern for investors given the fact that PMCs usually find it hard to raise management fee rate. Social security reform, which will be effective on Jan 1, 2019, mandates that the power to collect the funds will be consolidated in taxation departments to close loopholes enabling evasion. Many small/mid PMCs made social security payment based on minimum salary instead of the actual ones, which infers that labor cost would rise with enhanced enforcement of the payment rules. Rising cost may place small players under pressure, which would provide acquisition opportunities for listed PMCs.

We estimated managed GFA growth of the listed PMCs to increase by 30%YoY for 2019E on average via new projects from parent developers or third parties, without assuming any M&A.

Stock Recommendations

- **Developers:**

Larger SOE players are safer bets. Given a rising interest rate and significant refinancing risks of the sector, we believe SOE players, whose bonds and bank borrowing entail lower rates than private developers, would outperform. Our top picks are **COLI (688 HK)** and **Jinmao (817 HK).**

- **PMCs:**

A-Living (3319 HK) is our top pick. We like A-living for its fast managed GFA growth, higher-than-peer margins and large net cash balance. In 1H18, A-Living had the highest net margins of 23.6% in 1H18, up 7.4ppt YoY, driven by growth in VAS revenue with higher margins. With improving margins and increasing contracted GFA, we expect A-Living to have the highest net profit growth of 150% YoY for 2019E, compared to 30%-81% YoY among peers based on consensus.

Risk Factors

- **Developers:**

1) Rising finance cost of bond issuances; 2) Further policy tightening; 3) FX risks due to volatile currency as a result of Sino-US trade war

- **PMCs:**

1) Substantial related-party transactions between PMC subsidiaries and parent developers; 2) Reliance on shareholders for new projects for non-independent PMCs; 3) Potential margin erosion due to M&A activities.

Exhibit 1: 10M18 contracted sales of major listed developers

		10M18						2018	
		Amount RMB bn	YoY %	GFA 000 sqm	YoY %	ASP RMB/sqm	YoY %	Target RMB bn	% Achieved
1	Jinmao	102.7	146%	3,574	103%	28,723	21%	120	85.5%
2	Aoyuan	67.5	125%	6,419	117%	10,521	3%	73	92.5%
3	Shimao	136.0	73%	8,279	77%	16,431	-2%	140	97.2%
4	Logan	59.9	72%	3,343	68%	17,912	2%	70	85.5%
5	KWG	53.1	67%	3,096	67%	17,161	0%	65	81.7%
6	CR Land	175.7	56%	9,822	34%	17,887	17%	183	96.0%
7	Times	47.7	51%	2,866	39%	16,632	8%	55	86.7%
8	Sunac	371.3	49%	24,241	69%	15,317	-12%	450	82.5%
9	Sino-Ocean	82.3	48%	3,830	32%	21,485	12%	100	82.3%
10	R&F	95.7	45%	7,331	43%	13,048	1%	130	73.6%
11	Poly-A	334.8	41%	22,357	31%	14,974	7%	na	na
12	Yuexiu	43.9	37%	2,069	12%	21,217	22%	55	79.8%
13	Beijing Capital	48.1	27%	1,928	1%	24,927	26%	75	64.1%
14	Country garden	611.6	26%	65,071	22%	9,398	3%	na	na
15	COLI*	250.9	25%	13,617	10%	18,426	14%	290	86.5%
16	Yuzhou	40.2	24%	2,611	38%	15,384	-10%	60	67.0%
17	Agile	78.5	23%	6,054	14%	12,969	8%	110	71.4%
18	Evergrande	501.9	19%	47,618	12%	10,539	6%	550	91.2%
19	Longfor	164.1	17%	10,131	11%	16,200	5%	200	82.1%
20	Vanke	485.6	12%	32,435	11%	14,972	1%	na	na
21	Greentown	71.6	-13%	2,930	-14%	24,437	2%	110	65.1%
22	SZI	7.0	-34%	371	-27%	18,857	-9%	20	35.0%

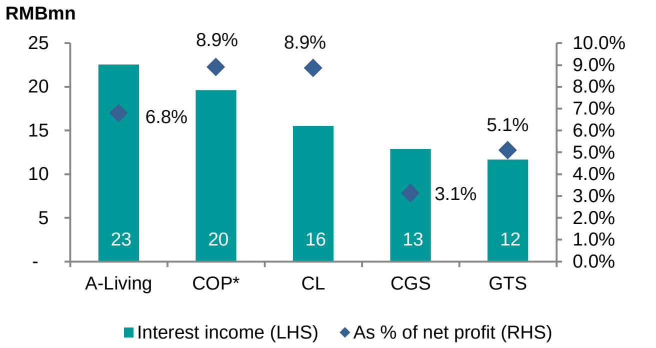
* In HKD
Source(s): Companies, HKEx, ABCI Securities

Exhibit 2: Recent USD bond issued by developers

Month	Company	Amount	Maturity	Coupon rate
		USDmn		
Oct-18	Evergrande (3333 HK)	1,800	2020-2023	11-13.75%
Nov-18	KWG (1813 HK)	400	2020	9.85%
Nov-18	Agile (3383 HK)	400	2020	9.50%
Nov-18	Times (1233 HK)	300	2020	10.95%

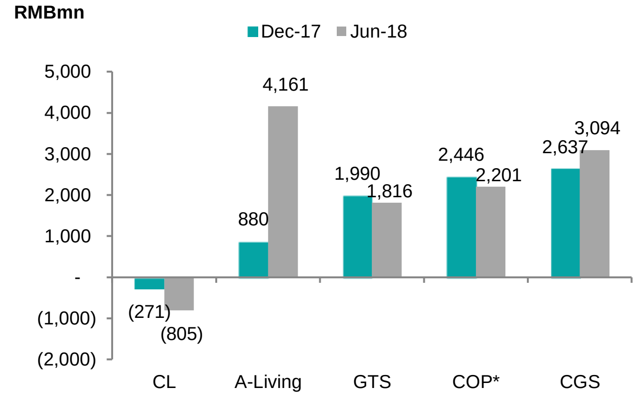
Source(s): Bloomberg, ABCI Securities

Exhibit 3: Interest income as a percentage of net profit for PMCs



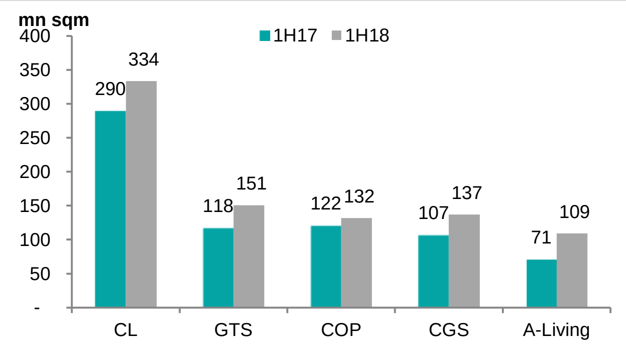
* in HK$
Source(s): Companies, ABCI Securities

Exhibit 4: Net cash/(debt) level of PMCs



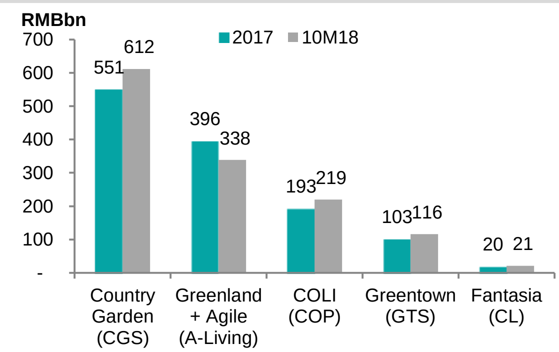
* in HK$
Source(s): Companies, ABCI Securities

Exhibit 5: Managed GFA of PMCs



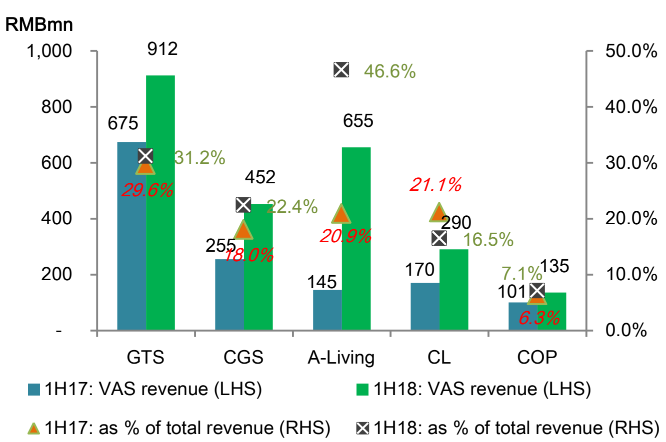
Source(s): Companies, ABCI Securities

Exhibit 6: Contracted sales of parent/ major shareholders of PMCs



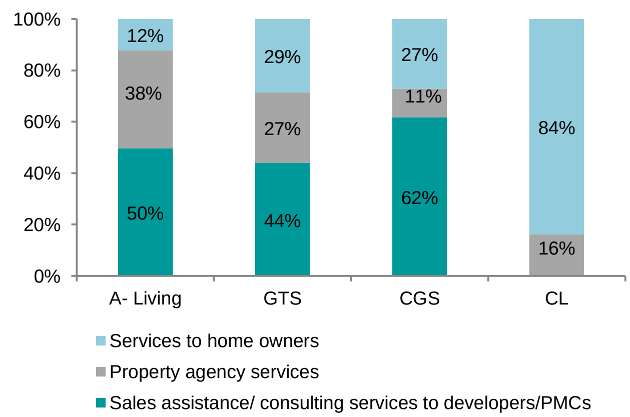
Source(s): Companies, ABCI Securities

Exhibit 7: VAS revenue of PMCs



Source(s): Companies, ABCI Securities

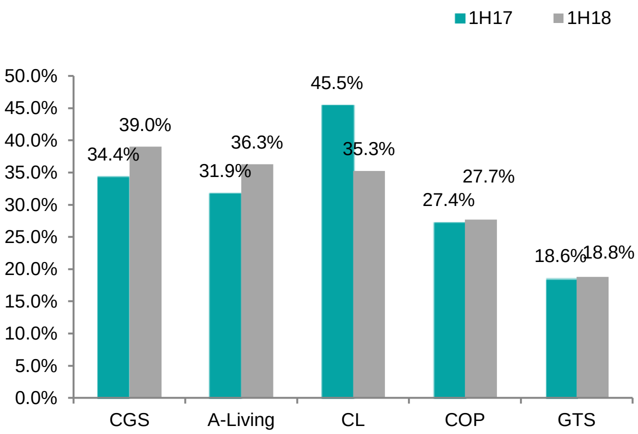
Exhibit 8: VAS revenue breakdown (2017)



Source(s): Companies, ABCI Securities

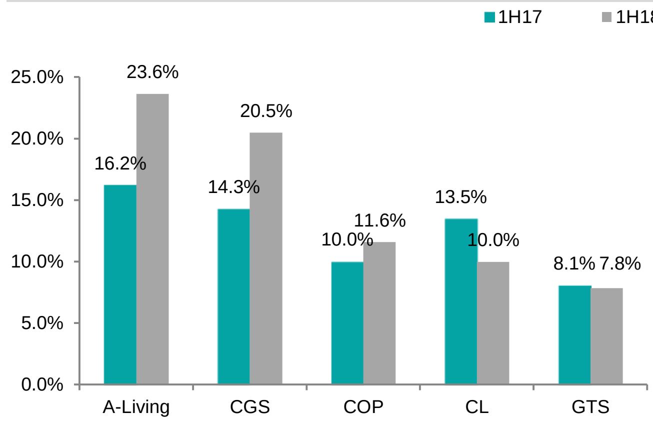
Notes for Exhibit 1-11: COP= China Overseas Properties (2669 HK); CL= Colour Life (1778 HK); CGS= Country Garden Services (6098 HK) ; GTS= Greentown Services (2869 HK)

Exhibit 9: Gross margin of PMCs



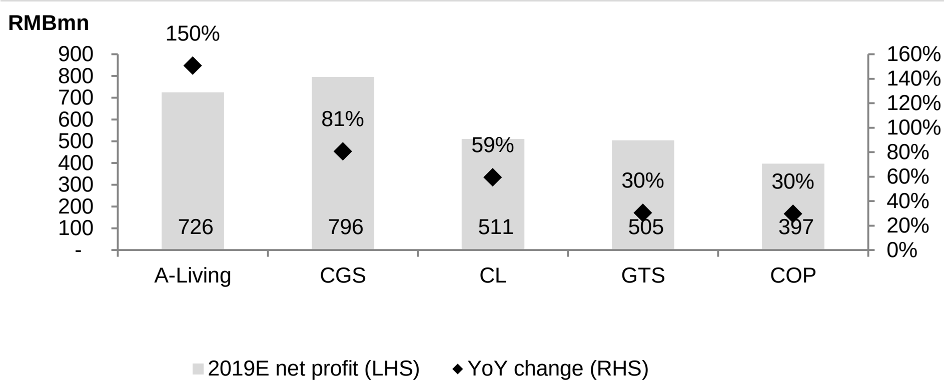
Source(s): Companies, ABCI Securities

Exhibit 10: Core net margin of PMCs



Source(s): Companies, ABCI Securities

Exhibit 11: 2019E Net profit and YoY growth of PMCs



ABCI estimates: A-Living; Consensus forecasts: CGS, GTS, COP and CL
Source(s): Bloomberg, Companies, ABCI Securities estimates

Notes for Exhibit 1-11: COP= China Overseas Properties (2669 HK); CL= Colour Life (1778 HK); CGS= Country Garden Services (6098 HK) ; GTS= Greentown Services (2869 HK)

Exhibit 12: Valuation of sector top picks (Data as of Nov 30, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)	FY18E Yield (%)	FY19E Yield (%)
A-Living	3319	BUY	18.60	81.3	17.4	11.8	2.26	1.98	1.64	2.42
COLI	688	BUY	34.90	27.8	9.6	7.8	1.04	0.94	2.82	3.48
Jinmao	817	BUY	6.40	70.7	9.1	6.8	1.13	1.03	4.42	5.88

Source(s): Bloomberg, ABCI Securities estimates

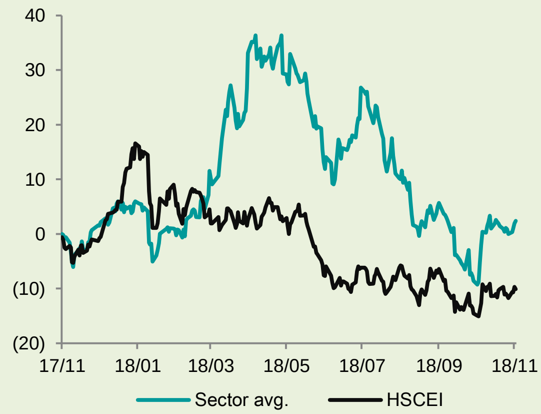
OVERWEIGHT

China Alternative Energy Sector – Wind power players to benefit from strong cash flow

Kelvin Ng

Key Data		**Sector Performance (relative to HSCEI)**	**Absolute (%)**	**Relative (%)**
Avg. 19E P/E (x)	5.87	1-mth	8.37	3.60
Avg. 19E P/B(x)	0.66	3-mth	(6.77)	(4.43)
Avg. 19E div yield (%)	4.49	6-mth	(22.33)	(10.70)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- China's wind power and nuclear power output are likely to expand at 11%/14% CAGRs in 2017-20E as energy structure shifts from coal-fire sources to greener alternatives
- **Longyuan Power (916 HK)** is our top pick in the wind power sector given its prime assets conducive to higher utilization hour and stronger cash flow. **CGN Power (1816 HK)** is our preferred nuclear power play based on its leading position in China and key assets located in the economically active Guangdong province

Nationwide nuclear and wind power generation grew 15%/23% YoY in 10M18. According to China Electricity Council (CEC), China's nationwide nuclear power and wind power generation grew 25.1% YoY and 8.5%YoY in Oct 2018 and 15.0%YoY and 23.1%YoY in 10M18. Such growth was higher than China's overall power generation that increased 4.8%YoY in Oct and 7.2%YoY in 10M18, suggesting the push for alternative energy use has been successful.

China wind power output to grow at 11% CAGR during 2017-20. China is likely to continue to expand the use of wind power. According to CEC, 10M18 wind power output was up 23.1%YoY, the highest increase among all energy sources (the second was nuclear power, up 15.0%YoY). We believe this trend would continue as the government keeps its target to generate 420bn kWh by 2020, which suggests a 37% jump from 306bn kWh in 2017 or 11% CAGR in 2017-20. We believe wind power operators will grow further.

China nuclear power: power output to expand at 14% CAGR in 2017-20. China's nationwide nuclear power output jumped 300% from 62bn kWh in 2007 to 248bn kWh in 2017, representing a 10-year CAGR of 15%. 10M18 nuclear power output was up 15.0% YoY, reflecting a persisting uptrend in the industry. We believe China's strong capacity growth in nuclear power with high utilization hour would elevate output to 366bn kWh by end-2020, suggests a 14% CAGR in 2017-20.

China wind power operators would become the cash-rich utility stocks. Since most wind power operators in China are deleveraging, CAPEX in the next few years would lean on the conservative side. The reduced CAPEX would allow for a positive free cash flow. Amid volatility in the stock market at present, investors are favoring cash-rich companies with stable cash dividends and high earnings visibility. We believe wind power operators with prime asset quality and higher utilization hours would benefit the most.

Long-term Outlook

We believe both nuclear power and wind power sectors would undergo robust growth in the next three years as China aims to reduce both air pollution and reliance on coal-fired power. Nuclear power, due to its high stability and low production cost, is likely to become one of the core alternative energy sources, especially given that nuclear power took up only 4.0%of overall power output in China compared to 30% in advanced nations. Wind power would also expand its contribution since it accounted for only 4.3% of overall energy output in China in 2017.

Main challenges for the nuclear power sector would come from 1) weakening power demand, especially in times of economic downturn; 2) safety issues in daily operation or risks of accidents and disasters. For wind power sector, we believe challenges would come from fluctuations in power demand.

Short-term Outlook

Wind power operators: We believe high account receivables would be the key risk. Given the high debt ratio in local governments, subsidies to wind power operators could be delayed, which may affect cash flow in operators.

Nuclear power operators: Public concern on safety issue would be the key risk. Any nuclear and radiation accidents will result in public panic, which can potentially set back the development pace of nuclear power.

Share price catalyst: We believe investors are currently seeking out utility stocks with high earnings visibility and strong cash inflow amid market uncertainty. For nuclear power, announcement of new plants approval or construction would be positive to share price.

Stock Recommendations

- **Wind power operators:**

Longyuan power (916 HK) is our top pick. We believe the wind power industry would continue to enjoy robust capacity and output growth due to their low bases (accounted for 9%/4% of national energy output/capacity in 2017). However, against the back drop of deleveraging and decreasing wind power tariff, aggressive players who have been over-expanding may suffer from poor cash flow and high leverage, running the risk of bankruptcy. We advise investors to select operators with prime asset quality – facilities with higher utilization hours and generate stronger cash flow. **China Longyuan Power (916 HK)** is our sector top pick. In the long run, we believe wind power operators would become pure utility stocks at present as cash flow improves and stabilizes.

- **Nuclear power operators:**

CGN Power (1816 HK) is our top pick. CGN Power (CGN) is the sole nuclear power operator listed in Hong Kong and the largest nuclear power operator in China by operating capacity. Since it controls ~60% of existing operating nuclear power capacity in China, its share performance is sensitive to news or trends in the sector. Around 65% of CGN's existing operating capacity is located in Guangdong province, one of the most economically vibrant regions in China. Prime locations of its plants also allow for higher utilization hours and stronger cash flow.

Risk Factors

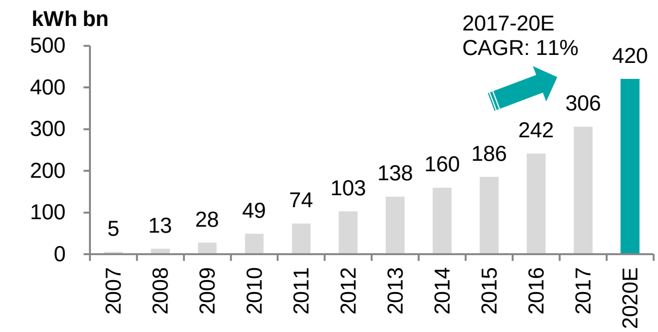
- **Wind power operators:**

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

- **Nuclear power operators:**

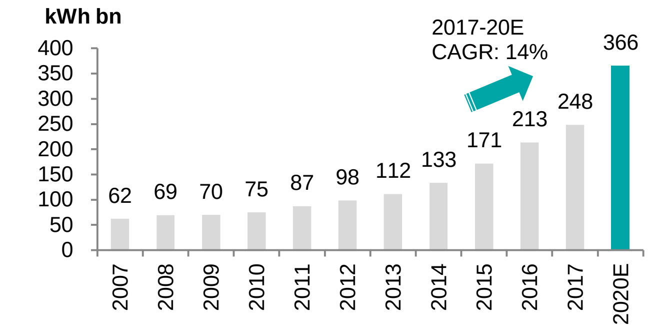
1) Operation safety risk; 2) Construction risk; 3) Fuel cost risk; 4) Tariff risk; 5) Currency and interest rate risks; 6) Fundraising activities to finance future M&A.

Exhibit 1: China's wind power output outlook



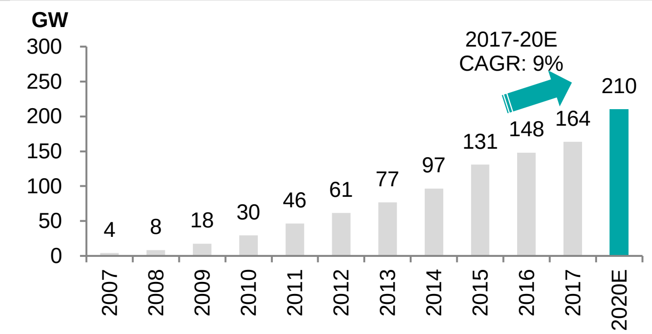
Source(s): NDRC, ABCI Securities estimates

Exhibit 2: China's nuclear power output outlook



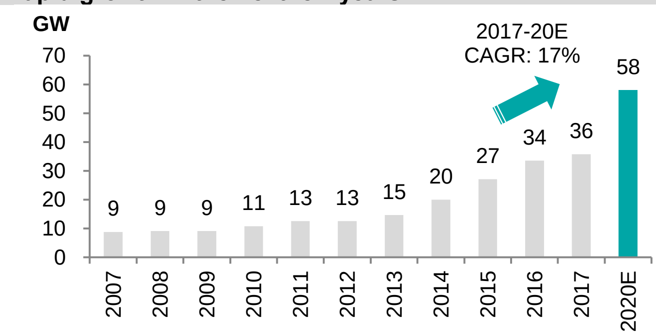
Source(s): NEA, ABCI Securities estimates

Exhibit 3: China's wind power capacity outlook



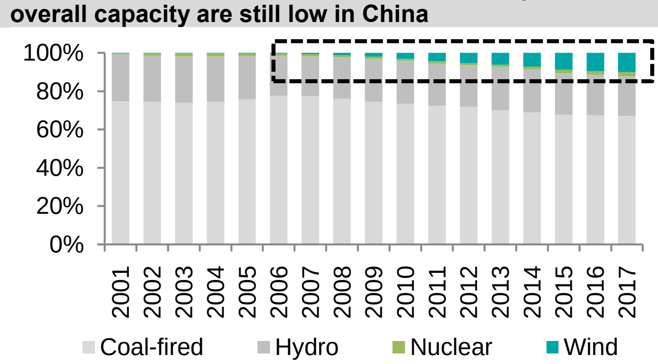
Source(s): NEA, ABCI Securities estimates

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



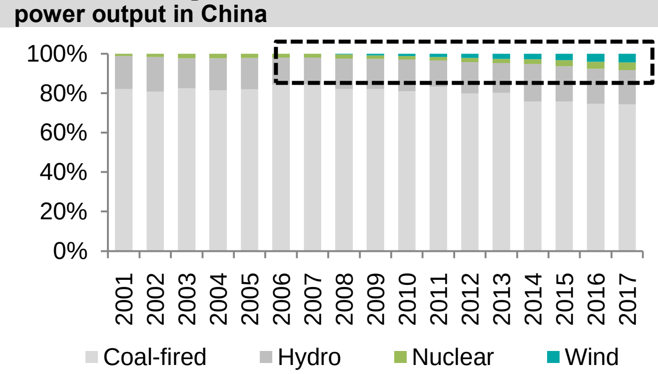
Source(s): NEA, ABCI Securities estimates

Exhibit 5: Contributions of wind and nuclear power to overall capacity are still low in China



Source(s): NEA, ABCI Securities

Exhibit 6: Rising contributions of wind and nuclear power output in China



Source(s): NEA, ABCI Securities

Exhibit 7: Valuation of sector top picks (Data as of Nov 30, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)	FY18E Yield (%)	FY19E Yield (%)
Longyuan	916	BUY	8.40	36.59	9.55	8.23	0.90	0.83	2.09	2.43
CGN Power	1816	BUY	2.70	39.18	8.70	7.69	1.11	1.01	3.47	3.92

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Environmental Protection Sector – Focus on market winners
Kelvin Ng

Key Data	
Avg. 19E P/E (x)	8.29
Avg. 19E P/B(x)	1.26
Avg. 19E div yield (%)	3.34

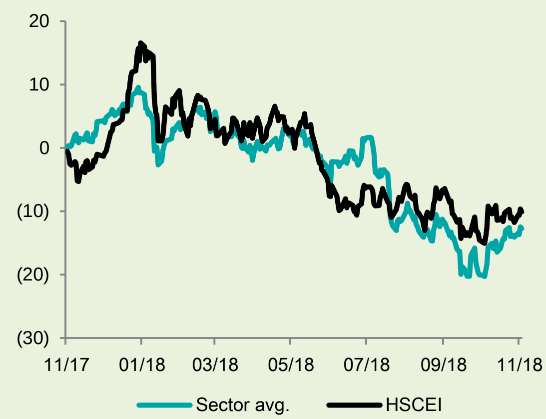
Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSCEI)	Absolute (%)	Relative (%)
1-mth	7.91	3.14
3-mth	(3.35)	(1.01)
6-mth	(15.03)	(3.39)

Source(s):Bloomberg, ABCI Securities

- Increasing O2O activities would elevate solid waste produced per capita and spur demand for incineration service
- Low penetration rate in urban areas would support incineration growth. Waste incinerated in urban areas would increase 18% CAGR in 2016-20E.
- Nationwide wastewater treatment volume would show a 5% CAGR in 2016-20E
- **Beijing Enterprises Water (BEW, 371 HK)** is our preferred pick in China wastewater treatment sector for its largest operating capacity in China with above-peer profitability.

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Increasing O2O activities means more solid waste produced per capita and higher demand for incineration service. According to Ministry of Housing and Urban-Rural Development (MOHURD), China's urban solid waste produced per capita has been trending down from 1.44kg/day in 2003 to 1.11kg/day in 2013, representing -2.6% CAGR during the period. However, the trend has reversed since 2013 from 1.11kg/day to 1.17kg/day by end-2016, representing 1.8% CAGR during the period. We believe such increase can be attributed to Online-To-Offline (O2O) activities nationwide. According to iResearch data, O2O sales in China grew at 35% CAGR from RMB 1.9tn in 2013 to RMB 4.7tn in 2016. We expect solid waste produced per capita would expand at 0.3% CAGR in 2016-20E on robust O2O business.

Low penetration rate leaves room for growth. According to MOHURD, incineration treatment rate in China is low, especially in inland provinces. In 2016, Jiangsu was the only province where 70% of residential solid waste was treated by incineration; five provinces (Zhejiang, Anhui, Fujian, Yunnan and Hainan) attain an incineration rate of 50%-70%, while 15 provinces are below 30%. Since China targets an incineration rate of 50% by end-2020, expansion of incineration facilities will continue in coming years. More specifically, incineration operators would start entering the inland provinces.

Waste incinerated in urban areas to grow at 18% CAGR in 2016-20E. Growing O2O activities, rising urbanization and solid waste produced per capita, and the government's target in increasing the proportion of waste incinerated will raise the proportion of solid waste incinerated in urban areas. According to MOHURD data and estimates by National Development and Reform Committee (NDRC), as population in urban areas would increase by 3.8% CAGR in 2016-20, solid waste produced per capita would increase by 0.3% CAGR; hence, the proportion of solid waste incinerated would rise from 31% in 2016 to 50% by end-2020. We expect waste incinerated in urban areas would jump from 80mn ton in 2016 to 155mn ton in 2020E, suggesting a 94% rise or a 4-year CAGR of 18%.

Urbanization remains the key driver for wastewater treatment sector, but current penetration rate is high. We believe increasing urbanization rate would continue to drive population growth in urban areas and demand for wastewater treatment service. According to NDRC estimate, China's urbanization rate would reach 60% by end-2020, up from 57% at end-2016. The State Council estimates total population would reach at least 1.45bn by end-2020, implying an additional of 77mn people will move to urban areas in years to come. According to MOHURD, as of end-2016, wastewater treatment rate in urban areas reached 92% – close to China's target of 95% by end-2020. We believe wastewater treatment operators will expand through M&A and improve quality of operational management to gain market share.

Nationwide wastewater treatment volume would grow at 5% CAGR in 2016-20E. With rising urbanization rate and wastewater produced per capita, urban wastewater to be treated would grow in years to come. According to MOHURD and NDRC data, assuming an urbanization rate of 60% and a wastewater treatment rate of 95% by end-2020E, wastewater produced per capita would grow by 0.9% per year during 2016-2020E (wastewater produced per capita expanded by 0.7% p.a. in 2006-16), total wastewater treatment volume would be 65bn tons, representing a 23% increase on wastewater treatment volume from end-2016 (53bn tons), or a 5% CAGR in 2015-20E.

Pick the winners. Only two provinces (Qinghai, Hainan) have a wastewater treatment rate below 80%. Urban wastewater treatment rates in 23 provinces are 80%-95% and six provinces exceeds 95%. High penetration rate in urban areas means operators would opt for expansion through acquisition or entering the rural areas. We believe market leaders with large operating capacity and high profitability would have an advantage.

Long-term Outlook

We believe China's urbanization will continue to boost demand for incineration and wastewater treatment service. For incineration sector, given the penetration rate in urban area is quite low now (2016: ~31%), we believe increasing urban population and land price will drive demand forward and solid waste incinerated would record mid-teens growth in volume. For wastewater treatment sector, as penetration rate is high (2016: ~92%) suggests growth would be at the single-digit level.

Short-term Outlook

Incineration operator will benefit from rising urbanization and solid waste produced per capita, solid waste incinerated incineration in urban area would stay robust in 2019.

For wastewater treatment operators, more focus will be on BOT (Build-Operate-Transfer) projects rather than Engineering, Procurement and Construction (EPC) projects due to BOT's high margins. Capital-raising through Public-Private Partnership (PPP) is unlikely to increase.

Stock Recommendations

- **Wastewater treatment operators:**

Beijing Enterprises Water (BEW, 371 HK) is our top pick in wastewater treatment sector. BEW is the largest wastewater treatment operator in China by operating capacity (11.7mt/day in 2017, accounts for 5.9% of total market share); in addition, it has the highest ROAE among peers in 2017 (20% vs. peer average of 11%). BEW's background as an SOE would be advantages for project acquisitions.

Risk Factors

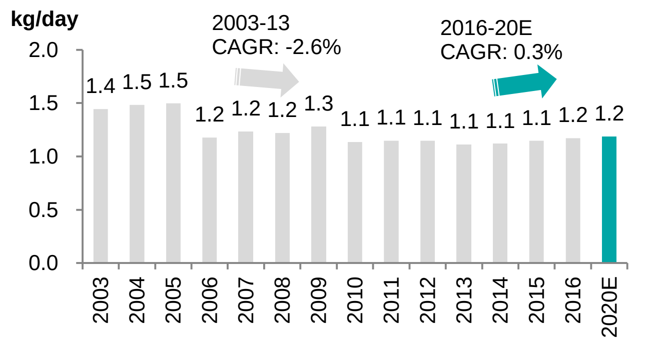
- **Incineration operators:**

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:**

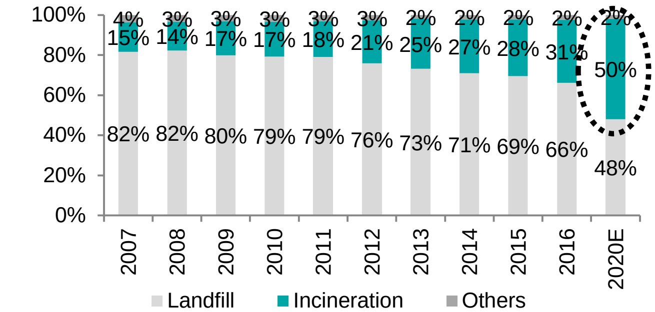
1) Slower-than-expected capacity growth; 2) Default risk; 3) Policy risk; 4) High net gearing ratio; 5) Negative cash flow.

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



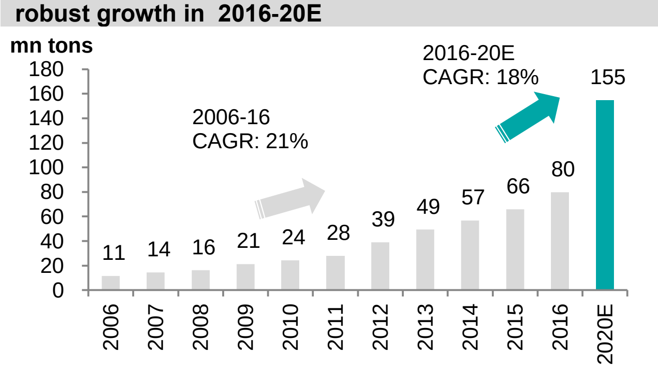
Source(s): MOHURD, ABCI Securities estimates

Exhibit 2: China to increase proportion of waste incinerated in 2020E



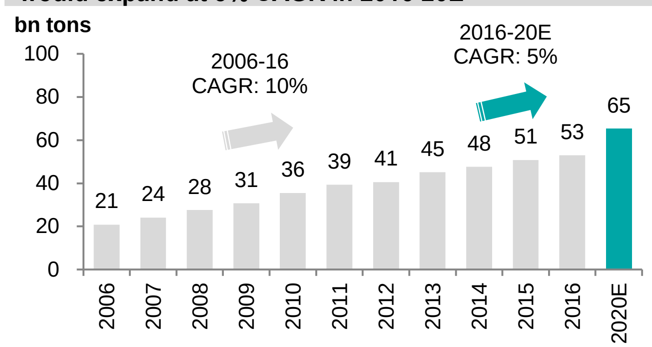
Source(s): NDRC, ABCI Securities

Exhibit 3: Waste incinerated in urban areas would saw robust growth in 2016-20E



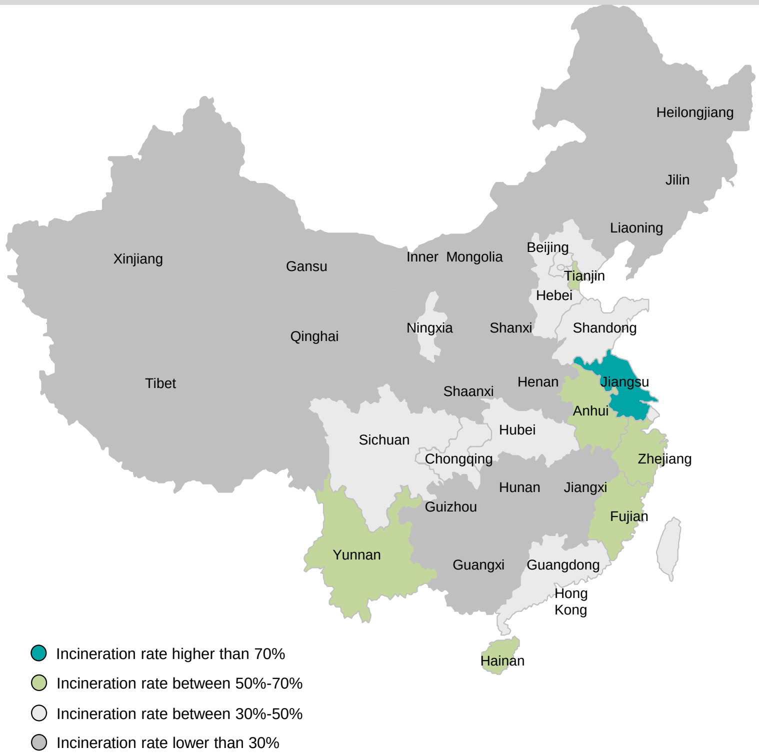
Source(s): MOHURD, NDRC, ABCI Securities estimates

Exhibit 4: Nationwide wastewater treatment volume would expand at 5% CAGR in 2016-20E



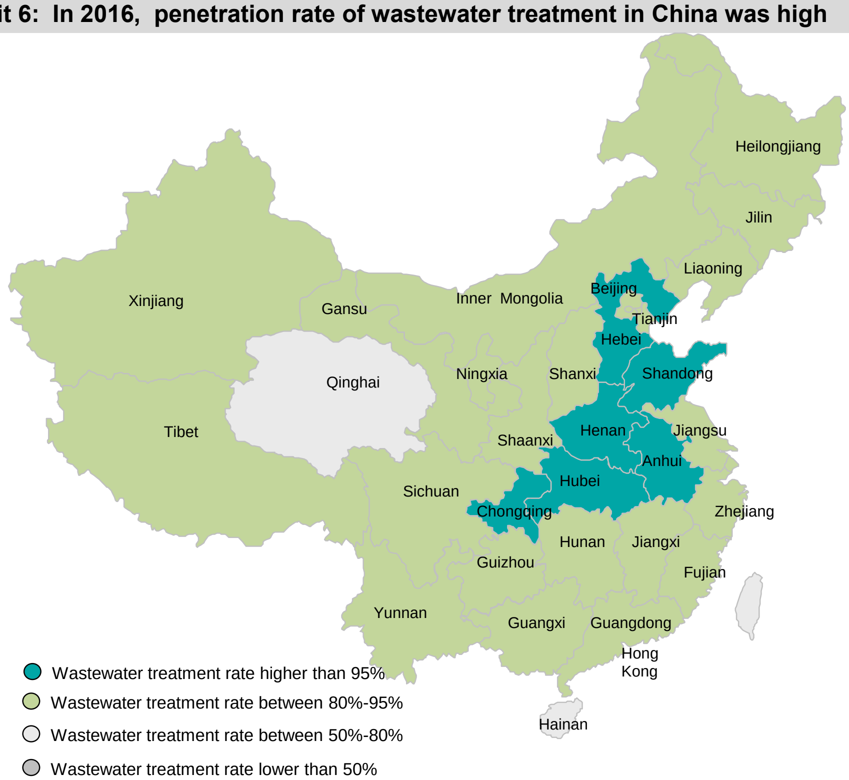
Source(s): MOHURD, NDRC, ABCI Securities estimates

Exhibit 5: In 2016, penetration rate of incineration in China remains low



Source(s): MOHURD, ABCI Securities

Exhibit 6: In 2016, penetration rate of wastewater treatment in China was high



Source(s): MOHURD, ABCI Securities

Exhibit 7: Valuation of sector top pick (Data as of Nov 30, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY19E P/E (x)	FY19E P/B (x)	FY19E P/B (x)	FY19E Yield (%)	FY19E Yield (%)
BEW	371	HOLD	5.00	10.37	8.97	8.19	1.62	1.45	3.34	3.67

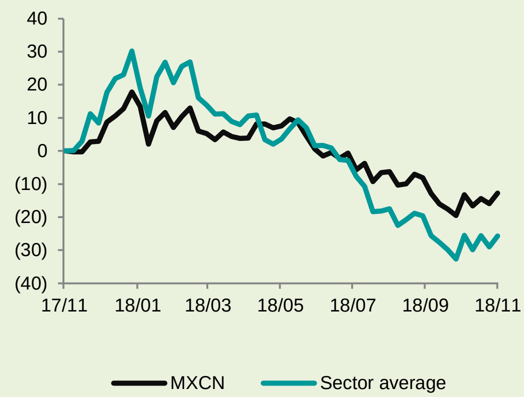
Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
Internet Media and Consumer Commerce – Be selective
Steve Chow

Key Data		**Sector Performance (relative to MSCI)**	**Absolute (%)**	**Relative (%)**
Avg. 19E P/E (x)	23.4	1-mth	1.5	0.8
Avg. 19E P/B(x)	3.7	3-mth	(7.5)	(6.1)
Avg. 19E div yield (%)	0.7	6-mth	(25.5)	(18.9)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- We believe the rise of short video has diluted users' share of time spent on other forms of online entertainment including online games
- Tightened regulatory environment would inevitably disrupt game developers' game pipeline,
- **Alibaba (BABA US)** is our top pick for the sector of its ongoing market share gains

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Intensified competition on users' time spent. According to JiGuang, the average number of mobile apps installed per mobile user has seen an upward trend in recent quarters, reaching 50 in 3Q18 versus 34 in 3Q17. In our view, this implies competition on users' time spent among mobile apps has been intensifying. In addition, users' time spent on mobile apps could have become more fragmented, making it more difficult for internet platforms to maintain user stickiness.

The rise of short video presents threats to other forms of online entertainment. According to QuestMobile, mobile users have increased their share of time spent on short videos from 2.0% in June 2017 to 8.8% in Sep 2018. On the other hand, share of users' time spent on other form of online entertainment including instant message, long video, browser, and real-time strategy game have dropped accordingly

Online gaming is facing headwinds. According to MIIT, growth momentum in internet gaming has weakened since Apr, with revenue growth (YoY) falling from 33.2% YoY in 1Q18 to negative territory in Sep 2018. In our view, current weakness would extend to 2019. Tightened regulatory environment would inevitably disrupt game developers' game pipeline, thus further reducing the appeal of online games as an online entertainment. This could further prompt users to spend more time on other emerging forms online entertainments such as short video viewing.

Online shopping –a mixed bag. China's online sales of physical goods grew 25.5% YoY in 10M18, accounting for 17.5% of total retail sales during the same period, according to NBS. On a monthly basis, growth momentum of online sales of physical goods has moderated since 3Q18, reflecting a weakened macro environment. Alibaba has achieved high revenue growth than **JD.com (JD US)** in recent quarters, implying ongoing market share gains.

Stock Recommendations

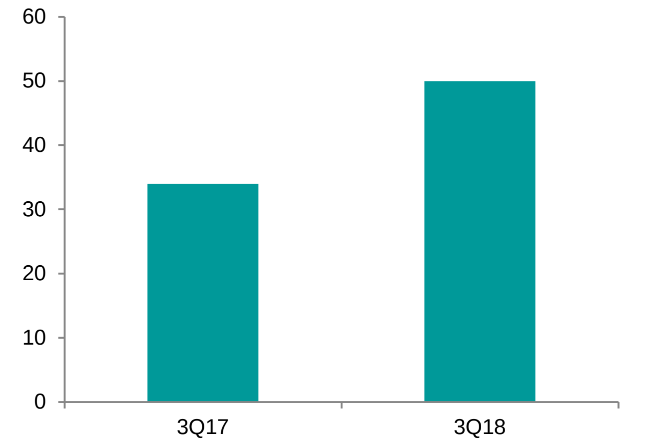
Alibaba is our top pick among large-cap internet stocks because we believe online shopping will fare better than online gaming, and Alibaba is a leader in the former segment. Although Alibaba's near-term margin is likely to be pressured due to ongoing investments in new business initiatives such as new retails, Ele.me, etc., we believe its undemanding valuation has priced in this concern.

For **Tencent (700 HK),** we believe the lack of positive catalyst in the near term amid ongoing regulatory headwind in online gaming and emerging threats from short video platforms may reduce users' time spent on online gaming.

Risk Factors

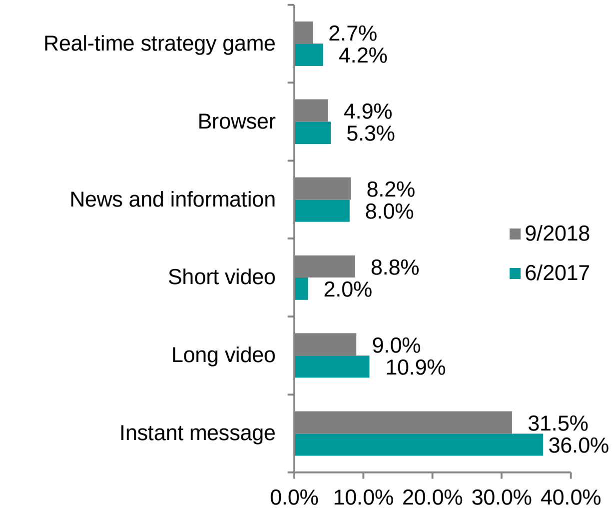
1) Tightening regulation on internet finance/mobile game/online payment; 2) Entry of foreign competitors such as Facebook and Google; 3) Slowdown in ecommerce and internet finance; 4) Life cycle of mobile games;

Exhibit 1 : No. of installed apps per mobile user



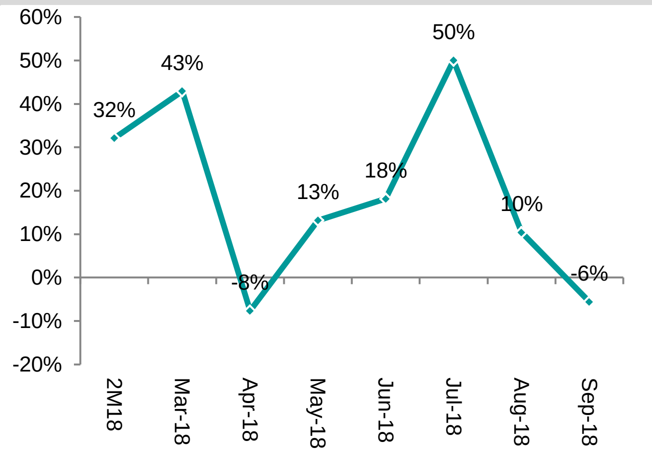
Source(s): JiGuang, ABCI Securities

Exhibit 2: Mobile users' time spent allocation



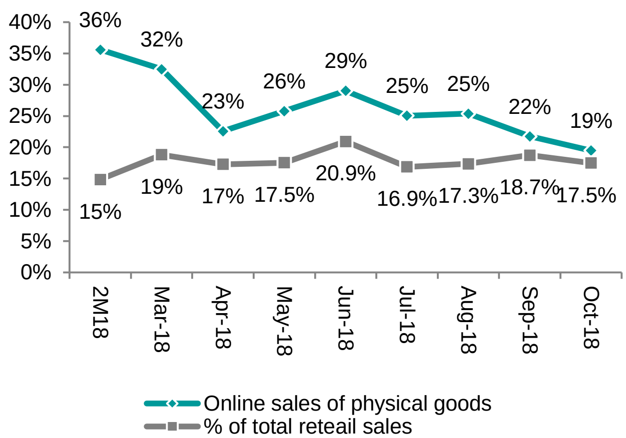
Source(s): QuestMobile, ABCI Securities

Exhibit 3: Online gaming revenue growth (YoY)



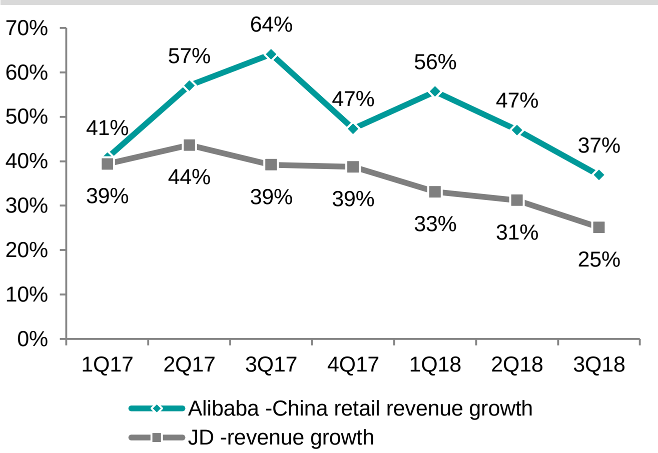
Source(s): MIIT, ABCI Securities

Exhibit 4: Online sales of physical goods



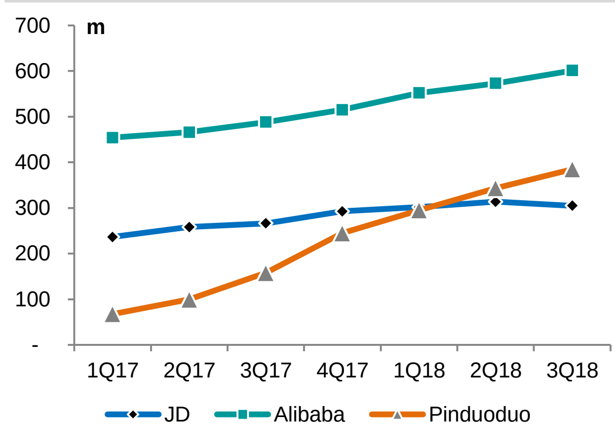
Source(s): NBS, ABCI Securities

Exhibit 5: Revenue growth – Alibaba vs. JD.com



Source(s): Companies, ABCI Securities

Exhibit 6: Annual active buyers comparison



Source(s): Companies, ABCI Securities

Exhibit 7: Valuation of sector top pick (Data as of Nov 23, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)	FY18E Yield (%)	FY19E Yield (%)
Alibaba	BABA US	BUY	183	14	31.6	24.5	6.1	5.0	-	-

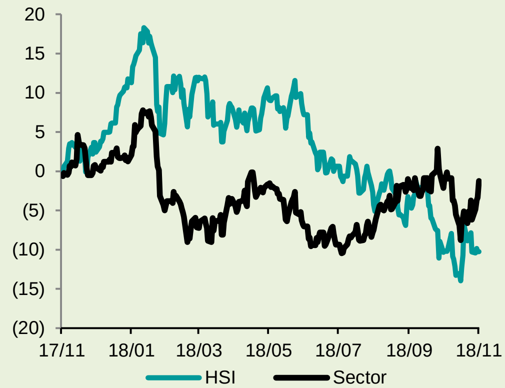
Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Telecom Sector– New momentum from 5G network
Ricky Lai

Key Data		Sector Performance (relative to HSI/HSCEI)	Absolute (%)	Relative (%)
Avg. 19E P/E (x)	14.9	1-mth	(7.0)	(6.1)
Avg. 19E P/B(x)	1.1	3-mth	3.6	11.1
Avg. 19E div yield (%)	1.8	6-mth	(1.7)	12.4
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- We expect stable growth in China's wireline broadband market in 2019 with better network speed and IPTV utilization rate
- Expansion of 4G telecom network coverage will drive demand for telecom towers. In addition, telecom operators will need a much denser base station network to support 5G network development
- **China Mobile (941 HK)** is our top pick in the sector with high dividend yield and healthy balance sheet position. The Group dominates the mobile business in China with rapid growth in wireline business.

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

4G user penetration in China to reach 78.5% in 2019E and 82.0% in 2020E. According to MIIT, mobile business of telecom operators accounted for 70.4% of total telecom revenue in 10M18, driven by ramp-up demand of data services and value-added services. China's mobile users reached 1.55bn in Oct 2018, up 10.7% YoY. The launch of unlimited data packages by telecom operators have stimulated growth, with China's overall mobile internet users exceeding 1.3bn in Oct 2018, accounting for 83.8% of total mobile users. According to MIIT, as of Oct 2018, 4G users reached 1.16bn, representing 74.8% of total mobile users in China. In 2017, **China Unicom (762 HK)** issued the highest number of unlimited SIM cards through cooperation with internet companies among the Chinese telecom operators. Although the promotion of unlimited SIM cards boosted user growth, mobile ARPU was pressured. The average mobile data per user reached over 5.66GB in Oct 2018, up 151% YoY. We expect 4G penetration rate to further increase, driven from the migration of low-end users (from 2G/3G platforms to 4G), dual SIM cards smartphones, and lower mobile service tariff.

4G network coverage to reach 98% by 2020, according to Ministry of Industry and Information Technology (MIIT). Aggregate telecom revenue in China grew 2.7% YoY in 10M18. Overall telecom volume usage surged 139.8% YoY. The wireline broadband users with 100M transmission speed or above accounted for over 60% of total broadband users as of Oct 2018. The 200M and 500M speed broadband networks are increasing in popularity. China Mobile surpassed **China Telecom (728 HK)** as China's largest wireline broadband service market provider in Oct 2018. China Mobile recorded a strong growth in wireline broadband market thanks to its relative lower service fee, network coverage improvement and the launch of bundled service packages.

Market share of China Mobile, China Unicom, China Telecom accounted for 61.0%/ 18.8%/ 20.2% in Oct 2018, respectively. We expect stable growth in China's wireline broadband market in 2019 with better network speed and IPTV utilization rate. As of Oct 2018, 4G penetration rate of China Mobile, China Unicom, China telecom were 75.9%/ 69.0%/ 79.4%, respectively. China Telecom had the highest 4G user penetration rate driven by the frequency re-farm of 800MHz frequency spectrum for 4G network usage. According to MIIT, wireline broadband users reached 400mn in Oct 2018 and FTTH (fiber to the home) users reached 359mn, or 89.8% of total wireline users. China's IPTV users reached over 151mn as of Oct 2018, thanks to stronger demand of 4K TV program, online games, and high definition video contents. The robust user growth in wireline network was driven by the launch of value-added services and quality video contents by telecom operators.

Long-term Outlook

We expect higher CAPEX by telecom operators for 2019 for 5G network development that requires more base stations and wider fiber network coverage. Commercial launch of 5G network is expected to drive up data usage, thanks to better transmission speed with low latency. Increased data usage will help mitigate the lower handset data tariff. Telecom operators are lowering their operating expenses such as handset subsidy to improve margin and alleviate the impact of lower mobile service tariff. Regulatory pressure to reduce service tariff further may hamper ARPU and revenue growth. Telecom operators have launched various value-added services, IPTV, and video contents to improve user experiences and boost adoption. We expect the wireline broadband market in China will grow in a moderate pace.

Expansion of 4G telecom network coverage will drive demand for telecom towers. In addition, telecom operators will need a much denser base station network to support 5G network development since 5G frequency spectrum is much higher than that of the 4G network. Consequently, we expect China Tower's (788 HK) tenancy ratio to rise from 1.44 in 2017 to 1.52 in 2020E.

Short-term Outlook

Telecom operators have canceled domestic data roaming tariff in July 2018 and lowered the handset service tariff by 30% in 2018, which affect ARPU. Lower service tariff, however, have boosted mobile data usage and user growth. Proliferation of multi-SIM smartphones in China is expected to promote mobile user growth and demand for mobile SIM cards. We forecast moderate growth in mobile service revenue (~1% YoY) in 2019E based on robust data usage of over 100% YoY and moderate mobile user growth (3.4%), whose benefits would be partially offset by lower mobile service tariff.

To comply with the target of 4G network covering 98% of the population by 2020, tower demand will rise in short term and we can expect high CAPEX from telecom operators. We forecast the tower discount rate can encourage telecom operators to expand 4G network coverage, which in turn will enhance growth of 4G users.

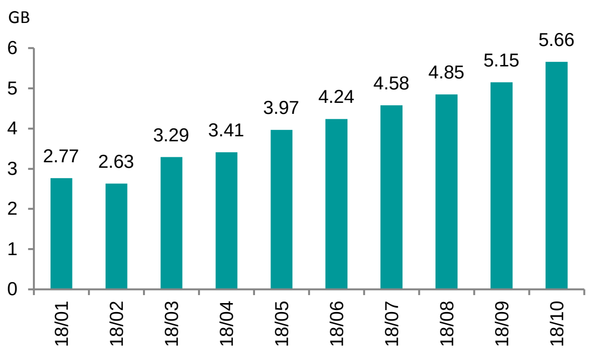
Stock Recommendations

China Mobile (941 HK) is our top pick based on its dominate position in mobile business characterized by rapid growth in wireline network. As of Oct 2018, market share of China Mobile's mobile business reached 61.0%, thanks to its network advantage with better coverage and customer loyalty. We forecast mobile data usage to sustain robust growth in FY18E (+150% YoY). Higher growth in data traffic volume would help offset the impacts brought by lower mobile data service tariff. The Group showed robust wireline broadband user growth in 10M18, surpassing China Telecom to become China's largest wireline broadband service provider in China. We expect China Mobile's user growth and data revenue to improve in 2019E thanks to better network coverage and effective service packages. Our TP is HK$ 83.0, which implies 12.3x/12.0x FY19E/20E P/E.

Risk Factors

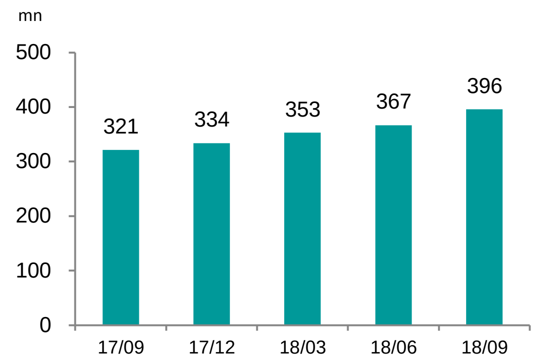
1) Further reduction in service tariff as requested by official authorities; 2) User saturation; 3) Intensifying market competition which may result in price war.

Exhibit 1: China's average monthly data usage



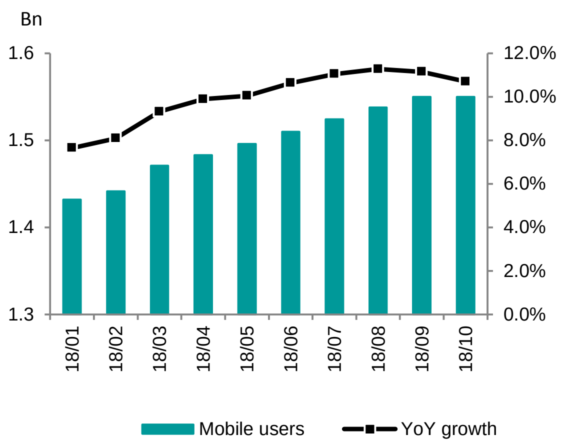
Source(s): MIIT, ABCI Securities

Exhibit 2 China's mobile base stations



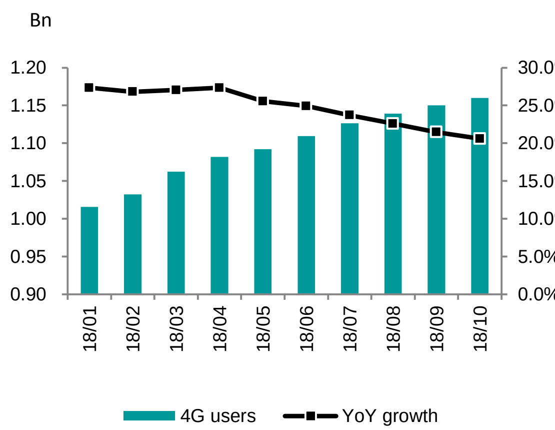
Source(s): MIIT, ABCI Securities

Exhibit 3: China's overall mobile users and YoY growth



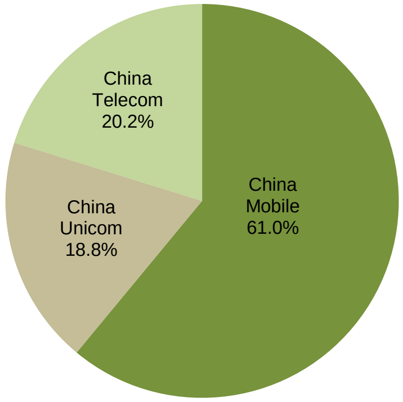
Source(s): MIIT, ABCI Securities

Exhibit 4: China's 4G users and YoY growth



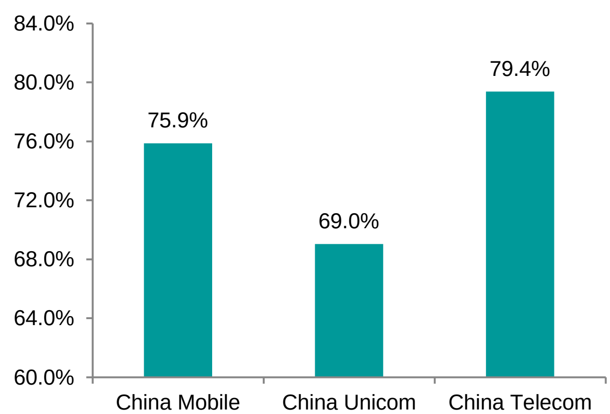
Source(s): MIIT, ABCI Securities

Exhibit 5: China's 4G user market share



Source(s): Companies, ABCI Securities

Exhibit 6: China's 4G users penetration



Source(s): Companies, ABCI Securities

Exhibit 7: Valuation of sector top picks (Data as of Nov 30, 2018)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)	FY18E Yield (%)	FY19E Yield (%)
China Mobile	941	BUY	83.00	6.9	12.1	12.0	1.3	1.3	4.0	4.1
China Tower	788	BUY	1.35	2.7	69.4	35.8	1.0	0.9	2.9	3.1

Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Education Sector –Policy risk as major overhang
Paul Pan

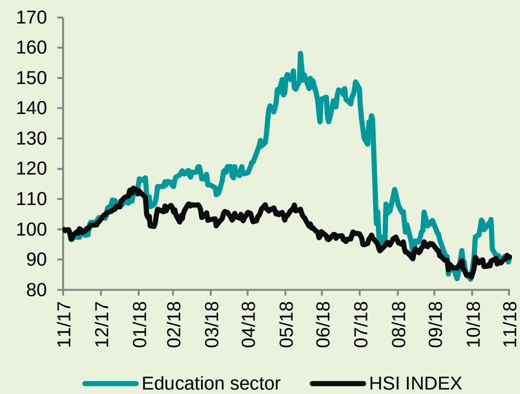
Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 19E P/E (x)	12.49	1-mth	3.37	(2.75)
Avg. 19E P/B(x)	1.91	3-mth	(16.10)	(11.14)
Avg. 19E div yield (%)	2.58	6-mth	(38.67)	(25.67)

Source(s):Bloomberg, ABCI Securities estimates

Source(s):Bloomberg, ABCI Securities estimates

- The trend of increased regulatory oversight on education sector is clear and the government's policy stance on education sector has shifted
- We foresee higher operating costs for education operators as a consequence of the new policy directives
- Expansion model of formal education sector is also about to change
- We expect more polices on higher education to be announced

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Good news, bad news. Latest policies on China's education sector have roiled the market. Regulations for preschool/kindergarten aim to curb high tuitions, while those targeting the K-12 after-school tutoring business intend to restrain excessive exam-driven behaviors. Measures to regulate vocational education aims to promote development by introducing industry reform and private capital. The new polices would be beneficial to the sector in the long run, and we believe the industry leaders would adapt better to the evolving business environment.

Policy stance on education has shifted. We believe the government is stimulating consumption in other areas by reducing the burden on education consumers. Such policy shift is evident in recent announcements targeting to curb excessive competition, rein in profit-driven behaviors, and increase supply. We believe negative impacts will be felt most by players in early/mid-stages (kindergarten – Grade 9) of both formal and informal education services in the short term.

Higher operating costs for education players. The government has proposed to increase the salaries for teachers in compulsory education to match those of civil servants in the same region. Such process is targeted to be completed within three years. In addition, new policy requires K-12 after-school tutoring instructors teaching certain subjects must obtain relevant teacher qualifications. Hence, we believe the number of employable K-12 after-school tutoring instructors would decrease as a result and the cost of retaining/acquiring these staff would rise. Similar requirements could be applied to preschool/kindergarten and other tutoring service providers, raising the overall operating cost for the education industry. Moreover, the minimum floor space per student required for K-12 after-school tutoring centers may lead to higher rental costs.

Expansion model is bound to change. The "Committee Draft Implementation of the Private Education Promotion Law" ("Committee Draft"), which is yet to be finalized, states that not-for-profit schools can no longer be acquired through M&A, franchising, and business agreements. The new policies for preschool/kindergarten also states that listed companies cannot invest in for-profit preschool/kindergarten through equity financing. We believe that 1) K-12 school operators may need to rely more on organic growth in the future as Grade1-9 schools (compulsory education) can only apply to become a not-for-profit schools, meaning that these operations cannot be acquired if the new clause in the "Committee Draft" is enacted in the final version; 2) financing options for acquisitions of preschool/kindergarten will be narrowed; 3) expansion of higher education service providers may be affected due to some schools may become not-for-profit entities in the future.

Higher education will be regulated further. The "Notice on Measures and Mechanism on Promoting Consumption in 2018-20" ("The Notice") issued by the State Council specifically stresses the opening up of China's education sector and reforms in three education tiers – preschool/kindergarten, vocational education, and higher education. Soon after the announcement of "The Notice", new policies on preschool/kindergarten and vocational education have been released, while those regarding higher education industry have yet to be disclosed. We expect more foreign higher education programs to be introduced and cooperation between quality domestic and foreign higher education institutions will be promoted. Competition in the private high education industry will remain stiff.

Long-term Outlook

As regulatory oversight on the early/mid stages of education industry has intensified, operating costs of private education service providers would increase, resulting in sector consolidation. Future policy/regulation may challenge the current business structure of the listed education companies, i.e. related party transactions, structured contracts, and VIE structure.

Demand for quality education service would be supported by rising personal income level and escalating academic competition. Even though the government has announced measures to increase the number of kindergartens and accelerating the development of vocation education, quality education resources remain scarce in China and key players would maintain their leading positions due to their higher capability in attracting talents and longer operating history.

Short-term Outlook

As the "Committee Draft Implementation of the Private Education Promotion Law" has not been finalized, higher education and fundamental education (Grade 1-12) would be under pressure. We also expect more policies to be announced in the short term, especially those pertaining to higher education. Investors should attend to the business mix and track record of education players, and avoid those with high exposure in sub-segments overshadowed by risks.

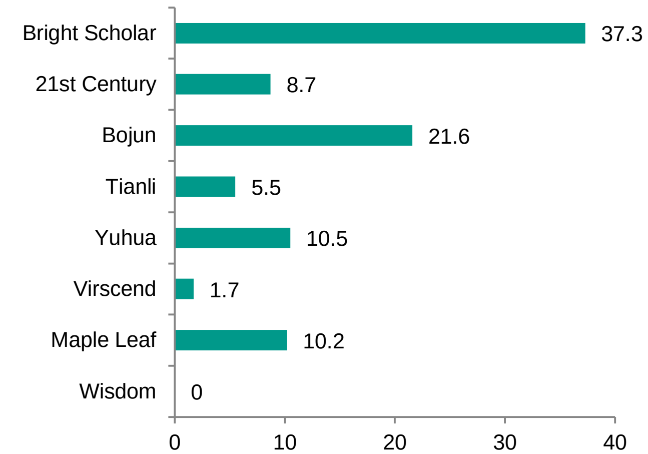
Stock Recommendations

We maintain **NEUTRAL** on the sector since its outlook is tainted by policy uncertainties. Providers of formal education services (from primary school to high school) are likely to be under the most pressure. Policy risk of K-12 after-school tutoring sub-segment is partially relieved since relevant measures have already been disclosed, while professional education is facing the lowest risk at present.

Risk Factors

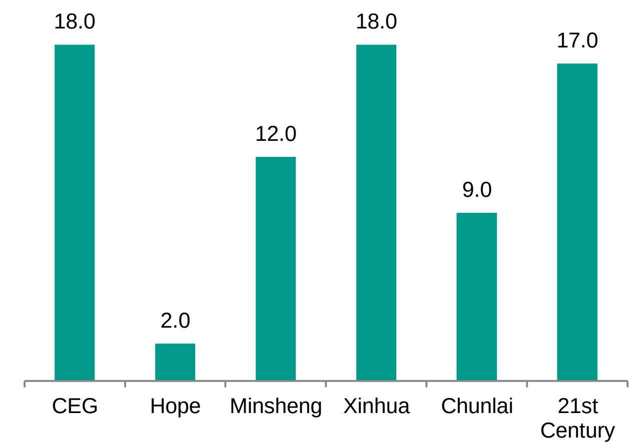
1) Regulatory/policy risk; 2) Growth risk; 3) Cost risk; 4) Operational risk; 5) Failure to recruit and retain qualified teaching staff; 6) Education quality and student dropout risk; 7) Acquisition/investment risk.

Exhibit 1: Preschool enrollment /total formal education enrollment (%)



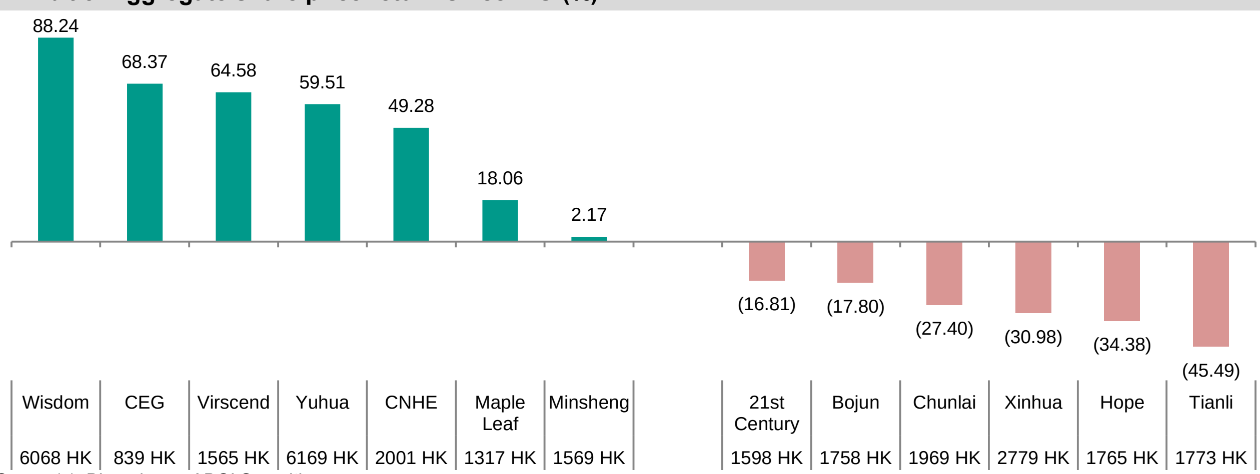
Notes: Data of Maple Leaf is for 2016/17 school year, others are for 2017/18 school year
Source(s): Companies, ABCI Securities

Exhibit 2: Vocational education enrollment /total enrollment in 2016/17 school year (%)



Source(s): Companies, ABCI Securities

Exhibit 3: Aggregate share price return since IPO (%)



Source(s): Bloomberg, ABCI Securities

Exhibit 4: Recent regulation/policy on education industry

Regulation/Policy	Target	Objective
Notice on Measures and Mechanism on Promoting Consumption in 2018-2020 (国务院办公厅关于印发完善促进消费体制机制实施方案（2018—2020 年）的通知 国办发〔2018〕93 号)	Entire education sector	1) Accelerate the amendment process of the law for promoting private education 2) Experiment on the cooperation between corporations and education institutions, and encourage shareholding structure reform of vocational schools 3) Develop preschool/kindergarten education that benefits the mass - encourage local government to guide and support private preschool/kindergarten to provide education services at more favorable rates by purchasing services, reducing rent, and offering teaching staff support 4) Launch policies and measures to support the development of care service for children under the age of 3 5) Implement the opinion for regulating the after-school tutoring service providers 6) Encourage the introduction of high-quality higher education/vocational education resources; start high-level Sino-Foreign cooperation at program and school level; establish the mechanism in which education bureau and the local government jointly participate in the approval of Sino-Foreign education programs at above the bachelor level
Committee Draft of the regulations on the Implementation of the Law on Promoting Private Education in PRC (Revised Draft) (Committee Draft Implementation of the Private Education Promotion Law) (中華人民共和國民辦教育促進法實施條例（修訂草案）(送審稿）)	Entire education sector	1) To provide national guidelines for provincial governmental authorities to issue their own implementation opinions and licensing measures in relation to the specific implementation methods and operative approaches of the amended law based on the local conditions 2) One of the newly-added policy is: Private education Groups cannot take control of not-for-profit private schools via M&A, franchising, or business agreements
State Council's Opinion on Regulating the Tutoring Industry "State Council Opinions 80" （国务院办公厅关于规范校外培训机构发展的意见 "国办发〔2018〕80 号"）	K-12 after-school tutoring industry	1) To provide guidance on regulating after-school training market for primary and secondary school students, including, among others, the operation standards that after-school training institutions should follow, the requirements and approvals necessary for opening new after-school training institutions, the guidance for daily operation of after-school training institutions, and the regulatory supervision scheme for after-school training institutions. 2) Avg. floor space per student during one tutorial session should be no less than 3sqm 3) Instructors in Chinese, Math, English, Physics, Chemistry, and Biology should obtain teacher qualifications 4) Tutorial centers cannot receive students' tuition payments for more than 3 months in advance 5) Contents of tutorial courses should not exceed the national guideline; students should be placed in courses that matches their grade levels
Circular on Special Enforcement Campaign concerning After-school Training Institutions to Alleviate Extracurricular Burden on Students of Primary Schools and Middle Schools (關於切實減輕中小學生課外負擔開展校外培訓機構專項治理行動的通知), ("Circular 3")	K-12 after-school tutoring industry	1) Aims to alleviate after-school burden on primary and middle school students through inspection and rectification on after-school tutoring institutions 2) By end-June 2018, the process of surveying the industry condition should be completed 3) By end-2018, rectification of non-compliance practices should be completed 4) By end-June 2019, the inspection and review processes should be completed
Mandatory salary increase for teachers in Grade1-9 (全力保障义务教育教师工资待遇 不断提高教师职业吸引力)	Compulsory education (Grade 1-9)	1) Emphasize the current regulations' guidance on salary level of teachers in compulsory education (Grade 1-9) 2) Increase salary levels of teachers in compulsory education to match those of the civil servants in the same region 3) Solve the low salary issue of compulsory education teachers in three years

Opinions on deepening the reform of preschool education (中共中央国务院关于学前教育深化改革规范发展的若干意见)	Preschools and kinder-gartens	1) Increase coverage of kindergartens that benefits the mass (普惠性幼儿园) to 80% by 2020; Increase the gross admission rate (毛入院率) for preschool/kindergarten to 85% by 2020 2) Establish the systematic training system for bachelor/junior college students majoring in preschool education and increase the number of bachelor/junior college graduates majoring in preschool education to 200k+ by 2020; increase the number of teachers/principals to 1.5mn 3) By 2035, full coverage of preschool education for both urban and rural areas should be completed 4) Private kindergartens are prohibited to sell shares to the public either by themselves or as part of asset packages 5) Listed companies are not allowed to invest in private kindergartens through share sales or cash injections under the new policy 6) Private investors will be barred from backing public kindergartens
Reform measures for vocational education (国家职业教育改革实施方案)	Vocational education	1) The government would emphasize the role of vocational education in the society 2) To develop the education and training system of vocational education to cater to market demand and technology development 3) To reform the vocational education industry 4) To encourage and support the society and private corporations to play a bigger role in the vocational education development

Source(s): gov.cn, company information, ABCI Securities

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 do not serve as officer(s) of the listed company (ies) covered in this report.

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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 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

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

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