農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

2020 Economic Outlook and Investment Strategy

From Mediocre to Marvelous: the R&D factor

ABCI China/HK Equity Research

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Global Economic Outlook

Andy Yao, ABCI Economist

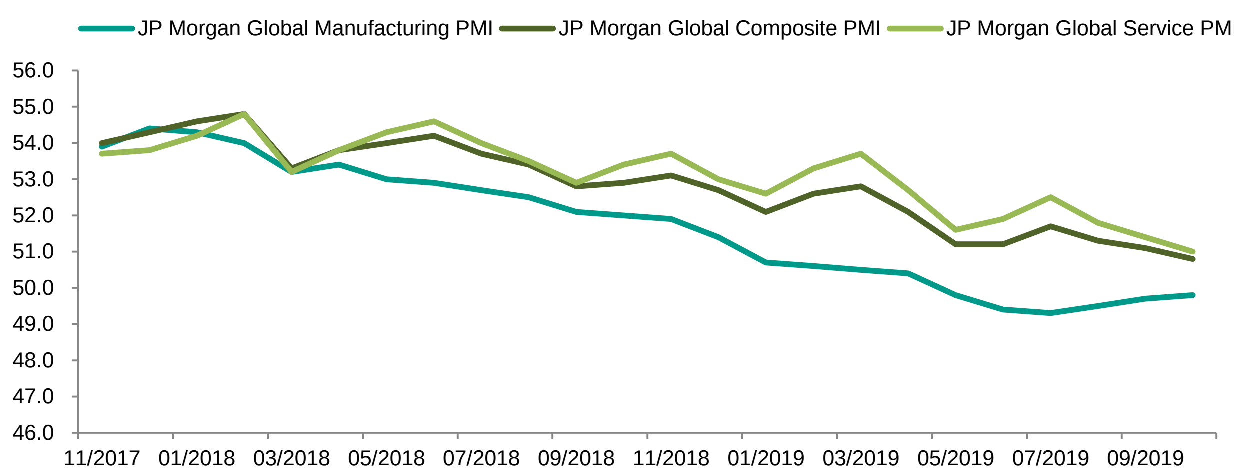
2020 Global Economic Outlook

- The global economic growth has continued to slow since the start of 2019 with rising global trade protectionism and elevated uncertainty surrounding geopolitics despite easing monetary policy
- Global inflation has been mild since the start of 2019 on sluggish growth and low energy prices. Core inflation, excluding food and energy prices, were muted on anemic wage growth
- Global economic growth is expected to remain sluggish in 2020 as global trade disputes and heightened uncertainty on the economic and political fronts could further disrupt supply chains, hampering confidence and investment
- We expect economies in the US, China, Eurozone, Japan, and the UK to grow by 2.3%, 6.1%, 1.2%, 0.9%, and 1.4% in 2019E and 1.9%, 5.9%, 1.0%, 0.6% and 1.2% in 2020E, respectively, compared with 2.9%, 6.6%, 1.9%, 0.8% and 1.4% in 2018

Global growth momentum continued to weaken

The global economic growth has continued to slow since the start of 2019 with the rising global trade protectionism and elevated uncertainty surrounding geopolitics despite significant easing in monetary policy. Global trade, manufacturing activity and investment have been pacing down, with business and consumer confidence dipping down. As shown in Exhibit 1, both the JP Morgan global manufacturing PMI and service PMI moderated in 10M19, pointing to a slowing economic expansion.

Exhibit 1: JP Morgan Global PMIs (%)



Source(s): Bloomberg, ABCI Securities

Global trade has continued to soften on descending growth in global manufacturing activity. According to the latest WTO quarterly trade volume statistics, merchandise trade rose only 0.2%[1] in 2Q19, compared with 3.5% in 2Q18. The World Trade Outlook Indicator released by WTO remained at the below-average growth level at 96.6 in Nov, well below the baseline value of 100. The sub-indicator export order index was at the contraction level of 97.5 in Nov, suggesting further slowdown in trade for 2020.

Year to date, momentum in global major economies have been frail on the whole. In 9M19, the US economy grew 2.3%, down from 2.9% in 2018 as boost from the tax cuts faded (Exhibit 2). Economies in China, Eurozone, Japan and the U.K. expanded by 6.2%, 1.2%, 1.0% and 1.5% in 9M19, respectively, compared with 6.6%, 1.9%, 0.8% and 1.4% in 2018. Economic growth in many emerging markets was slower than expected, including India, Mexico, Russia, and many commodity-exporting economies.

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

Real GDP Growth (YoY)	2017	2018	9M19
U.S.	2.4	2.9	2.3
China	6.9	6.6	6.2
Eurozone	2.5	1.9	1.2
Japan	2.0	0.8	1.0
U.K.	1.9	1.4	1.5

Source(s): Bloomberg, ABCI Securities

Global inflation has been mild since the start of 2019 on sluggish growth and low energy prices. Core inflation, excluding food and energy prices, stayed muted on anemic wage growth. In most advanced economies, core inflation failed to meet targets of central banks despite substantial improvement in unemployment rate. Among the emerging economies, core inflation remains at below 2% as economic activity moderates. For some, however, currency depreciation has boosted inflation, partially offsetting the downward pressure resulted from low energy prices. Although headline CPI in China advanced from 2.1% in 2018 to 2.6% in 10M19 due to the rather sharp rises in pork price, however, core inflation remained mild at 1.7% in 10M19, down from 1.9% in 2018.

Major central banks have adopted a more relaxed monetary stance amid subdued inflation and decelerating economic activities. The Fed cut its target range for the Fed Funds rate thrice to 1.50%–1.75% within the first 10 months of 2019; it also halted reduction in balance sheet to resume expansion. In Sep meeting, the ECB decided to slash the deposit rate by 10bps, pushing it further down into the negative territory while announcing a resumption of quantitative easing. BOJ and BOE kept the interest rates unchanged while adhering to a loose monetary policy. PBOC has relaxed monetary policy, partially by cutting the rates for OMO, MLF and LPR. Among the emerging markets and developing economies, central banks in several countries have been trimming policy rates since Apr.

Global growth is likely to remain weak in 2020

Global economic growth is expected to remain tepid in 2020 as global trade disputes and heightened uncertainty on economic and political fronts could further disrupt supply chains, hampering confidence and investment. Given the escalating trade tensions amid a slowing global economy, WTO forecasts merchandise trade volume to grow by 1.2% in 2019E and 2.7% in 2020E, down from 3.0% in 2018. According to the latest World Economic Outlook released by IMF in Oct 2019, global economic growth is projected at 3.0% for 2019E and 3.4% in 2020E, 0.3ppt and 0.2ppt below its forecasts in Apr 2019 (Exhibit 3). Given that we expect the growth for major economies to decelerate in 2020, we believe IMF may revise down the 2020 forecasts for global growth in the future. In OECD's latest Economic Outlook released in Nov 2019, the global economic growth forecasts for 2019E and 2020E are revised down to 2.9% and 3.0% from 3.2% and 3.4% in the May version.

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

We expect the US economy to expand by 1.9% in 2020E, down from our estimate of 2.3% in 2019E due to fading impact of fiscal stimulus, impasse in Sino-US trade talks, and headwinds from a dimmer global outlook. Although household spending is likely to grow at a strong pace, business fixed investment and exports would remain weak, weighing on economic growth. On the monetary front, with a weakening outlook for economic growth under the Sino-US trade conflicts, we expect (1) the Fed to cut interest rate once in 2020E if the US decides to uphold the existing tariffs on Chinese goods; (2) the Fed to cut interest rate twice in 2020E if the country decides to raise the tariffs for Chinese goods; (3) the Fed to leave interest rate unchanged if the tariff size or rate on Chinese goods is reduced. Meanwhile, we estimate the Fed would expand its balance sheet till 2Q20E or later.

In China, the ongoing trade tension, stumbling industrial production, and tightening measures on property market would impede growth. We maintain our 6.1% and 5.9% GDP growth forecasts for 2019E and 2020E. On the monetary front, PBOC is expected to maintain a neutral monetary policy with a loosening bias. It is likely to keep liquidity abundant to support loan growth for private firms and SMEs. RRR would continue to trend down in 2020E, while OMO, MLF and LPR rates are expected to fall on the economic slowdown. The Chinese government is expected to adopt a more proactive fiscal policy to support the economy through tax and fee reductions, measures to boost infrastructure investment, and specific-consumption measures.

We project the Eurozone economy to expand by 1.0% in 2020E, slightly lower than estimated 1.2% in 2019E, as weak external demand, global trade, and policy uncertainties will limit the rebound in exports and business investment. Political risks remain elevated in the form of a potential no-deal Brexit and the volatile political environment in Italy and Spain. On the monetary front, according to ECB's monetary meeting in Oct, QE would be restarted on Nov 1, 2019, at a pace of EUR 20bn per month and to last for as long as is deemed necessary. The ECB will provide banks with additional low-cost credit to support economic growth. With a weakening economy and persistently low inflation, we believe the refinancing rate would remain at a record-low of 0.00% in 2020E. Meanwhile, we expect the UK economy to grow by 1.2% in 2020E, down from 1.4% in 2019E due to a heightened possibility of a disorderly exit from the EU.

We forecast Japan's economic growth to fall from estimated 0.9% in 2019E to 0.6% in 2020E due to the negative effect of the consumption tax hike on private consumption, rising trade protectionism, and weaker business fixed investment. The consumption tax hike from 8.0% to 10.0% on Oct 1, 2019, is expected to hinder 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 2020E. The central bank's short-term policy rate is likely to remain at -0.10% through to the end of 2020E.

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

Real GDP Growth (YoY)	2018	2019E	2020E
U.S.	2.9	2.3	1.9
China	6.6	6.1	5.9
Eurozone	1.9	1.2	1.0
Japan	0.8	0.9	0.6
U.K.	1.4	1.4	1.2
World (IMF)	3.6*	3.0*	3.4*
World (OECD)	3.5#	2.9#	3.0#

* IMF estimates and forecasts
# OECD estimates and forecasts
Source(s): IMF, OECD, Bloomberg, ABCI Securities estimates

China Economic Outlook

Andy Yao, ABCI Economist

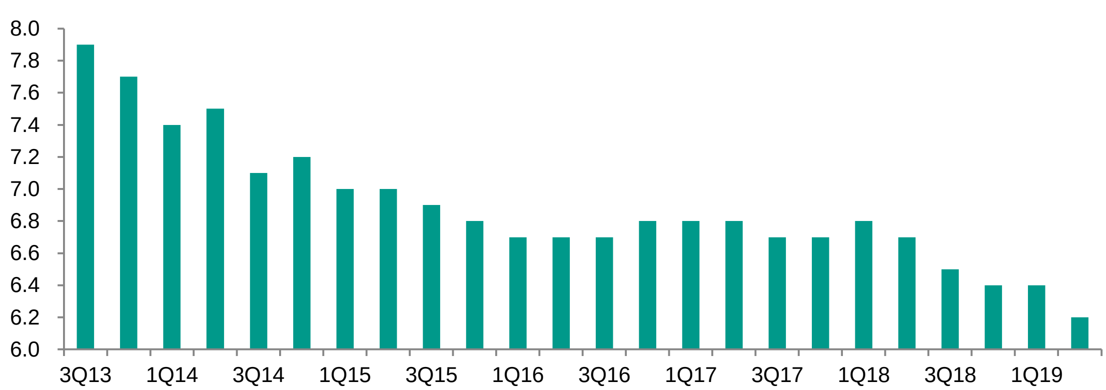
2020 China Economic Outlook

- China's economic growth has slowed since the start of 2019 due to ongoing US-China trade tension, softening manufacturing activity, and deteriorating profitability in industrial sectors. Official figures show the world's second-largest economy had expanded by 6.2% in the first three quarters of 2019, down from 6.7% in the same period last year
- Looking ahead, we expect China's economic growth to slow in 2020 due to the trade friction, stumbling growth in industrial production, and tightening measures on property market. On the whole, we expect China's economy to grow by 5.9% for 2020E, slower than the estimated 6.1% for 2019E
- On the monetary front, PBOC is expected to maintain a neutral monetary policy with a loosening bias to support economic growth. The rates for one-year LPR and five-year LPR are expected to be 3.80% and 4.70% for end-2020E. 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-2020E.
- The central government is expected to adopt a more proactive fiscal policy in 2020 to support economic growth through tax and fee reductions, specific-consumption measures, and programs to boost infrastructure investment. We expect fiscal deficit ratio to approach to ~4.0% of GDP in 2020E

China's economic growth eased in 10M19

China economic growth has slowed since the start of 2019 due to ongoing US-China trade tension, softening manufacturing activity, and deteriorating profitability in industrial sectors. Official figures show the world's second-largest economy had expanded by 6.2%[1] in the first three quarters of 2019, down from 6.7% in the same period last year (Exhibit 1). A breakdown of the GDP components shows consumption was still the key growth driver, contributing to 3.8ppt to the economic growth in the first three quarters of 2019. Investment added 1.2ppt to overall growth, while growth in net exports of goods and services also increased by 1.2ppt.

Exhibit 1: China's GDP growth (%)

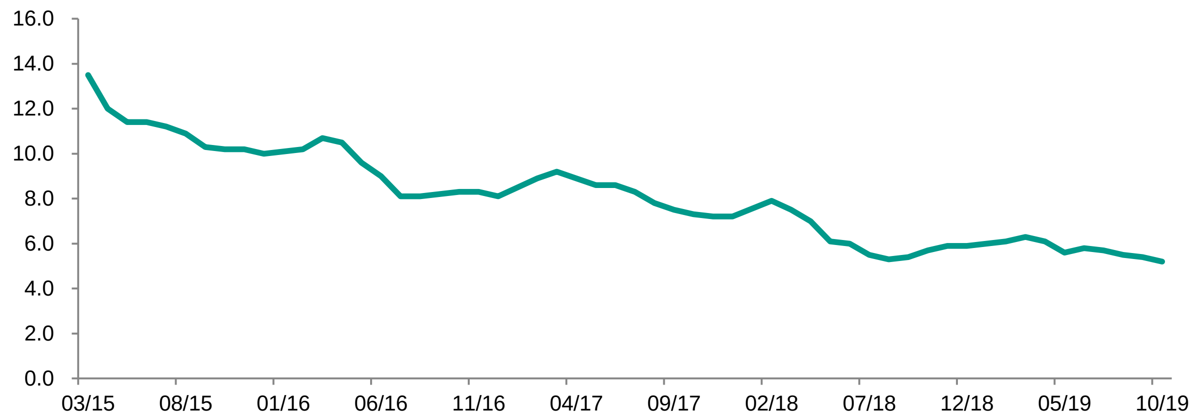


Source(s): NBS, ABCI Securities

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

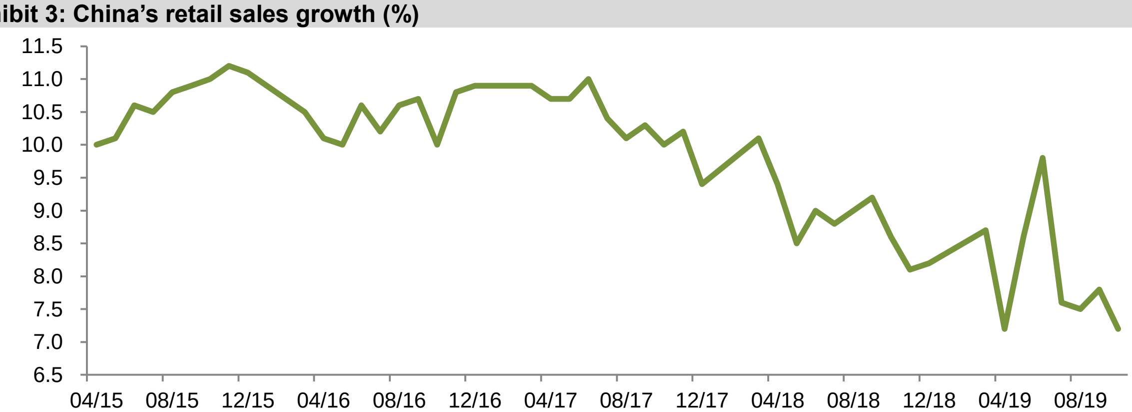
Compared with 2018, domestic demand showed weakness, with both investment and retail sales growth declining in 10M19. FAI growth in urban areas retracted to 5.2% in 10M19 from 5.9% in 2018, which we believe is a result of the slowdown in manufacturing and private investment amid US-China trade conflicts (Exhibit 2). Retail sales growth also decelerated to 8.1% in 10M19 from 9.0% in 2018, mainly attributable to weak car sales as tax rebate phases out (Exhibit 3). On the production side, the real growth of industrial output slowed to 5.6% in 10M19, compared with 6.2% in 2018 (Exhibit 4).

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



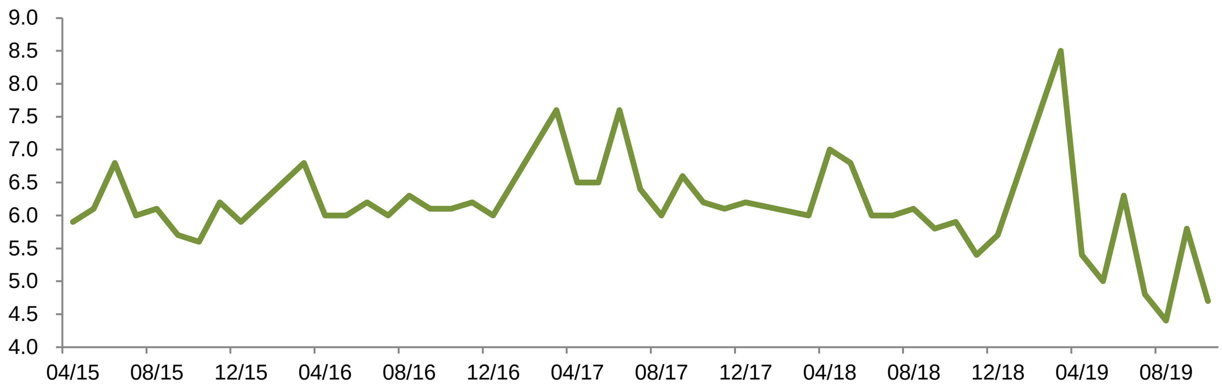
Source(s): NBS, ABCI Securities

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



Source(s): NBS, ABCI Securities

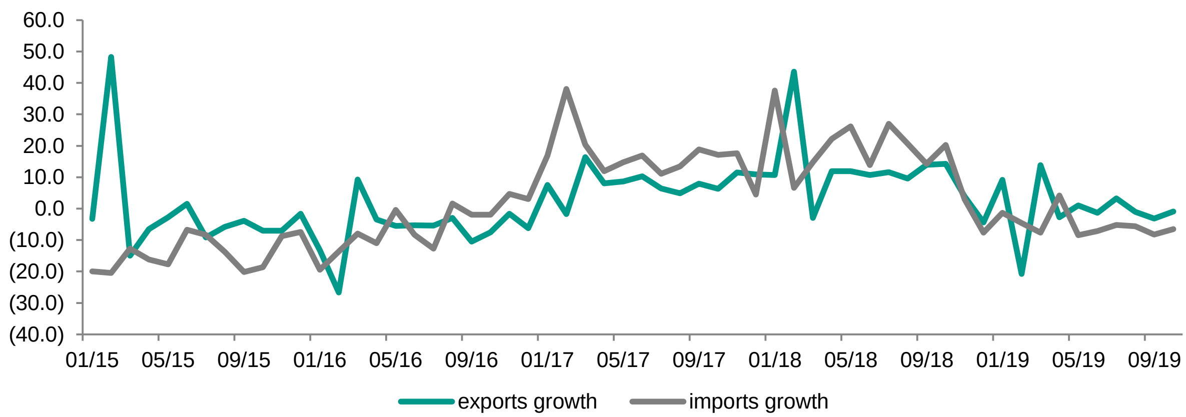
Exhibit 4: China's industrial output growth(%)



Source(s): NBS, ABCI Securities

Externally, both exports and imports slowed significantly in 10M19 due to the Sino-US trade disputes (Exhibit 5). The USD value of China's exports fell by 0.2% in 10M19 despite the back of RMB depreciation, well below the 9.9% increment in 2018. Imports also declined by 5.1% in 10M19, compared with the 15.8% increase last year. With the weaker import growth, trade balance widened to US$ 340.3bn in 10M19 from US$ 252.8bn in 10M18.

Exhibit 5: China's export and import growth (%)



Source(s): NBS, ABCI Securities

Inflation continued to diverge in 10M19. CPI picked up to 2.6% in 10M19 from 2.1% in 2018, driven by risen food prices, especially for the pork price. However, PPI eased significantly to -0.2% in from 3.5% during the same period due to lethargic 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 2019. It slashed RRR three times in 10M19 to lower financing costs. Although the benchmark interest rates set by PBOC has stayed unchanged, the interest rates for OMO, MLF and LPR have been shaved. M2 growth accelerated to 8.4% in Oct 2019 from 8.0% in the same month last year, while new social financing, a comprehensive measure of all types of financing for the real economy, ascended to RMB 19.4tr in 10M19 from RMB 16.2tr in 10M18.

Economic growth is set to slow in 2020

Looking ahead, we expect China's economic growth to slow in 2020 due to the ongoing trade tension, stumbling growth in industrial production, and tightening measures on property market. On the whole, we expect China's economy to expand by 5.9% for 2020E, slower than the estimated 6.1% for 2019E (Exhibit 6). It should be noted that the above forecast for 2020 is based on our base case scenario that US will leave the existing tariffs unchanged on Chinese goods. If the US decides to raise or reduce the tariffs for Chinese goods, our forecasts will be adjusted accordingly. Overall, a looser fiscal stance and a more accommodative monetary policy should help prevent a sharp economic downturn even if the US decides to impose heavier tariffs on imports from China.

Exhibit 6: Economic forecasts

Economic indicators	2018	2019E	2020E
Real GDP growth, %	6.6	6.1	5.9
FAI growth, %	5.9	5.2	5.0
Retail Sales growth, %	9.0	8.1	7.8
Export growth in USD terms, %	9.9	-0.5	0.5
Import growth in USD terms, %	15.8	-5.0	-4.0
Industrial Production growth, %	6.2	5.5	5.0
CPI, %	2.1	2.8	3.5
PPI, %	3.5	-0.2	-0.5
M2 growth, %	8.1	8.5	8.5
Aggregate Financing, RMB bn	19,260	21,000	23,000
New Yuan Loans, RMB bn	16,170	17,000	18,000
Spot CNY per USD, End-year	6.8785	7.0000	6.9000

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

Domestically, infrastructure investment is expected to pick up in 2020 as the local government bonds can be used as equity capital for major infrastructure projects, and the minimum capital requirement for some infrastructure projects has already lowered. Property regulation is likely to remain tight, and property investment is likely to fall back slightly as property sales will be flat in 2020. Manufacturing investment will remain steady amid lower tax and financing costs. Overall, we predict total FAI growth to slow to 5.0% in 2020E from 5.2% in 2019E. Retail sales are expected to remain anemic in 2020 on sluggish income growth and higher consumer inflation, though personal income tax reform would help support consumer spending. We expect retail sales growth to slow to 7.8% in 2020E from 8.1% in 2019E. Externally, frictions over trade between the US and China cast uncertainties on trade growth in 2020 despite ongoing bilateral negotiations. We forecast the growth of exports and imports to remain weak at 0.5% and -4.0% in 2020E, compared with our -0.5% and -5.0% in 2019E.

CPI inflation would rebound to 3.5% in 2020E from 2.8% in 2019E due to higher food price, especially for pork price as the supply will continue to be tight on the African Swine Fever. The pork price is likely to remain high in 1H20 and then ease in 2H20, assuming a recovery in pork supply. Hence, CPI would trend up in 1H before softening in 2H. We forecast PPI inflation to ease to -0.5% in 2020E from the -0.2% for 2019E with moderating commodity prices and softening domestic demand. Divergence between CPI and PPI will persist in 2020.

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 drive loan growth for private firms and SMEs. We predict new RMB-denominated loans and new aggregate financing to increase by 5.9%

and 9.5% to ~RMB 18.0tr and ~RMB 23.0tr in 2020E. Meanwhile, the authority will likely lower the interest rates of OMO, MLF and LPR, though it will keep the benchmark interest rates steady in 2020E. We estimate the rates for one-year LPR and five-year LPR to be 3.80% and 4.70% for end-2020E. RRR would continue to trend down given the economic downturn. 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-2020E. Broad money supply (M2) is set to grow by about 8.5% in 2020E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 6.9000 by end-2020E with potential US interest rate cuts, as compared to 7.0000 for 2019E.

The central government will adopt a more proactive fiscal policy in 2020 to support economic growth through tax and fee reductions, specific-consumption measures, and programs to boost infrastructure investment. China has announced that capital requirements for some infrastructure projects, e.g., the minimum capital requirement for ports and shipping projects, to be lowered to 20% from 25%. Minimum capital requirement for some road, rail and ecological projects will be slashed as much as 5ppt. Faster growth in fiscal expenditure than fiscal revenue will result in another fiscal deficit in 2020E, with the headline ratio approaching ~ 4.0% of GDP.

Investment Strategy

Philip Chan, ABCI Head of Research

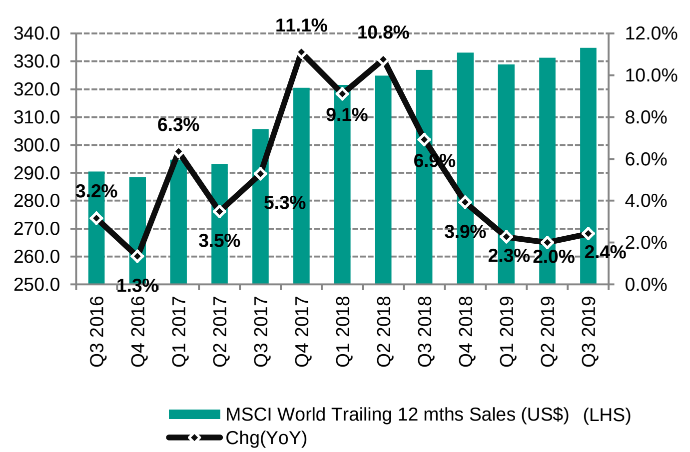
From Mediocre to Marvelous: the R&D factor

Our view
- Weakening growth impetus in advanced economies is spreading to Asian countries
- Negative real interest rate environment is spreading from Eurozone and Japan to the US
- High-yield debts and stocks offered by the Chinese corporates are luring investors from advanced economies
- Stress tests (such as trade war, tech war, slowdown of economies in major industrial nations) in 2018-19 help investors identify outperformers

Our strategies
- Tracking the movement of smart money in China
- Bullish view on higher education and vocational education services in the long term
- Select visionary winners with high R&D intensity

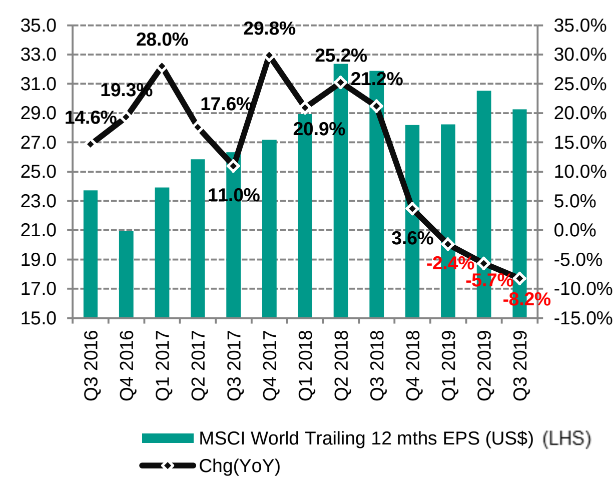
Affected by the downturn in global economies, sales and earnings growth of MSCI World Index is weakening. The slowdown of sales and earnings growth in the MSCI World Index has begun in 3Q18 and continued throughout 2019, indicating the softening momentum in sales and earnings will likely extend to 2020. Situations in North Asia and South Asia are less than sanguine – the 3-mth moving average manufacturing PMIs of China, Japan, South Korea, AESAN, and China Taiwan have fallen to below 50 since 3Q19. Manufacturing PMIs of India and Australia have been trending downwards in 2019.

Exhibit 1: MSCI World Index - Slowdown of global economy dragged down sales growth of global blue chips



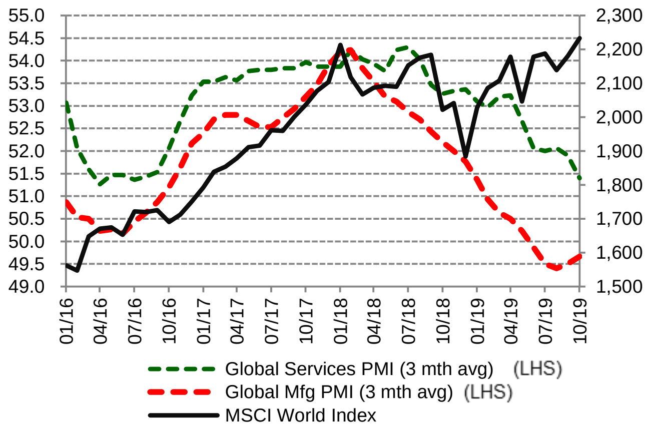
Source(s): Bloomberg, ABCI Securities

Exhibit 2: MSCI World Index – Earnings have been declining since 1Q19



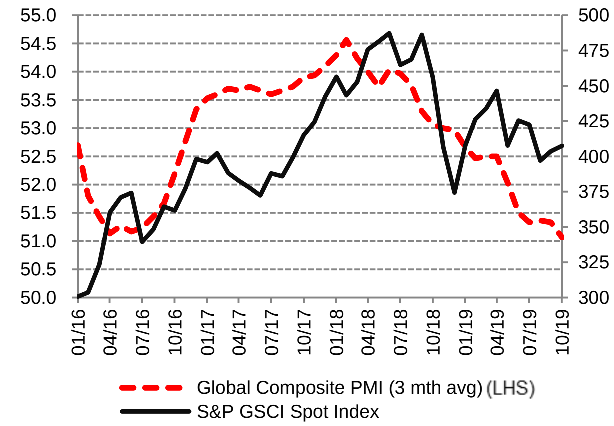
Source(s): Bloomberg, ABCI Securities

Exhibit 3: Global Mfg & Services PMI (LHS) vs. MSCI World Index (RHS) – Stock market index is trending in an opposite direction from the macro economy



Remarks: We apply the 3-mth moving average of PMI to illustrate the trend
Source(s): Bloomberg, IHS Markit, ABCI Securities

Exhibit 4: Global Composite PMI (LHS) vs. S&P GSCI Spot Index(RHS) - Composite PMI and commodity index are trending down



Remarks: We apply the 3-mth moving average of PMI to illustrate the trend
Source(s): Bloomberg, IHS Markit, ABCI Securities

Boosting the services sector to alleviate downturn in manufacturing sector NOT a long-term solution. Manufacturing PMIs among major industrial nations are highly correlated. Hence, slowdown of manufacturing activities in one major industrial nation will result in a domino effect and drag down performance in others; moreover, a turnaround in a single industrial nation would require concerted efforts of the others. Some industrial nations, including China, attempt to expand tertiary industry to soften the blow from declining manufacturing activities. We believe this could be a short-term antidote to the current malaise as correlation of non-manufacturing PMI and manufacturing PMI is high in Eurozone, the US, the UK, and China. In the longer term, however, the slowdown in secondary industry will inevitably stifle growth in the tertiary industry.

Exhibit 5: PMI correlations of major economies - High correlations in manufacturing industry but low correlations in non-manufacturing industry

Mfg PMI	US	PRC	Euro	Japan	UK	Non-mfg PMI	US	PRC	Euro	Japan	UK
US	1.00	**0.63**	0.75	0.82	0.63	**US**	1.00	**0.35**	0.35	0.17	0.23
PRC	**0.63**	**1.00**	**0.83**	**0.73**	**0.72**	**PRC**	**0.35**	**1.00**	**0.59**	**0.25**	**0.35**
Euro	0.75	**0.83**	1.00	0.85	0.81	**Euro**	0.35	**0.59**	1.00	0.29	0.57
Japan	0.82	**0.73**	0.85	1.00	0.69	**Japan**	0.17	**0.25**	0.29	1.00	0.06
UK	0.63	**0.72**	0.81	0.69	1.00	**UK**	0.23	**0.35**	0.57	0.06	1.00

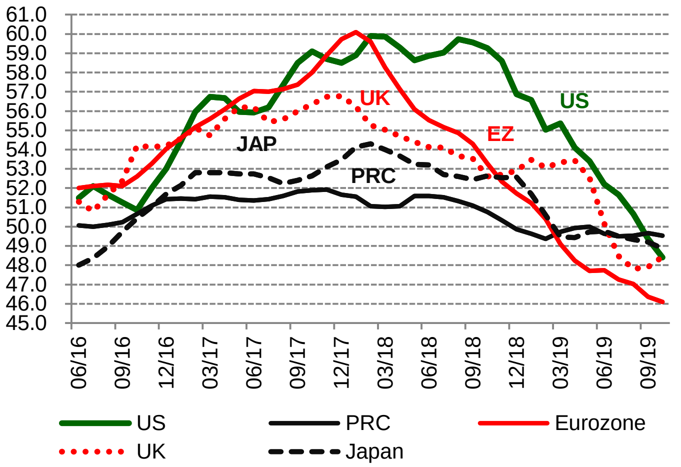
Remarks: Correlations analysis from June 2016 to Oct 2019
Source(s): NBS, Institute of Supply Management, IHS Markit, Bloomberg, ABCI Securities

Exhibit 6: Correlation between mfg activities and non-mfg activities in major countries

Country	Parameter	Parameter	Correlation	Remark
Eurozone	Markit Mfg PMI	Markit Services PMI	**0.80**	High correlation
US	ISM Mfg PMI	ISM Non-mfg PMI	**0.72**	
UK	Markit Mfg PMI	Markit Services PMI	**0.65**	Medium correlation
PRC	NBS Mfg PMI	NBS Non-mfg PMI	**0.59**	
Japan	Markit Mfg PMI	Markit Services PMI	**0.22**	Low correlation

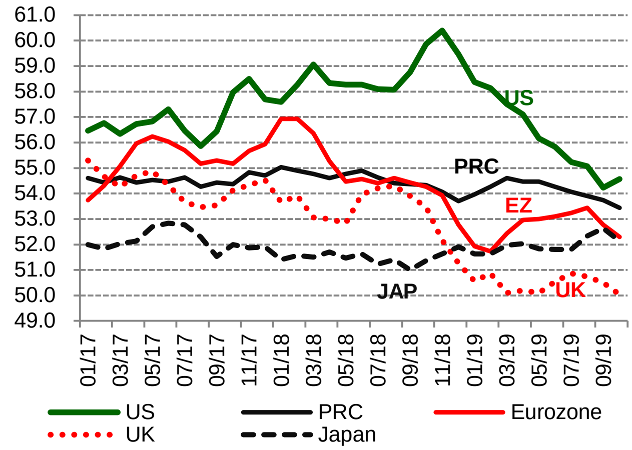
Remarks: Correlations analysis from June 2016 to Oct 2019
Source(s): NBS, Institute of Supply Management, IHS Markit, Bloomberg, ABCI Securities

Exhibit 7: The world's top five economies Mfg PMI: Downtrend persists



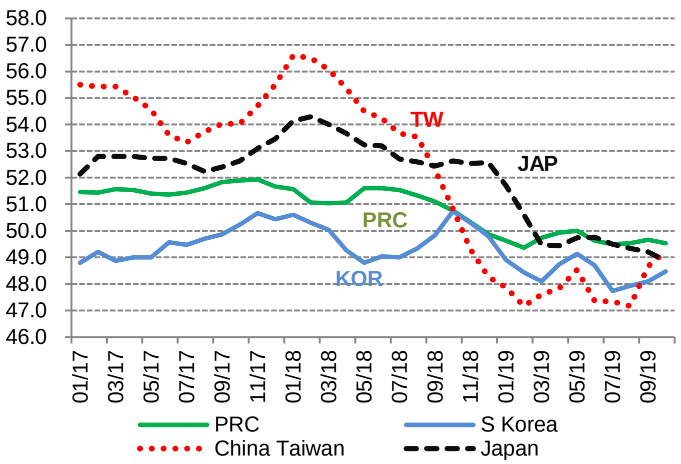
Remarks: We apply the 3-mth moving average of PMI to illustrate the trend
Source(s): NBS, Institute of Supply Management, IHS Markit, Bloomberg, ABCI Securities

Exhibit 8: Non-mfg PMI in the top five economies: Slowdown in mfg activities is adversely affecting non-mfg activities



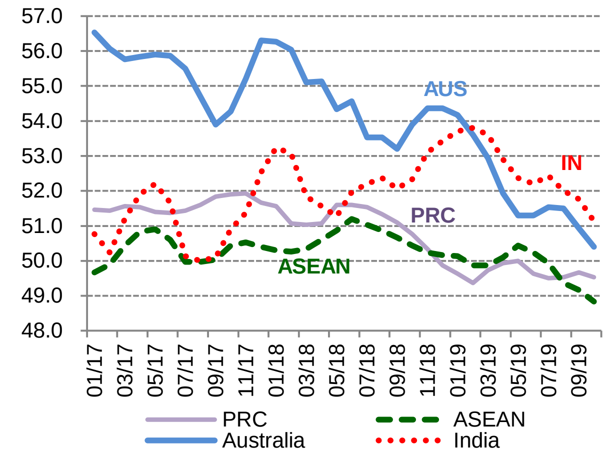
Remarks: We apply the 3-mth moving average of PMI to illustrate the trend
Source(s): NBS, Institute of Supply Management, IHS Markit, Bloomberg, ABCI Securities

Exhibit 9: Mfg PMI of North Asia Economies is contracting



Remarks: We apply the 3-mth moving average of PMI to illustrate the trend
Source(s): NBS, IHS Markit, Bloomberg, ABCI Securities

Exhibit 10: Mfg PMI of PRC, India, ASEAN, Australia: Contraction of mfg activities is greater in ASEAN than in China



Remarks: We apply the 3-mth moving average of PMI to illustrate the trend
Source(s): NBS, IHS Markit, Bloomberg, ABCI Securities

Negative real interest rates become a widespread phenomenon. After three rate cuts in the US in 2H19, the Fed has adjusted the real Fed Funds rate to the near-zero level (Fed Funds rate ranges between 1.50% and 1.75% but core PCE price inflation was 1.59% in Oct 2019). European Central Bank (ECB) and Bank of Japan (BOJ) have already maintained negative real interest rates for more than two years. The latest economic data in Eurozone and Japan indicates the marginal stimulus effects of the negative real interest rates environment has been fading after years of implementation. The full-year marginal effect of the lower real Fed Funds rate will be reflected in 2020.

PPI in advanced economies (such as the US, China, Eurozone, Japan, and the UK) trended down in 2H19, therefore, cost-push inflation risk in 2020 will not be high. Advanced economies will be tackling deflationary risk in 2020. In China, the 2-year treasury yield has fallen below CPI since July 2019 because of the surge in food prices but remained above the core CPI (excl. food & energy). We expect demand for high-yield debts and high-yield stocks to remain strong in 2020 from investors in advanced economies because of the negative real interest rate environment.

Exhibit 11: Change of total assets in major central banks - Global economies suffer from shrinking growth or downsizing of balance sheets by major central banks in 2018-1H19

Central bank	End-2017 (YoY)	End-2018 (YoY)	10M19 (YoY)	10M19 (YTD)	Comments
PBOC	5.6%	2.6%	0.4%	(3.5%)	Turning to negative change
Federal Reserve	(0.1%)	(8.4%)	(2.9%)	(1.4%)	Decline reducing
ECB	22.1%	4.4%	1.2%	0.3%	Weakening momentum
BOJ	9.4%	5.9%	4.3%	4.3%	Steady expanding

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

Exhibit 12: Core inflation rate (excluding fuel and food), (%YoY) - Low core inflation rate provides a more favorable condition for central banks to adjust monetary policies

	12/2018	6/2019	10/2019
China core CPI	1.8	1.9	1.5
US core PCE	1.97	1.61	1.59
Eurozone	0.9	1.1	1.1
Japan core CPI	0.1	0.3	0.3

Source(s): Bloomberg, NBS, Bureau of Economic Analysis, Eurostat, ABCI Securities

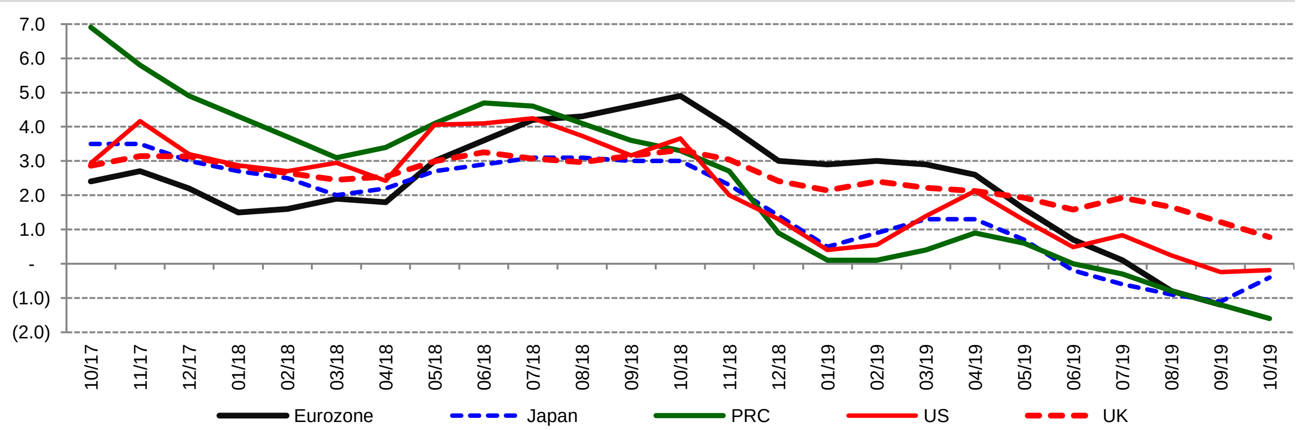
Exhibit 13: Negative real treasury yields - US real yield nears zero

	10-year government bond yield (%)	Latest core inflation rate (%)	Estimated real bond yield (%)
China	3.20	1.50	1.70
US	1.76	1.59	0.17
Japan	(0.09)	0.30	(0.39)
UK	0.70	1.70	(1.00)
Eurozone	(0.35)	1.10	(1.45)

Estimated real yield = Nominal yield minus Core inflation rate

Source(s): Bloomberg, ABCI Securities

Exhibit 14: PPI of the top five economies is trending down, indicating an increasing global deflationary risk in 2020



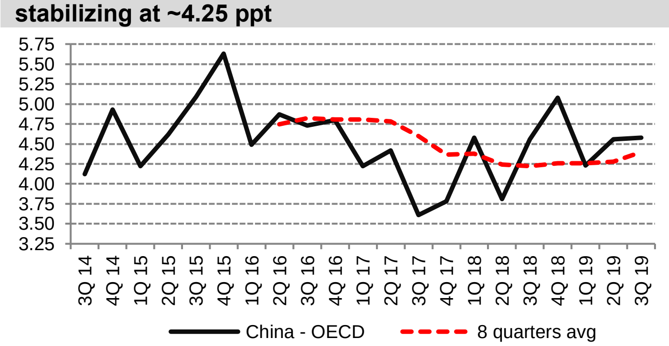
Source(s): Bloomberg, ABCI Securities

Growth gap between China and OECD to exceed 4ppt in 2020 and 2021- Global funds would increase allocation to onshore securities (debt or equity) in China. For China, escalating trade dispute amid a slowing economy may have deterred investment – but such pessimism has been overplayed in our view. For global investors, relative growth, instead of absolute growth, is more relevant in their evaluation of a country's economy. The wide GDP growth gap between China and advanced economics, in addition to the opening of China's capital market and financial industry, will continue to lure global corporates or investors to increase investments in China. Non-financial FDI increased by 2.9%YoY to US$ 100.78bn in 9M19 and 3.0%YoY in 2018. In coming years, China will allow foreign securities firms, futures firms, asset management companies, and insurance firms to hold majority stakes in their China's operations. These open-door policies will attract financial FDI.

Offshore investors have net bought RMB 278.8bn of A-shares through the Northbound Stock Connect in 11M19; the cumulative net purchase amounted to RMB 926.4bn since the launch of the Stock Connect. Moreover, offshore institutions increased their holdings of China onshore bonds from RMB 974bn at end-2017 to RMB 1,507 bn at end-2018 and RMB 1,806bn at-end Oct 2019.

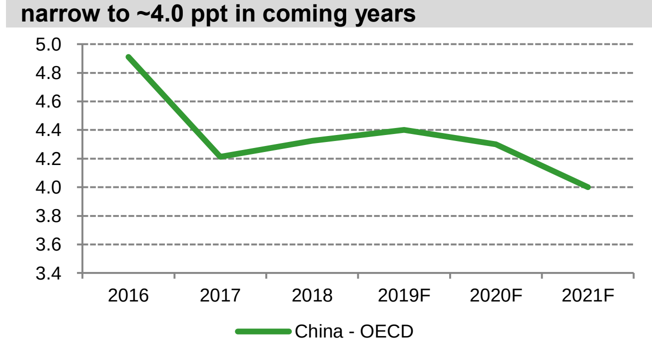
Meanwhile, mainland investors have net bought ~HK$ 208.0bn of HK stocks in 11M19; the cumulative net purchase amounted to HK$1,017.2bn since the launch of the Stock Connect.

Exhibit 15: China's quarterly real GDP growth relative to the OECD's(ppt)- China-OECD GDP growth gap is stabilizing at ~4.25 ppt



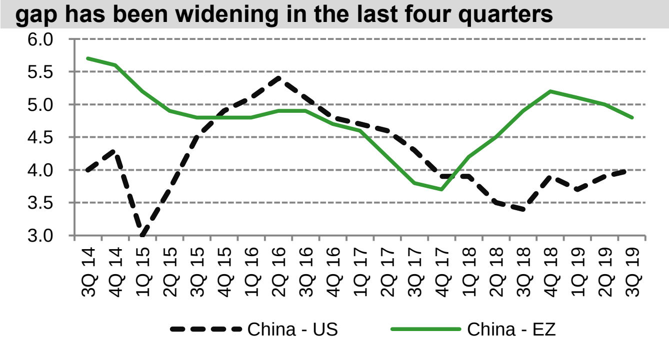
Source(s): OECD, ABCI Securities

Exhibit 16: China's annual real GDP growth relative to the OECD's (ppt)- The growth gap is expected to narrow to ~4.0 ppt in coming years



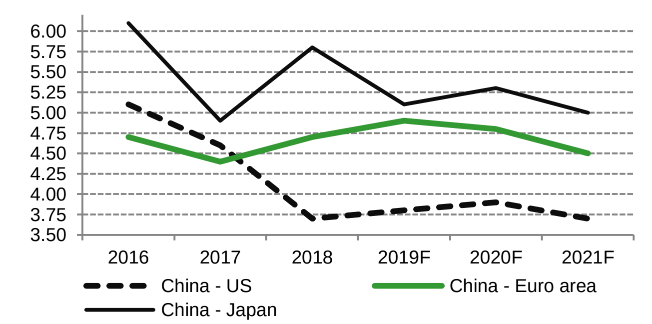
Source(s): OECD, ABCI Securities

Exhibit 17: China's quarterly real GDP growth relative to the US and Eurozone's (ppt)- The China-US GDP growth gap has been widening in the last four quarters



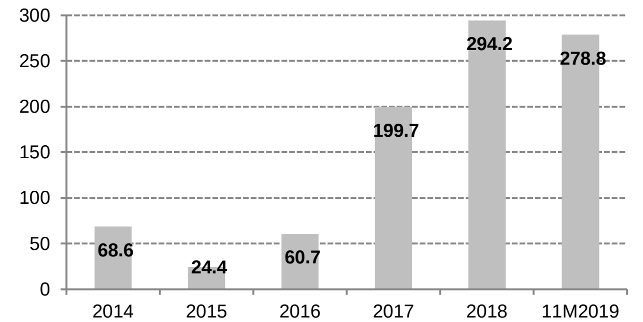
Source(s): OECD, ABCI Securities

Exhibit 18: China's annual real GDP growth relative to the US, Eurozone's & Japan's (ppt) - The growth gap is expected to narrow in 2020-2021



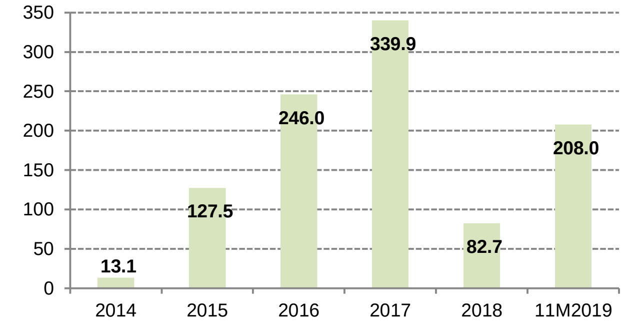
Source(s): OECD, ABCI Securities

Exhibit 19: Annual net purchase of A-shares via the Stock Connect, (RMB bn) - Offshore investors are increasing their holdings in A-share markets



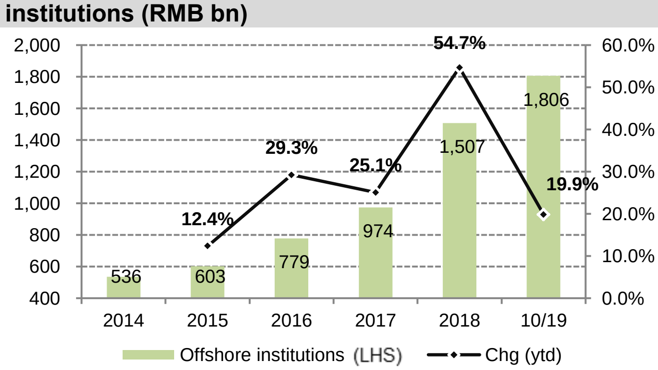
Source(s): HKEX, Bloomberg, ABCI Securities

Exhibit 20: Annual net purchase of HK stocks via the Stock Connect, (HK$ bn) – mainland investors are increasing their exposure to HK stocks



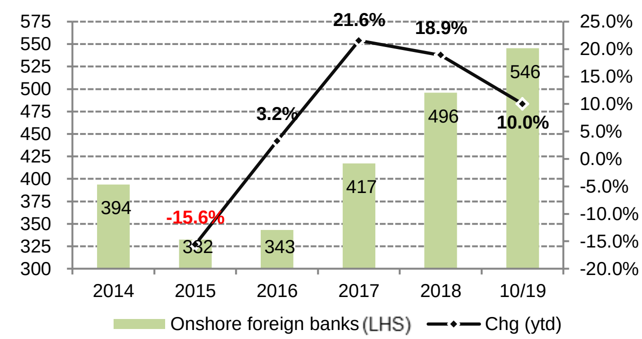
Source(s): HKEX, Bloomberg, ABCI Securities

Exhibit 21: China's onshore bonds held by offshore institutions (RMB bn)



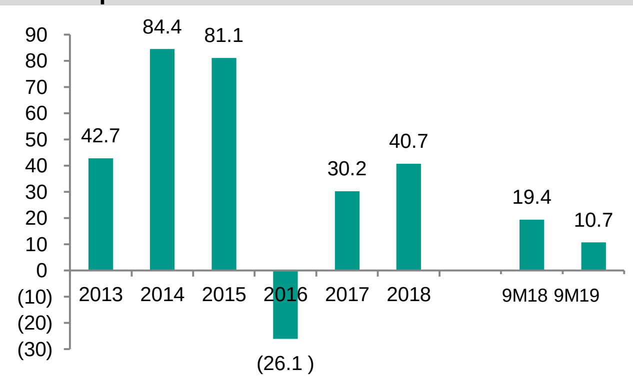
Source(s): SAFE, Bloomberg, ABCI Securities

Exhibit 22: China's onshore bonds held by onshore foreign banks (RMB bn)



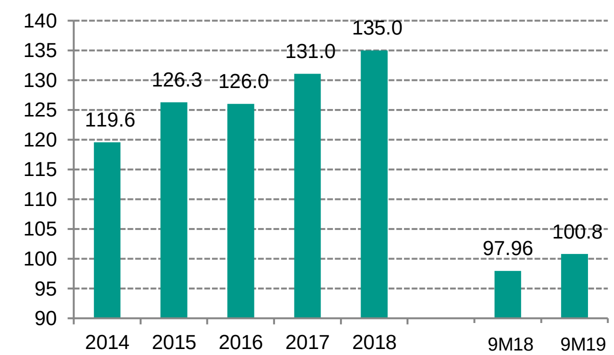
Source(s): SAFE, Bloomberg, ABCI Securities

Exhibit 23: Foreign investors' direct net investment in financial institutions* in China (US$ 100mn) – Financial FDI is expected to increase in 2020-21



Net investment = Inflow minus Outflow
* Referring to foreign investors' investments (bond or equity) in invested enterprises with voting rights of 10% or more
Source(s): SAFE, ABCI Securities

Exhibit 24: China's non-financial FDI (US$ bn) – Offshore investors are still bullish on China



Source(s): SAFE, ABCI Securities

With risk comes opportunity: Identifying investment opportunities through economic challenges in China

Expansion of higher education and vocational education services is crucial to economic growth in the long run. Total employment force in the tertiary industry was 333.88mn in 2018, or 1.68x of the workforce in the secondary industry. Expansion of the tertiary industry has succeeded in creating jobs in the past; relying on the sector to absorb surplus labor or expand employment, however, is not an efficient way to support economic growth because of the low value added per employed person in the tertiary industry based on China's current economic structure.

We estimate nominal GDP per employed person was RMB 184,226 in the secondary industry in 2018; meanwhile, nominal GDP per employed person was RMB 140,643 in the tertiary industry. Nominal GDP per employed person in tertiary industry was equivalent to 76.3% of that in secondary industry in 2018. Narrowing this gap will be a daunting yet crucial task.

Although the tertiary industry generated 53% and 54% of nominal GDP in 2018 and 9M19, the relatively low economic value added in the tertiary industry is posing major threats to economic growth. As we see it, improving education quality, including that of higher education and vocational education, is the long-term solution since it would increase supply of high value-added labors to secondary and tertiary industries. A higher proportion of education resources should be allocated to cultivate a competent workforce in high value-added industries. As such, our long-term view on the higher education and vocational education industries is positive.

Exhibit 25: China's nominal GDP per employed person in major industries

	2018 Nominal GDP (RMB 100mn)	% to total GDP	2018 employed persons (10K)	% to total Employed In 2nd & 3rd industries	Nominal GDP / Employed person (RMB/person)	Comments
Secondary industry	**364,835**	**39.7%**	**19,867**	**37.3%**	**184,226**	**High value-added**
Manufacturing	264,820	28.8%	12,109	22.7%	**218,703**	**Labor intensive & high value-added**
Construction	61,808	6.7%	6,759	12.7%	**91,440**	
Others (e.g. utilities)	38,207	4.2%	999	1.9%	**394,198**	
Tertiary industry	**489,701**	**53.3%**	**33,388**	**62.7%**	**140,643**	**Low value-added**
Real estate	59,846	6.5%	1,441	2.7%	**415,427**	**High value-added industries**
Financial services	69,100	7.5%	1,832	3.4%	**377,265**	
Information transmission, software and information technology	32,431	3.5%	1,056	2.0%	**307,258**	
Transport, storage and post	40,550	4.4%	2,608	4.9%	**155,496**	
Leasing and business services	24,427	2.7%	2,589	4.9%	**94,336**	**Labor highly intensive but low value-added**
Wholesale and retail	84,201	9.2%	10,452	19.6%	**80,562**	
Hotels and catering services	16,023	1.7%	2,942	5.5%	**54,460**	
Others	163,122	17.7%	10,469	19.7%	**132,987**	
Secondary & tertiary industries	**854,536**	**93.0%**	**53,255**	**100.0%**	**156,901**	

Remarks: Nominal GDP values in secondary and tertiary industries are finalized data but GDP value of their sub-industries are preliminary data
Employed persons include employed persons in legal entities and self-employed individuals
Source(s): NBS, Communiqué on the Fourth National Economic Census (No. 2), ABCI Securities

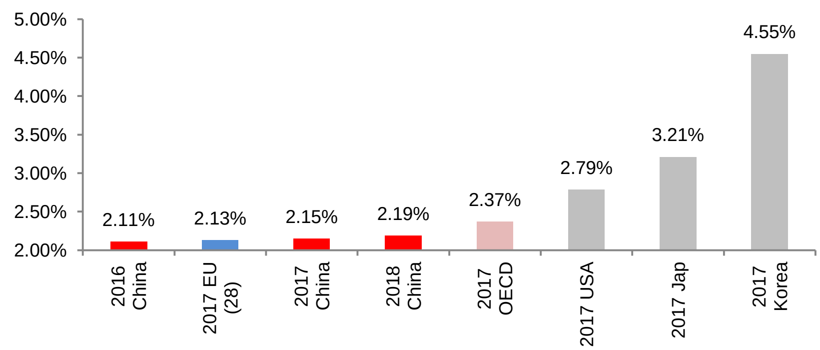
Differentiating the exceptional from the mediocre - R&D intensity. Trade war, technology war, financial war, open-door policy, and a leveling playfield are factors changing the competitive landscape of industries in both the domestic and global contexts. These factors, functionally speaking, are stress tests to economies and corporates alike. Market competition will intensify and enhancing corporate competitiveness becomes essential in the ever-changing environment.

With this foresight in mind, China increased its R&D intensity (R&D expenses/GDP for country or R&D expenses/ revenue for industry or corporate) to 2.19% in 2018 from 2.11% in 2016. Its R&D intensity has surpassed EU but is still far below the OECD, USA, Japan, and South Korea.

Based on NBS, R&D intensity of large-sized industrial enterprises was 1.23% in 2018, but 28% of the surveyed large-sized enterprises had incurred R&D activities. We estimate the number of R&D staff in large-sized enterprises with R&D activities was 28. The survey results pointed out the fundamental weakness of most large-sized industrial enterprises; most of them will encounter challenges when competition intensifies. From an investment point of view, we advise investors to stay with industries and enterprises with strong commitment in R&D because this will provide them with a competitive edge to succeed in the market.

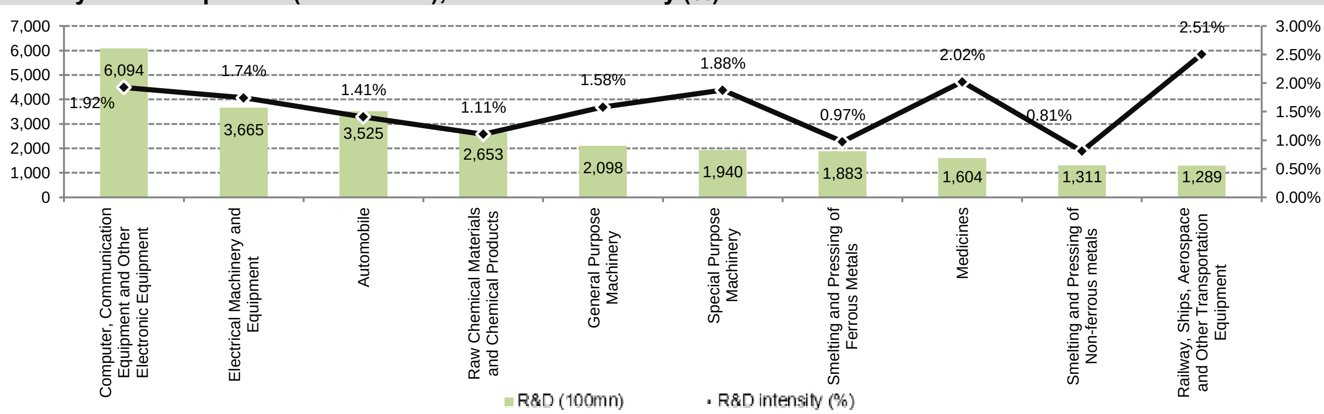
On one hand, China has a wide range of industries that helps diversify economic risk and drive economic growth; on the other hand, R&D resources allocated in each industry are diluted. We compare the R&D value and R&D intensity in each industry to identify possible outperformers. In 2016-18, computer, communication equipment and other electronic equipment industry, electrical machinery and equipment industry, automobile industry, raw chemical materials and chemical products and general purpose machinery are the top five manufacturing industries with the highest R&D expenses. We expect competitiveness of these industries in China to strengthen in a global context.

Exhibit 26: R&D intensity of major countries



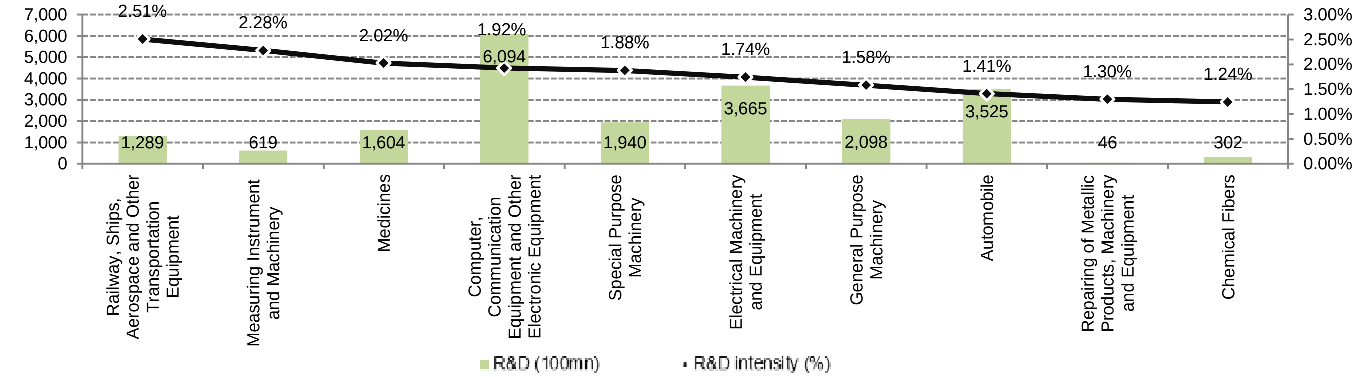
Country R&D intensity = R&D expenses/GDP
Source(s): NBS, OECD, ABCI Securities

Exhibit 27: Ten manufacturing industries in China with the highest R&D expenses in 2016-18
LHS: 3-yrs R&D expenses (RMB100mn); RHS: R&D intensity (%)



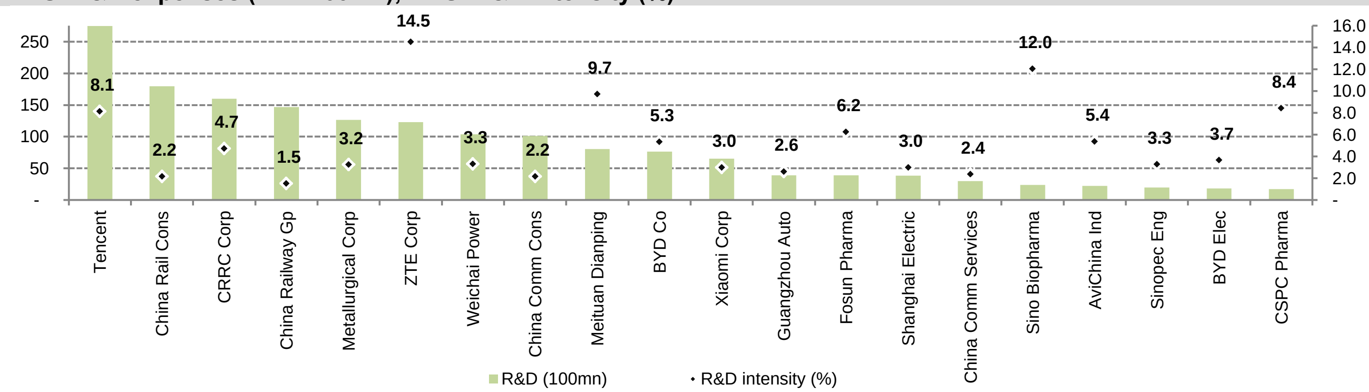
Industry R&D intensity = R&D expenses/industry revenue
Source(s): NBS, ABCI Securities

Exhibit 28: Ten manufacturing industries in China with the highest R&D intensity in 2016-18
LHS: 3-yr R&D expenses (RMB100mn); RHS: R&D intensity (%)



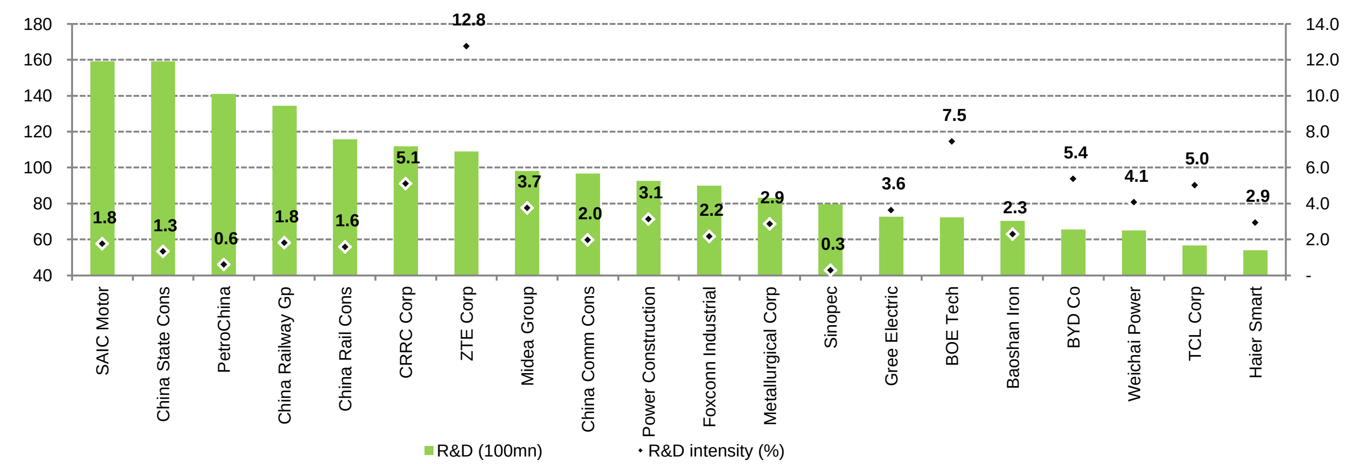
Industry R&D intensity = R&D expenses/industry revenue
Source(s): NBS, ABCI Securities

Exhibit 29: Twenty listed companies in Hang Seng Composite Index with the highest R&D expenses in the latest financial year
LHS: R&D expenses (RMB100mn); RHS: R&D intensity (%)



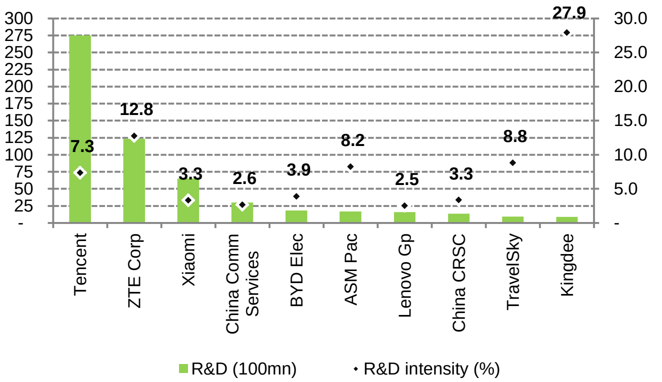
Corporate R&D intensity = R&D expenses/company revenue
Based on member stocks in the index at end-Nov
Source(s): Bloomberg, ABCI Securities

Exhibit 30: Twenty listed companies in CSI 300 Index with highest R&D expenses in the latest financial year
(LHS) R&D expenses (RMB100mn, RHS); (RHS): R&D intensity (%, LHS)



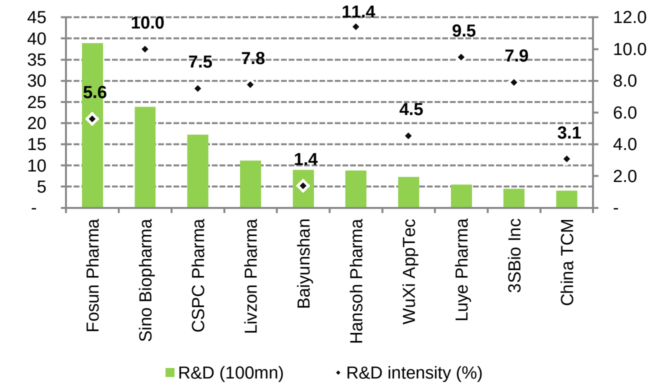
Corporate R&D intensity = R&D expenses/company revenue
Based on member stocks in the index at end-Nov
Source(s): Bloomberg, ABCI Securities

Exhibit 31: Ten listed companies in Hang Seng Composite IT Index with highest R&D expenses in the latest financial year
LHS: R&D expenses (RMB100mn); RHS: R&D intensity (%)



Corporate R&D intensity = R&D expenses/company revenue
Based on member stocks in the index at end-Nov
Source(s): Bloomberg, ABCI Securities

Exhibit 32: Ten listed companies in Hang Seng Composite Healthcare Index with the highest R&D expenses in the latest financial year
LHS: R&D expenses (RMB100mn); RHS: R&D intensity (%)



Corporate R&D intensity = R&D expenses/company revenue
Based on member stocks in the index at end-Nov
Source(s): Bloomberg, ABCI Securities

Tracking where the smart money goes by industry and region

Given the slowdown of economic growth and money supply growth in China, financial resources are allocated to regions or industries with better outlooks. Despite of the softening FAI growth in secondary and tertiary industries, FAI growth in pharmaceutical industry and education services industry has been accelerating. FAI growth in computers, telecom & electronics industry, special purpose machinery industry, cultural, sports & entertainment industry, and road transportation industry also suggests fund providers are optimistic on their prospects.

By region, Guangdong, Jiangsu, Zhejiang, Shandong and Beijing were the top five regions in China attracting the most aggregate financing to real economy in 9M19 and 2015-18. Capital flow usually associates with talent flow and will induce chains of positive reactions in driving regional economic growth in the future. Public and private capitals directed to these regions remain intact; in contrast, fund providers are evidently more hesitant in allocating financial resources to most northern and western regions.

Exhibit 33: China's FAI in secondary & tertiary industries, (YoY) - Tracking capital flow to identify sectors that may outperform in the future

FAI change:	2018	1-10/2019	Comments
Secondary industry	**6.2%**	**2.3%**	
Computers, telecom & electronics	16.6%	13.6%	High growth rate but slowing
Special purpose machinery	15.4%	9.8%	High growth rate but slowing
Pharma manufacturing	4.0%	7.9%	**Moderate growth rate & accelerating**
Tertiary industry	**5.5%**	**6.8%**	
Education	7.2%	18.0%	**High growth rate & accelerating**
Cultural, sports & entertainment	21.2%	13.8%	High growth rate but slowing
Road transportation	8.2%	8.1%	Stable
Railway transportation	(5.1%)	5.9%	Recovering
Health & social works	8.4%	3.5%	Slowing

Remarks: Private capital accounted for 62% and 57% of total FAI in 2018 and 10M19
Source(s): NBS, ABCI Securities

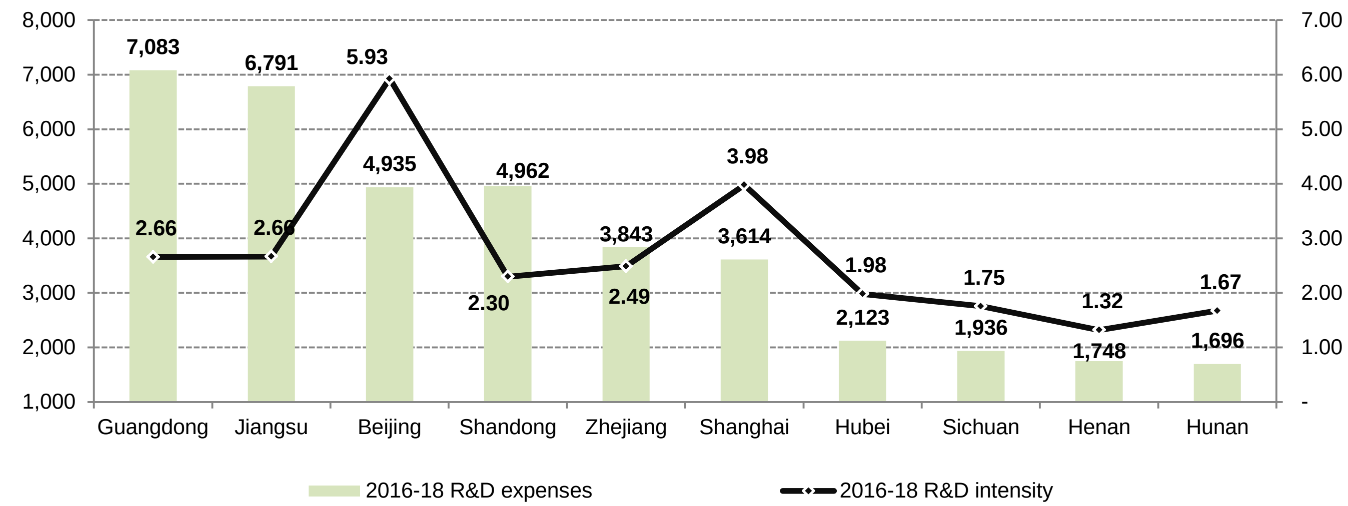
Exhibit 34: Aggregate financing flow to real economy in 9M19

Top 10 regions aggregate financing flow in 9M2019		
(RMB100mn)	9M2019	2018
广东 Guangdong	21,273	22,502
江苏 Jiangsu	20,188	17,699
浙江 Zhejiang	16,415	19,499
山东 Shandong	11,811	9,225
北京 Beijing	10,586	17,784
河南 Henan	8,910	7,794
四川 Sichuan	7,909	8,087
福建 Fujian	7,661	5,620
上海 Shanghai	7,091	5,765
湖南 Hunan	7,008	6,024

Bottom 10 regions aggregate financing flow in 9M2019		
(RMB100mn)	9M2019	2018
辽宁 Liaoning	2,859	3,796
吉林 Jilin	2,261	1,510
黑龙江 Heilongjiang	2,085	1,218
新疆 Xinjiang	2,071	836
甘肃 Gansu	1,497	2,347
内蒙古 Inner Mongolia	1,281	1,627
青海 Qinghai	1,057	126
海南 Hainan	698	389
宁夏 Ningxia	604	529
西藏 Tibet	16	542

Source(s): PBOC, ABCI Securities

Exhibit 35: Top 10 R&D expense regions – Technological advancement is enhancing economic development
YRD area (Jiangsu, Zhejiang & Shanghai) links up to form a national R&D nucleus, outpacing Guangdong in southern China
(LHS) Cumulated R&D expenses in 2016-18 (RMB100mn); (RHS): R&D intensity (%)



R&D intensity = R&D expenses/GDP
Source(s): NBS, ABCI Securities

Hong Kong Stock Market Outlook

2019 Review: Stress tests on HK stock market

In 11M19, Hang Seng Index (HSI) was traded in the range of 24,896.87-30,280.12, hitting the trough on Jan 3 and the peak on Apr 15. A slew of negative events have clouded over the outlook- escalating Sino-US trade war since 1Q, the slowdown of China and US economic growth in 3Q, social unrest in HK in 2H, and downward revisions of earnings outlook of blue chips for 2019-20.

These adverse events were de facto stress tests on the HK stock market in 2H19. Corporate results for 9M19 or 3Q19 have largely factored in these negative factors. The lowest point of HSI in 2H19 was still higher than that in 1H19.

While businesses have been adversely affected given the circumstances, we believe extreme pessimism is unwarranted. From an investment point of view, these stress tests have prompted investors to identify corporates with good earnings quality.

Exhibit 36: Hang Seng Index market valuation in 2018 and 2019

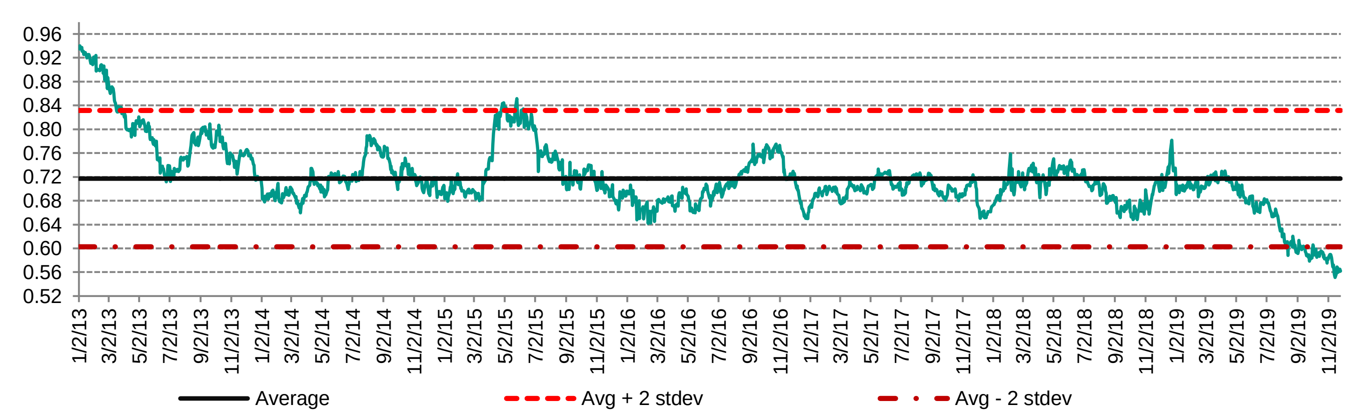
	High	Low	Period end
Period: 2018			
Index	33,484	24,541	25,846
P/E	14.20	10.41	10.96
P/B	1.67	1.22	1.29
Yield	2.99%	4.08%	3.88%
Period: 2019			
Index	30,280	24,896	27,900
Est. 2019 P/E	12.01	9.88	11.07
Est. 2019 P/E	1.31	1.07	1.20
Est. 2019 yield	3.43%	4.17%	3.72%

Source(s): Bloomberg, HKEx, ABCI Securities

Relative valuation of HK stock market shows a bargain price

Since 2013, HSI has been trading at a discount of ~28% to DJIA in terms of P/E. Since 3Q19, the discount widened to 44% (as of Nov 26). The increasing discount in 2H19 is mainly due to local factors in HK (social unrest and recession risk in 2H19). We expect the discount to narrow in 2020 with the restoration of social stability and recovering economy. If the discount narrows to the historical average level, HSI would rise by 28%.

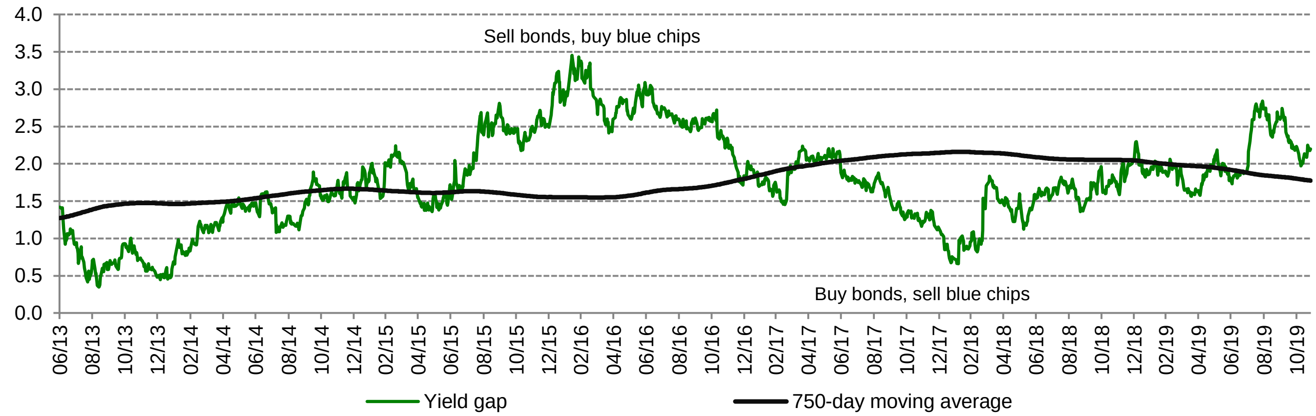
Exhibit 37: Relative valuation - HSI est. P/E / DJIA Index est. P/E



2013 to present average: 0.717 , SD= 0.057

Source(s): Bloomberg, ABCI Securities

Exhibit 38: Yield gap - HSI dividend yield minus 10-yr HK government bond yield (ppt)



750-day average yield gap: 1.76 ppt; current yield gap 2.197 ppt
Source(s): Bloomberg, ABCI Securities

HSI in 2020-2021

We are cautiously optimistic on the HK stock market in 2020 and 2021 for the following reasons.

1. The real impacts of the stress tests (such as Sino-US trade war, global economic slowdown, HK social unrest), to a large extent, have been reflected on the results of HK-listed companies in 2019 as well as their share prices. Trailing 12-mth ROAE (as of end-Sep 2019) of HSI was 11.5%, compared with 11.9% in 2018.
2. In 2017-1H19, Chinese enterprises and their international peers were operating in a tightened monetary environment, with central banks in China, the US, Eurozone, and Japan downsizing or constraining growth in balance sheets. Monetary expansion policies in the US and Eurozone have begun in 2H19. Considering lag effect of six to nine months, we expect the positive impacts to emerge in 2Q20.
3. Market is expecting blue chips to achieve an average earnings growth of ~5% in 2020 (vs. 6.4% growth in 2018 and 6.9% in 2019) with an ROAE of ~11% in 2020 (vs. 11.4% in 2018 and 11.7% in 2019). Market expectations for 2020 are in-line with the trend in recent years.
4. We expect the trading range of HSI to be 26,000-31,800 in 2020, which represents 9.8-12.0x 2020 P/E, 1.05-1.28x 2020 P/B or a 2020 yield 4.2-3.4%.
5. From the global investors' perspective, the weak spot of the HK stock market is the lower profitability of blue chips compared to those in the international indices. ROAE of HSI is expected to remain at ~11% in 2019-21; ROAE of S&P 500 and Nasdaq 100 in the US are expected to be ~19% and ~28%, and CSI 300 Index in China and Stoxx 50 in Europe are estimated at ~12%. While HSI's discount to the US indices is justified, it deserves a similar valuation to the benchmark indices in China or Europe.

Exhibit 39: HSI projections for 2020E-21E

Period: 2020	High	Low	Year end
Index	31,852	26,061	30,525
Implied 2020 P/E (x)	12.00	9.82	11.50
Implied 2020 P/B (x)	1.28	1.05	1.23
Implied 2020 yield	3.44%	4.20%	3.59%
Period: 2021	**High**	**Low**	**Year end**
Index	32,944	26,621	31,511
Implied 2021 P/E (x)	11.50	9.29	11.00
Implied 2021 P/B (x)	1.24	1.00	1.18
Implied 2021 yield	3.52%	4.35%	3.68%

Sources: ABCI Securities estimates

Sectors in Focus

High-yield stocks are still preferred. High-yield blue chips will remain appealing to risk-averse investors in 2020. In view of the downtrend of interest rates cycle in the US and negative interest rates in Eurozone and Japan, high-yield blue chips are good alternatives to yield investors in advanced economies. Continuous growth of China's insurance market will also boost demand for yield stocks from China insurance funds. Any market corrections will be a buying opportunity for yield investors.

Consumers are seeking for services. Tertiary industry has become a dominant part of China's economy, and the government is pushing to stimulate private consumption to drive economic growth. Based on the data on per capita expenditure in 2017-9M19, households are willing to increase spending on two areas – a) medical & healthcare and b) education, cultural & entertainment. Consumers are increasing spending on services, driven by a strong desire to upgrade their living standard. We expect consumption behaviors will continue to evolve in this direction.

The intricate interplay of the property development and property completion cycles. New homes completion cycle usually lags behind the new home development cycle by three years. Investment cycle of residential property development projects entered the downtrend during 2012-15, bottomed in 2016, and trended up from 2016 to present. Based on a three-year construction cycle, property completion cycle stayed down in 2016-18, bottomed in 2019, and will enter the up-cycle in 2020-22. The uptrend of property completion cycle in the next three years will have the following implications on the demand side: (1) demand for furniture, furnishing materials, and electrical household appliances will increase; (2) demand for automobiles will increase after homeowners move into their new homes; (3) property management services industry will surge on increased GFA under management in coming years.; (4) reported revenues of property developers will follow the property completion cycle and trend up.

Exhibit 40 : Per capita expenditure in medical & healthcare in China (%YoY)

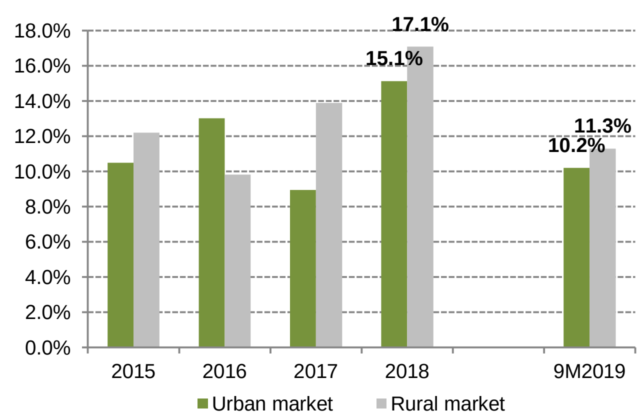
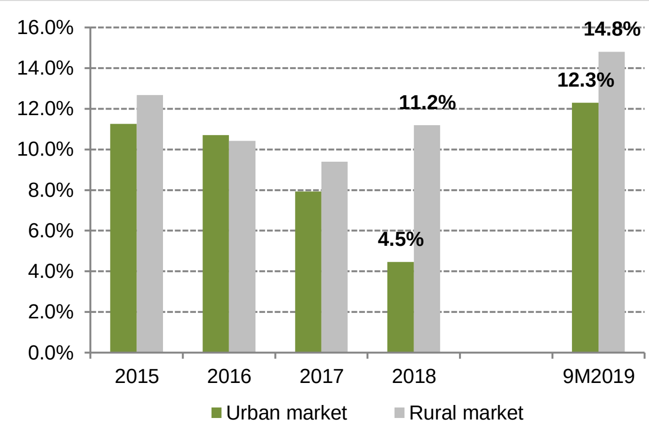


Exhibit 41: Per capita expenditure in education, cultural & entertainment in China (%YoY)



Remarks: Per capita disposable income grew by 8.7% YoY and 8.8% YoY in 2018 and 9M19
Source(s): NBS, ABCI Securities

Exhibit 42: Residential property investment & GFA completed in China (YoY chg %) - GFA completion is going to rebound in 2020-22

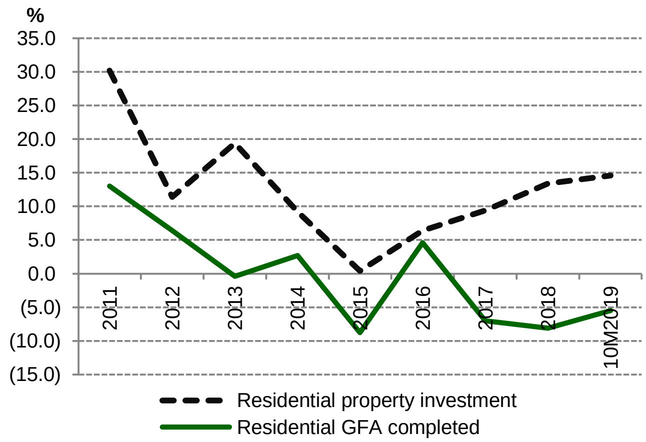
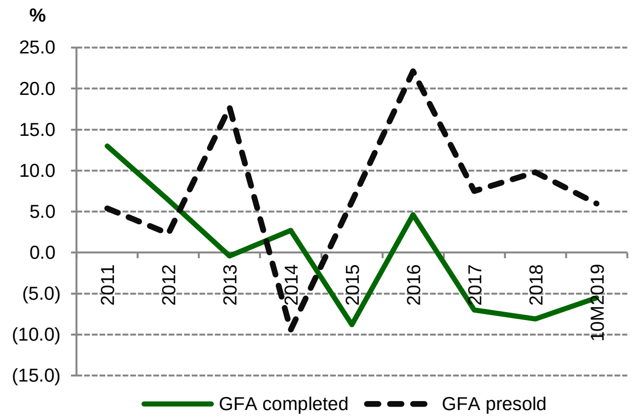


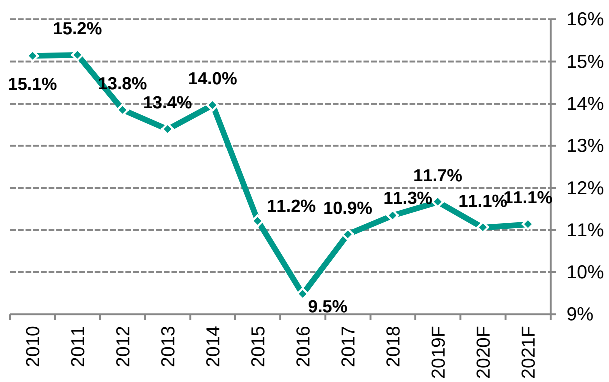
Exhibit 43: New homes GFA presold & GFA completed in China (YoY chg %) - GFA completion will rebound sharply in 2020 due to strong contracted sales growth in 2016



Remarks: Above data refer to private housing
Source(s): NBS, ABCI Securities

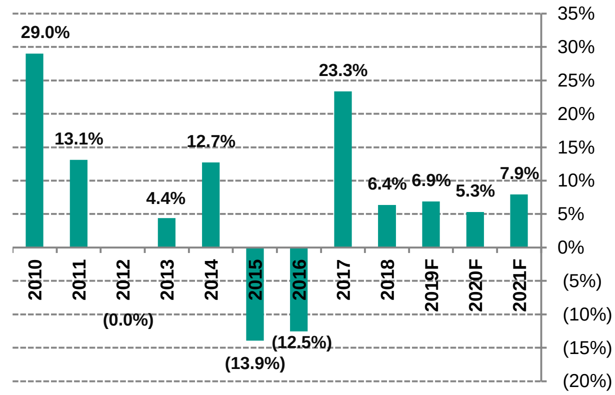
Hong Kong Stock Market

Exhibit 44: HSI ROAE



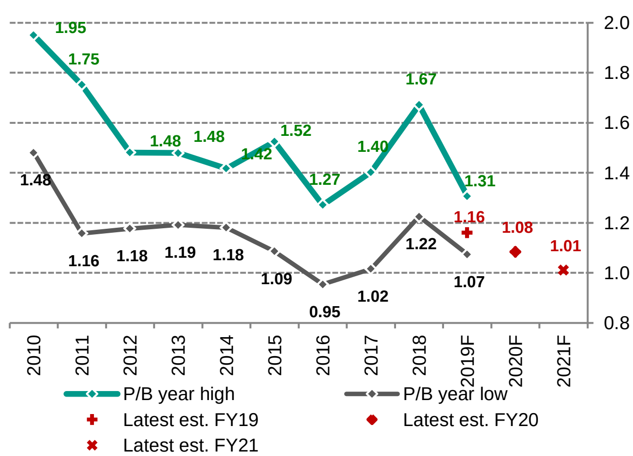
Source(s): Bloomberg, ABCI Securities

Exhibit 45: HSI EPS Growth



Source(s): Bloomberg, ABCI Securities

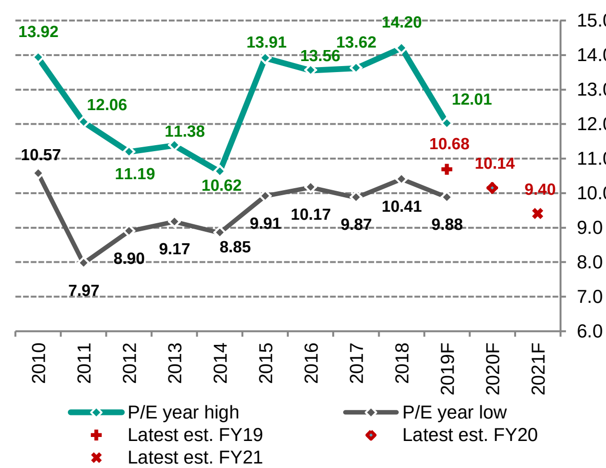
Exhibit 46: HSI P/B band (x)



Index at 26,914

Source(s): Bloomberg, ABCI Securities

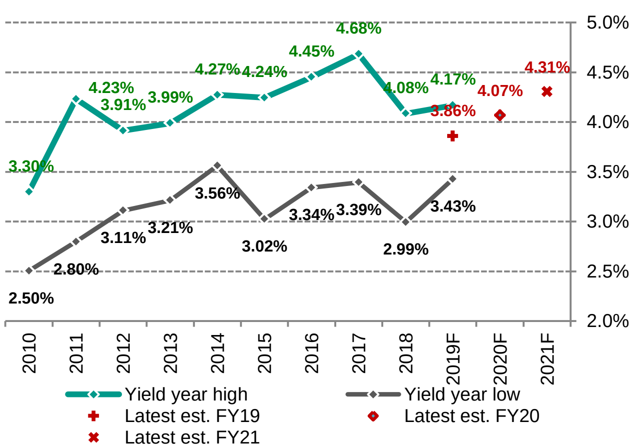
Exhibit 47: HSI P/E band(x)



Index at 26,914

Source(s): Bloomberg, ABCI Securities

Exhibit 48: HSI Dividend yield

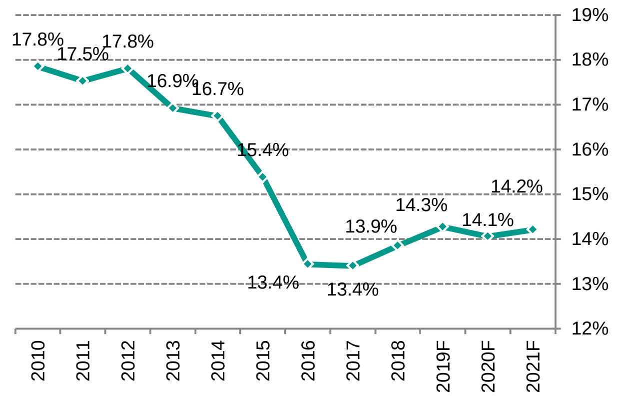


Index at 26,914.

Source(s): Bloomberg, ABCI Securities

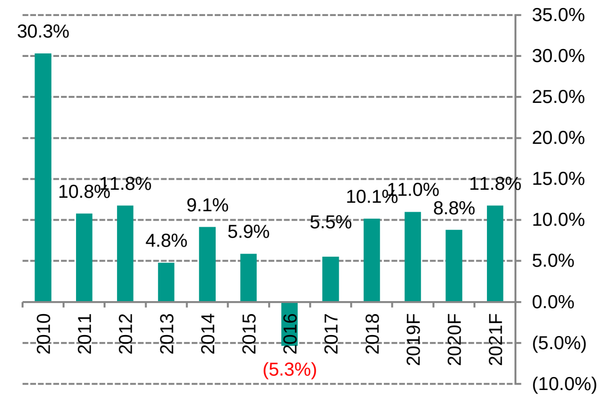
China Stock Market

Exhibit 49: SSE50 Index ROAE



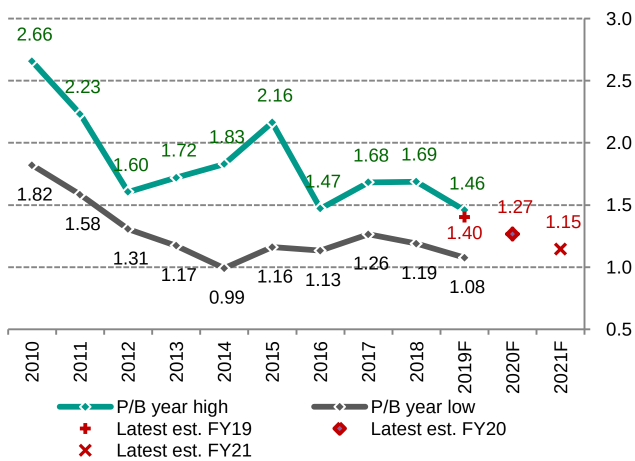
Source(s): Bloomberg, ABCI Securities

Exhibit 50: SSE50 Index EPS Growth



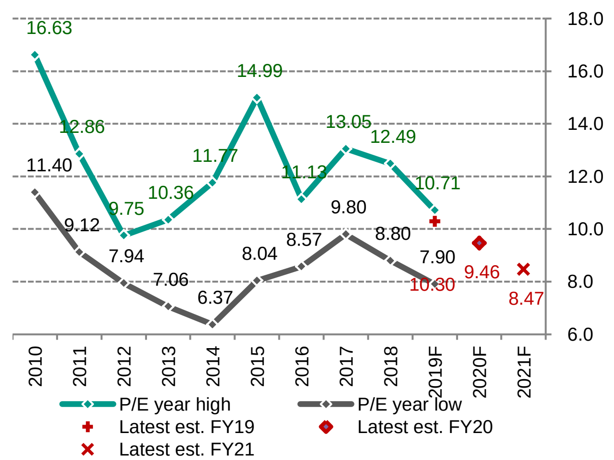
Source(s): Bloomberg, ABCI Securities

Exhibit 51: SSE50 Index P/B band (x)



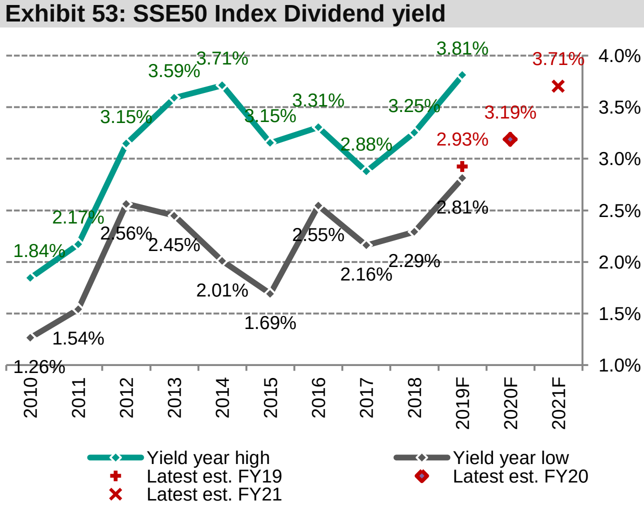
Index at 2,944
Source(s): Bloomberg, ABCI Securities

Exhibit 52: SSE50 Index P/E band (x)



Index at 2,944
Source(s): Bloomberg, ABCI Securities

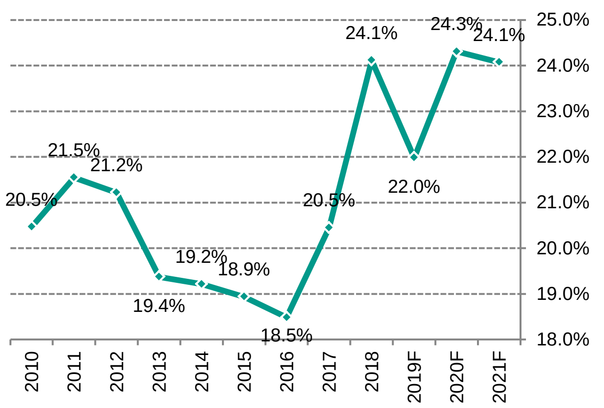
Exhibit 53: SSE50 Index Dividend yield



Index at 2,944.
Source(s): Bloomberg, ABCI Securities

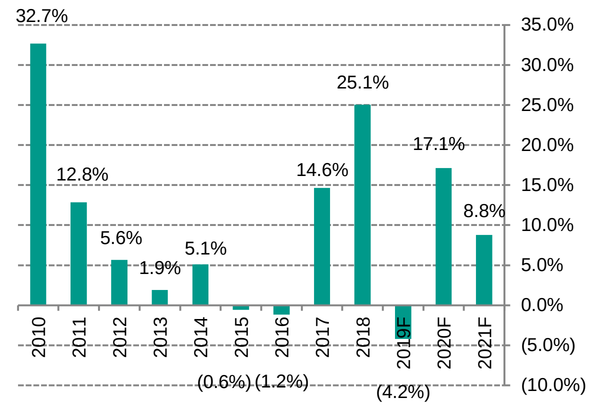
US Stock Market

Exhibit 54: DJIA Index ROAE



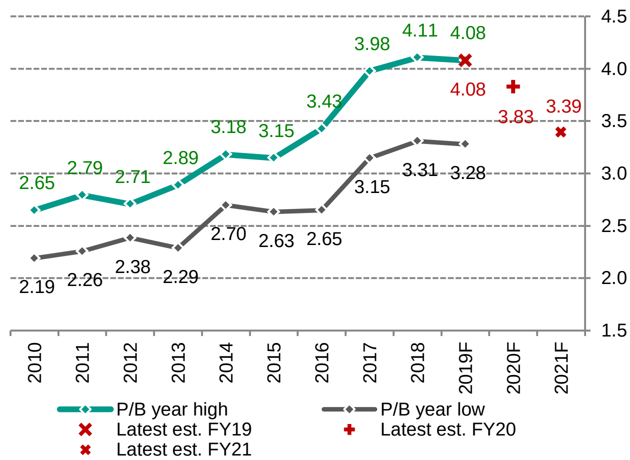
Source(s): Bloomberg, ABCI Securities

Exhibit 55: DJIA Index EPS Growth



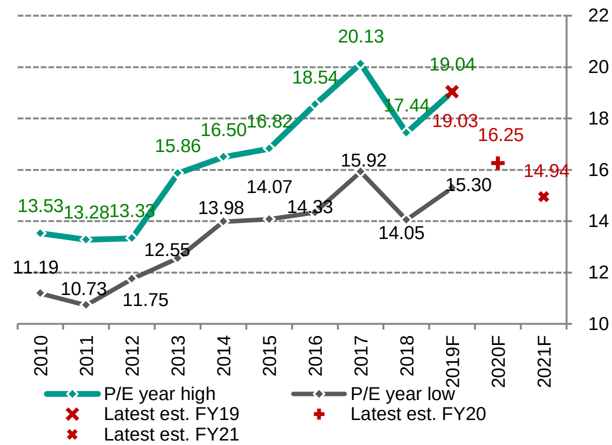
Source(s): Bloomberg, ABCI Securities

Exhibit 56: DJIA Index P/B band (x)



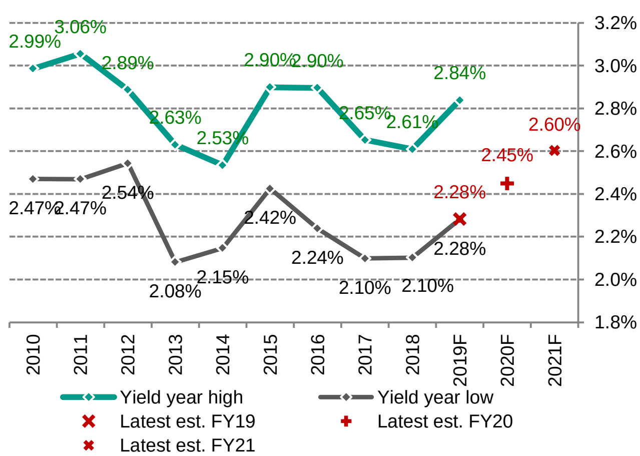
Index at 28,164
Source(s): Bloomberg, ABCI Securities

Exhibit 57: DJIA Index P/E band (x)



Index at 28,164
Source(s): Bloomberg, ABCI Securities

Exhibit 58: DJIA Index Dividend yield



Index at 28,164.
Source(s): Bloomberg, ABCI Securities

Exhibit 59: Hang Seng Index market valuation

			2021E	2021E	2021E	2021E	2021E	2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E
		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	79.95	16.21	3.40	1.69	3.48	10.6	16.80	3.52	1.74	3.35	10.5	17.80	1.80	3.17	10.3
3	HK China Gas	14.88	27.35	4.72	3.56	2.12	13.2	28.78	4.96	3.69	2.01	13.0	30.62	3.81	1.89	12.8
6	Power Assets	55.20	15.90	12.31	1.36	4.92	8.6	16.16	12.51	1.38	4.84	8.6	16.32	1.40	4.79	8.6
1038	CKI Holdings	53.45	12.53	16.78	1.07	4.68	8.7	12.48	16.71	1.11	4.70	9.0	12.72	1.15	4.62	9.4
1113	CK Asset	51.85	7.66	(0.91)	0.52	2.29	6.9	7.79	(0.92)	0.53	2.25	6.9	6.42	0.55	2.73	8.9
101	Hang Lung PPT	16.14	13.70	2.33	0.50	3.04	3.7	14.37	2.45	0.51	2.90	3.6	15.36	0.52	2.71	3.4
12	Henderson Land D	37.65	10.83	6.33	0.55	2.35	5.1	10.65	6.22	0.56	2.39	5.3	11.20	0.57	2.27	5.1
16	SHK PPT	113.00	8.77	2.36	0.52	3.08	6.0	8.91	2.40	0.54	3.03	6.2	9.43	0.56	2.86	6.0
17	New World Dev	10.20	9.86	1.03	0.42	2.08	4.4	10.96	1.14	0.44	1.87	4.1	11.83	0.45	1.73	3.9
1997	Wharf Real Est	43.35	12.59	6.98	0.57	4.21	4.6	12.83	7.11	0.58	4.13	4.6	13.05	0.59	4.06	4.6
823	Link REIT	79.25	23.83	3.18	0.87	0.48	3.6	25.66	3.43	0.86	0.45	3.4	27.54	0.87	0.42	3.2
83	Sino Land	11.42	8.62	0.26	0.47	2.82	5.5	7.74	0.23	0.49	3.14	6.5	15.37	0.51	1.58	3.4
2007	Country Garden	11.14	4.07	0.29	0.95	7.45	25.6	4.63	0.33	1.15	6.55	27.5	5.29	1.42	5.73	29.9
688	China Overseas	27.55	5.07	0.33	0.74	4.33	15.5	5.75	0.37	0.83	3.82	15.4	6.74	0.94	3.25	14.8
1398	ICBC-H	5.53	5.11	0.84	0.60	5.98	12.2	5.45	0.89	0.65	5.61	12.5	5.75	0.71	5.31	13.0
939	CCB-H	6.20	4.69	0.78	0.56	6.52	12.4	4.98	0.83	0.61	6.14	12.8	5.27	0.67	5.80	13.3
3328	Bank Comm-H	5.12	4.09	0.74	0.42	7.28	10.7	4.35	0.79	0.45	6.84	10.8	4.55	0.49	6.54	11.2
3988	Bank Of China-H	3.11	4.07	0.77	0.43	7.65	10.9	4.31	0.82	0.46	7.23	11.1	4.51	0.50	6.91	11.5
11	Hang Seng Bank	159.50	11.97	20.40	1.60	4.95	13.7	12.08	20.59	1.69	4.90	14.4	12.11	1.79	4.89	15.5
2388	BOC Hong Kong	26.50	8.08	2.62	0.86	6.00	10.9	8.37	2.72	0.91	5.80	11.2	8.58	0.97	5.65	11.5
5	HSBC	57.95	10.11	3.96	0.85	8.01	8.5	10.64	4.16	0.88	7.61	8.4	10.64	0.90	7.61	8.5
2318	Ping An-H	90.00	8.10	1.24	1.58	3.53	21.0	9.24	1.41	1.85	3.09	21.6	9.20	2.17	3.11	26.0
2628	China Life-H	19.88	10.25	(1.39)	1.12	4.00	11.4	11.35	(1.54)	1.22	3.62	11.2	8.80	1.33	4.66	16.4
1299	AIA	79.00	15.08	1.22	2.11	1.99	14.6	17.05	1.38	2.31	1.76	14.2	19.04	2.55	1.58	14.7
388	HKEX	247.40	26.84	2.62	6.93	3.32	25.5	29.48	2.88	6.75	3.02	23.4	32.63	7.09	2.73	22.5

(Continue next page)

			2021E	2021E	2021E	2021E	2021E	2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E
		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	6.76	9.63	0.42	0.53	4.22	5.6	11.29	0.49	0.55	3.60	4.9	14.59	0.57	2.78	4.0
941	China Mobile	59.40	9.84	12.58	0.90	5.78	9.4	10.01	12.81	0.95	5.68	9.7	9.99	0.99	5.70	10.2
700	Tencent	331.00	20.61	0.98	4.31	0.59	23.3	25.05	1.19	5.41	0.49	24.0	30.18	6.77	0.40	25.3
2018	AAC Technologies	55.30	16.70	0.68	2.49	2.81	15.7	19.16	0.78	2.77	2.45	15.1	25.98	3.04	1.81	12.0
2382	Sunny Optical	129.10	21.20	0.67	6.24	1.18	33.1	26.68	0.84	8.00	0.93	34.2	36.78	10.60	0.68	32.6
386	Sinopec Corp-H	4.37	7.79	2.80	0.61	10.59	7.9	7.85	2.82	0.63	10.51	8.1	8.23	0.65	10.03	8.0
857	PetroChina-H	3.58	9.71	0.93	0.44	2.37	4.7	10.71	1.02	0.46	2.15	4.4	11.85	0.48	1.94	4.1
883	CNOOC	11.34	7.41	1.69	0.91	9.50	12.6	7.89	1.81	0.96	8.91	12.6	8.07	1.03	8.72	13.1
1088	China Shenhua-H	15.24	6.67	(2.03)	0.66	5.95	10.3	6.53	(1.99)	0.71	6.08	11.2	6.24	0.76	6.36	12.7
1093	CSPC Pharma	17.60	16.48	0.73	3.90	1.86	25.8	20.10	0.89	4.67	1.53	25.3	24.75	5.60	1.24	23.0
1177	Sino Biopharm	10.18	25.04	1.31	2.71	0.37	11.5	30.44	1.59	3.07	0.31	10.6	35.51	3.42	0.26	9.7
151	Want Want China	6.81	17.66	3.45	4.14	0.60	23.9	18.69	3.65	4.30	0.56	23.8	19.52	4.59	0.54	24.4
2319	Mengniu Dairy	30.40	19.42	2.26	2.83	1.20	15.5	23.11	2.69	3.20	1.01	14.7	22.90	3.59	1.01	17.0
288	WH Group Ltd	7.97	10.39	0.91	1.44	3.80	14.5	11.07	0.97	1.59	3.57	14.9	12.89	1.72	3.07	14.1
1044	Hengan Intl	51.25	12.09	1.55	2.69	4.87	23.0	13.10	1.68	2.88	4.49	22.8	14.04	3.11	4.19	21.5
2313	Shenzhou	105.40	19.17	1.03	4.36	2.71	24.2	22.83	1.22	4.97	2.28	23.2	27.00	5.67	1.93	20.9
669	Techtronic	60.20	16.33	0.95	3.13	2.29	20.5	19.32	1.12	3.57	1.94	19.7	22.42	4.06	1.67	19.2
175	Geely Automobile	14.90	10.25	0.65	1.72	2.54	18.0	10.80	0.68	2.00	2.42	19.9	13.77	2.33	1.90	18.1
1928	Sands China Ltd	37.15	14.74	1.28	7.10	7.43	50.9	16.59	1.44	7.96	6.60	49.4	18.32	8.46	5.97	46.8
27	Galaxy Entertain	51.80	14.29	1.75	2.44	2.12	18.1	16.24	1.99	2.77	1.87	18.2	16.73	3.15	1.82	20.1
66	MTR Corp	43.40	18.52	1.73	1.35	2.45	7.4	20.48	1.91	1.39	2.22	6.9	22.70	1.43	2.00	6.4
1	CKH Holdings	70.50	6.17	1.20	0.50	5.08	8.4	6.47	1.26	0.53	4.85	8.5	6.83	0.56	4.59	8.6
19	Swire Pacific-A	69.65	10.55	1.04	0.36	1.81	3.4	10.98	1.08	0.37	1.74	3.4	12.79	0.37	1.49	3.0
267	Citic	9.88	4.84	0.97	0.42	4.90	8.9	5.11	1.03	0.45	4.64	9.0	5.33	0.48	4.45	9.3

Priced on Dec 3, 2019
RMB 0.8998/HK$1.00; HK$ 7.8289/US$ 1.00
PEG = P/E / EPS CAGR in 2019-21
Source(s): Bloomberg, ABCI Securities

Exhibit 60: Hang Seng China Enterprises Index market valuation

			2021E	2021E	2021E	2021E	2021E	2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E
		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	5.53	5.11	0.84	0.60	5.98	12.3	5.45	0.89	0.66	5.61	12.6	5.75	0.72	5.31	13.1
939	CCB-H	6.20	4.69	0.78	0.56	6.52	12.4	4.98	0.83	0.61	6.14	12.8	5.27	0.67	5.80	13.3
1288	ABC-H	3.19	4.23	0.66	0.49	6.97	12.0	4.53	0.71	0.53	6.51	12.2	4.79	0.58	6.16	12.6
3988	BANK OF CHINA-H	3.11	4.07	0.77	0.43	7.65	10.9	4.31	0.82	0.46	7.23	11.2	4.51	0.50	6.91	11.6
3328	BANKCOMM-H	5.12	4.09	0.74	0.42	7.28	10.8	4.35	0.79	0.46	6.84	10.9	4.55	0.49	6.54	11.3
1658	POSTAL SAVINGS-H	5.06	5.20	0.43	0.65	5.77	13.2	5.84	0.49	0.72	5.14	12.9	6.52	0.79	4.60	12.7
3968	CM BANK-H	37.55	7.34	0.55	1.16	4.01	16.8	8.39	0.63	1.32	3.51	16.7	9.42	1.49	3.12	16.8
998	CITIC BANK-H	4.32	3.57	0.51	0.37	7.09	10.8	3.90	0.55	0.40	6.48	10.7	4.09	0.44	6.18	11.1
1988	CHINA MINSHENG-H	5.49	3.68	0.62	0.40	8.23	11.4	3.96	0.67	0.44	7.64	11.5	4.12	0.47	7.34	12.0
2628	CHINA LIFE-H	19.88	10.25	(1.39)	1.19	4.00	12.1	11.35	(1.54)	1.29	3.62	11.7	8.80	1.36	4.66	16.7
2318	PING AN	90.00	8.10	1.24	1.58	3.53	21.0	9.24	1.41	1.85	3.09	21.6	9.20	2.16	3.11	25.9
1339	PICC GROUP-H	3.13	6.15	(2.18)	0.60	2.48	10.3	6.36	(2.25)	0.66	2.40	10.8	5.81	0.72	2.62	13.2
2601	CHINA PACIFIC-H	27.85	7.39	2.84	1.14	6.80	16.1	8.10	3.11	1.24	6.20	15.9	7.78	1.34	6.46	18.3
1336	NEW CHINA LIFE-H	30.05	5.92	2.36	0.85	3.46	15.3	6.69	2.67	0.97	3.06	15.3	6.22	1.09	3.29	19.0
2328	PICC P&C-H	9.17	6.86	2.52	0.95	5.70	14.6	7.54	2.77	1.05	5.18	14.5	7.24	1.14	5.40	16.8
966	CHINA TAIPING IN	18.24	5.73	0.61	0.79	0.95	14.7	6.63	0.70	0.91	0.82	14.6	6.86	1.04	0.79	16.4
6030	CITIC SEC-H	14.74	9.92	0.87	0.89	4.58	9.2	11.23	0.99	0.94	4.05	8.6	12.31	0.99	3.69	8.3
6837	HAITONG SECURI-H	7.89	6.90	0.53	0.58	4.83	8.7	7.95	0.61	0.62	4.19	8.0	8.81	0.65	3.78	7.6
267	CITIC	9.88	4.84	0.97	0.46	4.90	9.9	5.11	1.03	0.50	4.64	10.1	5.33	0.54	4.45	10.5
1088	CHINA SHENHUA-H	15.24	6.67	(2.03)	0.67	5.95	10.4	6.53	(1.99)	0.71	6.08	11.3	6.24	0.76	6.36	12.7
857	PETROCHINA-H	3.58	9.71	0.93	0.44	2.37	4.6	10.71	1.02	0.46	2.15	4.3	11.85	0.47	1.94	4.0
386	SINOPEC CORP-H	4.37	7.79	2.80	0.64	10.59	8.2	7.85	2.82	0.65	10.51	8.3	8.23	0.66	10.03	8.0
883	CNOOC	11.34	7.41	1.69	0.92	8.01	12.8	7.89	1.81	0.98	7.51	12.7	8.07	1.03	7.35	13.1
1193	CHINA RES GAS	44.25	15.48	1.36	3.00	2.44	20.7	17.37	1.53	3.45	2.17	21.2	19.21	3.96	1.97	22.3
2688	ENN ENERGY	84.85	12.25	0.78	2.60	3.79	22.6	14.28	0.91	2.97	3.25	22.2	16.42	3.40	2.83	22.4
384	CHINA GAS HOLD	29.60	11.97	0.76	2.73	2.26	25.0	13.42	0.85	3.30	2.01	27.2	16.04	4.08	1.68	28.3
270	GUANGDONG INVEST	16.46	17.25	1.72	2.56	4.04	15.2	18.73	1.87	2.70	3.72	14.8	20.89	2.86	3.34	14.1

(Continue next page)

			2021E	2021E	2021E	2021E	2021E	2020E	2020E	2020E	2020E	2020E	2019E	2019E	2019E	2019E
		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)	(%)	(%)
1800	CHINA COM CONS-H	5.95	3.52	0.38	0.38	5.35	11.3	3.86	0.42	0.42	4.88	11.3	4.20	0.46	4.49	11.4
1766	CRRC CORP LTD -H	5.13	8.23	0.64	0.84	4.67	10.6	9.18	0.72	0.91	4.19	10.2	10.47	0.97	3.67	9.5
1211	BYD CO LTD-H	37.25	28.80	1.24	1.59	0.76	5.6	34.32	1.47	1.66	0.64	4.9	43.77	1.73	0.50	4.0
175	GEELY AUTOMOBILE	14.90	10.25	0.65	1.73	2.15	18.1	10.80	0.68	2.00	2.04	20.1	13.77	2.37	1.60	18.3
2202	CHINA VANKE-H	29.70	5.49	0.36	1.16	6.37	22.8	6.28	0.42	1.36	5.57	23.4	7.27	1.60	4.81	23.9
2007	COUNTRY GARDEN	11.14	4.07	0.29	0.96	7.45	25.9	4.63	0.33	1.17	6.55	27.7	5.29	1.43	5.73	30.0
960	LONGFOR GROUP	32.65	7.24	0.35	1.41	4.92	21.0	8.71	0.42	1.64	4.09	20.2	10.52	1.89	3.38	19.1
1918	SUNAC	41.15	4.16	0.18	1.18	5.24	32.0	4.98	0.22	1.54	4.38	35.3	6.27	2.06	3.48	38.2
914	CONCH CEMENT-H	50.25	7.96	(2.25)	1.35	3.77	18.0	7.86	(2.22)	1.53	3.82	20.8	7.41	1.76	4.05	26.1
656	FOSUN INTL	10.72	4.70	0.50	0.56	4.39	12.5	5.08	0.54	0.62	4.07	12.8	5.63	0.68	3.67	12.8
1099	SINOPHARM-H	25.95	8.32	0.60	1.18	3.60	14.9	9.51	0.68	1.31	3.15	14.5	10.79	1.46	2.78	14.2
1177	SINO BIOPHARM	10.18	25.04	1.31	2.94	0.37	12.4	30.44	1.59	3.29	0.31	11.4	35.51	3.65	0.26	10.7
1093	CSPC PHARMA	17.60	16.48	0.73	3.77	1.86	25.0	20.10	0.89	4.54	1.53	24.7	24.75	5.47	1.24	24.1
700	TENCENT	331.00	20.61	0.98	4.44	0.50	23.9	25.05	1.19	5.53	0.41	24.6	30.18	6.93	0.34	25.7
941	CHINA MOBILE	59.40	9.84	12.58	0.90	4.88	9.3	10.01	12.81	0.94	4.79	9.6	9.99	0.99	4.80	10.2
728	CHINA TELECOM-H	2.99	9.15	1.93	0.57	5.25	6.4	9.51	2.01	0.59	5.06	6.3	10.04	0.61	4.79	6.2
788	CHINA TOWER CO-H	1.61	24.56	0.61	1.26	0.52	5.3	31.50	0.78	1.32	0.41	4.3	48.30	1.38	0.27	2.9
291	CHINA RESOURCES	42.00	29.70	0.85	4.74	1.35	16.9	37.92	1.09	5.32	1.05	14.8	53.93	5.92	0.74	11.5
151	WANT WANT CHINA	6.81	17.66	3.45	3.94	4.10	23.1	18.69	3.65	4.23	3.88	23.5	19.52	4.55	3.71	24.3
2020	ANTA SPORTS	74.45	20.87	0.90	6.29	2.45	33.0	25.13	1.08	7.62	2.03	33.3	31.70	9.29	1.61	32.3
2313	SHENZHOU INTL	105.40	19.17	1.03	4.33	2.71	24.1	22.83	1.22	4.97	2.28	23.2	27.00	5.65	1.93	22.2
1044	HENGAN INTL	51.25	12.09	1.55	2.63	5.78	22.6	13.10	1.68	2.85	5.33	22.6	14.04	3.08	4.97	22.8

Priced on Dec 3, 2019
RMB 0.8998/HK$1.00; HK$ 7.8289/US$ 1.00
PEG = P/E / EPS CAGR in 2019-21
Source(s): Bloomberg, ABCI Securities

Hong Kong IPO Market

Resilient IPO market amid unrest

Steve Chow, ABCI Analyst

- **Despite the ongoing social unrest in the city, Hong Kong's IPO market remained resilient. In 11M19, Hong Kong IPO market has raised US$ 34.8bn, with several blockbuster deals, including Top Spring (3688 HK), Budweiser Asia (1876 HK), and China's largest ecommerce platform**

- **As a result of these IPOs, consumer discretionary and consumer staple stocks have collectively taken up 61% of IPO volume in 11M19. In contrast, technology/new-economy stocks accounted for only 3% of IPO volume in 11M19**

Despite social unrest in recent months in the city, Hong Kong's IPO market remained resilient. In 11M19, the IPO market has raised US$ 34.8bn versus US$36.9bn in 2018. In 11M19, a total of 263 IPOs were issued, with an average issue size of US$ 133mn each.

The IPO market was temporarily affected in July-Aug but has recovered Since Sep, with the debuts of several large-scale IPOs including Top Spring, Budweiser Asia, and China's largest ecommerce platform.

As a result of these three consumer-related large scale IPOs, consumer discretionary and consumer staple stocks have become the major contributor of the IPO market accounting 61% of IPO volume in 11M19, significantly higher than 21% in 2018.

After the consumer discretionary and consume staple, financials was the third largest contributor accounting for 17% of IPO volume in 11M19, similar to 18% in 2018.

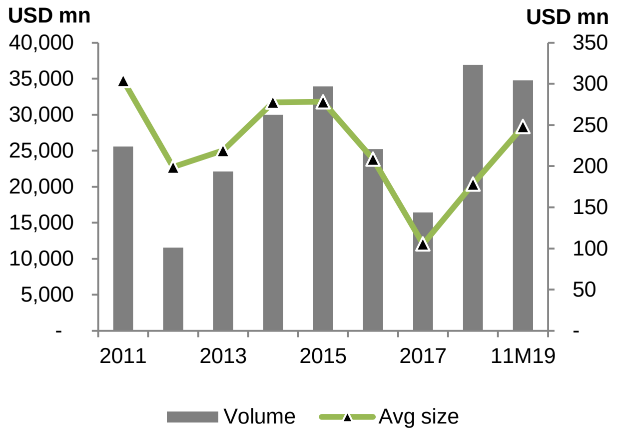
Conversely, technology/new-economy stocks took up a mere 3% of IPO volume in 11M19, significantly lower than 21% in 2018. In particular, after Xiaomi (1810 HK) and Meituan (3690 HK), no dual-class shares IPO has been made in 2019 so far. In our view, this could imply that enthusiasm for new-economy stocks may have ebbed, with investors turning more rational compared with 2018.

Exhibit 1: 11M19 HK IPO Overview

Industry*	Volume (US$ mn)	Avg deal size (US$ mn)
Consumer Discretionary	14,628	357
Consumer staple	6,789	1,132
Financials	5,875	267
Health Care	4,353	272
Industrials	885	38
Technology	660	5
Others	1,690	73

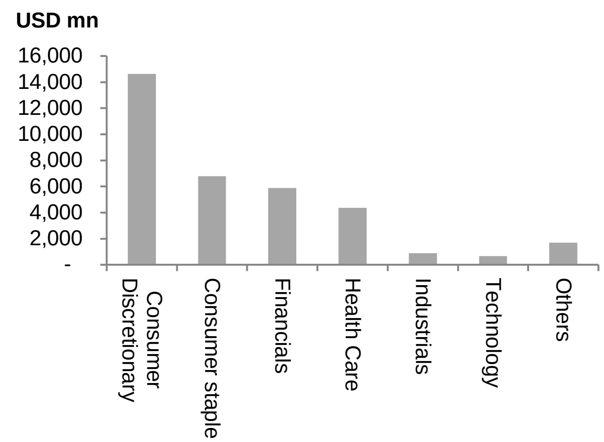
*Based on Bloomberg's industry classification
Source(s): Bloomberg, ABCI Securities

Exhibit 2: HK IPO volume and average deal size



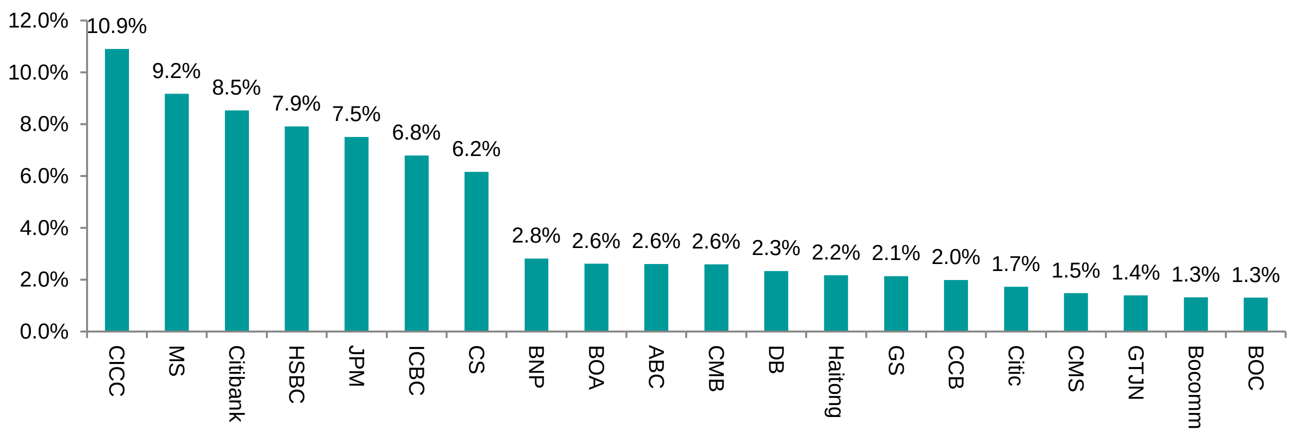
Source(s): Bloomberg, ABCI Securities

Exhibit 3: HK IPO volume by industry* (11M19)



*Based on Bloomberg's industry classification
Source(s): Bloomberg, ABCI Securities

Exhibit 4 : Market share of HK IPO underwriters by volume in 2019 (as of Dec 5, 2019)



Source(s): Bloomberg, ABCI Securities

Sector Outlook

ABCI Analysts

OVERWEIGHT
China Banks Sector – Stable fundamentals with mild NIM pressure and benign asset quality
Johannes Au

Key Data		Sector Performance	Absolute (%)	Relative (%)
H-shr		**H-shr (relative to MXCN)**		
Avg. 20E P/E (x)	4.5	1-mth	(2.2)	(3.8)
Avg. 20E P/B(x)	0.5	3-mth	7.1	0.8
Avg. 20E div yield (%)	5.5	6-mth	(1.8)	(8.1)
A-shr		**A-shr (relative to CSI300)**		
Avg. 20E P/E (x)	6.0	1-mth	(1.6)	0.5
Avg. 20E P/B(x)	0.7	3-mth	4.1	3.1
Avg. 20E div yield (%)	5.3	6-mth	3.2	(1.3)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Reduced social financing cost and measures to support real economies would result in mild NIM pressure
- Increased loan mix of higher-yield MSE loans and proactive balance sheet management would defend NIM
- Benign asset quality outlook on proactive NPL handling ; provision scale would remain stable
- Rapid balance sheet growth stimulates capital-raising activities
- Reiterate **OVERWEIGHT** sector rating for both A/H markets. Prefer big banks for defensiveness and promising dividend yield. **ABC-H(1288 HK)** and **CCB-H(939 HK)** are our H-share top picks; **ABC-A (601288 CH)** and **ICBC-A(601398 CH)** are our A-share top picks

Mild NIM pressure to persist in 2020. With government policies supporting MSE and private enterprise lending and reducing social financing cost, mild NIM pressure has been shown in recent quarters. Explicit targets have been set for the Big 5 Banks (ICBC [1398 HK/601398 CH], CCB [939 HK/601939 CH], ABC [1288 HK/601288 CH], BOC [3988 HK/601988 CH] and BoCom [3328 HK/601328 CH]) to increase MSE loan balance by 30% and to reduce average lending yield of MSEs by 1ppt in 2019. By category, big banks' average NIM stayed flat QoQ in 3Q19 at 2.11%, while average NIM of JSBs, city commercial banks and rural commercial banks expanded by 4bps, 2bps and 2bps to 2.13%, 2.11% and 2.74% QoQ, respectively, as we have previously expected. We believe the increased proportion of higher-yield MSE loans in bank loans and proactive balance sheet management were keys to offset negative impact from declining asset yields. Monetary policies, on the other hand, are targeting to maintain liquidity in the banking system through RRR cuts, which would ease funding cost pressure and support growth in banks. This has been reflected by a persistently low SHIBOR since mid-Jan 2019 and a robust loan growth in 10M19, whose amount reached 84.1% of our full-year loan estimate of RMB 17tr. We expect two RRR cuts in 2020E to support a full-year loan target of RMB 18tr next year. According to CBIRC data, system NIM in 3Q19 inched up further by 1bp QoQ to 2.19%, while system net profit growth slowed from 10.2% YoY in 2Q19 to 7.9% YoY in 3Q19 due to large provisions. We forecast system NIM to be stable over 2019-20; by category, big banks can expect continuous pressure, while JSBs and district banks may have a mild NIM upside given their clientele strength in MSEs and private enterprises.

All eyes on asset quality. Against the backdrop of Sino-US trade dispute, asset quality risk has drawn concerns. System NPL ratio inched up by 5bps from 1.81% in 2Q19 to 1.86% in 3Q19. In particular, average NPL ratios of big banks, city commercial banks and rural commercial bank increased by 6bps, 18bp, and 5bps QoQ to 1.32%, 2.48%, and 4.00% in 3Q19, respectively; JSBs was the only category reporting a QoQ decrease in average NPL ratio (- 4bps to 1.63%) as of Sep 2019. This set of data hints to a slight increase in asset quality risk and JSB's proactivity in NPL handling. We expect overall asset quality to stay benign in 2020, with system NPL ratio remaining stable or increasing slightly QoQ in 4Q19-4Q20, under the assumption that no unforeseeable global factors resulting in pervasive damage to China's macro outlook would occur. Strengthened buffers of the banks, compounding with the MOF's new financial rules to control excessive provisions, would calm provisioning ratio and provision coverage ratio in coming quarters. For district banks with marginal risk buffers, pressure on earnings would persist; for banks with excessive buffers such as PSB (1658 HK) and CMB (3968 HK/600036 CH), earnings may increase.

Higher capital needs for balance sheet growth. Continuous growth in balance sheet has driven up capital needs in banks. According to CBIRC data, total assets and total liabilities growth in commercial banks remained high at 8.7% and 8.2% YoY in Oct 2019, compared to 8% and 6.4% YoY in Dec 2018. System CT1 and CAR were reported at 10.85% and 14.54% as of Sep 2019, reflecting increased capital-raising activities in 3Q19. Aside from the long IPO queue in both A/H markets, more H-share banks, including PSB and ZSB (2016 HK), have received approval for their listing in the A-share market in 3Q19. By category, JSBs recorded a balance sheet growth of 8.9% YoY for total assets and 8.0% YoY for total liabilities as of Oct 2019, which implies a higher capital need. In our view, raising funds in the equity market has turned harder in recent years due to the expanding pool of listed banks in both A/H markets. We expect more alternative funding tools, such as preference shares and perpetual bonds, will be utilized in coming quarters by banks to improve capital position amid balance sheet growth.

Long-term Outlook

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

Short-term Outlook

Although we believe the enforcement of new policies in the sector will be beneficial in the long run, uncertain timing and details of new regulations would reduce risk appetite and weigh on the sector in the near term. This is especially true for smaller banks less defensive against policy risk. In contrast, promising dividend yield of big banks may draw interest from yield investors.

Stock Recommendations

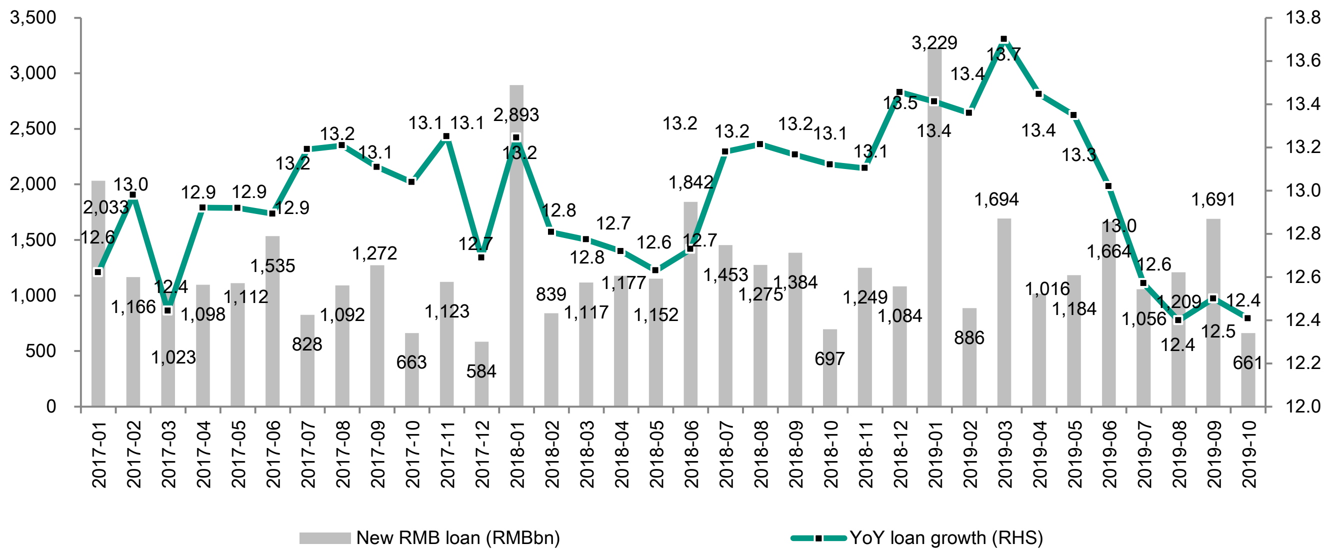
We reiterate our **OVERWEIGHT** rating for the China banks sector in both A/H share markets on undemanding valuation, stable growth, and sound fundamentals. Big banks, with promising dividend yield and high degree of business diversification, have repeatedly demonstrated defensiveness against policy risks and high adaptability to macro changes. Our sector H-share top picks are **ABC-H (1288 HK)** for its robust risk buffer and its position as a major beneficiary of policies supportive of inclusive finance and Sannong. We also like **CCB-H (939 HK)** for its prudent practices and diversified businesses. Our A-share top picks are **ABC-A (601288 CH)** and **ICBC-A (601398 CH)**; the latter has a lower valuation than **CCB-A (601939 CH)**.

District banks, with a smaller balance sheet, have higher operational flexibility; nonetheless, they are also more sensitive to changes in macro and policy environments compared to other banks. District banks, whose balance sheets have been expanding rapidly, would need to utilize alternative fundraising channels to satisfy their greater capital needs. Also, investors need to be aware of the low trading liquidity.

Risk Factors

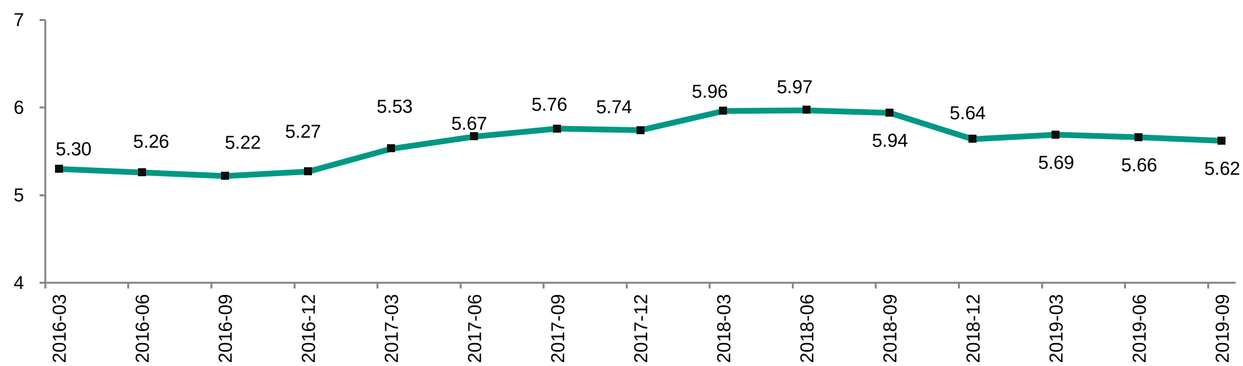
1) Radical changes in business environment induced by increased supervision and heavy-handed policies; 2) Increasing competition from non-bank financial institutions and foreign players; 3) Sharp deterioration in asset quality; 4) Sharp decline in loan demand; 5) Increasing policy risk in new and fast-growing businesses.

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



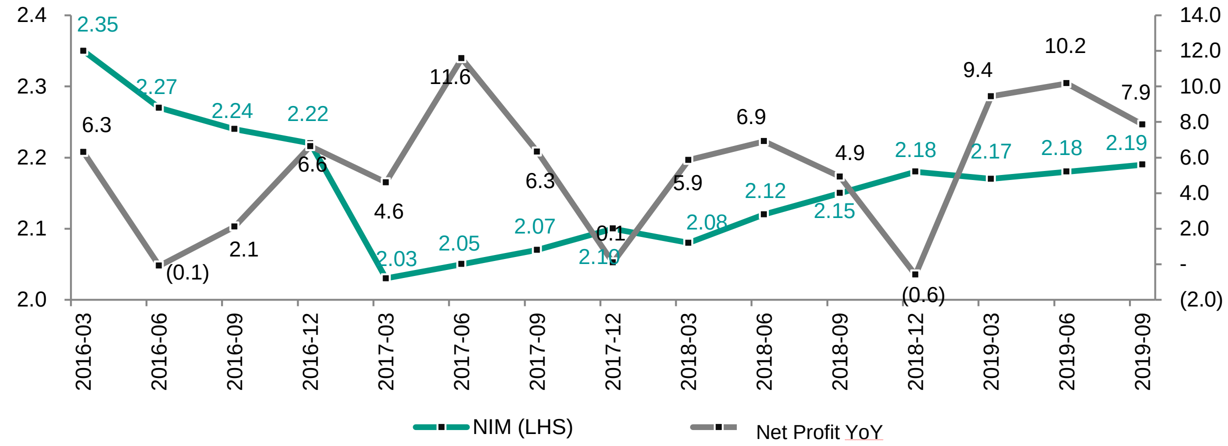
Source(s): PBOC, ABCI Securities

Exhibit 2: Average loan yield (%)



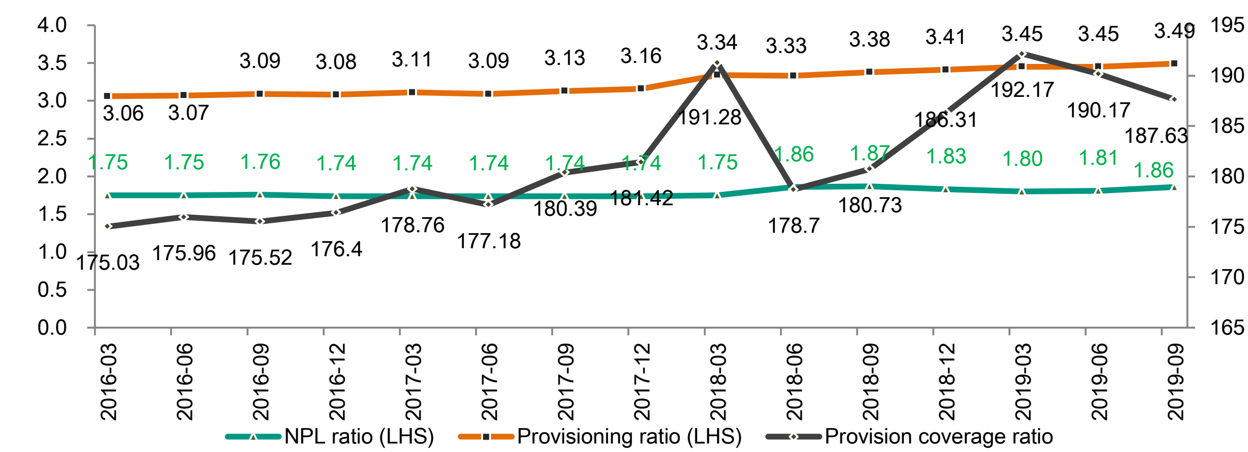
Source(s): PBOC, ABCI Securities

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 for H-shr market (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
ABC	1288 HK	BUY	5.41	70.13	4.45	4.13	0.58	0.53	6.57	7.26
CCB	939 HK	BUY	9.60	54.09	5.29	4.97	0.68	0.62	5.83	6.18

Source(s): Bloomberg, ABCI Securities estimates

Exhibit 6: Valuation of sector top picks for A-shr market (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
ABC	601288 CH	BUY	5.52	52.07	5.58	5.19	0.73	0.67	5.23	5.79
ICBC	601398 CH	BUY	8.65	48.63	6.61	6.13	0.84	0.76	4.64	4.98

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

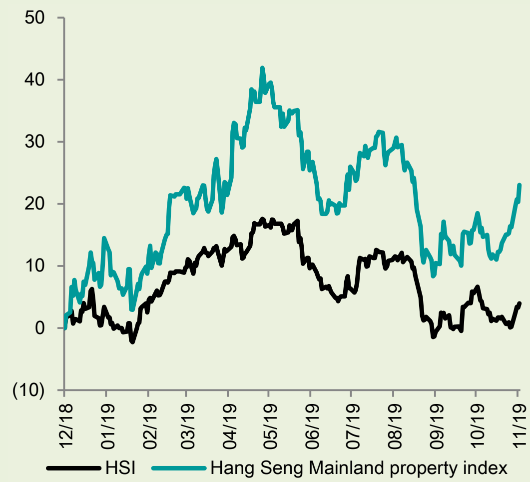
China Property Sector –Cash-rich PMCs deserve attention

Kenneth Tung

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	5.5	1-mth	7.0	2.3
Avg. 20E P/B(x)	1.1	3-mth	10.5	7.4
Avg. 20E div yield (%)	7.0	6-mth	(3.2)	2.5
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Developers' contracted sales rose 34%YoY on average in Oct 2019. We expect the figure to go up by 8%YoY in 2020E
- The property management sector is transforming into an innovative service industry as community VAS, as a percentage of total revenue, grew from 11.6% in 2018 to 12% in 1H19 among listed players
- We prefer Greater Bay Area (GBA) players over national ones. **Aoyuan (3883 HK)** is our top pick among the Chinese developers given its faster-than-peer contracted sales growth (+35%YoY in 10M19) and capability in urban redevelopment in GBA. **A-Living (3319 HK)** is our top pick in the PM Sector as the group has the largest managed GFA after the acquisition of CMIG

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Sector Outlook

■ Developers:

Contracted sales may have bottomed out. In recent months, China's residential sales have resumed rapid growth. According to the National Bureau of Statistics (NBS), sales of new homes in 3Q19 increased by 14%YoY, faster than the 8.4%YoY increase in 1H19. According to data from 23 major developers listed in Hong Kong, contract sales of developers also rebounded significantly in Oct, up 34% YoY (Sep: +30%YoY; Aug: +26% YoY; July: +16% YoY). For 10M19, contracted sales rose 18%YoY on average. Developers' ASP registered a negative YoY growth for four months straight since June, but the discount offered did stimulate stronger purchasing demand. In particular, contracted sales improved despite the fact that mortgage rate has been on the rise amid credit tightening. According to Rong360, first-home mortgage rate rose 10bps to 5.52% in Oct 2019 from 5.42% in June 2019, reversing the downtrend in 1H19. Most banks may have fulfilled its full-year loan target or reached its exposure limit for the property sector by 4Q. We expect mortgage loan rate to decline in 1H20 since historical pattern suggests a more proactive stance in mortgage approval in 1H. Overall, we expect contracted sales to grow at 8% YoY while ASP would remain flat in 2020.

Sensible easing ahead. Given a slowing economy and uncertain development of the Sino-US trade dispute, the government may relax policies to stimulate property demand ahead. We may see selective easing on home purchase restriction in specific cities. In fact, the Chinese government has already introduced new measures to facilitate property purchases by Hong Kong residents in the GBA. Hong Kong residents will be treated as local residents when purchasing properties in the mainland cities of the Guangdong-Hong Kong-Macao Greater Bay Area (GBA). They will no longer be required to provide evidence of their duration of residence, study or employment; nor will they have to meet conditions on the payment of individual income tax and social security. We believe this could hint to a more relaxed policy stance in 2020.

- **PMCs:**

Growing investor interest. Recent IPOs of Chinese PMCs in Hong Kong have received overwhelming responses, reflecting growing investor interest in the sector. E.g., share price of Xinyuan Property Management Service (1895 HK) and Yincheng Life Service (1922 HK) jumped 42% and 16% above their listed price in the first trading day. Share prices of these counters declined subsequently, but overall the sector has surged by 35% over the past three months since Aug. Investors are drawn by the cash-rich nature and earnings visibility of the PMCs. The sector has evolved in the capital market in two major aspects: **(1) the market cap of the major listed PMCs are now large enough to exceed the investment criteria of most funds.** Country Garden Services (6098 HK), the largest Chinese PMC by market cap, is worth HK$ 72.5bn (from HK$31bn as at end-2018); market cap of A-living (3319 HK) and Greentown Services (2869 HK) also exceed HK$30bn; **(2) Stock choice in the PM sector has broadened**. Up to Nov 2019, five PMCs have debuted their IPOs. These companies differentiate against each other in terms of geographic exposure and business mix. E.g., Nanjing accounted for 87% of Yincheng's PM revenue, while Henan and Hunan jointly accounted for 49% of Xinyuan's PM revenue.

Transforming into an innovative servicing industry supported by government. The sector has also transformed from an auxiliary business of property developers into a separate innovative servicing industry in PRC. Revenue from community VAS increased to 12.0% of total revenue in 1H19 from 11.6% in 2018. Apart from traditional PM services, PMCs also offers a wide range of community VAS such as property maintenance and repair, housekeeping and cleaning, decoration, turnkey and move-in furnishing services, agency services to cater for resident's daily needs. We also expect government to maintain its positive stance on supporting the services industry, especially on the tax reduction front. For instance, in Sep 2019, China announced additional tax deductions in the life services industry will increase from 10% to 15% from Oct 1, 2019 to Dec 31, 2021, based on the current period of deductible input VAT. Country Garden Services has also secured a status of "High and New Technology Enterprise", which has allowed it to enjoy a preferential income tax rate of 15% (vs. 25% normally) since 2018.

Stock Recommendations

- **Developers:**

GBA players to benefit from rising property demand. We prefer the GBA players over the large, national ones as economic growth in the region will outpace the national average on supportive policies from the government. Among the GBA developers, **Aoyuan (3883 HK)** is our top pick given impressive 10M19 presales (+31% YoY vs. peer average of 18% YoY) and expertise in urban redevelopment projects.

- **PMCs:**

A-Living (3319 HK) is our top pick for its solid track record in M&As. Its share price rose 45% since announcing the acquisition of CMIG Futurelife Property Management (CMIG) on Sep 26, 2019. Managed GFA of A-Living will jump from ~210mn sqm in 1H19 to ~500mn sqm upon completion of the transaction; in particular, its public properties operation will expand substantially since such projects account for ~50% of CMIG's managed GFA. A-Living will also become the largest HK-listed PMC by GFA post-acquisition.

Risk Factors

- **Developers:**

1) Slowing contracted sales performance due to moderating economic growth; 2) Weakening property demand in lower tier cities due to the scale-back of shantytown development; 3) FX risks due to currency volatility amid Sino-US trade dispute

- **PMCs:**

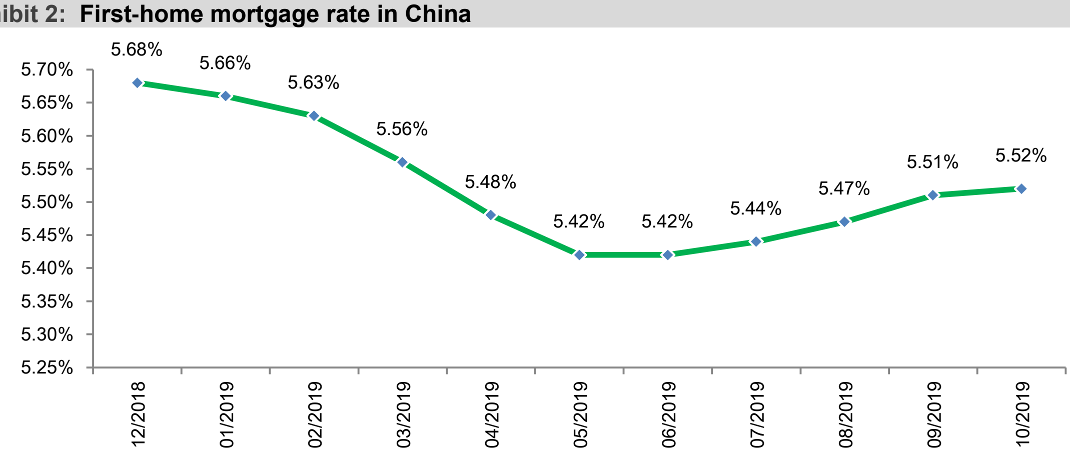
1) Substantial related-party transactions between PMC subsidiaries and parent developers; 2) Reliance on shareholders for new projects for non-independent PMCs; 3) Potential margin erosion caused by M&A; 4) Increasing number of PMC stocks may bring down sector valuation.

Exhibit 1: 10M19 presales of major listed developers

			10M19						2019	% Achieved
		Stock code	Amount RMBbn	YoY %	GFA 000 sqm	YoY %	ASP RMB/sqm	YoY %	Target RMBbn	
1	Shimao	813 HK	197.2	45%	10,995	33%	17,939	9%	210	93.9%
2	Yuzhou	1628 HK	58.2	45%	3,925	50%	14,821	-4%	67	86.8%
3	Greentown	3900 HK	98.6	38%	3,800	30%	25,947	6%	139	70.7%
4	Jinmao	817 HK	136.0	32%	6,166	73%	22,057	-23%	150	90.7%
5	CIFI	884 HK	155.8	32%	9,309	25%	16,734	5%	190	82.0%
6	Logan	3380 HK	78.8	32%	5,801	74%	13,575	-24%	85	92.6%
7	Aoyuan	3883 HK	88.6	31%	8,797	37%	10,074	-4%	114	77.7%
8	KWG	1813 HK	68.3	29%	3,949	28%	17,290	1%	85	80.3%
9	Agile	3383 HK	99.7	27%	7,415	22%	13,442	4%	113	88.2%
10	COLI*	688 HK	318.4	27%	15,261	12%	20,864	13%	350	91.0%
11	Beijing Capital	2868 HK	60.7	26%	2,450	27%	24,771	-1%	80	75.9%
12	Times	1233 HK	59.4	25%	3,992	39%	14,880	-11%	75	79.2%
13	Sino-Ocean	3377 HK	101.3	23%	5,001	31%	20,247	-6%	140	72.3%
14	Longfor	960 HK	201.6	23%	11,917	18%	16,919	4%	220	91.6%
15	Yuexiu	123 HK	52.5	20%	2,439	18%	21,518	1%	68	77.2%
16	Sunac	1918 HK	433.9	17%	29,707	23%	14,607	-5%	550	78.9%
17	R&F	2777 HK	106.6	11%	9,931	35%	10,738	-18%	160	66.7%
18	Evergrande	3333 HK	543.5	8%	52,466	10%	10,359	-2%	600	90.6%
19	Vanke	2202 HK	519.0	7%	33,330	3%	15,571	4%	na	na
20	Country garden	2007 HK	632.3	3%	70,251	8%	9,000	-4%	na	na

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

Exhibit 2: First-home mortgage rate in China



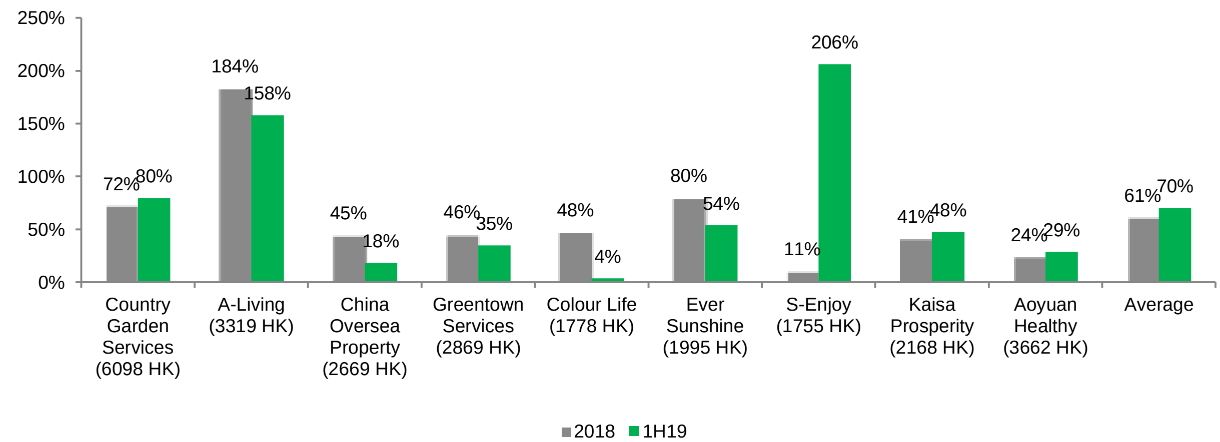
Source(s): Rong360, ABCI Securities

Exhibit 3: Recent HK IPOs of China PMCs

Listing date	Company	Stock code	IPO proceeds HK$mn	IPO price HK$	Current price HK$	Performance since listing	Performance 1st day
Oct 11, 2019	Xinyuan Property Management Service	1895	145	2.08	1.71	-18%	42%
Nov 6, 2019	Yincheng Life Service	1922	260	2.18	2.09	-4%	16%

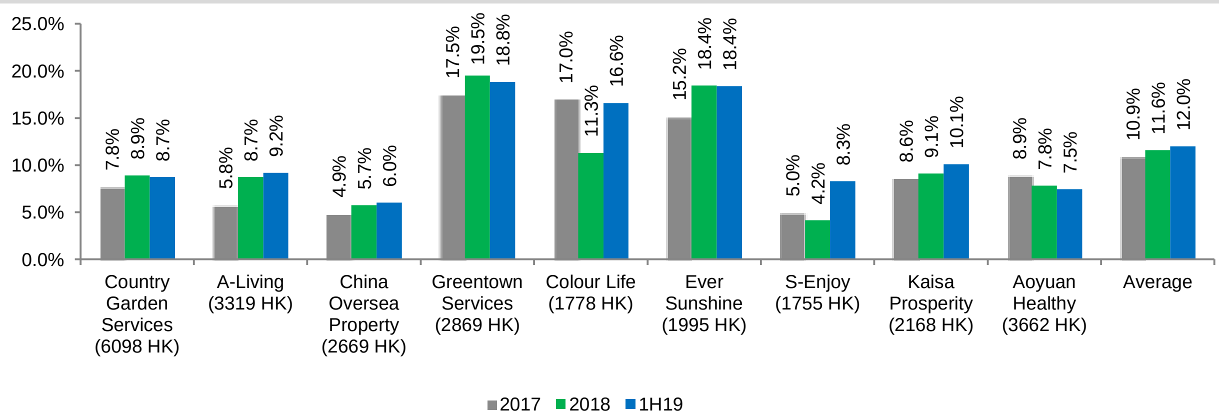
* Data as of Nov 29, 2019
Source(s): HKEx, ABCI Securities

Exhibit 4: Community VAS revenue- YoY growth



Source(s): Companies, ABCI Securities

Exhibit 5: Community VAS as a percentage of total revenue



Source(s): Companies, ABCI Securities

Exhibit 6: Valuation of sector top picks (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
A-Living	3319 HK	BUY*	19.1	--	26.9	19.2	5.0	4.4	1.5	2.1
Aoyuan	3883 HK	BUY	14.1	26%	7.7	4.8	2.0	1.5	3.9	6.2

*BUY rating is based on previous report on Aug 12, 2019
Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Alternative Energy Sector – Nuclear power in expansion phase
Kelvin Ng

Key Data	
Avg. 20E P/E (x)	6.5
Avg. 20E P/B(x)	0.7
Avg. 20E div yield (%)	3.1

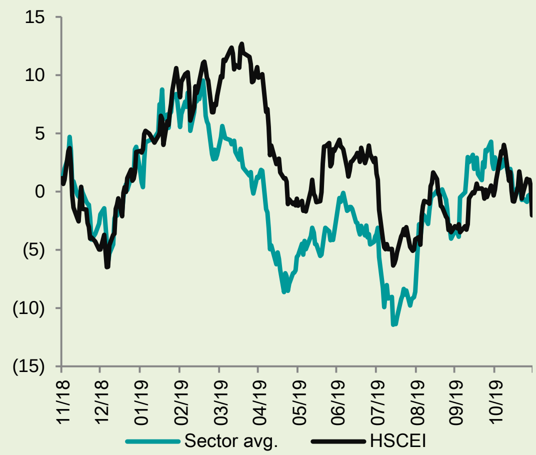
Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSCEI)	Absolute (%)	Relative (%)
1-mth	(2.7)	(1.1)
3-mth	8.5	6.3
6-mth	4.9	5.7

Source(s):Bloomberg, ABCI Securities

- Nuclear power is an ideal substitute for coal-fired power in China
- Contribution of nuclear power in total nationwide power output remains low; therefore, we expect such output to expand at 14% CAGR in 2018-20E.
- Subsidy-free policy would favor low-cost SOE in wind power industry; new tender requirement prefers sizable operators.
- We are positive on **CGN Power (1816 HK/003816 CH)** is based on its leading market position in China's nuclear power market and its high exposure in Guangdong province. **Longyuan Power (916 HK)** is our top pick for the wind power sector given its largest operating size in China and SOE background.

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Nuclear power

An ideal alternative energy source to coal-fired power in China. Nuclear power is an ideal alternative to coal-fired power due to its 1) high utilization hour; 2) low production cost, 3) clean nature with no greenhouse gas being emitted in power generation. In developed countries, nuclear power accounted for ~31% of total power output in 2018; for countries such as France, the figure neared 75%. In China, the unit production cost for nuclear power is ~RMB 0.307/kWh, lower than coal-fired power's RMB0.32/kWh. Unlike other alternative energy sources, the low cost of nuclear power means the industry does not require subsidy.

Contribution remains low in overall energy structure. We believe China's switch to alternative (e.g. wind, solar, and nuclear) will continue. Nuclear power accounted for only 4.2% of China's overall power output in 2018, far below the average of ~31% among developed countries. We believe more nuclear power plants will be constructed.

Nationwide output stayed strong in 10M19. According to China Electricity Council (CEC), nuclear power output reached 28.8bn kWh in Oct 2019, up 5.4% YoY. For 10M19, the figure was 282.6bn kWh, up 19.3%YoY. Nuclear power output was ascending at 15.6% CAGR in 2008-18. We expect the momentum to strengthen based on China's continuous shift to cleaner energy sources.

Capacity and power output would expand at 14% CAGR in 2018-20E. We believe China's nuclear power capacity would continue to expand swiftly due to its low contribution to the overall power output. According to China's "Strategic Action Plan of Energy Development (2014-20)" (The Plan) announced in June 2014, the government targets a nuclear power capacity of 58GW in 2020, representing a 30% jump from 2018 or a 2-year CAGR of 14% from 45GW. Driven by capacity growth, nuclear power output would continue to go up. Together with the high utilization hour (usually ~ 7,000hrs; much higher than 5,000hrs for coal-fired, 2,000hrs for wind and

1,500hrs for solar) and priority dispatch to the power grid, we believe nuclear power output would expand at 14% CAGR in 2018-20E.

Wind power

Subsidy-free policy would favor low-cost SOEs. As expected, China will cancel the tariffs paid to for wind and solar power operators. NDRC announced in May 2019 that the government will no longer subsidize onshore wind and solar power facilities approved before end-2018 but remain unfinished by end-2020; no subsidy will be made to onshore wind power facilities approved between Jan 1, 2019 and end-2020 but remain unfinished by end-2021. Starting from Jan 1, 2021, no subsidy will be provided to newly approved onshore wind power facilities. As the subsidy-free era nears, it becomes crucial for wind power operators to shore up competiveness.

New tender requirements favor sizable operators. The National Energy Administration (NEA) announced that the government will only select qualified wind power operators as candidates for project bidding in the future. The guidelines for applicant selection include 1)business capability; 2)equipment advancement; 3)technical solutions; 4)preliminary research; 5)dispatched capability; 6) assessment of the applied tariff of applicants. In our opinion, the new policy issued shows strong preference for sizable and experienced enterprises in the wind power generation industry; hence, we advise investors to stay with the sizable SOE players.

Uptrend in wind power output continued in 10M19. According to CEC, China's wind power output was 33.5 bn kWh in Oct 2019, up 16.9%YoY. For 10M19, wind power output was 325.0 bn kWh, up 9.7%YoY. Wind power output rose at 39.5% CAGR in 2008-18. The uptrend is likely to extend.

Capacity would expand at 12% CAGR in 2018-20E. According to the "13th Five-Year Plan for Renewable Energy" issued by National Development and Reform Commission (NDRC) in Dec 2016, the Chinese government targets to attain no less than 210GW wind power capacity by end-2020, a 14% jump from 184GW level by end-2018, or 7% CAGR in 2018-20E - a highly achievable goal in our view. Given NDRC would cancel the subsidy for facilities completed after 2020, we believe the national wind power capacity would increase in 2019 and 2020 as operators expedite their construction pace. We estimate wind power capacity in China would reach 231GW by end-2020 (12% CAGR in 2018-20E).

Power output would grow at 8% CAGR in 2018-20E. We believe wind power output in China would only be 429bn kWh by end-2020E, representing an 8% CAGR in 2018-20E, because 1) Sino-US trade friction would hamper industrial activities in 2019-20 and drag down the overall power demand. 2) China is switching from energy-intensive secondary industry to tertiary one consuming less fuel. This change in economic structure would slow down growth in power demand.

Long-term Outlook

Nuclear power: Low cost of nuclear power that requires no subsidy is an ideal substitute for coal-fired power in China. We believe the development of nuclear power (both by capacity and output) would remain strong in the next decade.

Wind power: Subsidy-free policy would reduce the number of wind power operators since the less competitive ones would be ousted. We believe rapid growth in the wind power industry will not sustain; the sector is now entering a steady phase marked by lower growth and reduced production cost. Low-cost SOEs would gradually dominate the market.

Short-term Outlook

Nuclear power operators: Public concern on safety issue would be the key risk. Nuclear and radiation incidents would result in public panic and defer development pace.

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

Stock Recommendations

■ **Nuclear power operators:**

CGN Power-H (1816 HK) is our top pick. China's nuclear power industry would experience robust growth in the next decade as a market leader with the highest installed capacity in China (~60% of total capacity in China). In addition, around 65% of CGN's existing operating capacity is located in Guangdong province, one of the most economically vibrant regions in China. Prime facility locations usually guarantee higher utilization hours and better cash flow.

■ **Wind power operators:**

Longyuan power (916 HK) is our top pick. We believe the company would outperform in the forthcoming subsidy-free era due to 1) its higher overall tariff among peers (2018: RMB 0.482/kWh vs. RMB 0.462/kWh for Huaneng Renewables [958 HK] and Datang Renewable [1798 HK]); 2) its lowest net gearing ratio among peers; 3) high utilization hours

Risk Factors

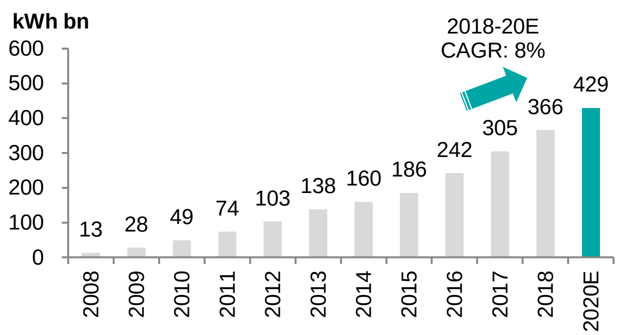
■ **Nuclear power operators:**

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

■ **Wind power operators:**

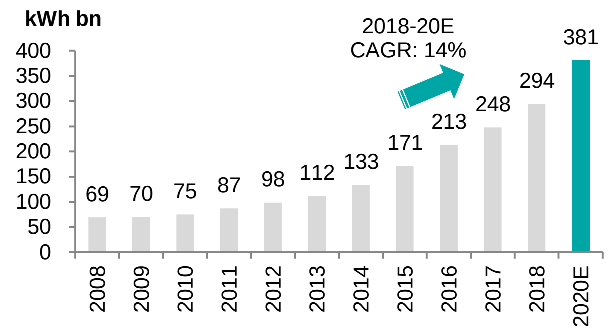
1) Power curtailment risk; 2) Wind resources risk; 3) Tariff risk; 4) Construction risks; 5) Fundraising risk 6) Government policy to deleverage may constrain growth

Exhibit 1: China's wind power output outlook



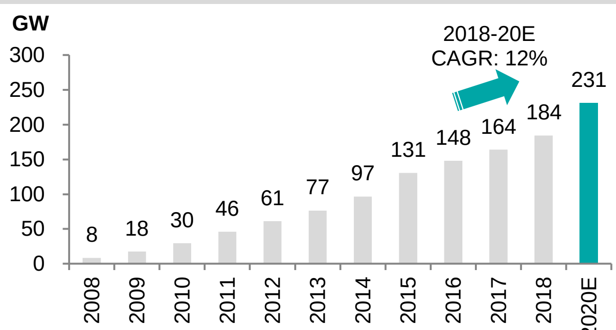
Source(s): NEA, CEC, ABCI Securities estimates

Exhibit 2: China's nuclear power output outlook



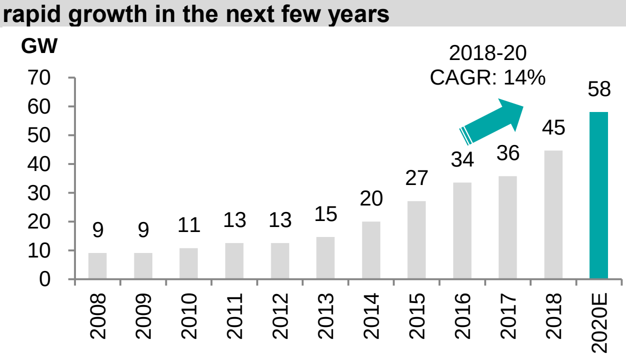
Source(s): NEA , CEC, ABCI Securities estimates

Exhibit 3: China's wind power capacity outlook



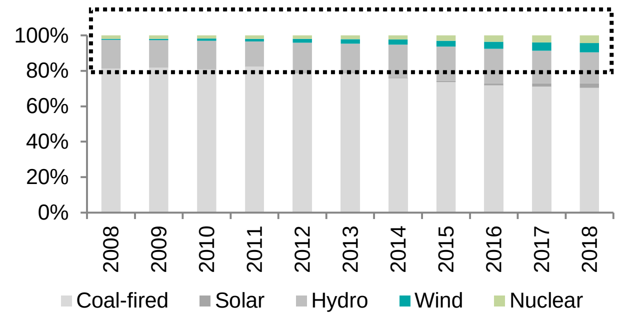
Source(s): NEA , CEC, ABCI Securities estimates

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



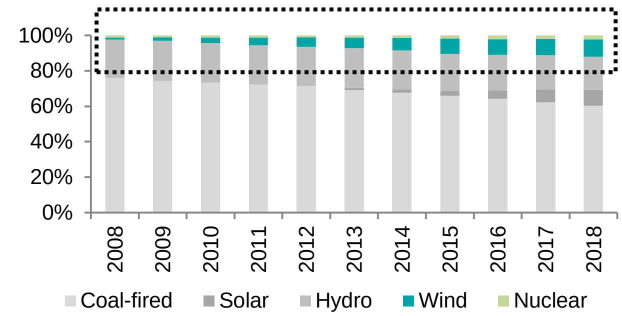
Source(s): NEA estimates, CEC, ABCI Securities

Exhibit 5: Contributions of wind and nuclear power will increase in China (by power output)



Source(s): NEA, CEC, ABCI Securities

Exhibit 6: Rising contributions of wind and nuclear power in China (by power capacity)



Source(s): NEA, CEC, ABCI Securities

Exhibit 7: Valuation of sector top picks (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
CGN Power-H	1816 HK	BUY	2.45	25.0	9.3	8.5	1.0	0.9	3.8	4.1
Longyuan	916 HK	BUY	5.30	25.0	6.8	6.4	0.6	0.6	2.9	3.1

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

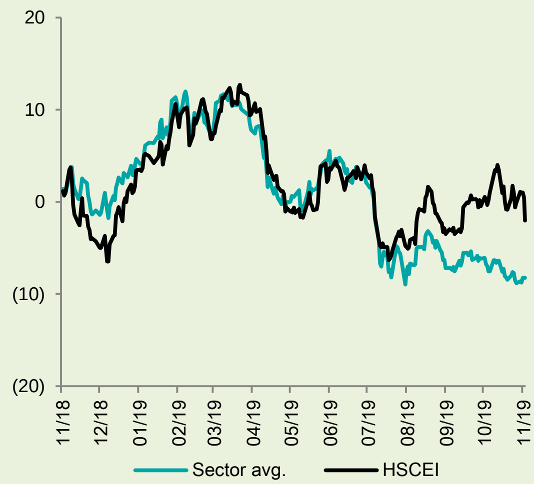
China Environmental Protection Sector – Future is burning bright for incinerators

Kelvin Ng

Key Data		Sector Performance (relative to HSCEI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	6.2	1-mth	(1.4)	0.3
Avg. 20E P/B(x)	1.0	3-mth	(1.7)	(3.8)
Avg. 20E div yield (%)	4.9	6-mth	(8.9)	(8.1)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Solid waste produced per capita maintains an uptrend on increasing O2O activities; 0.5% CAGR during 2017-20E is expected
- Average penetration rate in urban area remains low for incineration, waste incinerated volume is likely to grow at 19% CAGR in 2017-20E
- Nationwide wastewater treatment volume would increase at 5% CAGR in 2017-20E since current penetration has already reached 94%
- Future development of wastewater operators would expand via acquisition
- **China Everbright Int'l (257 HK)** is our preferred pick in incineration sector for its leading position in a growing industry

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Incineration

Solid waste produced per capita maintains an uptrend on increasing O2O activities; 0.5% CAGR in 2017-20E is expected. China's solid waste produced per capita was trending down in 2003-13 from 1.44kg/day to 1.11kg/day, representing -2.6% CAGR during the period. The figure rebounded to 1.20kg/day by end-2016, equivalent to 1.9% CAGR during the period. We believe such increase was driven by growing online-to-offline (O2O) activities in China. According to iResearch data, O2O sales in China rose from RMB 1.9tr in 2013 to RMB 6.3tr in 2017, indicating a 35% CAGR in 2013-17. We believe O2O shopping would drive up solid waste produced in urban area due to the disposal of packaging materials, and expect solid waste produced per capita to expand at 0.5% CAGR in 2017-20E.

Average penetration for inland provinces is low at 28%, suggesting ample room for growth. According to Ministry of Housing and Urban-Rural Development (MOHURD), incineration treatment rate in China is low, especially in inland provinces. In 2017, 70% of residential solid waste in Jiangsu province was treated via incineration; meanwhile, incineration rate in six provinces (Zhejiang, Anhui, Fujian, Shandong, Yunnan, and Hainan) was between 50%-70%, while 14 provinces had an incineration rate below 30%. Average penetration rate of incineration facilities in coastal provinces was higher than that of inland provinces (49% vs. 28%), suggesting opportunities in the latter.

2017-2020E outlook: urban waste incinerated would increase at 19% CAGR. We believe increasing urbanization, rising solid waste produced per capita, and the government's ambitious target on increasing the use of incineration in urban areas would drive up the amount of solid waste incinerated in the next few years. NDRC estimates urbanization to reach 60% by end-2020E, meaning that an additional of 57mn people would take up residence in urban areas. Solid waste produced per capita would increase at 0.5% CAGR in 2017-20E due to robust O2O activities in China. The government is targeting to have 50% of urban solid waste incinerated by end-

2020. We expect urban waste incinerated would jump from 93mn tons in 2017 to 159mn tons in 2020E, suggesting a 70% leap or a 3-year CAGR of 19%.

Wastewater

China's urban wastewater treatment rate reached 94% by end-2017 and would reach 95% by end-2020E. According to MOHURD, as of end-2017, urban wastewater treatment rate reached 94%, close to China's end-2020 target of 95%. Given the current run rate in urban areas, this target is likely to be reached.

Urban wastewater produced per capita would grow at 0.7% CAGR in 2017-20E. Rising living standard would increase wastewater produced. According to MOHURD, China's urban wastewater produced per capita increased from $85m^3$/ppl/yr in 2007 to $91m^3$/ppl/yr in 2017, up 7% (or 0.7% CAGR) during the period. We believe the uptrend will persist with the rise in hygiene awareness: Wastewater produced per capita would expand at 0.7% CAGR in 2017-20E.

Urban wastewater treatment volume to grow at 5% CAGR in 2017-20E. We believe 1) rising urbanization means more citizens would reside in urban areas, hence raising demand for wastewater treatment service; 2) rising living standard would boost wastewater produced per capita. Current penetration rate of wastewater treatment facilities is over 90%, suggesting future growth would be driven by newcomers to the cities (4% CAGR in 2017-20E) and increase in urban wastewater produced per capita (0.7% CAGR in 2017-20E). We therefore expect China's wastewater treatment volume to increase at 5% CAGR in 2017-20E.

High penetration rate at 94% suggests further development via acquisition. In 2017, urban wastewater treatment rate reached 94% except for the province Qinghai, whose treatment rate was below 80%. In China, 19 provinces recorded a treatment rate of 80%-95% and 11 provinces exceeded 95%. Unlike incineration, penetration rates of wastewater treatment facilities in both coastal and urban provinces are high (94% and 93%). High penetration rate means wastewater treatment operators would expand through acquisition or entering the less explored rural markets.

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

Long-term Outlook

Incineration: China's current low penetration rate in incineration (2017: 34%) would leave the industry with ample room to grow since the government is targeting to have 50% of solid waste incinerated in the long run. Low penetration rate in inland province presents opportunities for operators.

Wastewater treatment: Penetration rate of urban wastewater treatment facilities is high (2017: 94%). Since greenfield projects are rare, operators would opt to expand their operation scale through acquisition. We believe large and profitable players would dominate the market with their prime assets and higher acquisition capability.

Short-term Outlook

Incineration operators would report a solid double-digit earnings growth in the 2019E/20E. Skillful CAPEX planning would be required amid the high borrowing cost in China. For wastewater treatment operators, we believe they will focus more on BOT (Build-Operate-Transfer) projects for the stronger cash flow. Significant increase in EPC (Engineering, procurement and construction) projects is unlikely on slowdown in PPP (Public-Private Partnership).

Stock Recommendations:

China Everbright Int'l (257 HK) is our preferred pick in incineration sector for its leading position in a growing industry.

Risk Factors

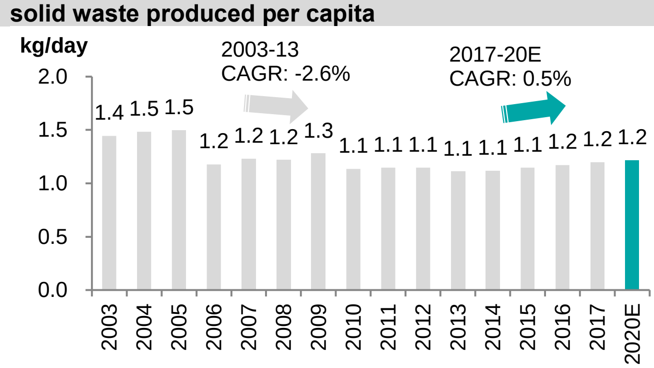
■ **Incineration operators:**

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:**

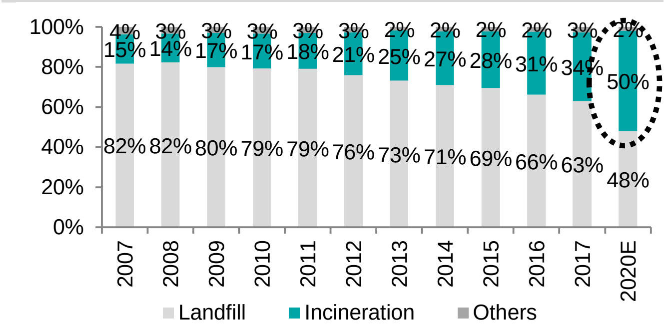
1).Slower-than-expected capacity growth; 2).Default risk; 3).Policy risk; 4).High net gearing ratio; 5).Negative cash flow.

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



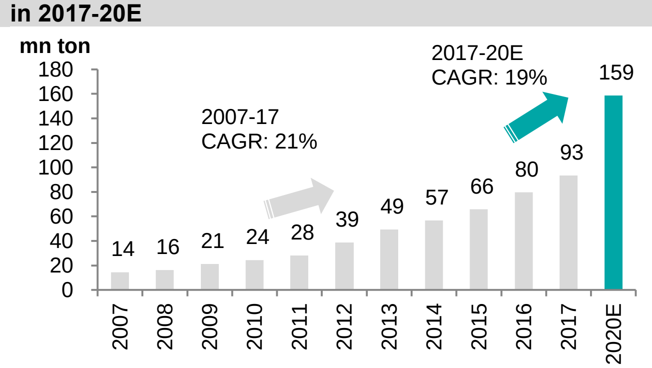
Source(s): MOHURD, ABCI Securities estimates

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



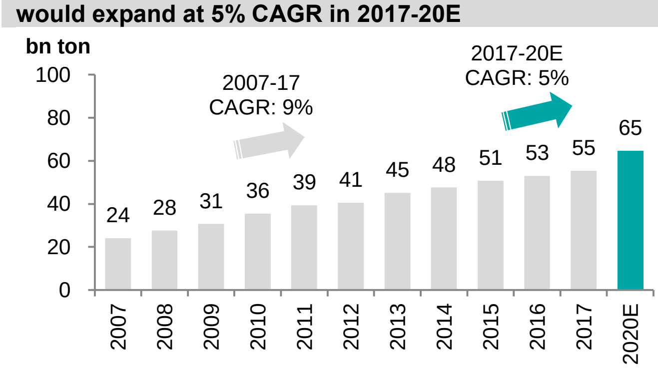
Source(s): NDRC estimates, ABCI Securities

Exhibit 3: Waste incinerated in urban areas would rise in 2017-20E



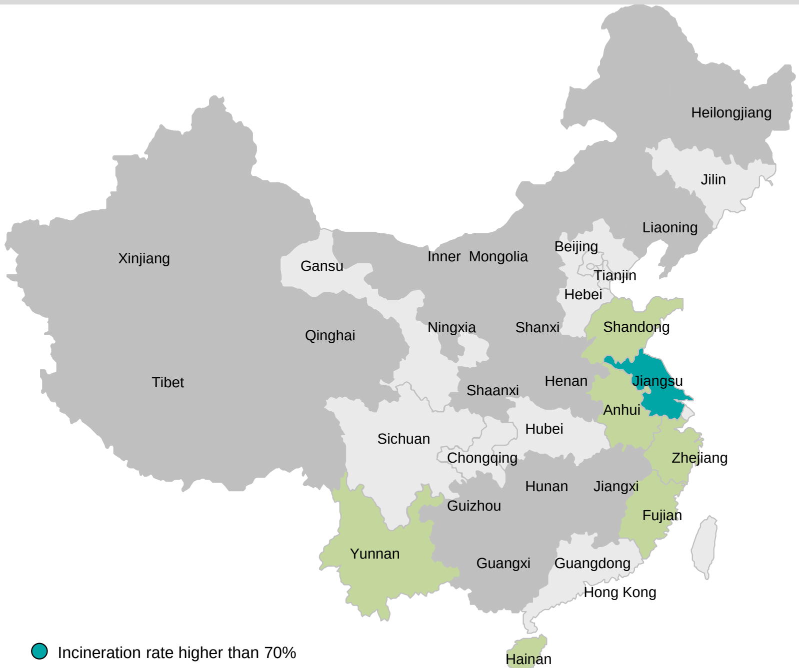
Source(s): MOHURD, NDRC, ABCI Securities estimates

Exhibit 4: Nationwide wastewater treatment volume would expand at 5% CAGR in 2017-20E



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

Exhibit 5: Penetration rate of incineration in China remains low (2017 data)



- Incineration rate higher than 70%
- Incineration rate between 50%-70%
- Incineration rate between 30%-50%
- Incineration rate lower than 30%

Source(s): MOHURD, ABCI Securities

Exhibit 6: Penetration rate of wastewater treatment in China is high (2017 data)

- Wastewater treatment rate higher than 95%
- Wastewater treatment rate between 80%-95%
- Wastewater treatment rate between 50%-80%
- Wastewater treatment rate lower than 50%

Source(s): MOHURD, ABCI Securities

Exhibit 7: Valuation of sector top pick (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
CEI	257	BUY	7.50	26.7	7.1	6.2	1.0	0.8	4.2	4.9

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Securities & Brokerage Sector – Healthy fundamentals with reasonable valuation
Steve Chow

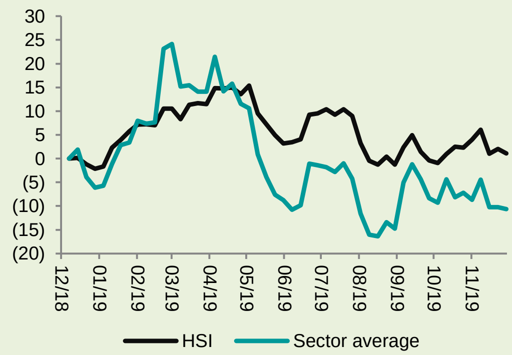
Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	8.7	1-mth	0.2	2.9
Avg. 20E P/B(x)	0.6	3-mth	1.5	(1.8)
Avg. 20E div yield (%)	4.2	6-mth	(7.6)	(5.7)

Source(s):Bloomberg, ABCI Securities estimates

Source(s):Bloomberg, ABCI Securities

- Operating environment may continue to improve in the near term
- We believe the market fundamental is healthy while policy outlook remains mixed
- We like **CSC-H (6066 HK)** and **SWHY-H (6806 HK)** for their high ROAE in recent years

1-year sector performance



Source(s):Bloomberg, ABCI Securities

Operating environment improves. According to SAC, industry revenue and net profit was up 38% and 88% YoY growth in 9M19. Annualized industry ROAE increased to 6.4% in 9M19 from 3.6% in 2018. Overall, A-share monthly average ADT improved significantly from RMB 393bn in 9M18 to RMB 562bn in 9M19, supporting the industry's commission income. In addition, the SHCOMP index rose 17.6% YTD in 9M19 vs. the 14.7% YTD decline in 9M18, boosting the industry's investment income. Margin financing and securities lending (MFSL) balance, on the other hand, increased from ~RMB 0.76tr at end-2018 to ~RMB 0.96tr at end-Sep 2019. In our view, market sentiment would continue to improve in the near term.

Market condition is healthy. We believe the current market condition is healthy. E.g., A-share total market cap/M1 ratio is at 0.7x, largely in line with the historical average of 0.8x, and significantly lower than the peak level of 1.3x during the bull market in 2015. In addition, MFSL balance currently accounts for 2.4% of total A-share market cap, significantly lower than the peak at ~5% in 2015, indicating a reasonable leverage level in A-share market.

Policy environment is mixed. In our view, the recent launch of "technology innovation board" reveals the government's support for the new-economy sector; it would bode well for brokers' investment banking business in the next few years. Meanwhile, the new rule allowing foreign brokerage firms to own a majority stake in Chinese brokerage firms by Dec 2020 may hint at intensified competition in the future.

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

Commitment on industry reform. We believe the Chinese government is committed to industry reform over the long run. China will increase the contribution of direct financing in the economy through the development of a diverse, multi-layered capital market while promoting 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 14% of the aggregate financing in the economy in 9M19 vs. 50% in US (2015), implying strong potential for further development.

Industry outlook. We expect average A-share ADT to increase by 15% YoY in 2020E to RMB 613bn. We also expect MFSL balance to rise by 15% YoY in 2020E.

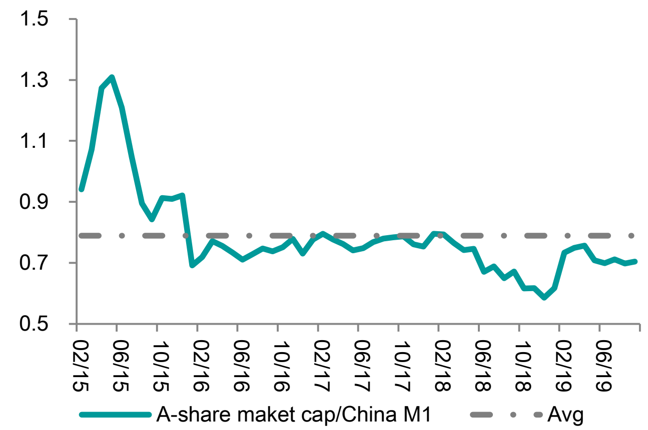
Stock Recommendations

Among our covered brokerage stocks, we like **CSC-H (6066 HK)** and **SWHY-H (6806 HK)** for their high ROAE across the market cycle and reasonable valuations.

Risk Factors

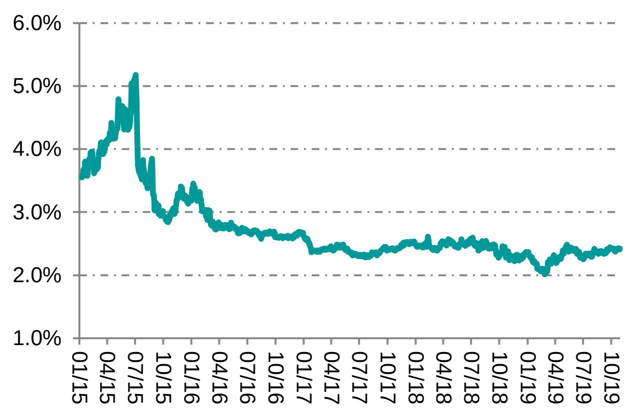
1) Market risk of financial assets; (2) Credit risk associated with bond investments and lending business; (3) Volatility in market turnover; (4) Penalties on misconduct or staff malpractice in securities firms; (5) Regulatory changes in direct financing; (6) Spill-over impact from deleveraging in the financial sector; (7) Intensifying competition after the relaxation of foreign ownership in the industry; (8) Intensifying competition between banks and securities companies in direct financing business.

Exhibit 1: A-share market cap/China M1



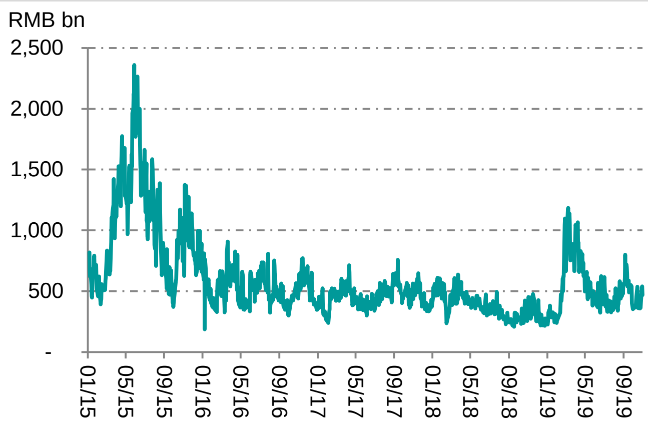
Source(s): Bloomberg, ABCI Securities

Exhibit 2: MFSL balance/A-share market cap



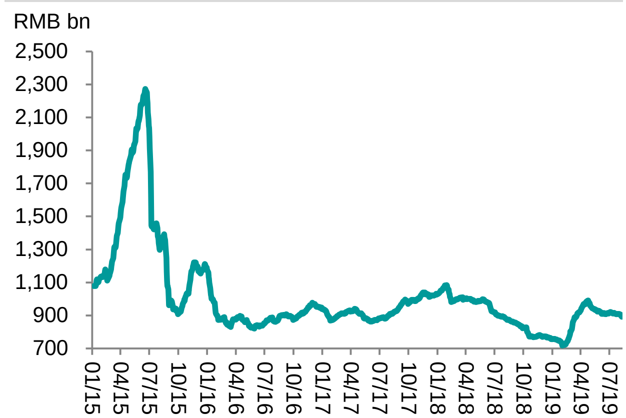
Source(s): Bloomberg, ABCI Securities

Exhibit 3: A-share ADT



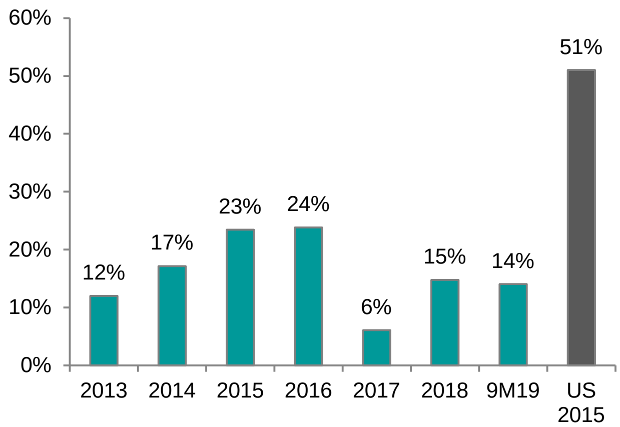
Source(s): Bloomberg, ABCI Securities

Exhibit 4: MFSL Balance



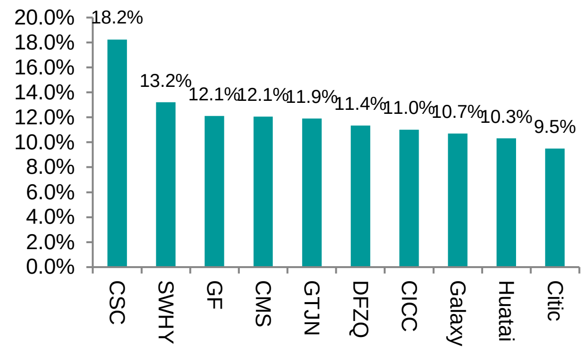
Source(s): Bloomberg, ABCI Securities

Exhibit 5: Direct financing/total social financing in China



Source(s): PBOC, ABCI Securities

Exhibit 6: ROAE (2014-18 average)



CSC (6066 HK), SWHY (6806 HK), GF (1776 HK), CMS (6099 HK), GTJN (2611 HK), DFZQ (3958 HK), CICC (3908 HK), Galaxy (6881 HK), Huatai (6886 HK), CITIC (6030 HK)
Source(s): Companies, ABCI Securities

Exhibit 7: Valuation of sector top picks (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
CSC-H	6066 HK	BUY	7.0	30.1	8.3	7.3	0.8	0.8	3.7	3.7
SWHY-H	6806 HK	BUY	3.0	40.8	7.3	6.0	0.6	0.6	3.4	4.1

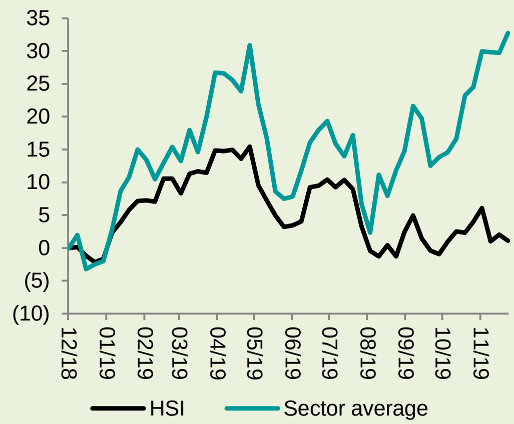
Source(s): Bloomberg, ABCI estimates

NEUTRAL
Internet Media and Consumer Commerce – Diverging trends in sub-segments
Steve Chow

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	27.4	1-mth	7.9	10.6
Avg. 20E P/B(x)	4.1	3-mth	16.8	13.5
Avg. 20E div yield (%)	0.3	6-mth	27.4	29.3
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Diverging trends among sub-segments amid intensified competition in online advertising and stabilizing situation in online gaming
- Online sales growth shows resilience despite weakened macro environment.
- **Tencent (700 HK)** is lacking near-term positive catalyst

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 trended up in recent quarters, reaching 58 in 3Q19 vs. 34 in 3Q17. On the other hand, the average daily time spent on mobile apps per mobile user has remained largely stable at 4.5-5.0 hours in recent quarters. In our view, this implies competition on users' time spent among mobile apps has intensified, with internet platforms finding it more challenging to maintain user stickiness.

The rise of short video poses threat to other forms of online entertainment. According to QuestMobile, mobile users have increased their share of time spent on short video from 3.6% in Sep 2017 to 13.3% in Sep 2019. In our view, this could inevitably reduce the share of users' time spent on other forms of online entertainment such as instant messaging, long video, and online gaming.

Online gaming –stabilizing but headwinds remain. According to QuestMobile, mobile users reduced their share of time spent on online game from 9.3% in Sep 2017 to 7.9% in Sep 2019. On the regulatory front, more new games have been approved by regulators in recent months, which should bode well for game developers' new game pipelines. Nonetheless, regulatory headwinds are likely to linger with the government's recent measures to further limit playing times for youngsters and children. Also, the rise of other forms of online entertainment would continue to compete for user time.

Online advertising – intensified competition amid an economic slowdown. Tencent's online advertising revenue growth has slowed significantly in recent quarters. In 3Q19, the figure was 13% YoY vs. 38% YoY in 4Q18. In our view, it indicates that online advertising segment is facing rising competition from Douyin, which has been ramping up its online advertising business in recent quarters. In addition, the online advertising market has been hit by softening economy in China as well. According to Questmobile, online advertising market growth has slowed from 29.8% in 4Q18 to 12.9% in 3Q19.

Online shopping –still resilient. Despite a softening macro outlook, China's online sales of physical goods grew 19.8% YoY in 10M19, accounting for 19.5% of total retail sales during the same period, according to NBS. On a monthly basis, online sales growth of physical goods has been largely resilient in recent months.

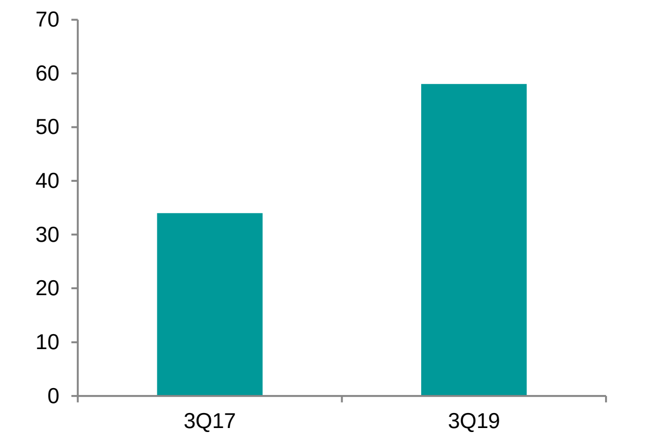
Stock Recommendations

We maintain our **HOLD** call on **Tencent (700 HK)** due to the lack of near-term positive catalyst. The company has experienced broad-based slowdown across its major segments including online gaming, online advertising, and FinTech.

Risk Factors

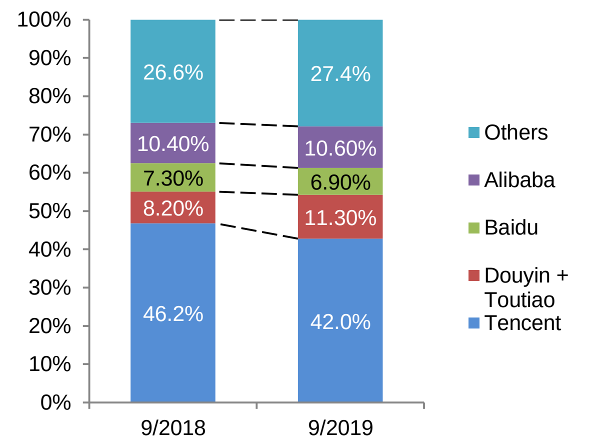
1) Tightening regulation on internet finance/mobile game/online payment; 2) Entry of foreign competitors such as Facebook and Google; 3) Slowdown in ecommerce and internet finance; 4) Lifecycle of mobile games;

Exhibit 1: No. of installed apps per mobile user



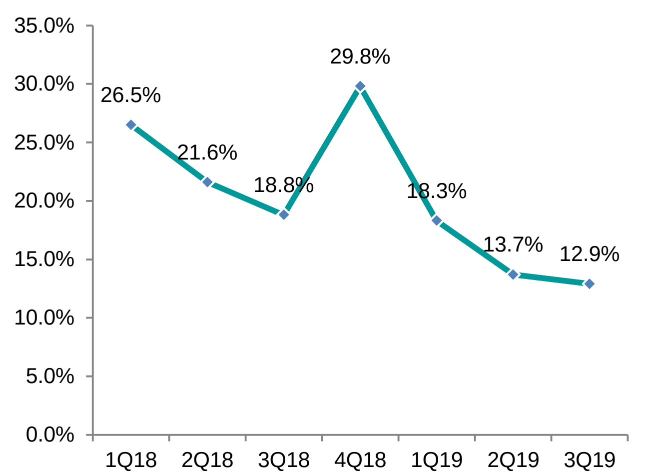
Source(s): JiGuang, ABCI Securities

Exhibit 2: Share of user time among major online platforms



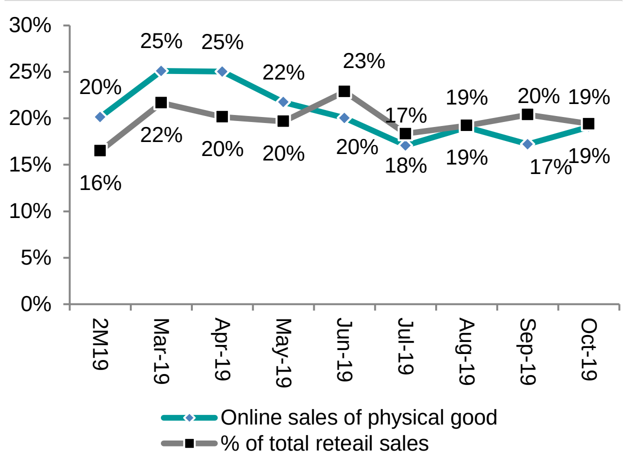
Source(s): QuestMobile, ABCI Securities

Exhibit 3: Online advertising market growth



Source(s): Questmobile, ABCI Securities

Exhibit 4: Online sales of physical goods



Source(s): NBS, ABCI Securities

OVERWEIGHT

China Consumer Goods Sector – Bracing for short-term pain

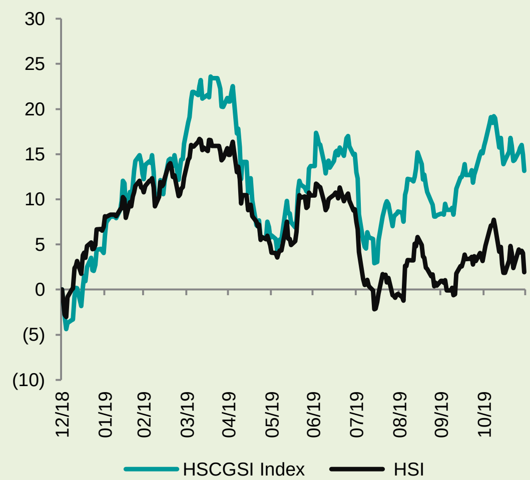
Pau Pan

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	14.9	1-mth	(2.44)	(0.36)
Avg. 20E P/B(x)	2.8	3-mth	4.13	1.71
Avg. 20E div yield (%)	2.9	6-mth	6.75	8.81

Source(s):Bloomberg, ABCI Securities estimates

Source(s):Bloomberg, ABCI Securities

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- Weak retail sales reflect the combined effects of structural and cyclical factors
- Inflation continues to rise as pork price increase has become a major contributor to the increase of CPI
- Weak economic fundamentals deter consumption growth; domestic economic growth has been trending down while externally trade environment has remained unstable
- We favor leaders in the consumer goods sector with strong domestic presence. We maintain **BUY** on **WH Group (288 HK)**, **Anta (2020 HK), Mengniu (2319 HK)**, and **Yili (600887 CH)**

Retail sales nominal growth reached 7.2% YoY in Oct. Real growth of retail sales reached 4.9% YoY in Oct. Online retail sales growth further slid to 16.4% for 10M19, lower than the 25.5% YoY growth for 10M18. We believe that weakness of the consumer sector may extend beyond 2019.

Inflation pressures on consumption. In Oct, CPI reached 3.8% YoY, according to NBS. Such rise was mainly induced by rising pork price. According to MOA, despite decline in recent weeks, the average wholesale price of pork surged 133.5% YoY in Nov, accelerating from 114.4% in Oct. The higher pork price also triggered price rise in other animal protein, such as chicken. We believe the long lead time required to replenish the hog supply and continuous impacts of the African Swine Fever (ASF) will constrain hog supply, hence keeping the pork price high. Increasing inflationary pressure would ultimately dampen consumers' willingness to spend as well as reduce purchasing power. Rising inflation would restrict the maneuvering space for the government to deploy stimulus policies.

Weakening economic fundamentals provide less support to consumption. GDP growth in 3Q19 was 6.0% YoY, representing the second consecutive quarter of decline in 2019. Other macroeconomic data also points to a broad-based weakening of the domestic economy amid a worsening external trade environment. A sustainable recovery of consumption growth is unlikely in the short to medium term. We should brace for a gradual and continuous decline in retail sales growth.

Long-term Outlook

We believe the consumer sector would benefit from the large population base, but the declining birth rate may pose challenges for the long-term outlook. In addition, consumption pattern may change with the aging population.

Short-term Outlook

Near-term challenges include rising inflationary pressure and weakening macroeconomic fundamentals. We expect hog supply to remain tight in the short to medium term, which will increase inflationary pressure till 2020 or beyond.

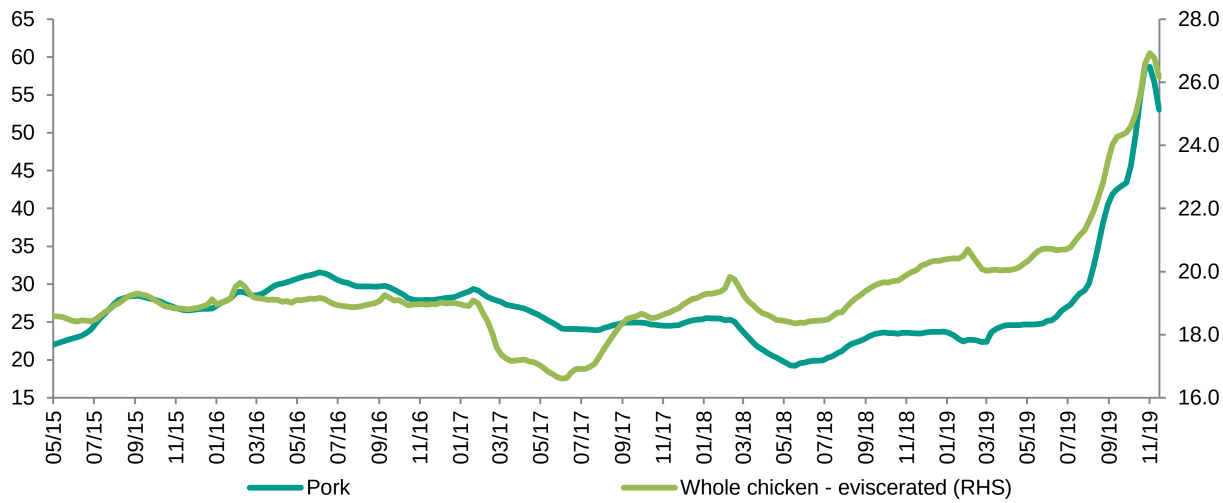
Stock Recommendations

Industry leaders in the consumer goods industry would show defensiveness amid the challenging environment. Our top picks include **WH Group (288 HK), Anta (2020 HK), Mengniu (2319 HK),** and **Yili (600887 CH)**.

Risk Factors

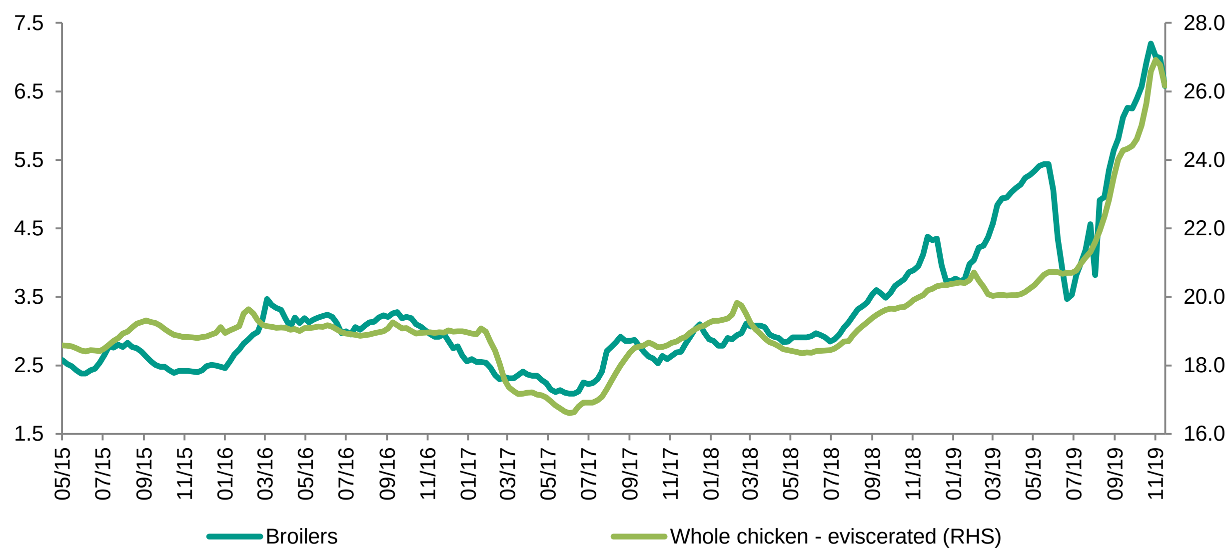
1) Macroeconomic risk; 2) Policy risk; 3) Product quality risk; 4) Commodity price risk

Exhibit 1: Weekly average wholesale price of pork (RMB/kg) and eviscerated-chicken (RMB) in China



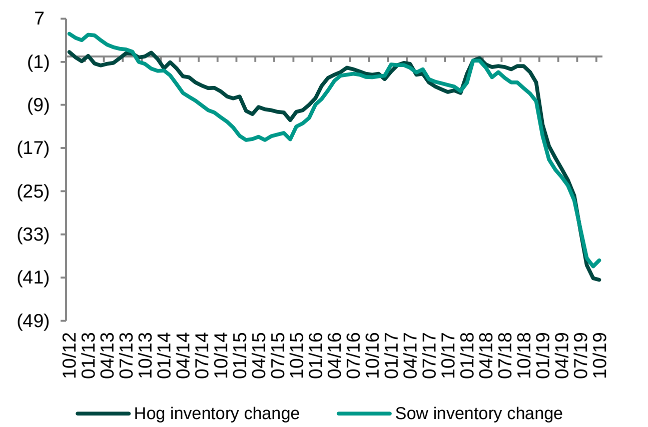
Source(s): MOA, ABCI Securities

Exhibit 2: Weekly average wholesale price of eviscerated chicken and broilers in China (RMB)



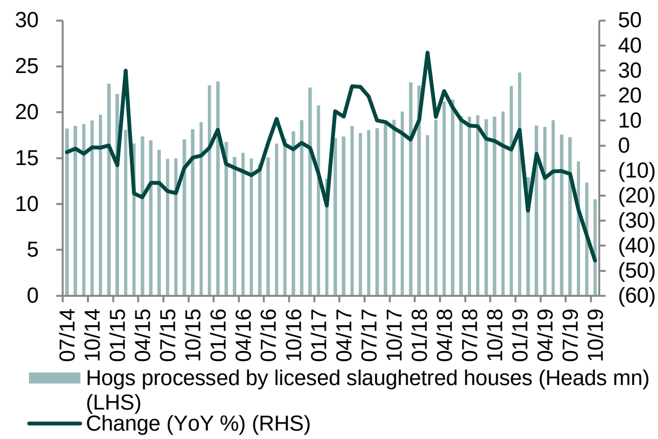
Source(s): MOA, ABCI Securities

Exhibit 3: Hog and sow inventory in China (YoY %)



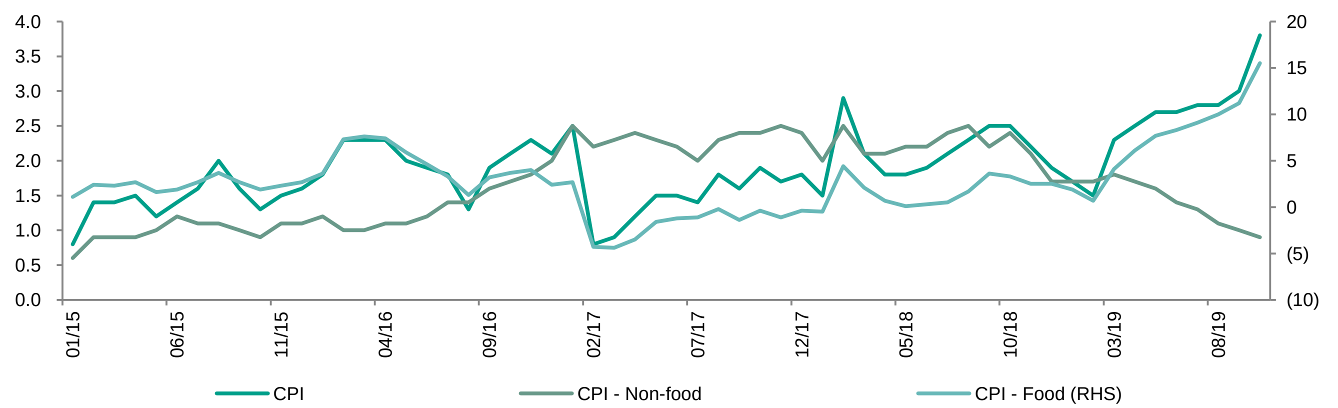
Source(s): MOA, ABCI Securities

Exhibit 4: Slaughter house output (YoY %)



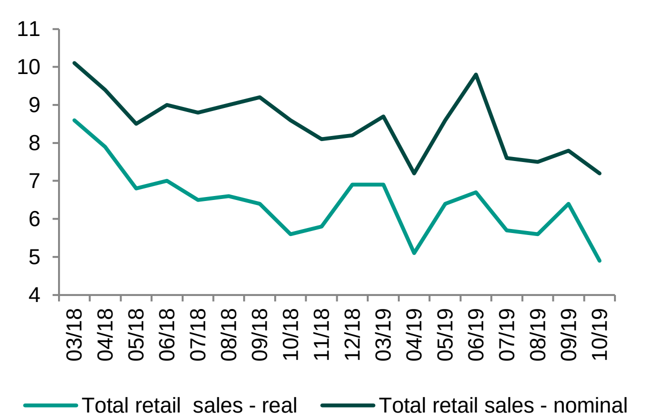
Source(s): MOA, ABCI Securities

Exhibit 5: CPI (YoY %)



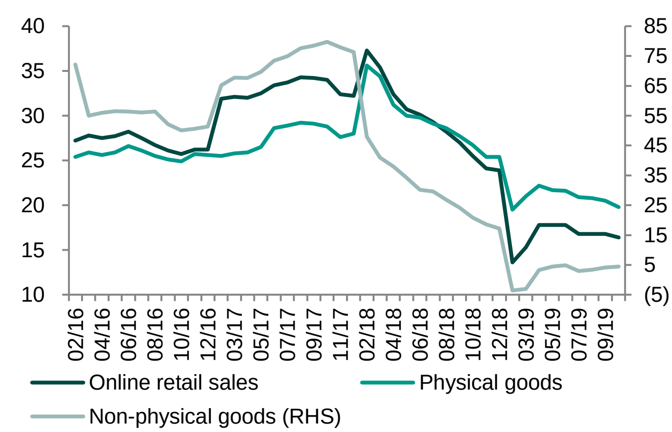
Source(s): NBS, ABCI Securities

Exhibit 6: National retail sales growth (YoY %)



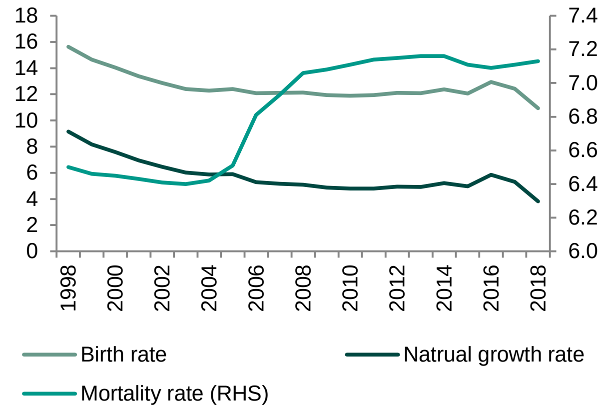
Source(s): NBS, ABCI Securities

Exhibit 7: Online retail sales (YTD YoY %)



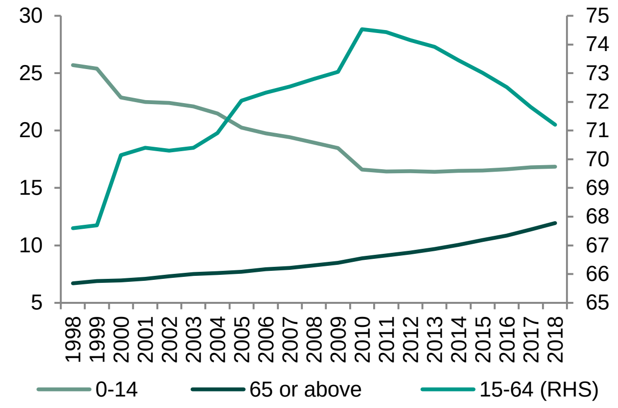
Source(s): NBS, ABCI Securities

Exhibit 8: Birth rate and population growth (‰)



Source(s): NBS, ABCI Securities

Exhibit 9: Age distribution (%)



Source(s): NBS, ABCI Securities

Exhibit 10: Valuation of sector top picks (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
WH Group	288 HK	BUY	8.8	9.45	17.32	13.51	1.93	1.72	2.12	2.75
Anta	2020 HK	BUY	74.9	1.77	33.14	21.49	9.57	7.62	1.29	1.95
Mengniu	2319 HK	BUY	34.6	15.53	33.41	25.47	4.43	3.97	0.84	1.16
Yili	600887 CH	BUY	RMB 34.9	19.97	31.16	29.58	7.26	6.20	2.06	3.96

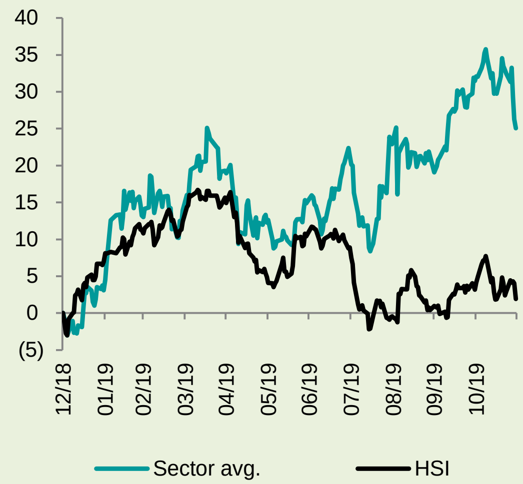
Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Education Sector – Policy to determine sentiment
Paul Pan

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	11.3	1-mth	(5.3)	(3.2)
Avg. 20E P/B(x)	2.1	3-mth	1.8	(0.7)
Avg. 20E div yield (%)	2.9	6-mth	11.0	13.1
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Policy environment remains uncertain due to the pending release of the finalized version of the Private Education Law; several policies were released this year to support development in vocational and online education
- Investment sentiment in subsectors differs on relevant policies enacted
- Valuation of market leaders continues to be higher
- Industry leaders remain attractive; recommend **BUY** on **CEG (839 HK)** and **Wisdom Edu (6068 HK)**

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Policy environment remains uncertain. The education sector continues to face policy uncertainties, since the finalized version of the Regulations on the Implementation of the Law on Promoting Private Education in PRC (Private Education Law) has yet to be released. In its current draft, limitations on acquisitions of non-profit schools are proposed. Several major policies benefiting the development of certain education subsectors have been announced since the beginning of 2019. The government has stated in the Government Work Report released in Mar 2019 that the targeted additional student enrollment in the vocational education should increase by 1mn; new complementary policies to boost the development of online education were also devised.

Sentiment in different subsectors varies on policies and fundamentals. Currently, higher education and informal education subsectors are facing fewer restrictions than the K-12. We believe differences in policy condition have led to variation in valuation and share price performance. In addition, growth pattern of the subsectors varies; while the limitations in formal education is much more pronounced due to regulatory requirements, the informal education is able to deliver more growth based on its business model.

Market leaders maintain a valuation premium. Even in subsectors favored by investors, not all companies are valued the same. Market leaders are able to maintain a valuation premium due to their size and track record. In addition, the players with geographical advantages generally attain a higher valuation.

Long-term Outlook
The growth prospect of the education industry is still attractive on ample growth opportunities spurred by industry consolidation and untapped market opportunities. Declining birth rate, however, would be a major risk affecting the industry's prospect.

Short-term Outlook
In the short term, we believe that the policy condition in the fundamental education segment would continue to tighten and the higher education segment would receive more supportive measures from the government. In

addition, we expect the government will soon release the final draft of private education law, which would finally clarify the regulatory guidelines for different subsectors in the education industry.

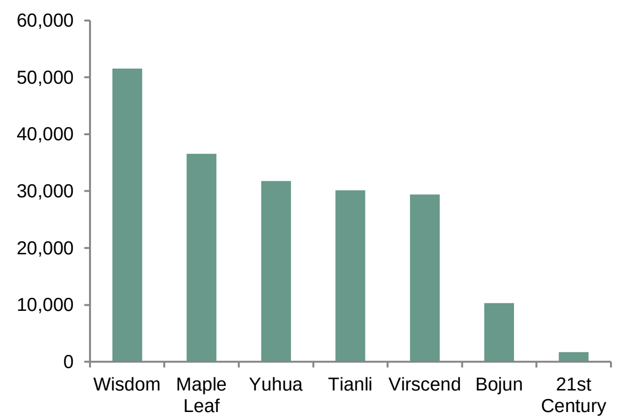
Stock Recommendations

One of our top pick is **CEG (839 HK)** due to its track record in expansion, a more favorable policy environment for higher education, and its leading market position in terms of student enrollment. Another top pick of ours is **Wisdom Education (6068 HK)**. Despite the policy restrictions on acquisition, we believe the Group has strong track record in organic growth and has shored up new projects recently for future development; its strategic focus on developing schools in the Guangdong and Greater Bay Area would further benefit its future growth trajectory.

Risk Factors

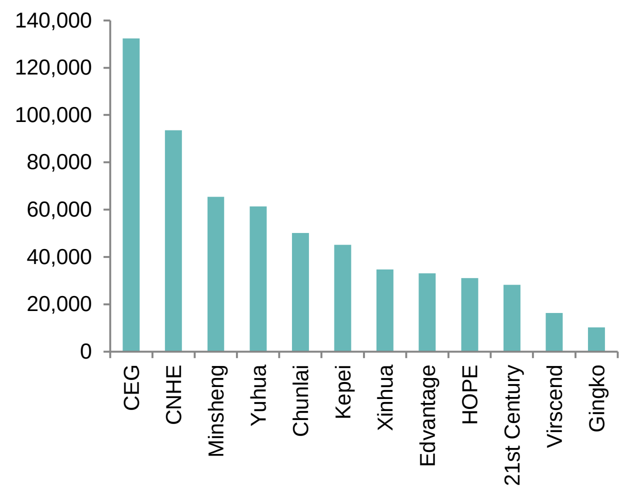
1) Demographic changes; 2) Policy risk; 3) Education quality and dropout risk; 4) Operation and reputation risks; 5) Expansion bottleneck.

Exhibit 1: Enrollment of fundamental education players (2018/19 school year)



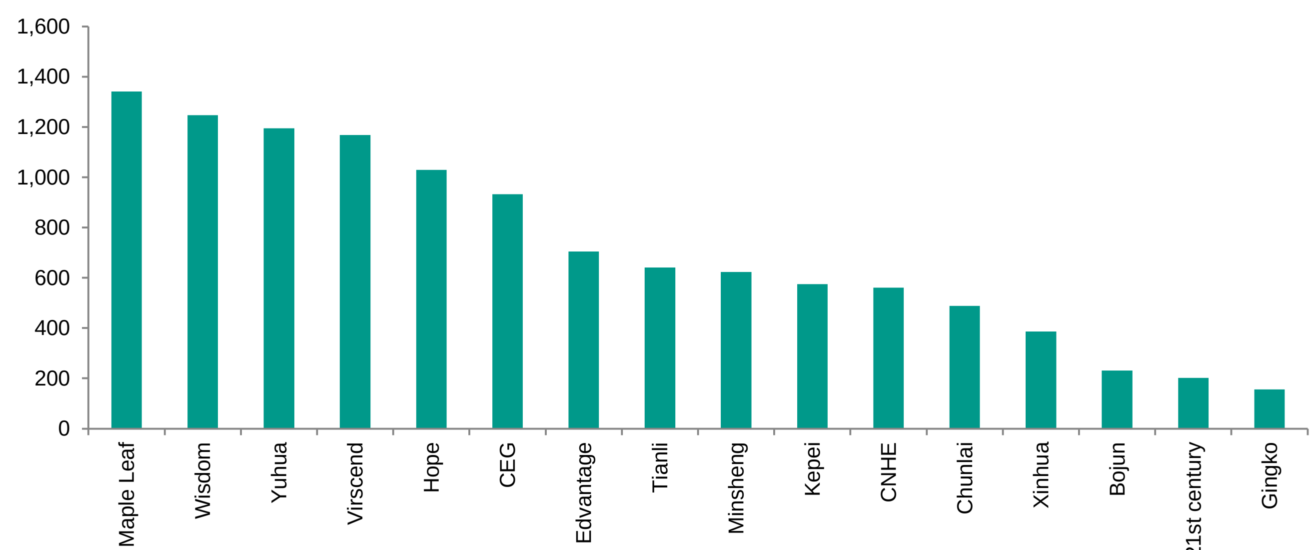
Source(s): Companies, ABCI Securities

Exhibit 2: Enrollment of higher education players (2018/19 school year)



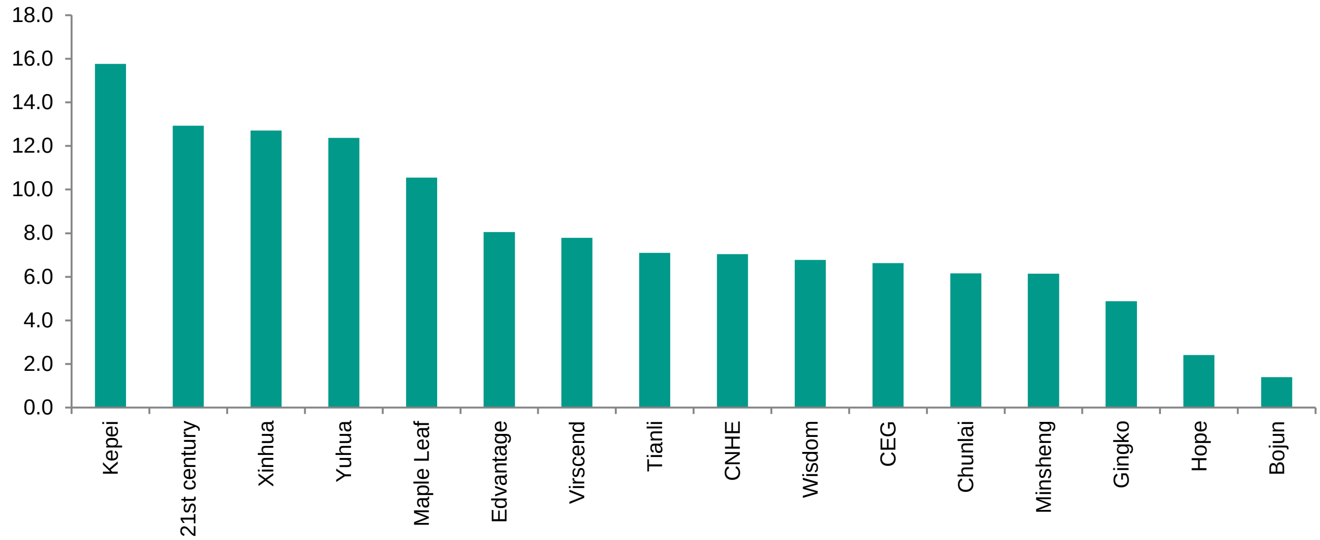
Source(s): Companies, ABCI Securities

Exhibit 3: Revenue size of formal education players in FY18 (RMB mn)



Source(s): Companies, ABCI Securities

Exhibit 4: ROAA of formal education players in FY18 (%)



Source(s): Companies, ABCI Securities

Exhibit 5: ROAE of formal education players in FY18 (%)

Source(s): Companies, ABCI Securities

Exhibit 6: Valuation of sector top picks (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
CEG	839 HK	BUY	14	32.1	35.01	23.23	3.66	3.30	1.01	1.31
Wisdom	6068 HK	BUY	4.7	36.2	22.46	16.60	3.73	3.06	0.15	0.21

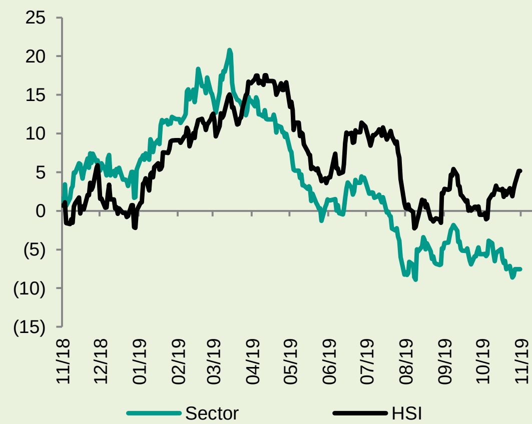
Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Telecom Sector– 5G network officially launched
Ricky Lai

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	10.9	1-mth	(2.9)	4.2
Avg. 20E P/B(x)	0.9	3-mth	(5.0)	0.3
Avg. 20E div yield (%)	3.5	6-mth	(8.6)	10.5
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Telecom operators have officially launched the 5G services in China in Nov 2019
- 4G user penetration rate in China reached 79.1% as of Sep 2019, which is low compared to other countries. We expect further increase in 2020
- **China Mobile (941 HK)** is our top pick for its high dividend yield, healthy balance sheet, and dominant position in China's mobile business

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Official launch of 5G telecom services in 2019. Telecom operators have officially launched the 5G network services in China in 2H19. Pricing of the 5G telecom services fee is relatively conservative compared to that of 4G, owing to the need to comply with the regulator's instruction to lower mobile service tariff. Hence, the potential of 5G as a stimulus for mobile ARPU has yet to be given full play. In order to cope with the expensive CAPEX for 5G, the smaller telecom operators (China Unicom [762 HK] and China Telecom [728 HK]) have teamed up to co-share and co-build the 5G network so as to compete with China Mobile.

China Mobile has the largest share of mobile users in China. MIIT has announced slashing telecom operators' mobile service tariff by 20% and broadband tariffs for small and medium enterprises by 15% to boost internet penetration and improve network coverage in 2019. Lower data service fee suppressed ARPU but stimulated data usage. Average mobile data per user reached over 8.54GB in Sep 2019, up 62.9% YoY. China's mobile users reached 1.6bn in Sep 2019, up 3.3% YoY. According to MIIT, as of Sep 2019, 4G users reached 1.26bn, representing 79.1% of total mobile users in China. We expect 4G penetration rate to reach 85.0% in 2020E, driven by migration of low-end users (from 2G/3G platforms to 4G), widespread use of dual SIM cards smartphones, and lower mobile service tariff. As of Sep 2019, 4G market share of China Mobile China Unicom, and China Telecom were 53.2%, 23.2%, and 23.6%, respectively.

Telecom operators have launched bundled service packages to boost user adoption and improve penetration rate. A multitude of family-related telecom products is available in the market, including smart-home services, IPTV, video contents, online games, etc. These products can help telecom operators improve value-added services (VAS) revenue. Users are seeking quality IPTV, video contents, and stable streaming for online games that require high transmission speed of wireline broadband. We expect China's wireline broadband market in 2019 to grow steadily with better network speed and IPTV utilization rate. According to MIIT, wireline broadband users reached 450mn in Sep 2019, while fiber to the home (FTTH) users hit 411mn, or 91% of total wireline users. We forecast China's FTTH users to reach over 92% in 2020E, driven by rising demand for IPTV, online games, and high-resolution videos.

Global smartphone shipments rebounded in 3Q19. According to IDC, global smartphones shipments were 358.3mn in 3Q19, up 0.8% YoY, compared to the 2.3% decline in 2Q19. The slight increase was driven by the introduction of flagship smartphones. Huawei recorded the highest growth in smartphone shipments in 3Q19 because of the improvement in brand recognition and support from domestic market consumers. With the official launch of 5G telecom services, we forecast global smartphone shipments to grow moderately in 2020E. Many smartphones makers have introduced high-resolution camera and other new features to compete for market share.

Long-term Outlook

We expect 5G users to grow moderately in the telecom sector, which would raise mobile data consumption. Telecom operators will expedite 5G network development and increase CAPEX in 2020 since commercial launch would require more base stations and a wider fiber network coverage. Telecom operators may introduce more incentives and subsidies to attract users for 5G. Compared to 4G, 5G has a higher transmission rate with lower latency. Reduced tariff of mobile data service has affected revenue growth, but telecom operators have launched various value-added services, IPTV, and video contents to boost adoption.

Short-term Outlook

In the short term, we expect revenue of telecom operators to be affected by the Speed upgrade and Tariff Reduction policy. A reduction in mobile service tariff of over 20% is expected to weigh on ARPU. Operators may roll out 5G incentive scheme or handset subsidies to attract users for 5G. Demand for big data and cloud computing from enterprises have been growing in recent quarters, which would support revenue growth.

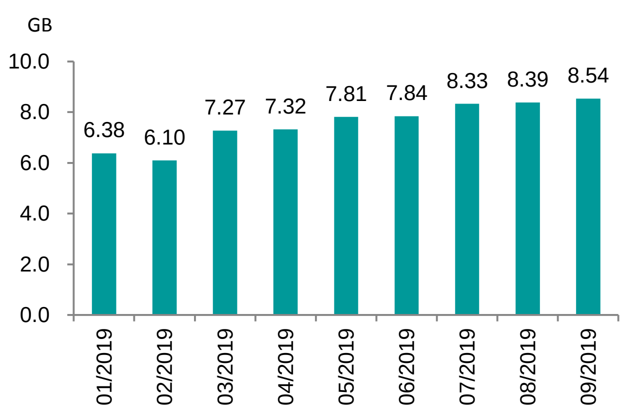
Stock Recommendations

China Mobile (941 HK) is our sector top pick. China Mobile maintains the largest market share for mobile users in the China market, thanks to its network advantage with better coverage and resources. We expect the Group to benefit from increased mobile data consumption amid tariff cut in data service. Our TP is HK$ 80.0, which implies 4.5x/ 4.2x FY19-20E EV/EBITDA.

Risk Factors

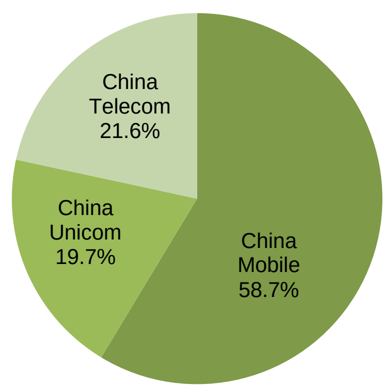
1) Further reduction in service tariff as requested by authorities; 2) User saturation; 3) Intensifying market competition; 4) Slower growth in smartphone shipments.

Exhibit 1: China's average monthly data usage



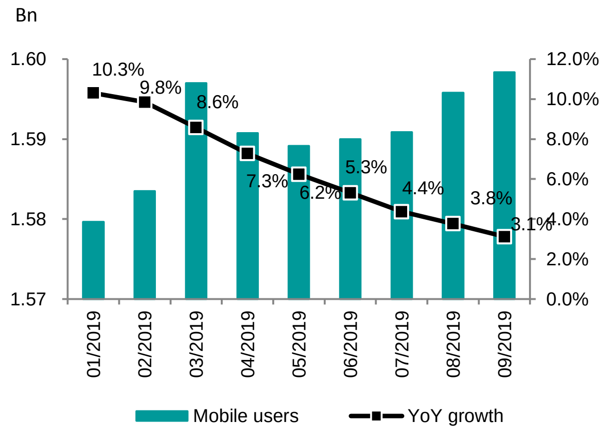
Source(s): MIIT, ABCI Securities

Exhibit 2: China's 4G users market share in Sep 2019



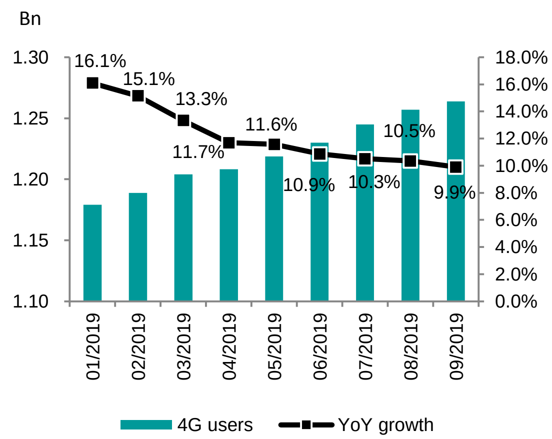
Source(s): MIIT, ABCI Securities

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



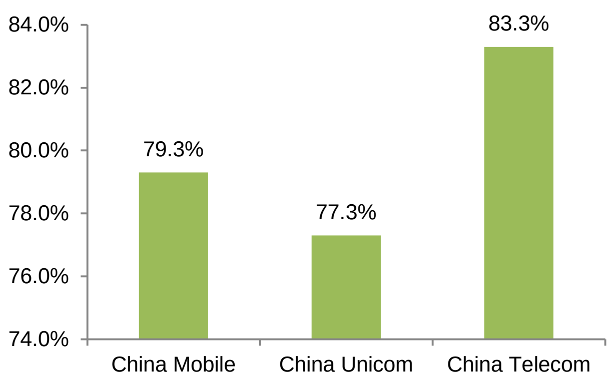
MIIT, ABCI Securities

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



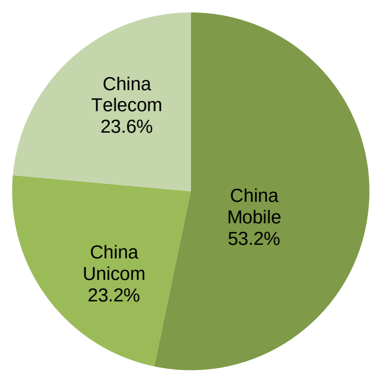
MIIT, ABCI Securities

Exhibit 5: China's 4G user penetration rate in Sep 2019



Source(s): MIIT, ABCI Securities

Exhibit 6: China's mobile user market share in Sep 2019



Source(s): MIIT, ABCI Securities

Exhibit 7: Valuation of sector top pick (Data as of Nov 29, 2019)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY19E P/E(x)	FY20E P/E (x)	FY19E P/B (x)	FY20E P/B (x)	FY19E Yield (%)	FY20E Yield (%)
China Mobile	941 HK	BUY	80.00	35.6	14.3	13.6	1.3	1.2	3.6	3.8

Source(s): Bloomberg, ABCI Securities estimates

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.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.
Philip Chan holds H-shares of Agricultural Bank of China Ltd (1288 HK).

Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (10%)
Hold	- Market return rate (-10%) ≤ Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2005 (HSI total return index 2005-18 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.

Disclaimers

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