



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

ABCI China / HK Equity Research

2H22 Economic Outlook & Investment Strategy

Decoupling of interest rate cycles and investment opportunities



July 4 2022



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Global / China Economic Outlook



2H22 Global Economic Outlook

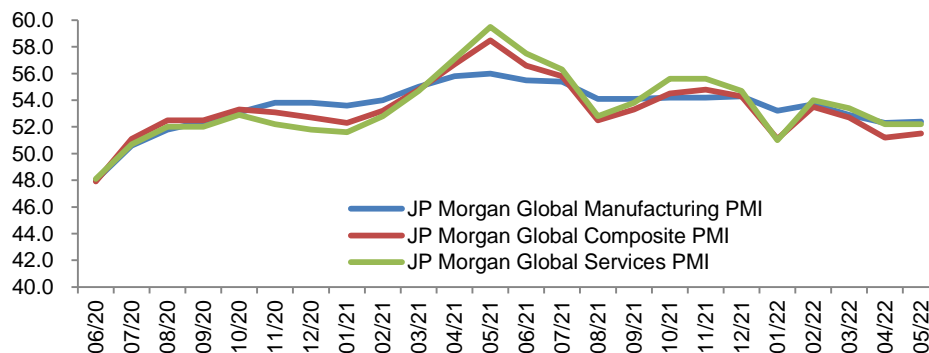
Economist: Andy Yao

- The global economy expanded steadily in 1H22 as the pandemic ebbed and economy reopened, especially for service sectors. Unemployment rate in major countries has steadily declined since the start of 2022, especially in service sectors
- Global inflation has accelerated since the start of 2022 on firming demand, supply chain disruptions in some sectors, and surging commodity prices pushed up by the dispute in Ukraine
- Looking ahead, global economic growth is expected to slow in 2H22, mainly due to surging inflation, rising interest rate, and the prolonged turmoil in Ukraine. Economic outlook is clouded by rising stagflation risk
- We expect economies in the US, China, Eurozone, Japan and UK to grow by 2.5%, 4.5%, 2.5%, 1.8%, and 3.6% in 2022E, respectively, compared with 5.7%, 8.1%, 5.4%, 1.7%, and 7.4% in 2021

The global economy expanded steadily in 1H22

The global economy expanded steadily in 1H22 as the pandemic ebbed and economy reopened, especially for the service sectors. As shown in Exhibit 1, both the JP Morgan global manufacturing PMI and service PMI remained stable and were above the 50 threshold in 5M22, pointing to a steady economic expansion. In general, despite the situation in Ukraine and recent pandemic-related lockdowns in China, global trade activities have stayed put in 1H22. Although the latest WTO Goods Trade Barometer fell to 99.0, slightly below the index baseline value of 100, the latest WTO Services Trade Barometer rebounded to 105.5, well above the baseline value of 100. Most of the WTO Goods Trade Barometer's component indices ears or exceeds their baseline value of 100. E.g., the export orders index was 101.2.

Exhibit 1: JP Morgan Global PMIs (%)



Source(s): Bloomberg, ABCI Securities



Compared with 4Q21, 1Q22 GDP growth in major countries was uneven. Economies in the US, China, Eurozone, Japan, and the UK expanded by 3.5%¹, 4.8%, 5.4%, 0.4% and 8.7%, respectively, in 1Q22, compared with 5.5%, 4.0%, 4.7%, 0.4% and 6.6% in 4Q21 (Exhibit 2). With the economy reopening, unemployment rate in major countries has steadily declined since the start of 2022; the drop was especially apparent in service sectors.

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

Real GDP Growth (YoY)	2021	4Q21	1Q22
US	5.7	5.5	3.5
China	8.1	4.0	4.8
Eurozone	5.4	4.7	5.4
Japan	1.7	0.4	0.4
UK	7.4	6.6	8.7

Source(s): Bloomberg, ABCI Securities

Global inflation has significantly accelerated since the start of 2022 on firming demand, supply chain disruptions in some sectors, and surging commodity prices pushed up further by the conflict in Ukraine. According to the World Bank estimates, Brent crude oil prices are expected to climb 42.0% to \$100.0/bbl in 2022 while non-energy commodity prices are expected to rise by 17.9%. While increases in food and energy prices have mainly driven the sharp rise in headline CPI, core CPI has also risen globally except China and Japan. Sharp inflation was seen in housing, fuel, transport, and furnishing sectors in 1H22. While wage pressure remains contained in most developing countries, the tight labor market in certain advanced economies in 1H22 has pushed up wages.

Major central banks except PBOC and BOJ have tightened their monetary policies amid rising inflation since the start of 2022, which has led to the marked rise in government bond yields. The Fed began to raise the target range for the Fed Funds rate in Mar. As of June, the Fed is also starting to reduce the size of its balance sheet. The ECB ended net asset purchases under the Pandemic Emergency Purchase Programme in Mar and terminated Asset Purchase Programme from July 1. The ECB stated that it will start its first rise in policy rates in July. The BOE, the Bank of Canada, and the Reserve Bank of Australia have all raised their main policy rates since the start of 2022. However, PBOC and BOJ have maintained a loose monetary policy to support economic growth due to mild inflation pressure.

Global growth to slow in 2H22

Looking ahead, global economic growth is expected to slow in 2H22, mainly due to surging inflation, rising interest rates, and ongoing turmoil in Ukraine. Economic outlook is clouded by rising risk of stagflation. In the Apr trade forecast, WTO estimated the volume growth of global trade in goods in 2022E will fall to 3.0% from 9.8% in 2021. According to the latest Global Economic Prospects released by the World Bank in June 2022, global economy is projected to grow by 2.9% in 2022E, down from the 5.7% growth in 2021

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



(Exhibit 3). In OECD's latest Economic Outlook released in Jun 2022, the global economy is projected to expand by 3.0% in 2022E, down from the previous estimate of 4.5% in the Dec 2021 OECD Economic Outlook.

We expect the US economy to grow by 2.5% in 2022E, down from the 5.7% growth in 2021, reflecting tighter financial conditions, higher inflation, and fiscal stimulus withdrawal. Although a lower unemployment rate and a rising wage level should support household spending, weak consumer confidence and high inflation will hinder household consumption. The significant withdrawal of fiscal support and monetary policy tightening will also weigh on growth. Although inflation is expected to peak at mid-2022, it is likely to remain high and well above the Fed's 2% target in 2H22. On the monetary front, with surging inflation pressure and rising inflation expectations, we expect the Fed to tighten further monetary policy in 2H22 with interest rate hikes and the balance sheet reductions. We expect the target range for the Fed Funds rate to reach 3.25-3.5% by the end of 2022, compared with 1.50-1.75% by the end of 1H22. The Fed will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities in 2H22.

Despite the anemic GDP growth in 2Q22, we believe China's economy will rebound significantly in 2H22 on the back of a series of policies. Steady external demand and strong infrastructure and manufacturing investment will be the main growth drivers. With the pandemic prevention normalizing, we believe China's economic growth is likely to rebound significantly in 2H22. Overall, we expect China's economy to grow 4.5% for 2022. The inflation divergence between CPI and PPI is expected to narrow further in 2H22 and macro policy is unlikely to be constrained by inflation. In terms of policy, we expect PBOC to maintain a supportive monetary policy in 2H22, including RRR and interest rate cuts. We expect that the fiscal policy in 2H22 will continue to be proactive to support economic growth.

We project Eurozone's GDP growth to fall to 2.5% in 2022E from 5.4% growth in 2021 due to high commodity prices, protracted supply chain disruptions, and downbeat confidence amid the situation in Ukraine, as well as tighter financial conditions. Pessimistic consumer sentiment and elevated inflation will hit household spending. External demand will be weak due to the global economic slowdown and Ukraine. According to ECB's monetary meeting in June, we expect the ECB to begin its first policy rate rise in July with a 0.25% hike, followed continuous increase in the next monetary meetings in 2H22 amid the high inflation pressure. We expect the interest rate on the main refinancing operations to rise to 0.75% at the end of 2022. Meanwhile, the UK economy would expand by 3.6% in 2022E, down from 7.4% for 2021 due to intense inflation and tighter monetary policy. Monetary policy will continue to normalize, with the policy rate set by BOE increasing to 2.0% at the end of 2022.

We forecast Japan's economic growth to rebound slightly from 1.7% in 2021 to 1.8% in 2022E, thanks to strong domestic demand and loosen monetary policy. Looser Covid-19 restrictions will boost private consumption while investment should recover. However, a weaker external sector will hamper momentum due to supply bottlenecks and a slowing global economy. With the inflation outlook remaining subdued, the country's loose monetary stance would be held firmly in place throughout 2H22 with yield curve control



maintaining 10-year Japanese government bond yields at around 0 within a range of plus or minus 0.25 ppt and with no limit on bond purchases. The short-term policy rate is likely to remain at -0.10% till the end of 2022.

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

Real GDP Growth (YoY)	2020	2021	2022E
US	(3.4)	5.7	2.5
China	2.2	8.1	4.5
Eurozone	(6.4)	5.4	2.5
Japan	(4.6)	1.7	1.8
UK	(9.3)	7.4	3.6
World	(3.3*)	5.7*	2.9*

*Denotes World Bank estimates and forecasts

Source(s): World Bank, Bloomberg, ABCI Securities estimates



2H22 China Economic Outlook

Economist: Andy Yao

- China's economy grew 4.8% in 1Q22, up from 4.0% in 4Q21 and higher than the market forecast of 4.2%. However, with repeated COVID-19 outbreaks and strict lockdowns across major cities, the economy eased substantially in 2Q22
- Despite the anemic GDP growth in 2Q22, we believe China's economy will rebound in 2H22 on the back of a series of policies to stabilize growth. Overall, we expect China's economy to expand 4.5% for 2022E
- We expect the CPI-PPI inflation divergence to narrow further in 2H22. CPI inflation would climb to 2.0% in 2022E from 0.9% in 2021 and PPI inflation is likely to ease to 5.0% in 2022E from 8.0% in 2021. Macro policy is unlikely to be constrained by inflation in 2H22
- We expect PBOC to maintain a supportive monetary policy stance in 2H22 with RRR and interest rate cuts. The rates for 1-year LPR and 5-year LPR are expected to fall to 3.60% and 4.25% by end-2022E from 3.70% and 4.45% at end of 1H22. RRR for large banks would be 9.50% and 7.50% for medium banks by end-2022E, while RRR for small banks is likely to stay at 5.0%. We expect a proactive fiscal policy in 2H22 to support economic growth. The State Council has stressed more support for smaller firms and those hit hard by recent COVID-19 outbreaks by doubling the amount of inclusive finance for smaller firms, increasing government tax rebates by RMB 142bn to RMB 1.64tr in 2022

China's economy eased significantly in 2Q22

China's economy grew 4.8%¹ in 1Q22, up from 4.0% in 4Q21, higher than the market forecast of 4.2%. However, with repeated COVID-19 outbreaks and strict lockdowns across major cities, the economy eased significantly in 2Q22. Economic activity in 2Q, marked by significant easing in investment, retail sales, and industrial production in Apr and May, was slower than that in 1Q22.

Affected by the unexpected impacts of the pandemic and the continuous rise in raw material and production costs, industrial production grew -2.9% in Apr and 0.7% in May after rising by 6.5% in 1Q22. As a synchronous indicator of the macro economy, electricity output declined 4.3% in Apr and 3.3% in May, compared with the 3.1% increase in 1Q22. PMI for manufacturing, which covers 31 industries, was also below the 50 threshold level in Apr and May. Meanwhile, profit growth of industrial enterprises fell 8.5% in Apr and 6.5% in May after rising 8.5% in 1Q22.

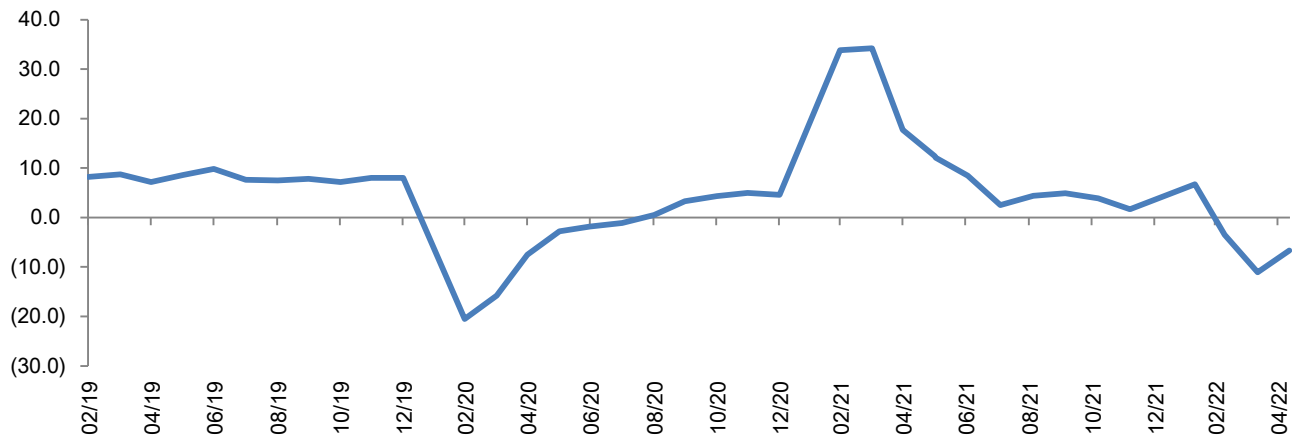
In terms of domestic demand, both consumer spending and FAI eased significantly. Retail sales fell 11.1% and 6.7% in Apr and May, compared to the 3.3% increase in 1Q22 (Exhibit 1). FAI growth in urban areas also slowed to 1.8% in Apr and 4.5% in May from 9.3% in 1Q22, attributable to weak growth in property investment (Exhibit 2).

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



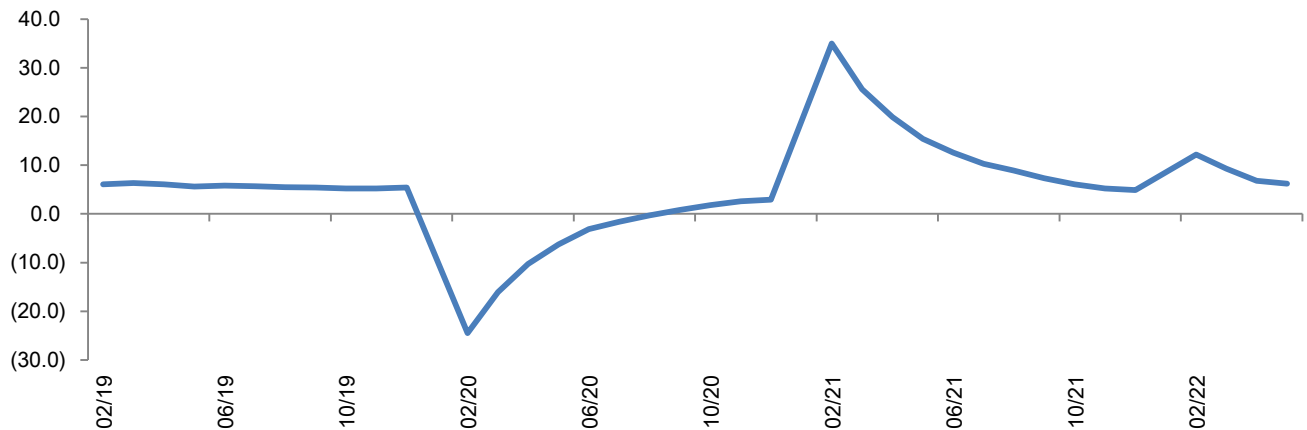
On the external front, trade growth in Apr and May slowed from 1Q22 due to disrupted port operations and logistics (Exhibit 3). Export growth was 3.9% in Apr and 16.9% in May in USD terms, compared with 15.8% in 1Q22. Import growth was 0.0% in Apr and 4.1% in May, lower than the 9.6% increase in 1Q22. However, trade surplus increased sharply to US\$ 51.1bn in Apr and US\$ 78.8bn in May due to weak growth in import, 46.9% higher than the same period in 2021.

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



Source(s): NBS, ABCI Securities

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



Source(s): NBS, ABCI Securities

The inflation divergence between CPI and PPI narrowed significantly in Apr and May. CPI rebounded to 2.1% in Apr and May from 1.1% in 1Q22 as food inflation escalated, especially for pork price. PPI eased significantly to 8.0% in Apr and 6.4% in May, compared with the 8.7% increase in 1Q22. The slowdown of PPI in Apr and May was mainly due to the high base effect and the moderation in commodity prices, including coals, non-ferrous metals, and ferrous metals.



On the monetary front, PBOC has adopted a loose monetary policy to support economic growth since the start of 2022. It slashed RRR and LPR to lower financing costs for the real economy, especially for small/medium enterprises and private companies. Growth in broad money supply (M2) accelerated to 11.1% in May from 9.0% in Dec 2021, while total social financing– a comprehensive measure of all types of financing for the real economy, increased to RMB 15.7tr in 5M22 from RMB 14.0tr during the same period last year.

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



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

Economic growth to rebound significantly in 2H22

Despite the anemic GDP growth in 2Q22, we believe China's economy will rebound significantly in 2H22 on a series of policies to stabilize growth. Steady external demand and strong infrastructure and manufacturing investment will be the main growth drivers. On the contrary, a crisis-laden property sector and potential COVID-19 variation will be the major challenge in 2H22.

Domestically, the overall investment growth will accelerate in 2H22 as growth in infrastructure investment would quicken on the back of increased uses of special local government bonds. Manufacturing investment and private investment would expand steadily amid stable external demand. In particular, high-tech manufacturing investment will increase substantially with the support of macro policies. However, property investment will only slowly recover in 2H22. Increasing income and low employment rate would support consumer spending. Driven by the central and local policies to promote automobile consumption, automobile retail sales, which accounted for 10% of overall retail sales, are expected to rebound significantly in 2H22. Meanwhile, catering consumption will pick up in 2H22 as the pandemic ebbs in China.

Externally, despite high base effect, export growth is expected to remain relatively quick as the US government is likely to cancel or cut the import tariffs on some Chinese goods, especially for daily



necessities. On the other hand, global shipping cost has already declined since the start of 2022, which may support China's export growth. Meanwhile, with the agreement of Regional Comprehensive Economic Partnership (RCEP) coming into force, China's trade with Asian economies in 2H22, especially with Japan, will increase.

With the normalizing pandemic prevention, we believe China's economic growth is likely to rebound in 2H22. Overall, we expect the economy to expand by 4.5% for 2022E, down from 8.1% in 2021, which is still a decent growth amid the pandemic (Exhibit 4).

We expect the inflation divergence between CPI and PPI to narrow further in 2H22. CPI inflation would climb to 2.0% in 2022E from 0.9% in 2021 due to higher food prices; in particular, pork prices are likely to rise as the supply tightens in 2H22. We forecast PPI inflation to ease to 5.0% in 2022E from 8.0% in 2021 with the moderating commodity prices, softening domestic demand, and the high base effect. Macro policy is unlikely to be constrained by inflation in 2H22.

On the monetary front, PBOC is expected to maintain a supportive monetary policy in 2H22. PBOC is likely to keep liquidity abundant to support loan growth for private firms and SMEs. We predict new RMB-denominated loans and new aggregate financing to be ~RMB 22.0tr and ~RMB 34.0tr in 2022E. Meanwhile, we expect the authority to continue the benchmark interest rates reduction in 2H22 in order to lower financing costs for real economy. The rates for 1-year LPR and 5-year LPR are expected to fall to 3.60% and 4.25% for end-2022E. RRR would be slashed once given the economic downturn; RRR for large banks would be 9.50% and 7.50% for medium banks by end-2022E, while RRR for small banks is likely to stay at 5.0%. Broad money supply (M2) is set to grow by about 10.5% in 2022E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 6.7000 by end-2022E with the narrowing of real interest rate gap between US and China, as compared to 6.3730 for the end of 2021.

We expect that the fiscal policy in 2H22 to be proactive. China's State Council announces 33 comprehensive measures to stabilize economy on May 31, seven of which were related to fiscal policy. The authority provided support for smaller firms and those hit hard by recent COVID-19 outbreaks by doubling the amount of inclusive finance for smaller firms, increasing government tax rebates by RMB 142bn to RMB 1.64tr in 2022. A total of RMB 60bn of taxes is expected to be waived from the purchase tax on some passenger vehicles in stages. The policy package urges local governments to complete the RMB 3.45tr special local government bonds issuance by end-June and to utilize the raised funds by end-Aug. In 5M22, over RMB 2.0tr of special local government bonds have been issued.

**Exhibit 4: Economic forecasts**

Economic indicators	2020	2021	2022E
Real GDP growth, %	2.2	8.1	4.5
FAI growth, %	2.9	4.9	6.0
Retail Sales growth, %	(3.9)	12.5	4.0
Export growth in USD terms, %	3.6	29.9	8.0
Import growth in USD terms, %	(0.7)	30.1	5.0
Industrial Production growth, %	2.8	9.6	5.0
CPI, %	2.5	0.9	2.0
PPI, %	(1.8)	8.0	5.0
M2 growth, %	10.1	9.0	10.5
New Aggregate Financing, RMB bn	34,900	31,400	34,000
New Yuan Loans, RMB bn	19,600	19,900	22,000
Spot CNY per USD, End-year	6.5273	6.3730	6.7000
1-year LPR, %	3.85	3.80	3.60
5-year LPR, %	4.65	4.65	4.25

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

Investment Strategy





Investment Strategy

Head of Research: Philip Chan

Decoupling of interest rate cycles and investment opportunities

(A) Global capital market

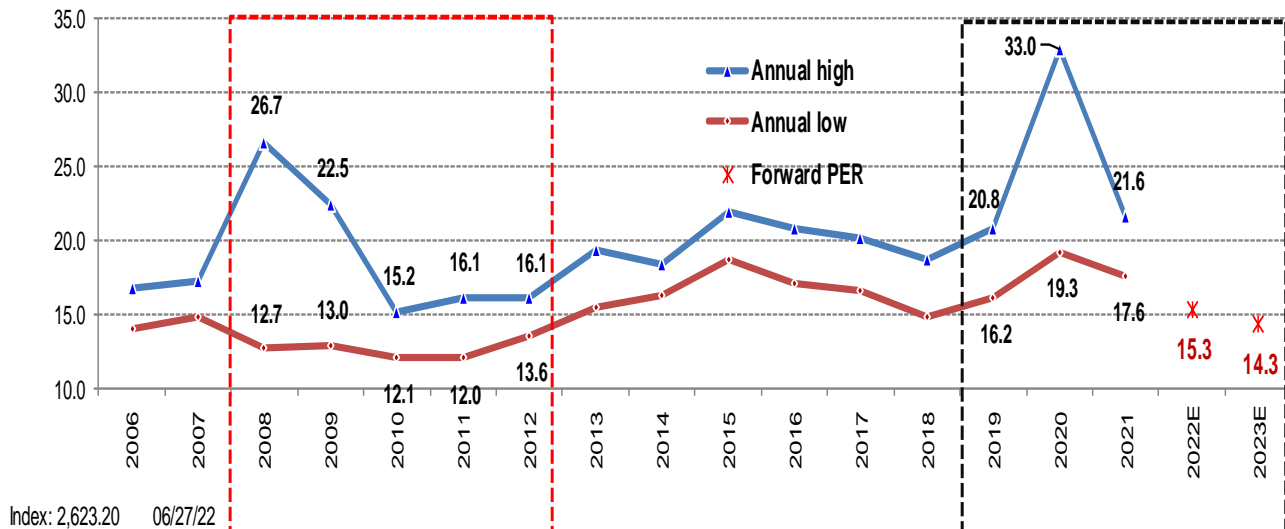
We expect the following economic scenarios to emerge in the next 6-12 months

- Rising interest rates in the US and most western economies will lead to a bear run in their bond and equity markets
- The highly effective interest rate transmission mechanism in the US and most western economies means inflation will be under control. Hence, stagflation risk is low, but recession risk is high
- Corporate earnings growth will slow significantly in 2022 and 2023 due to high base effect in 2021, deterring asset expansion amid the upward interest rate cycle. The durable goods industry will be adversely hit as corporates turn more hesitant in business expansion
- P/E valuation of the benchmark stock market indices will contract. Investors will demand a higher risk premium to compensate for the downside risk of corporate profit and the rise in recession risk
- Grey rhino risks. (1) Property market bubbles in major economies such as the US, UK, Eurozone, and Japan created by aggressive quantitative easing during 2020-21 may burst in the next 12 months when major central banks raise interest rates aggressively to combat inflationary pressure. The impacts on the financial system cannot be underestimated; (2) Successful containment of inflation implies a decline in commodity prices. The commodity super cycle will peak and reverse its course in 2H22. Thus, liquidity will switch from commodity market to the defensive long-term treasury market
- Geopolitical risk. We expect the Russia-Ukraine conflict to continue in 2H22 though the battlefield will unlikely expand to western Europe. The inflationary pressure caused by high energy prices has pros and cons. In the short term, real income and purchasing power are suppressed, but green energy development may quicken, especially in Europe. China may benefit from the rising import demand for green energy equipment such as solar wafers and NEV in Europe

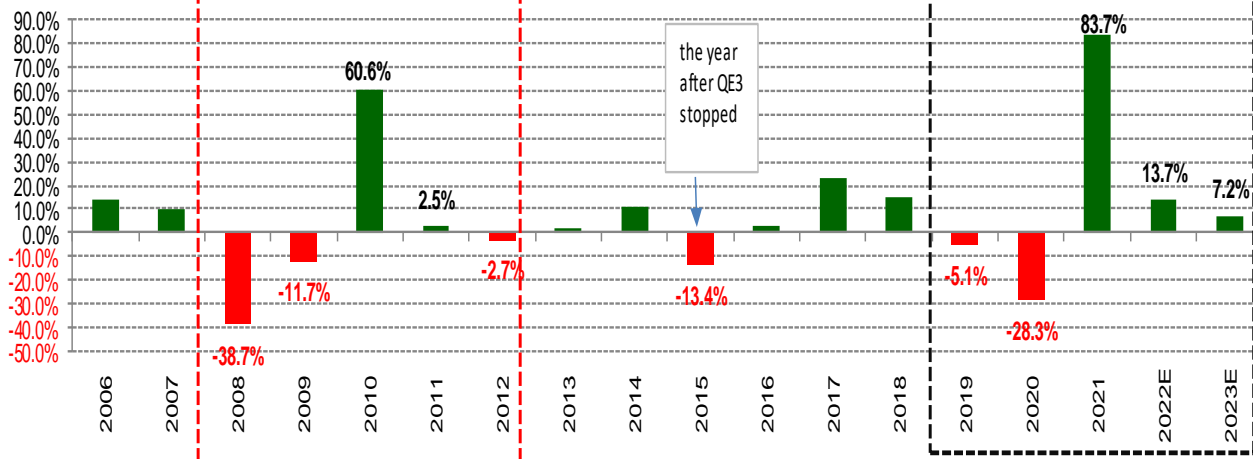


Exhibit 1: Significant slowdown in corporate earnings growth in 2022-23 in major developed economies will suppress P/E valuation in coming years

MSCI World Index historical PER range and forward estimated PER at current index level



MSCI World Index EPS (US\$) Change (YoY):



Sources: Bloomberg, ABCI Securities

Exhibit 2: Property price bubble: Residential price change (4Q 2021 vs 4Q 2019)

Euro Area	16.1%	The US	28.9%	Australia	31.4%
The UK	15.6%	Canada	25.2%	New Zealand	45.4%

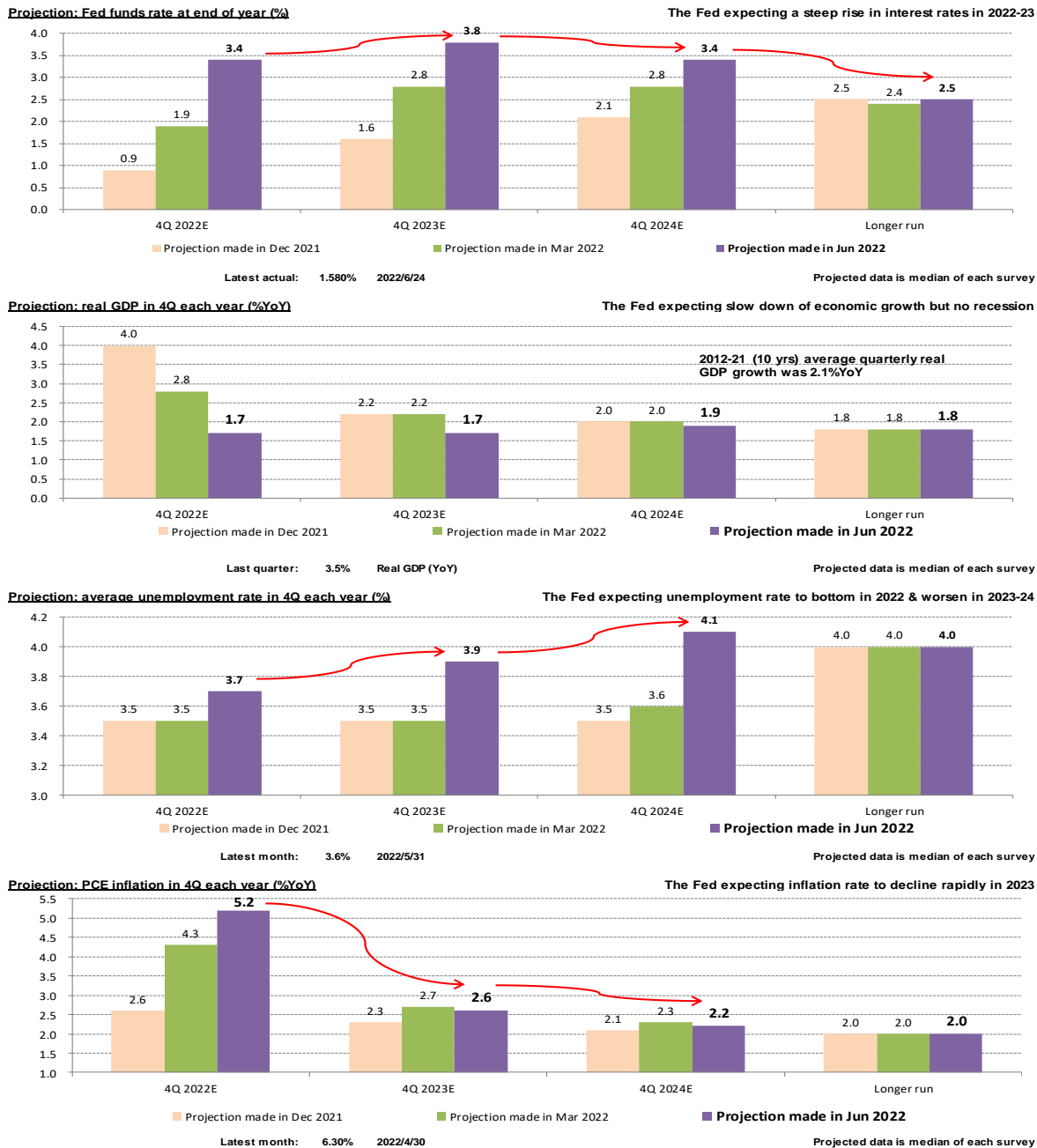
Source (s): Bank of International Settlement, ABCI Securities



(B) Federal Reserve projection on the economy and Fed Funds rate

In the latest FOMC meeting held in June 2022, the Fed expects inflation will be contained while economic growth will sustain in 2022-23. The interest rate upward cycle will extend to 2023. The longer the interest rate upward cycle, the longer the bear run in the bond market.

Exhibit 3 : Monitoring the Fed expectations - Economic projections by the Fed during FOMC meetings in 12/2021, 3/2022 and 6/2022

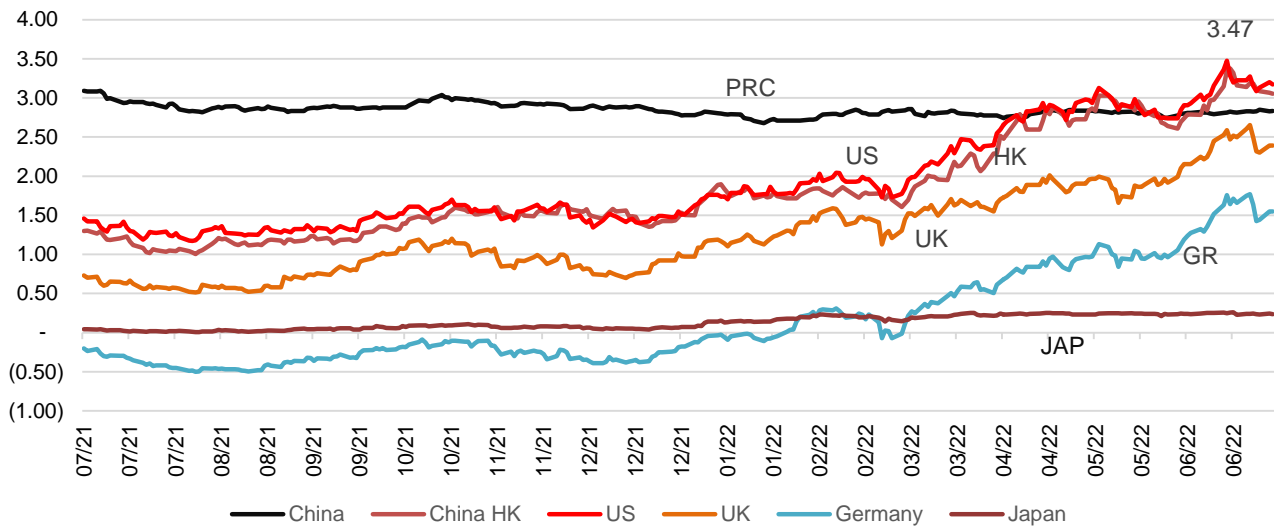


Source(s): The Federal Reserve



Exhibit 4: 10-year government bond yield in major economies (%)

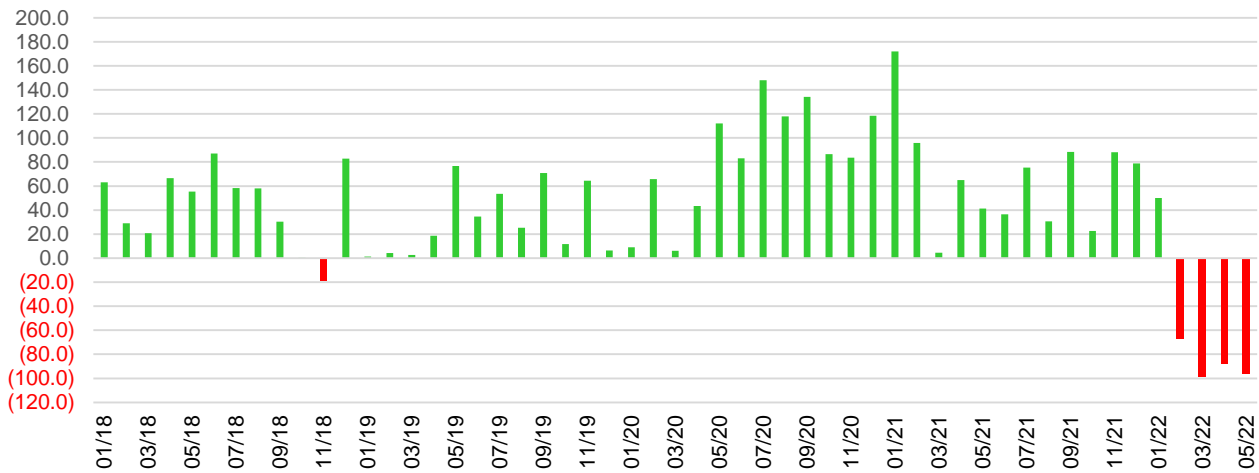
Except for China and Japan, government bond yield in the US, the UK, and Europe are surging in 2022. The 10-year US treasury yield has factored in the Fed rate hikes in 2022 and hit as high as 3.47% in June 2022



Sources: Bloomberg, ABCI Securities

Exhibit 5: Changes in outstanding balance of RMB onshore bonds held by external institutions (RMB bn)

US treasury yield was higher than the China government bond yield in 1H22; offshore institutions reduced their holding of RMB onshore bonds. The PBOC needs to inject liquidity into the banking system to ensure sufficient supply



Sources: China Clearing, ABCI Securities

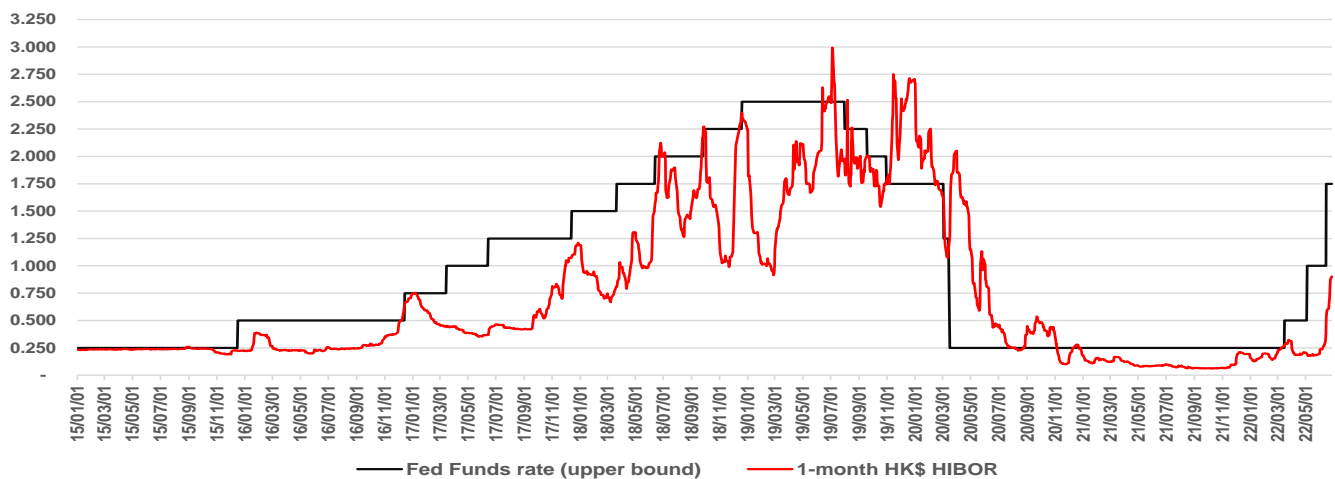


(C) HK interest rates outlook

The potential shock to the HK interest rate market is the sharp rise in short-term interest rates in 2H22. Owing to the linked-exchange rate mechanism, HK base rate will closely follow the increase in the Fed Funds rate. The HK base rate is fixed at 25bp higher than the upper bound or 50bp higher than the lower bound of the Fed Funds rate. However, the short-term HK interest rates are lagging behind. In the previous interest rate cycle, the 1-month HK\$ HIBOR and 3-month HK\$ HIBOR would eventually catch up and stay higher than the Fed Funds rate. Currently, the Fed predicts the Fed Funds rate to move up to 3.4% in 4Q22 and 3.8% in 4Q23. One-month HK\$ HIBOR will likely climb to around 3.4% from the current 0.90%. If the Fed's prediction is correct, the HK\$ 1-month HIBOR will climb to around 3.8% in 2023.

Exhibit 6: Fed Funds rate vs. 1-month HK\$ HIBOR, (%)

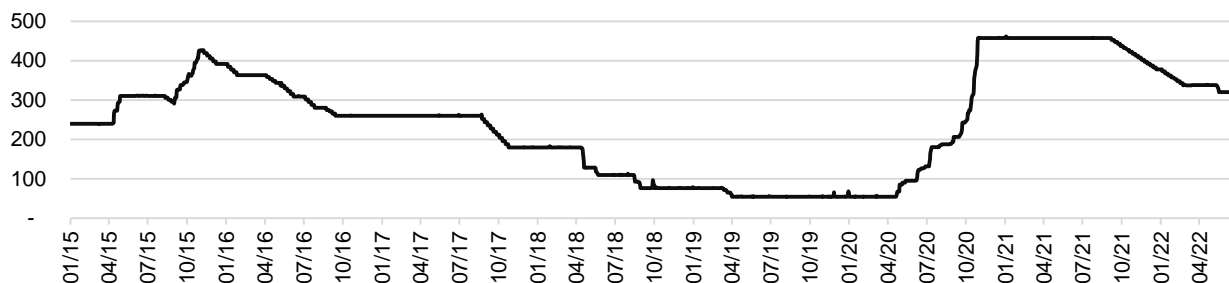
HK short-term interest rate is lagging behind but will eventually catch up with the US



Source(s): The Fed, HKMA

Exhibit 7: HK interbank liquidity aggregate balance (HK\$bn)

Falling supply of interbank liquidity in 2022 results in higher funding costs



Source(s): HKMA



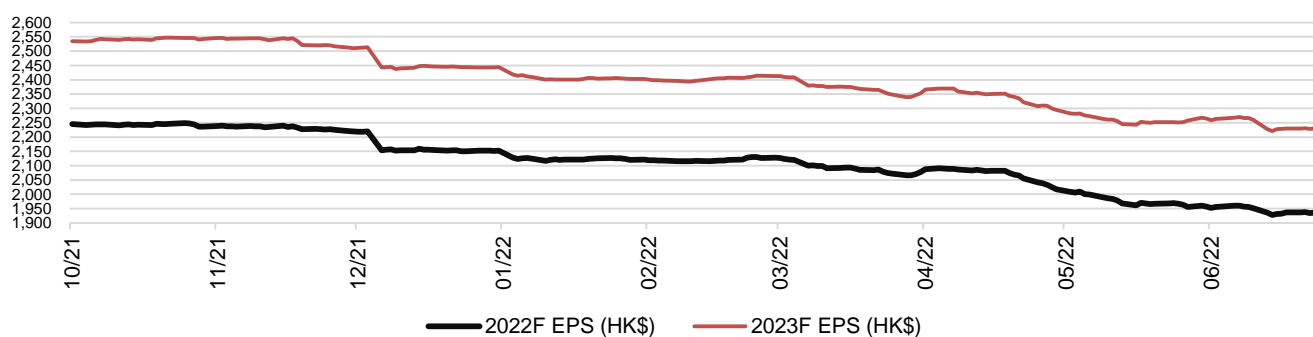
(D) Hang Seng Index (HSI)

We expect the reasonable trading range of the HSI in 2H22 to be at 20600-24800, which represents around 10.6-12.8x 2022E P/E based on the 2022E EPS.

Our judgment is based on the following factors.

- In 2022, China is in an interest rate downward cycle but the US and most developed economies are in an upward interest rate cycle. Earnings in Chinese enterprises will enter a recovery cycle, whereas its US counterparts will see a slowdown.
- In 1H22, the PBOC slashed the 1-year LPR by 10bp and 5-year LPR by 20bp to support the economy and cushion off the adverse effects of Omicron. In 1H20, the PBOC slashed the 1-year LPR by 30bp and 5-year LPR by 15bp to support the COVID-dampened economy. Although rate cuts in 1H22 were less than that in 1H20, the current LPR was lower than 2020.
- Post-Omicron economic cycle. The positive effects of rate cuts in China in 1H22 will emerge in 2H22 and 1H23. Approaching the end of 2022, investors will shift their focus to 2023 earnings outlook. We expect investor sentiment to turn more bullish by 4Q22 and 1H23.
- Effects of the government's counter-cyclical measures to boost private consumption and fixed assets investments will emerge in 2H22. Industrial enterprises will enter a post-omicron profit recovery cycle in 2H22 and 1H23.
- Since early 2022, the market has repeatedly revised down the earnings outlook of the HSI. The downward revision is caused by the change of member stocks and the sluggish financial results of some tech stocks in the index in 1Q22. Negative factors have largely been priced in based on current valuations.
- The 5-year average forecast P/E of the index is at 11.70x with a standard deviation of 1.07x. In view of the economic cycle in 2H22 and 1H23, the P/E valuation range of HSI will rise above the historical average.

Exhibit 8: 2022F and 2023F HSI EPS based on market consensus

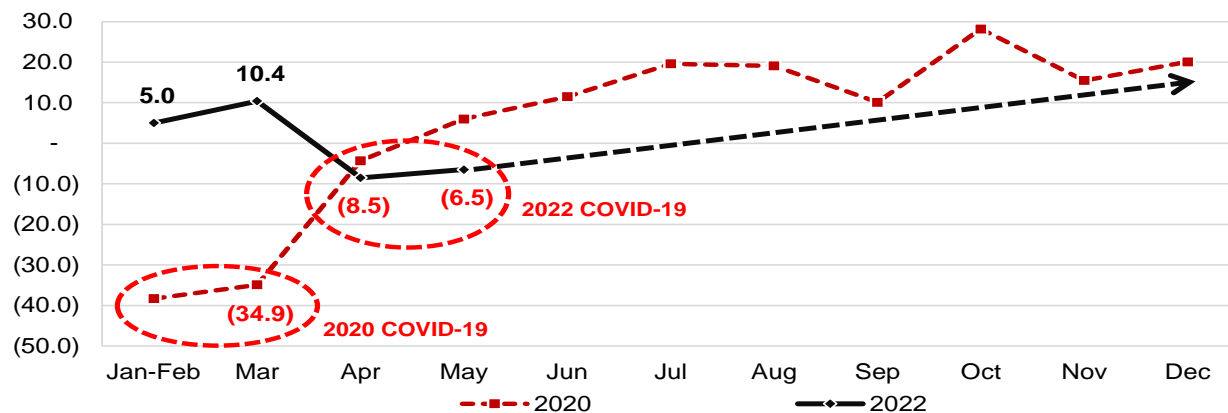


Source(s): Bloomberg



Exhibit 9: Large industrial enterprises' profit change (%YoY)

COVID impacts in 2020 vs. 2022: profit growth momentum is expected to pick up in 2H22 and 1H23



Source(s): NBSC, ABCI Securities

Exhibit 10: Hang Seng Index fwd P/E trading range (12/2019-6/2022)

Index valuation will rise above historical average during profit recovery cycle in 2H22-1H23



Mean refers to 5 years (7/2017-6/2022) average

"St dev" refers to standard deviation

5-year average:11.70

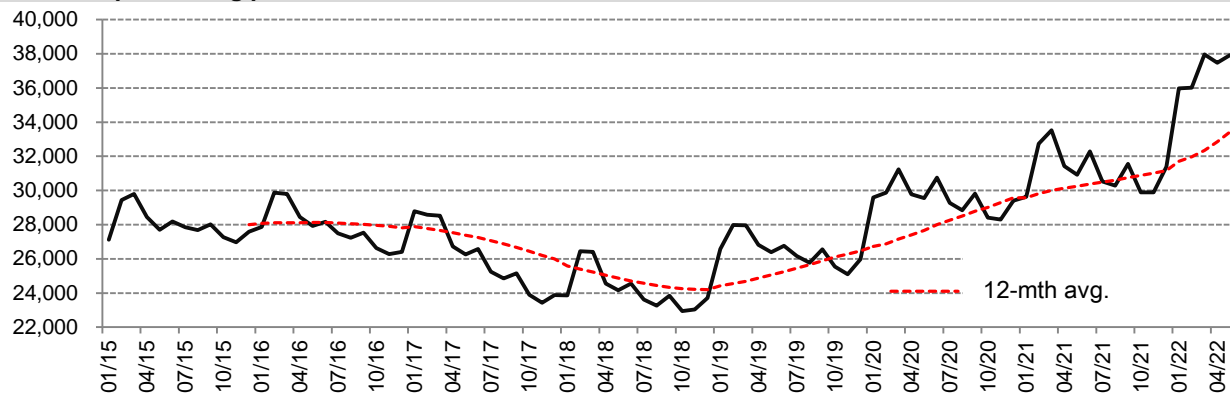
Standard deviation:1.07

Source(s): Bloomberg



Exhibit 11: Households net deposits (RMB bn)

Household purchasing power will be released in 2H22

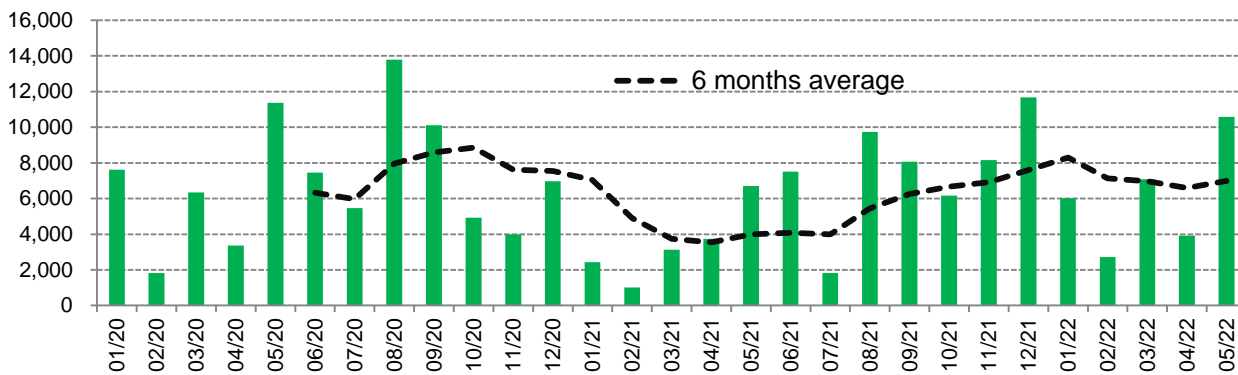


Estimated household net deposit at 5/2022: RMB37.9tr (+20.8%Ytd)

Net deposits = (Deposits held by households - loans owed by households)

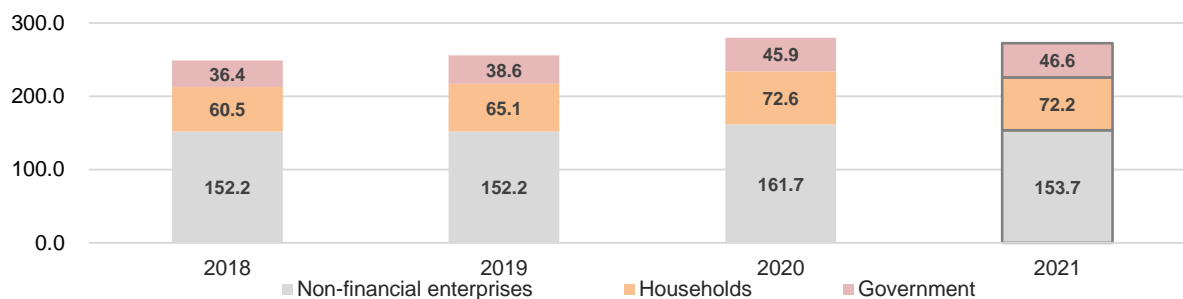
Source(s): PBOC, ABCI Securities

Exhibit 12: Government bond net financing (RMB 100mn): Government has increased borrowings to support economic growth since 2H21



Source(s): PBOC

Exhibit 13: Macro leverage (%): The relatively low macro-leverage of government allows it to increase leverage in 2022 to support economic growth

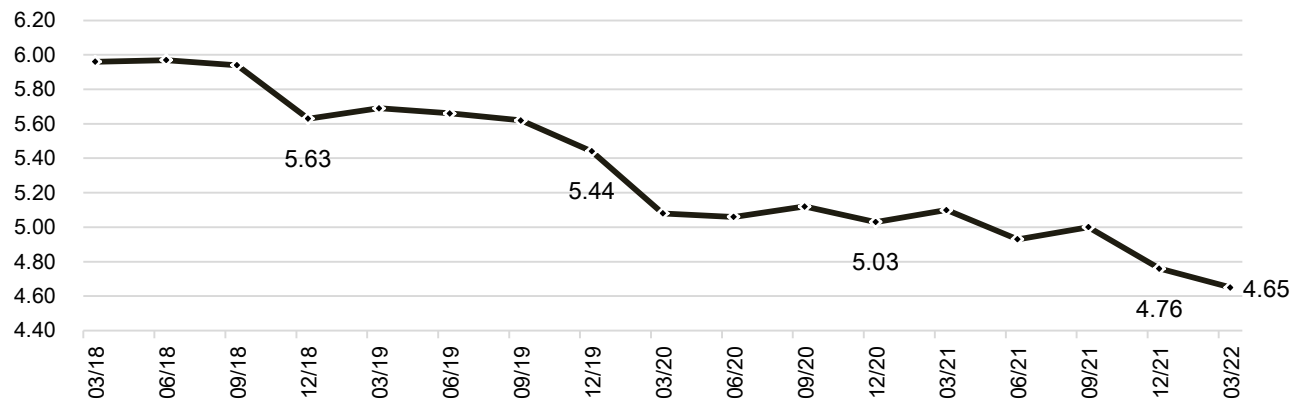


Remarks: One ppt of macro leverage represents ~RMB 1.1tr credit

Source(s): PBOC's Monetary Policy Report



Exhibit 14: New loans actual interest rate (weighted avg.) (%): Interest burden on real economy keeps reducing



Source(s) PBOC's Monetary Policy Report



Hong Kong IPO Market

Analyst: Steve Chow

- In 1H22, Hong Kong IPO market has raised US\$ 2.3bn vs. US\$ 42.9bn in 2021
- Hong Kong's IPO market has been impacted by various factors including a weakened economic backdrop, regulatory concerns for the internet sector, global geopolitical risk, among others
- 2H22 could be better amid post-pandemic economic rebound and improving regulatory environment for the internet sector

In 1H22 (up to June 20, 2022), the Hong Kong IPO market has raised US\$ 2.3bn vs. US\$ 42.9bn in 2021. In 1H22, a total of 18 IPOs were issued, with an average issue size of US\$ 129mn each. The market has been heavily impacted by tightened regulatory requirement on the internet sector, weakened economic environment, COVID resurgence, and global geopolitical risk.

In terms of industry mix, materials accounted for 23% of the IPO volume in 1H22, followed by healthcare (21%), consumer discretionary (14%), industrials (13%), finance (11%) and others (real estate, tech, and telecom) (18%). In addition, average deal size was US\$ 129mn in 1H22, significantly lower than US\$ 448mn in 2021.

The Chinese government has recently reiterated its long-term strategic goal to support the development of platform economy and support quality internet platforms to be listed overseas. This could imply a better IPO market in 2H22. In particular, attention will be on potential IPOs of DiDi and Bytedance in Hong Kong/China.

Exhibit 1: 1H22 HK IPO Overview *

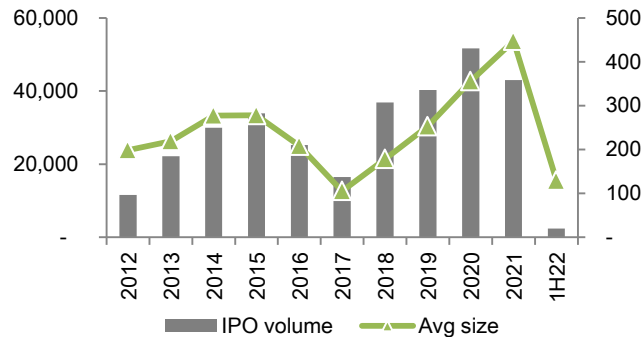
Industry	Volume (US\$ mn)	Avg deal size (US\$ mn)
Materials	544	544
Healthcare	489	98
Consumer Discretionary	321	80
Industrials	297	297
Finance	256	128
Real estate	160	53
Tech	151	151
Telecom	106	106

*Up to June 20, 2022

Source(s): Bloomberg, ABCI Securities



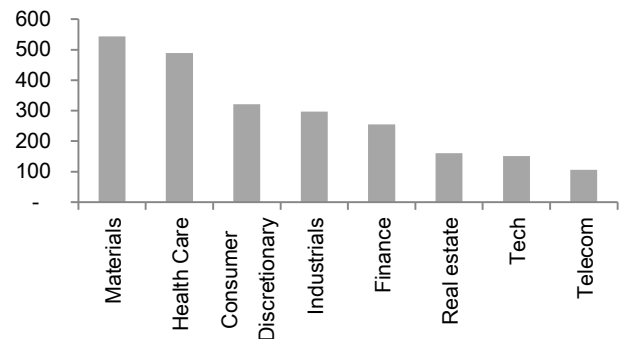
Exhibit 2: HK IPO volume and average deal size* (USD mn)



*Up to June 20, 2022 for 1H22

Source(s): Bloomberg, ABCI Securities

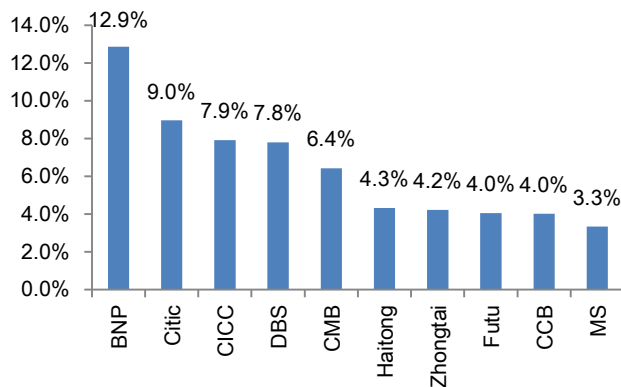
Exhibit 3: HK IPO volume by industry (1H22)* (USD mn)



*Up to June 20, 2022 for 1H22

Source(s): Bloomberg, ABCI Securities

Exhibit 4: Market share of HK IPO underwriters by volume (1H22)*



*Up to June 20, 2022 for 1H22

Source(s): Bloomberg, ABCI Securities



Sector Outlook



OVERWEIGHT

China Banks Sector – Fundamental challenges remain

Johannes Au

<u>Key Data</u>		<u>Sector Performance</u>	<u>Absolute (%)</u>	<u>Relative (%)</u>
H-shr		H-shr (relative to MXCN)		
Avg. 22E P/E (x)	4.02	1-mth	(0.5)	(6.5)
Avg. 22E P/B(x)	0.44	3-mth	(3.4)	(0.1)
Avg. 22E div yield (%)	8.18	6-mth	3.0	19.6
A-shr		A-shr (relative to CSI300)		
Avg. 22E P/E (x)	5.04	1-mth	(0.1)	(5.9)
Avg. 22E P/B(x)	0.54	3-mth	0.5	(0.7)
Avg. 22E div yield (%)	6.45	6-mth	2.3	16.9
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		
<div>➤ Revival of interest rate cut cycle would escalate system NIM pressure</div> <div>➤ Macro uncertainties and rising asset quality risk from property sector would induce mild rebound in system NPL ratio</div> <div>➤ Earnings surprise is possible if big banks lower provisions</div> <div>➤ Reiterate OVERWEIGHT sector rating for both A/H markets. Prefer big banks for stable fundamentals and promising dividend yield</div>				

Escalating NIM pressure. To support the economy, China started its interest rate cut cycle since Dec 2021. Such move has added to the NIM pressure of the Chinese banks, which are also required to provide larger credit support and lower financing cost to support the real economy. According to National Interbank Funding Center, 1Y and 5Y LPR aggregated dropped 15bps and 20bps to 3.70% and 4.45% between Dec 2021 and May 2022. Meanwhile, PBOC data shows average lending interest rate fell 45bps YoY or 11bps QoQ in Mar 2022 to 4.65%. As the impacts of loan re-pricing usually unfold over an extended period of time, the resultant NIM pressure would last for a year after the last interest rate cut in each cycle. Our ABCI economist expects further LPR cuts in 2H22, with 1Y and 5Y LPR reaching 3.60% and 4.25% by end-2022. In this way, we expect banks' NIM to stabilize by 4Q23 the earliest. In fact, NIM pressure started to show in 1Q22. According to the CBIRC data, system NIM narrowed by 11bps QoQ or 10bps YoY to 1.97%. By category, average NIM of big banks dropped 5bps YoY in 1Q22, compared to 14bps-17bps for JSBs, city commercial banks, and rural commercial banks. Robust balance sheet growth and optimization of balance sheet components will remain the core defensive factors against NIM pressure. Overall, we expect system NIM to lower by 12bps-19bps YoY for 2022E.

Mild rebound in NPL ratio. Extending the trend in 1H22, we expect asset quality risk from property sector to persist in 2H22. Also, economic growth affected by COVID-related measures in 1H22 may lead to a mild rebound in NPL ratio in 2H22, though we believe recovering macro environment and continuous NPL management by banks would mitigate some of the impacts. Our ABCI economist projects (1) China's real GDP to grow 4.5% and 6.0% for 2022E and 2023E; (2) new loans targets will be set at RMB 22tr and RMB 23tr for 2022E and 2023E. In our opinion, asset quality concerns will remain the major discounting factor in sector valuation, and banks with a high risk buffer will be preferred. As of Mar-22, system NPL ratio was down 4bps QoQ to 1.69%; system provisioning ratio and system provision coverage ratio declined 1bps QoQ to 3.39% and increased by 3.79ppt QoQ to 200.7%. By category, city commercial banks was the only category reporting a higher average NPL ratio (+6bps QoQ to 1.96%); the ratios in big banks and JSBs both went down (- 2bps QoQ to 1.35%), while rural commercial banks showed the largest decline (- 26bps QoQ to 3.37%).



Possible earnings surprise with lower provisions. Provision size has a large impact on banks' earnings. In Apr 2022, the central government encouraged big banks to boost the real economy by lowering provisions to raise earnings. As such, we believe earnings outlook in 2H22 will be supported. Still, we expect system net profit growth to be lower than 2021 due to the low base in 2020. According to the CBIRC data, system net profit rose 7.36% YoY or 32.83% QoQ in 1Q22.

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 in long run, while short term share price volatility would increase on policy uncertainties.

Short-term Outlook

Economic uncertainties from COVID-19 will cloud over the sector outlook in coming quarters, which may aggravate asset quality concerns; also, more new supportive measures may roll out to revive macro growth. Although we do not expect radical deterioration in asset quality given the high policy priority on financial system stability, investors will remain sensitive to macro and sector data in the near term.

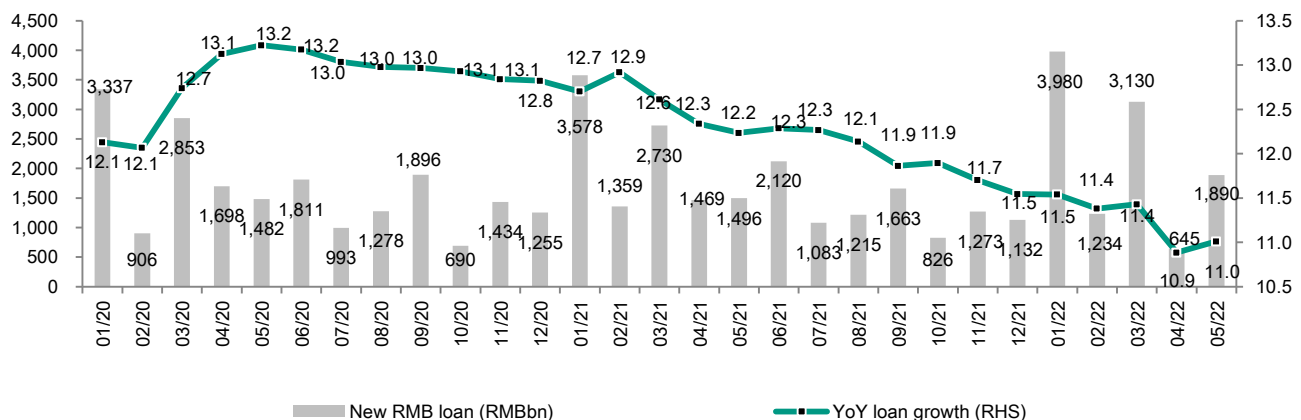
Stock Recommendations

We reiterate our **OVERWEIGHT** rating for the China banks sector in both A/H share markets since the deep valuation discount at present overinflates potential risk, in our view. Based on the historical pattern, the sector's share price would bottom in 3Q amid ambitious policy rollout before rebounding in 4Q. We prefer leading big banks for their stable fundamentals, promising dividend yield, defensiveness against policy risks, and high adaptability to macro changes.

Risk Factors

1) Increasing competition from non-bank financial institutions and foreign players; 2) Sharp deterioration in asset quality; 3) Increasing policy risk on macro uncertainties; 4) Prolonged impacts of COVID resurgence and Sino-US disputes.

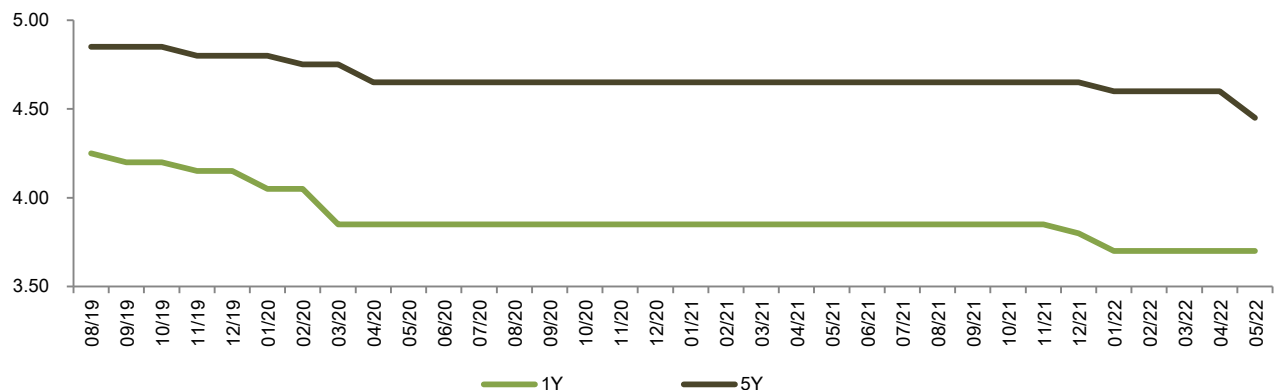
Exhibit 1: Monthly new RMB loans (RMB bn) and total RMB loan balance YoY (%)



Source(s): PBOC, ABCI Securities

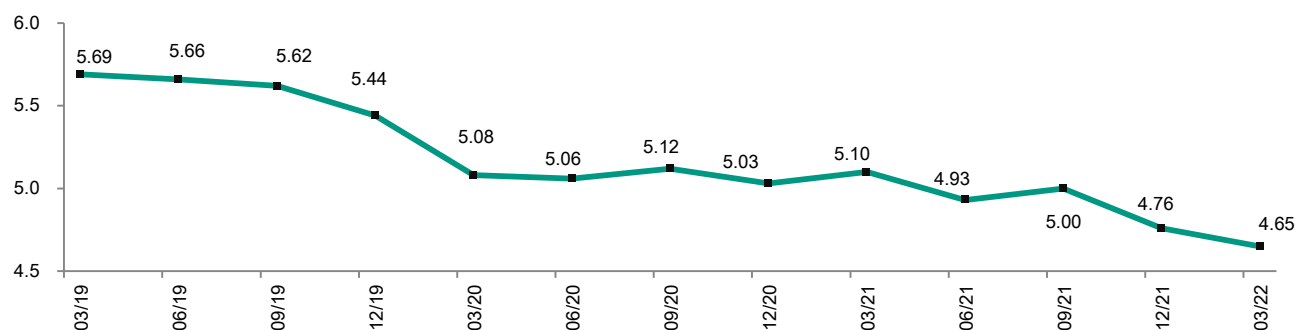


Exhibit 2: China LPR (%)



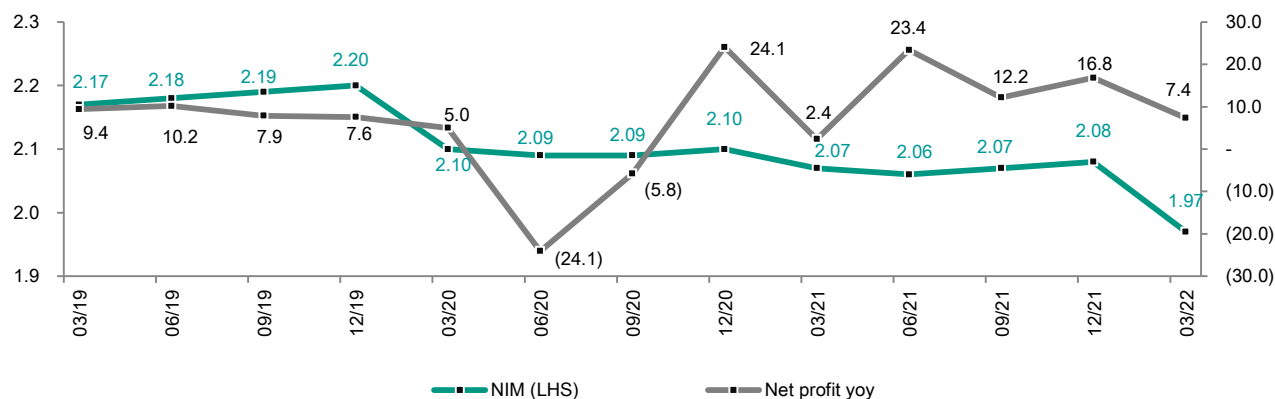
Source(s): National Interbank Funding Center, ABCI Securities

Exhibit 3: System monthly average lending rate (%)



Source(s): PBOC, ABCI Securities

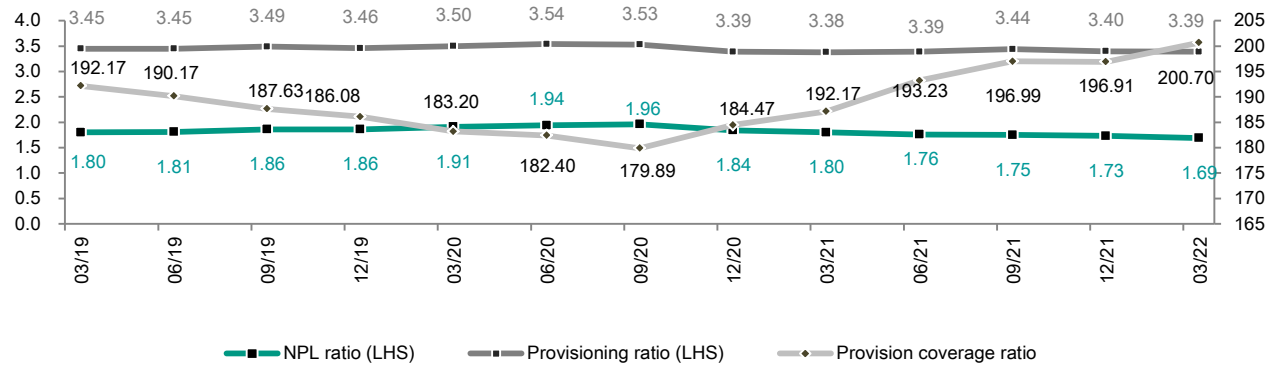
Exhibit 4: System NIM vs. system quarterly net profit YoY (%)



Source(s): CBIRC, ABCI Securities



Exhibit 5: System asset quality indicators (%)



Source(s): CBIRC, ABCI Securities



OVERWEIGHT

China Property Sector – Silver lining emerges

Kenneth Tung

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 22E P/E (x)	3.61	1-mth	3.91	(4.41)
Avg. 22E P/B(x)	0.42	3-mth	1.57	(0.67)
Avg. 22E div yield (%)	15.6	6-mth	(11.27)	(7.81)
Source(s): Bloomberg, ABCI Securities estimates		Source(s): Bloomberg, ABCI Securities		

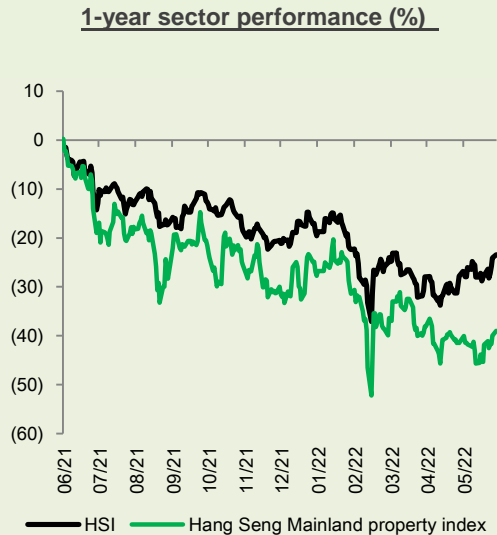
- Expect developers' contracted sales to recover in 4Q22 on further policy easing; onshore refinancing activities have resumed for quality names
- Visible growth momentum remains for the property mgt (PM) sector. Corporate governance remains a key concern
- **COLI (688 HK)** is our top pick among the PRC developers given its solid balance sheet and better-than-peer sales. We favor **CR MIXC (1209 HK)** in the PM sector for its leading position in shopping mall mgt and proactive M&A stance

1-year sector performance (%)

Date	HSI (%)	Hang Seng Mainland property index (%)
06/21	0	0
07/21	-10	-15
08/21	-15	-20
09/21	-10	-25
10/21	-15	-20
11/21	-20	-25
12/21	-25	-30
01/22	-20	-25
02/22	-30	-55
03/22	-25	-40
04/22	-30	-45
05/22	-25	-45

— HSI — Hang Seng Mainland property index

Source(s):Bloomberg, ABCI Securities



Source(s): Bloomberg, ABCI Securities

Sector Outlook

■ Developers:

Expect sales recovery in 4Q22 on further policy easing. Due to COVID resurgence, sales of commodity housing in China dropped 46%YoY in Apr, the largest YoY decline in a decade. Rounds of supportive policies have been launched since mid-May. On May 15, PBOC announced to cut the lower limit of first-home mortgage rate from 4.6% (5-year LPR) to 4.4% (5-year LPR-20bps); on May 20, 5-year LPR was slashed by another 15 bps with a revised lower limit of first-home mortgage rate of 4.25%. In 1Q22, weighted average mortgage rate, which includes both first and second homes, was still high at 5.49%, down 14bps QoQ only. Referencing the previous rate cut cycles, mortgage bottomed at 4.34% in 2009 and 4.52% in 2016. Hence, we expect mortgage rate to trend down gradually by 1.0ppt over the next six months. On the back of falling mortgage rate and active home loan lending, purchasing activities of first-home buyers will likely increase. The second round of relaxation would target at lifting upgrading demand through the removal of home-purchase restriction in certain lower-tier cities and cutting the down-payment ratio for second homes. The abovementioned policies had helped revived the property market to positive growth within 13 months during the previous property down cycle (2013-14), when the market was plagued by oversupply. In May, the YoY decline in sales amount and GFA of newly built commodity housing moderated to 38% YoY (from 47% in Apr) and 32%YoY (from 39% in Apr), or increased 30% and 26% MoM.

Refinancing resumes for quality names. Several reputable privately owned enterprise (POE) developers have recently resumed their onshore bond-raising activities despite the rising default cases in the industry. In May, Longfor (960 HK) launched a RMB 500mn corporate bond with a 4.0% coupon rate and 6-year maturity; Country Garden (2007 HK) issued a RMB 500mn corporate bond with a 4.5% coupon rate and 3-year maturity; Midea Real Estates (3990 HK) rolled out a RMB 1,000mn corporate bond with a 4.5% coupon rate and 4-year maturity. Successful bond issuances could be attributable to credit default swaps (CDS) issued by financial institution, which was advocated by various regulating bodies. In the event of default, bondholders will be compensated by paying a certain amount of



fees as insurance. We think the ability to refinance will increase both the homebuyers' and investors' confidence. Developers that have already defaulted on their bonds, such as Sunac (1918 HK), Yuzhou (1628 HK), and Aoyuan (3883 HK), saw deeper contracted sales decline in May 2022 (Sunac: -82%YoY; Yuzhou: -72% YoY; Aoyuan: -79%YoY vs. peer avg at -57%YoY), reflecting homebuyers' concern over completion of projects under construction. In our view, SOE developers will gain market share from smaller private developers in the long run; in our view, the reputation of these smaller players have already been heavily compromised in the past year.

■ Property mgt companies (PMCs):

Fundamental remains intact with high visibility; growth momentum in public projects to continue. In 2021, the top 10 listed PMCs by core profit grew 48%/39%/52%/54% YoY in GFA under mgt/ contracted GFA/ total revenue/ core profit on average despite falling new home sales of their parent groups. In particular, contracted GFA for these top players are 49% higher than their existing GFA under mgt, implying high visibility for future growth. Despite sluggish residential sales, leading PMCs are increasing their effort in public projects and city services to compensate for the slower new home completion. E.g., Poly Property Services' (6049 HK) PM revenue from public projects soared 82% YoY to RMB 1,462mn in 2021 while revenue from city services of Country Garden Services (6098 HK) jumped 412% YoY to RMB 4,52mn in 2021.

Corporate governance a key concern. For the cash-strapped developers, share disposal and hefty related-party transactions with their PM subsidiaries are ways to generate cash. Corporate governance thus becomes a key concern for the sector. Most of these listed PMCs have a huge net cash balance, and a significant portion of this balance has remained offshore post-IPO, meaning the reserve can be utilized for USD bond repayments of the parent developers. Sunac (1918 HK) placed 5.1% old share in Sunac Services (1516 HK) to raise HK\$ 2.33bn in Nov 2021 and disposed its tourism mgt business to the PM subsidiary to obtain RMB 1.8bn in cash. Powerlong CM (9909 HK) also announced to acquire an office building in Shanghai from parent at RMB 868mn (or RMB 24,800/sqm, a 6.6% discount to market value) on May 11, 2022. Concerns over poor corporate governance hit the market and Powerlong CM's share price fell 24% on that day. The transaction was subsequently cancelled on June 6, 2022 in a bid to regain investors' confidence.

Stock Recommendations

■ Developers:

Quality SOE will survive the storm. We believe homebuyers and investors will favor SOE names over POEs given their ability to refinance to ensure project completion. In fact, SOE players did outperform POE players over in Apr and May. COLI's contracted sales improved from -36%YoY in Apr to -23%YoY in May; Yuexiu (123 HK) registered a positive YoY growth (Apr: +61%YoY; May:+2%YoY) for two consecutive months, as compared to the listed peer average of -59%YoY in Apr and -57% YoY in May. **COLI (688 HK)** remains our top large-cap pick given its healthy net gearing of 31% with an average financing cost of 3.55% (-25bps YoY) as at Dec 2021. Leveraging its strong balance sheet, COLI has the resources for more landbanking and M&A activities. **Yuexiu (123 HK)** is also top small/mid-cap pick given its lucrative TOD model and backing by its strategic shareholder, GZ Metro.

■ PMCs:

Prefer SOE players in public projects. We prefer SOE players for the PM sector due to their ability to secure public projects. **CR MIXC (1209 HK)** remains our top large-cap pick given its leading position in the arena of shopping malls mgt and proactive stance in M&A. It secured over 72.48mn sqm in GFA via M&A in 1Q22, achieving 72% of its full-year third-party GFA addition target (100mn sqm). While COVID resurgence hampered 2Q performance, we believe pent-up demand will be released in 3Q upon relaxation of lockdown measures. **Yuexiu Services (6626 HK)** is our small/ mid-cap pick given its expertise in TOD management.



Risk Factors

■ Developers:

1) Uncertain development of COVID-19; 2) Margin erosion on price cut; 3) Impairment provision for unsold inventories due to steep decline in property prices; 4) Unsuccessful bond refinancing.

■ PMCs:

1) Corporate governance issues on substantial related-party transactions; 2) Heavy reliance on parents for new projects; 3) Potential margin erosion caused by M&A; 4) Increasing number of PMC stocks may suppress sector valuation; 4) Debt repayment of parent developers increases placement risks.

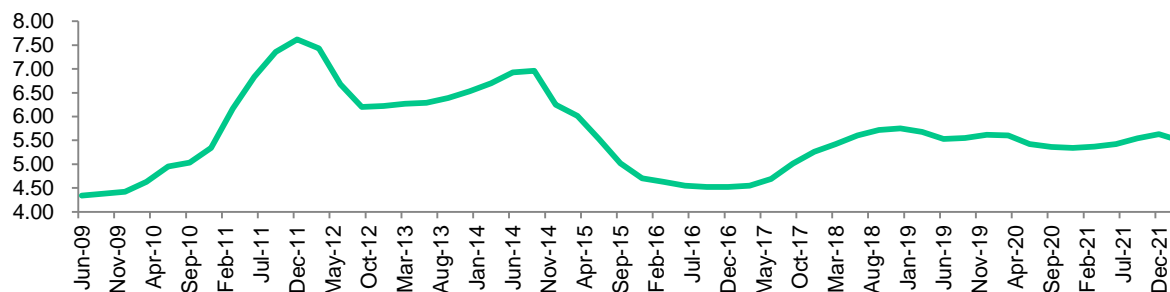
Exhibit 1: 5M22 contracted sales of major listed developers

			May 2022						5M22					
			Amount	YoY	GFA	YoY	ASP	YoY	Amount	YoY	GFA	YoY	ASP	YoY
			RMBbn	%	000 sqm	%	RMB/sqm	%	RMBbn	%	000 sqm	%	RMB/sqm	%
1	Yuxiu	123 HK	8.3	2	356	18	23,198	(14)	34.6	(15)	1,234	(17)	28,044	2
2	Sino-Ocean	3377 HK	7.4	(28)	417	(27)	17,770	(1)	29.3	(28)	1,795	(20)	16,326	(10)
3	Poly-A	600048 CH	38.0	(36)	2,436	(37)	15,604	2	159.2	(32)	10,156	(29)	15,677	(4)
4	CR Land	1109 HK	20.3	(19)	955	(32)	21,288	20	81.3	(35)	4,156	(42)	19,572	12
5	COLI	688 HK	26.4	(23)	1,022	(42)	25,825	33	95.0	(39)	4,425	(42)	21,475	6
6	Greentown	3900 HK	15.1	(52)	770	(44)	19,610	(14)	78.8	(39)	3,920	(28)	20,102	(15)
7	Country garden	2007 HK	28.7	(50)	3,570	(45)	8,042	(9)	150.6	(40)	19,280	(32)	7,810	(12)
8	Times	1233 HK	4.5	(50)	264	(44)	17,159	(11)	22.3	(40)	1,331	(31)	16,737	(14)
9	Vanke	2202 HK	30.8	(47)	1,875	(51)	16,405	9	168.1	(41)	9,811	(45)	17,134	7
10	Seazen	1030 HK	11.1	(54)	1,143	(48)	9,698	(12)	51.2	(46)	5,251	(42)	9,745	(7)
11	Agile	3383 HK	6.1	(39)	486	(33)	12,613	(9)	31.2	(49)	2,409	(39)	12,943	(17)
12	KWG	1813 HK	4.1	(64)	198	(69)	20,813	17	21.5	(53)	1,146	(52)	18,802	(2)
13	Jinmao	817 HK	9.0	(61)	394	(67)	22,844	17	50.9	(54)	2,600	(61)	19,575	17
14	CIFI	884 HK	10.8	(60)	650	(59)	16,613	(2)	49.6	(55)	3,344	(49)	14,845	(12)
15	Powerlong	1238 HK	3.8	(59)	262	(54)	14,527	(11)	19.0	(55)	1,242	(54)	15,311	(2)
16	Sunac	1918 HK	12.9	(82)	1,017	(80)	12,635	(9)	98.8	(59)	7,401	(56)	13,347	(8)
17	Yuzhou	1628 HK	2.9	(72)	164	(72)	17,738	0	16.9	(59)	944	(59)	17,916	(1)
18	Logan	3380 HK	3.5	(69)	254	(70)	13,937	3	26.6	(58)	1,699	(48)	15,656	(19)
19	Longfor	960 HK	9.1	(69)	559	(68)	16,208	(4)	40.5	(64)	2,394	(63)	16,913	(1)
20	Aoyuan	3883 HK	2.4	(79)	252	(74)	9,484	(20)	11.9	(77)	1,206	(74)	9,876	(14)

Source(s): Companies, ABCI Securities

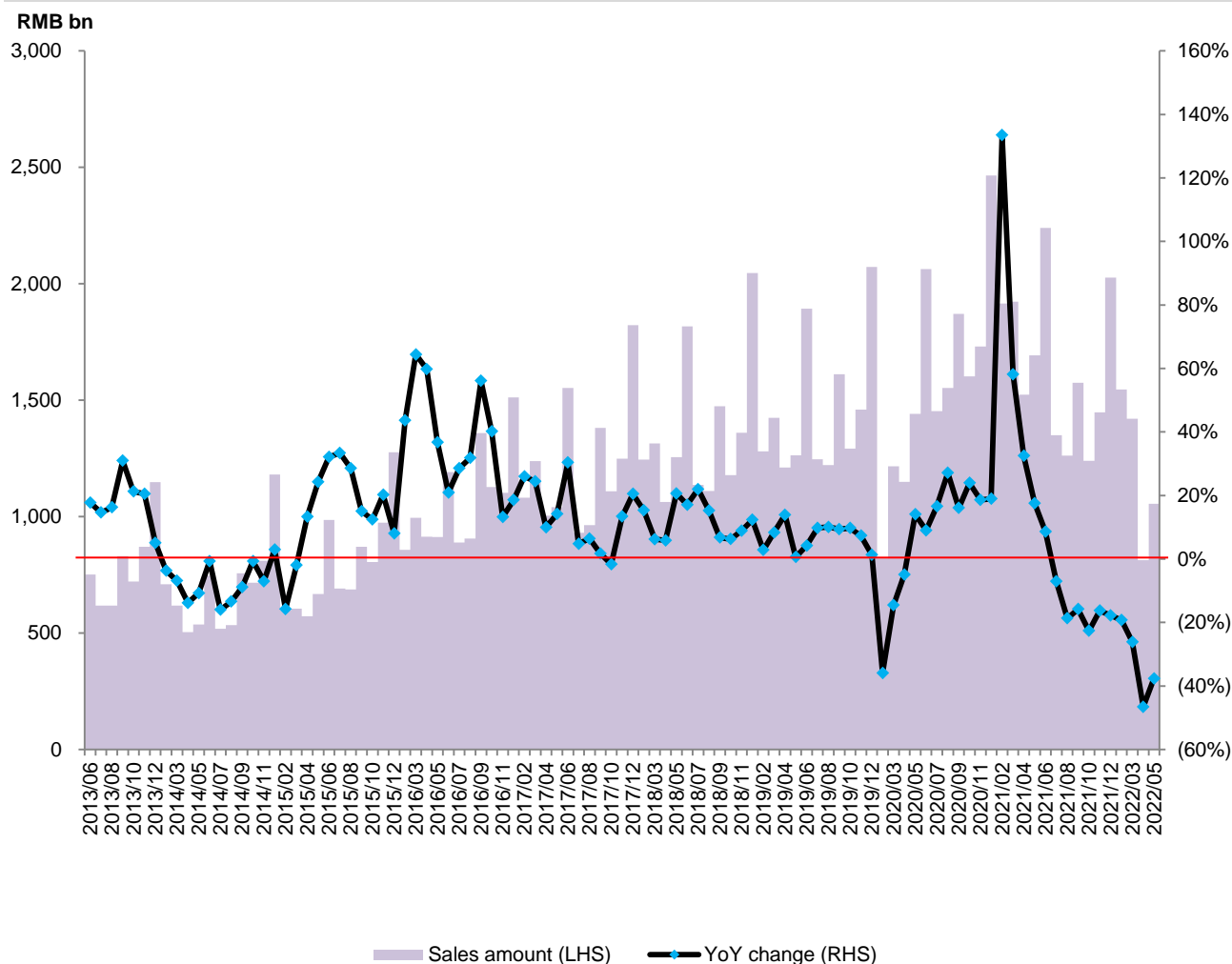


Exhibit 2: Weighted average mortgage rate in China (%)



Source(s): PBOC, ABCI Securities

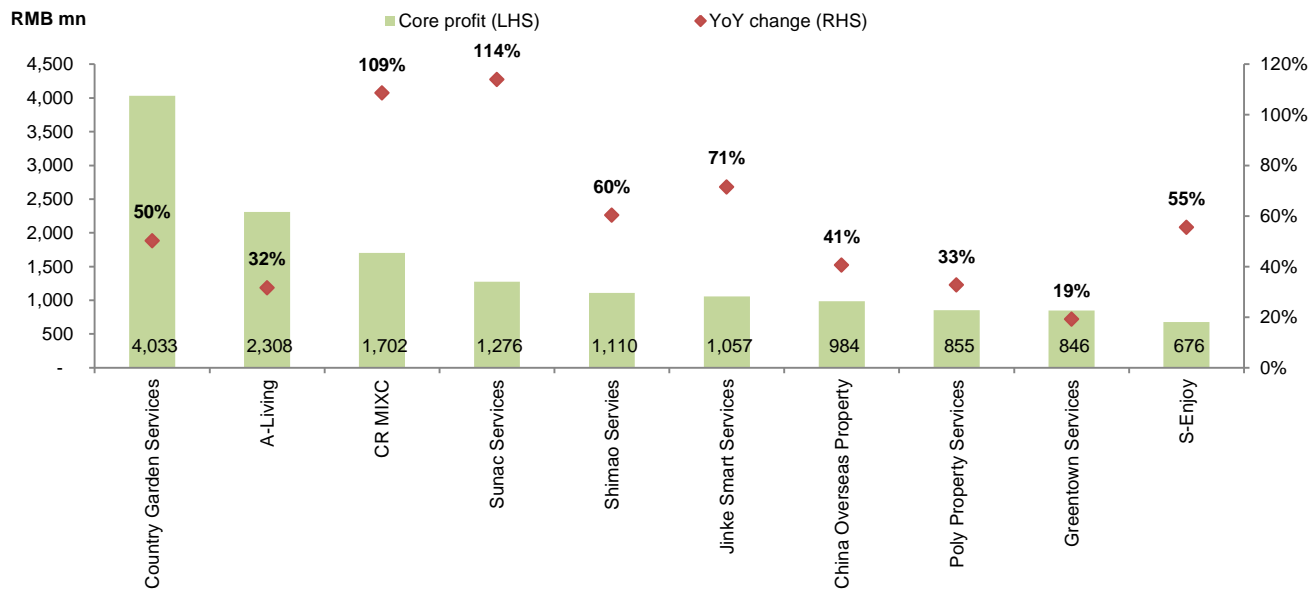
Exhibit 3: Sales of commodity housing in China



Source(s): NBS, ABCI Securities

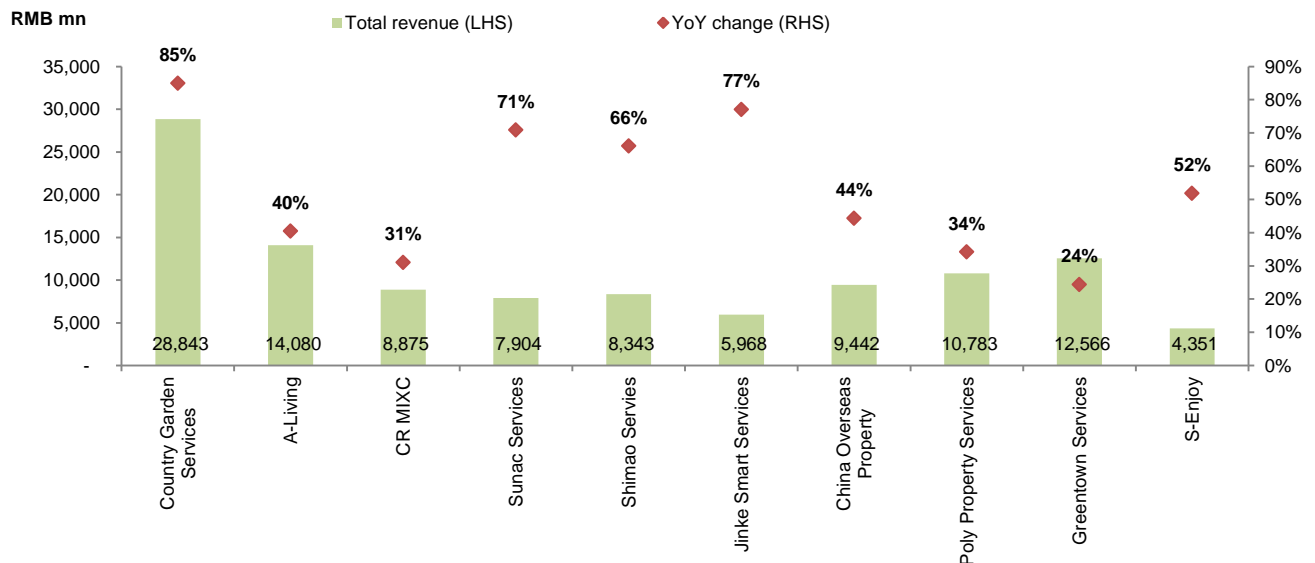


Exhibit 4: Core profit of major listed PMCs (2021)



* Figures of China Overseas Property are in HK\$
Source(s): Companies, ABCI Securities

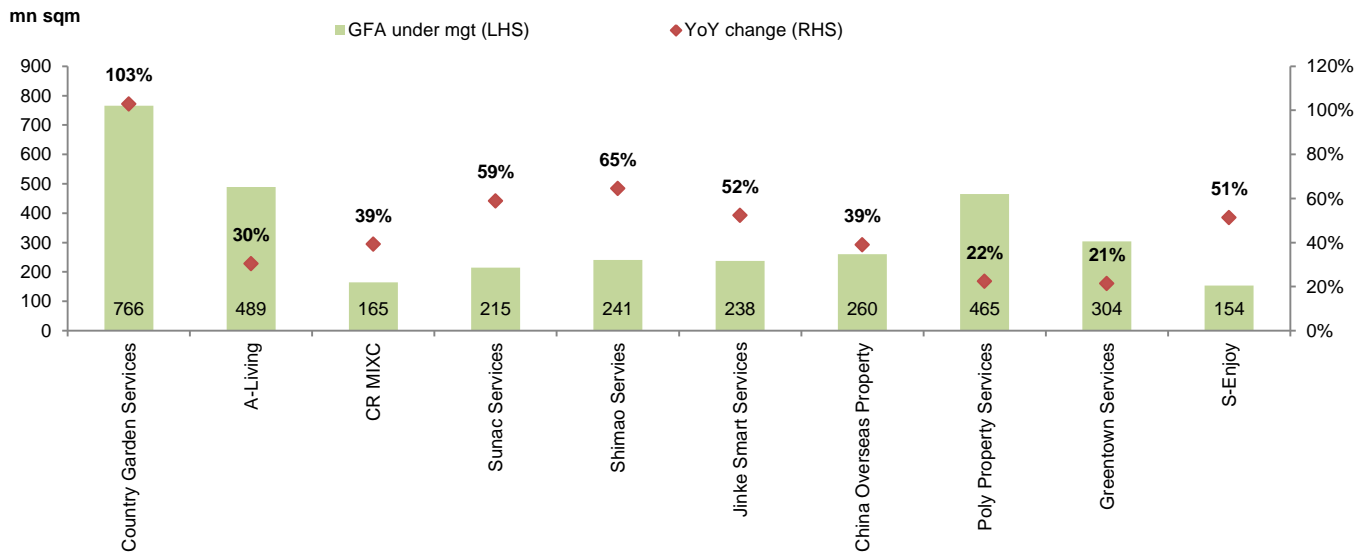
Exhibit 5: Total revenue of major listed PMCs (2021)



* Figures of China Overseas Property are in HK\$
Source(s): Companies, ABCI Securities

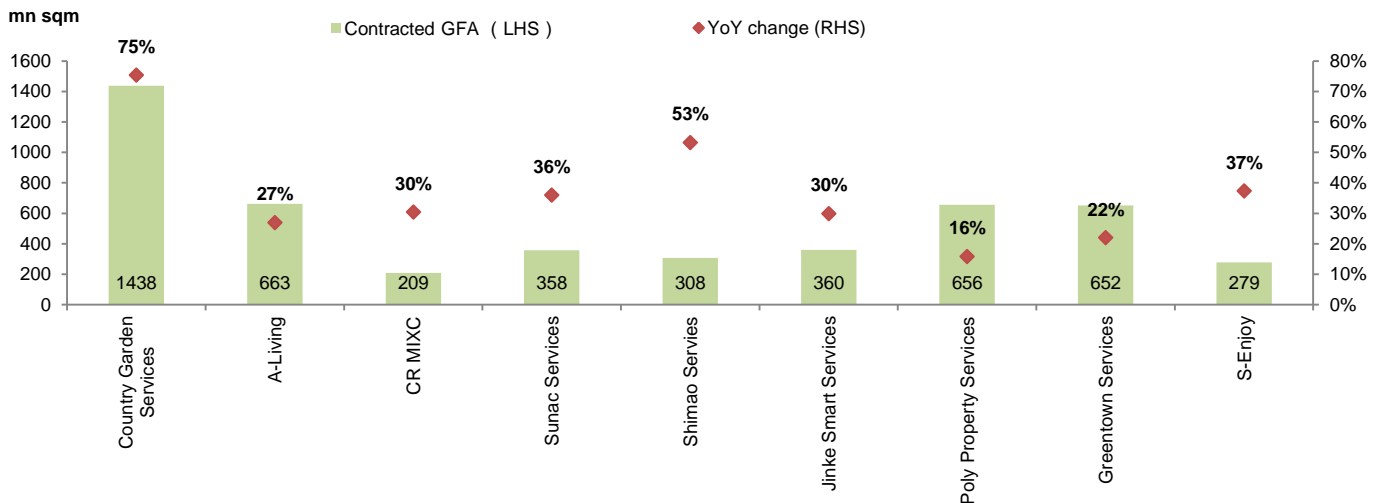


Exhibit 6: GFA under mgt of major listed PMCs (2021)



Source(s): Companies, ABCI Securities

Exhibit 7: Contracted GFA of major listed PMCs (2021)



Source(s): Companies, ABCI Securities

Valuation of sector top picks (Data as of June 27, 2022)

Company	Ticker (HK)	Rating	TP (HK\$)	Upside (%)	FY22E P/E(x)	FY23E P/E (x)	FY22E P/B (x)	FY23E P/B (x)	FY22E Yield (%)	FY23E Yield (%)
COLI	688	BUY	32.90	37.7	5.9	5.0	0.62	0.58	5.4	6.4
Yuexiu	123	BUY	10.24	6.4	5.6	5.0	0.52	0.49	7.2	8.1
CR MIXC	1209	BUY	52.60	34.9	30.8	21.1	4.87	4.19	1.0	1.4
Yuexiu Services	6626	BUY	5.45	44.7	7.7	5.1	1.45	1.21	3.9	5.9

Source(s): Bloomberg, ABCI Securities estimates



OVERWEIGHT

Internet Media and Consumer Commerce – More visible recovery for e-commerce

Key Data		Sector Performance (relative to MXCN)	Absolute (%)	Relative (%)
Avg. 22E P/E (x)	25.4	1-mth	25.8	13.8
Avg. 22E P/B(x)	2.4	3-mth	5.16	5.7
Avg. 22E div yield (%)	0.4	6-mth	(8.6)	3.9
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

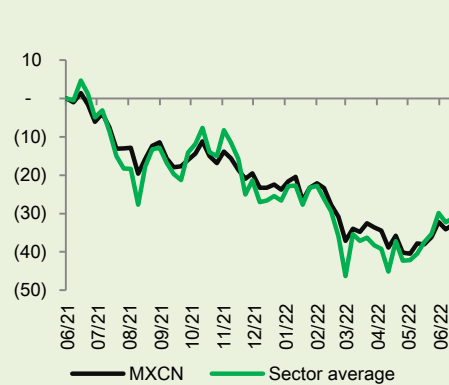
- Regulatory environment is gradually improving with the government reiterating long-term goal to support platform economy
- More visible recovery for online shopping platform
- **JD (9618 HK)** is our sector top pick

1-year sector performance (%)

Date	MXCN (%)	Sector average (%)
06/21	-5	-5
07/21	-10	-10
08/21	-15	-15
09/21	-10	-10
10/21	-15	-15
11/21	-10	-10
12/21	-15	-15
01/22	-10	-10
02/22	-15	-15
03/22	-30	-30
04/22	-35	-35
05/22	-30	-30
06/22	-25	-25

Source(s):Bloomberg, ABCI Securities

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Stabilizing regulatory environment. The government has recently reiterated its long-term strategic goal to support the healthy development of platform economy. In particular, it plans to speed up the development and integration of rural e-commerce and express delivery infrastructures, which is set to benefit the e-commerce sector.

E-commerce to recover first. Online sales growth of physical goods in China improved to 5.6% YoY in 5M22 vs. 5.2% in 4M22, indicating a gradual recovery driven by relaxation of social distancing measures and improving logistic bottleneck in May 2022. In addition, online penetration rate rose from 23.8% in 4M22 to 24.9% in 5M22, indicating ongoing shift from offline to online consumption. In particular, we see strong restocking demand for food and necessity products, which bodes well for e-commerce focusing on food and consumer staple products, including the community group-purchase platform.

Online gaming: Resumption of new games approval. Regulatory approval for new games has resumed since Apr 2022, ending a prolonged suspension starting July 2021. While the recent rounds of new games approval mainly concentrated on smaller game developers, it is likely that future approvals would extend to larger gaming platforms as well. Having said that, it remains to be seen whether the now-tightened requirement on gaming content and monetization method will affect user experience.

Online advertising to recover slowly. We see a slower recovery for the online advertising segment than the e-commerce segment given the softening economic growth at the moment. In particular, online advertising spending on education and automobile may reduce on industry-specific headwinds. E-commerce-related online advertising is likely to recover sooner along with the e-commerce segment.

Stock Recommendation

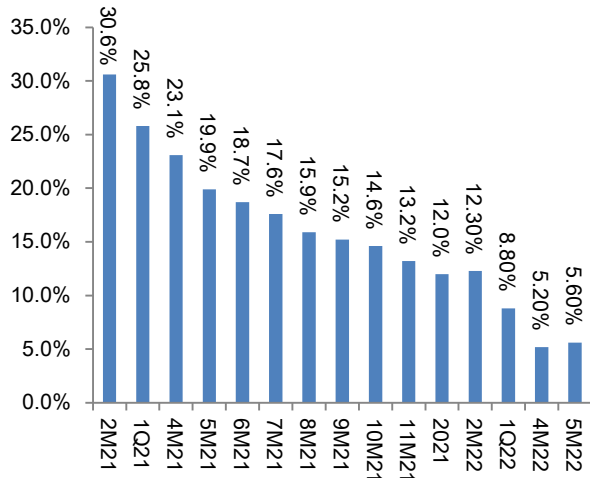
JD (9618 HK) has been experiencing resilient growth in recent quarters driven by its user growth lower-tier cities, mitigating the impact of macro softness. Compared to with peers such as Meituan (3690 HK) and Pinduoduo (PDD US), which have been investing heavily in community group-purchase business, JD generally adopts a more prudent approach to minimize the potential financial impact. In addition, the recent announcement of special dividend marks a good start of management's willingness to increase shareholders' return via utilizing its strong balance sheet.



Risk Factors

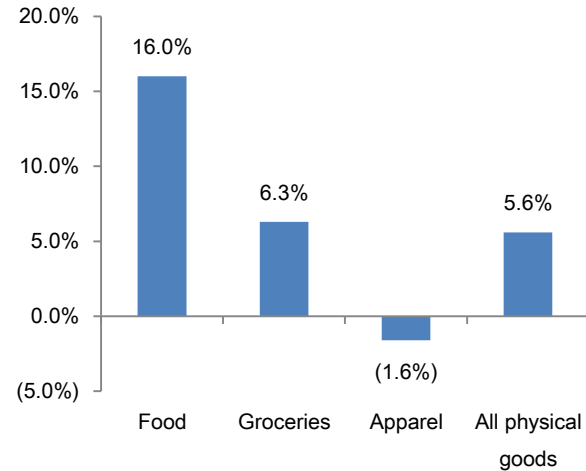
1) Regulatory risk such as anti-trust investigations; 2) Slowdown in e-commerce and internet finance; 3) Non-GAAP financials.

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



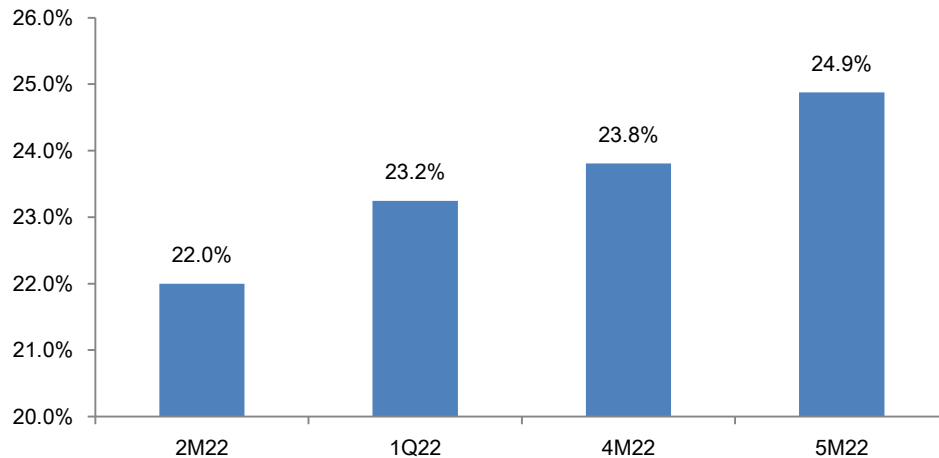
Source(s): NBS

Exhibit 2: Online sales of physical goods by category (5M22) (YoY Chg)



Source(s): NBS

Exhibit 3: Online shopping penetration rate



Source(s): NBS

Valuation of sector top picks (Data as of June 28, 2021)

Company	Ticker (SEHK)	Rating	TP (HK\$)	Upside (%)	FY22E P/E(x)	FY23E P/E (x)	FY22E P/B (x)	FY23E P/B (x)	FY22E Yield (%)	FY23E Yield (%)
JD	9618	BUY	290	11.5%	42.4	28.3	3.5	3.1	1.9	NA

Source(s): Bloomberg, ABCI Securities estimates



OVERWEIGHT

China Consumer Sector – Eyeing on post-pandemic recovery

Paul Pan

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 22E P/E (x)	19.3	1-mth	15.5	5.0
Avg. 22E P/B(x)	2.6	3-mth	9.9	6.1
Avg. 22E div yield (%)	2.0	6-mth	(12.9)	(8.7)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

➤ Post-pandemic recovery would be a major theme in the market in the near term

➤ Inflationary pressure to increase in 2H22

➤ **OVERWEIGHT** sector rating for defensiveness; our sector top picks include **Mengniu (2319 HK)** and **Yili (600887 CH)**

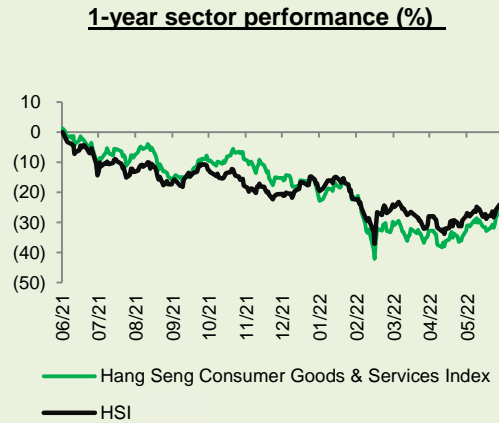
1-year sector performance (%)

Date	Hang Seng Consumer Goods & Services Index (%)	HSI (%)
06/21	0	0
07/21	-5	-10
08/21	-10	-15
09/21	-15	-20
10/21	-10	-15
11/21	-15	-20
12/21	-20	-25
01/22	-25	-30
02/22	-40	-45
03/22	-35	-30
04/22	-40	-35
05/22	-30	-25

— Hang Seng Consumer Goods & Services Index

— HSI

Source(s):Bloomberg, ABCI Securities



Source(s):Bloomberg, ABCI Securities

COVID resurgence disrupted consumer market. Recent COVID-19 resurgence across the country led to slowdown in Mar-May retail sales growth and per capita income & spending growth in 1Q22. Retail sales declined 3.5% YoY in Mar 2022 and 6.7% YoY in May 2022. In 1Q22, per capita income growth rose to 6.3% YoY from 5.4% YoY in 4Q21 but per capita spending growth slowed to 6.9% YoY from 8.6% YoY in 4Q21. However, we expect the consumer market to soon recover with the relaxation of social distancing measures and improving macroeconomic environment as the pandemic comes under control.

Supportive policies to aid recovery in consumer market. To support the consumer market, the central and local governments have rolled out policies, which include the “Notice of Measures to Stabilize Macroeconomic Situation” (《关于印发扎实稳住经济一揽子政策措施的通知》) by the State Department and two proposals by the Shanghai and Shenzhen government (《上海市加快经济恢复和重振行动方案》《深圳市关于促进消费持续恢复的若干措施》) that offer supportive measures to revive automobile and home appliance consumption. Plans to promote consumption in personal electronics and tourism are also outlined in the local government policies. In our view, these policies would aid market recovery and boost investors’ confidence on the sector.

Inflationary pressure to increase further in 2H22. CPI has been rising since the start of 2022 due to global commodity price increase. In May 2022, CPI reached 2.1% YoY. In 2H22, we expect the inflationary pressure to rise further. Global inflation is pushing up prices of feeds, resulting in a 17% increase in weekly average wholesale price of pork between the second week of Apr 2022 and the third week of June 2022. Pork price will show higher YoY growth due to the low-base effect in 2H21. The higher inflationary pressure would allow companies in the consumer sector to raise products prices.

Long-term Outlook

We believe large and diverse consumer demand in China will continue to support the consumer market. Market competition would intensify due to increased sophistication in consumer preference, improved information accessibility about products and services, and expanded channels to promote to target customers. Potential decline in newborns and population size remains a major overhang for the sector since overall demand may decline in the long run.



Short-term Outlook

We expect the sector to pick up gradually after the recent wave of COVID-19. Supportive policies for the consumer sector would aid recovery. In addition, increasing inflationary pressure would raise costs of raw material but companies would also have better pricing ability.

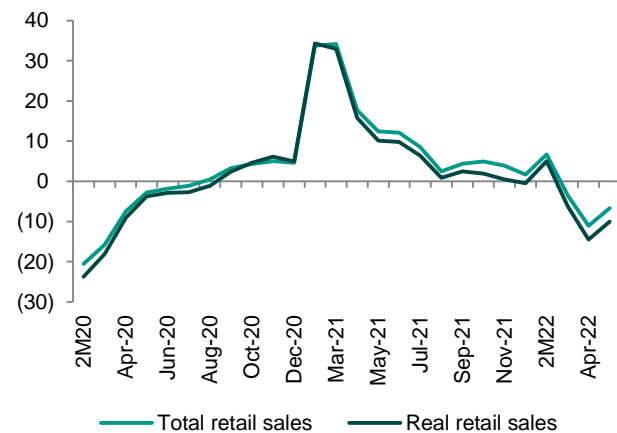
Stock Recommendations

We assign an **OVERWEIGHT** rating based on the sector's defensiveness. The leading consumer staple players would continue to be supported by solid fundamentals, improving domestic demand, and better pricing capability. As market volatility increases, investors are likely to switch to consumer staple players. Our current top picks include **Mengniu (2319 HK)** and **Yili (600887 CH)**.

Risk Factors

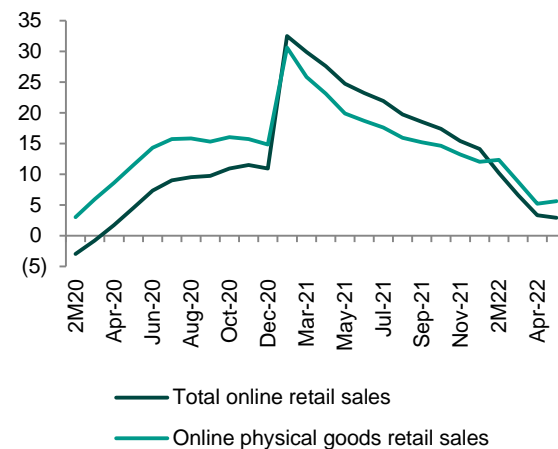
1) Macroeconomic risk; 2) Prolonged COVID-19 outbreak; 3) Rising raw material costs; 4) Regulatory/policy risk; 5) Product quality/safety risk; 6) Risk of changing consumer tastes.

Exhibit 1: Retail sales change (YoY %)



Source(s): NBS, ABCI Securities

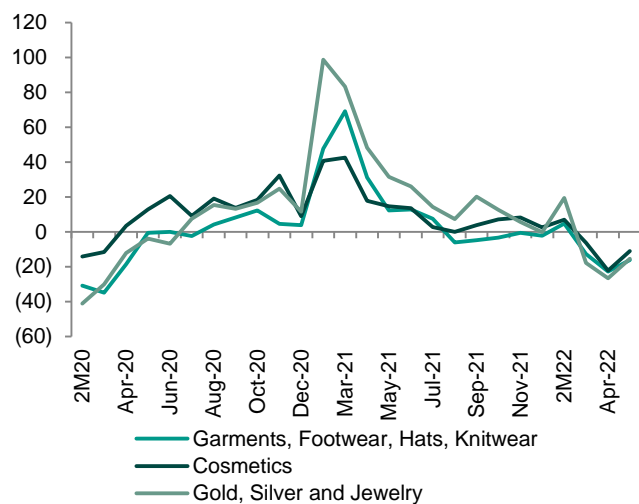
Exhibit 2: Online retails sales change (YoY %)



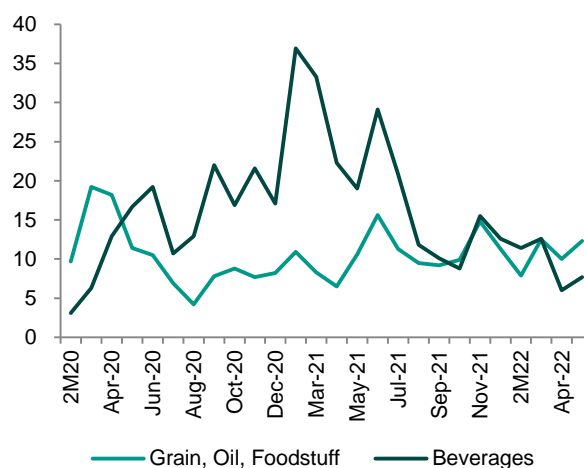
Source(s): NBS, ABCI Securities



Exhibit 3: Retail sales change of certain product categories (YoY %)

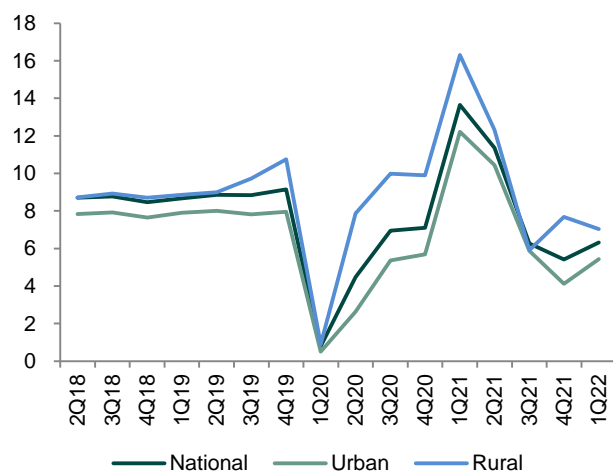


Source(s): NBS, ABCI Securities



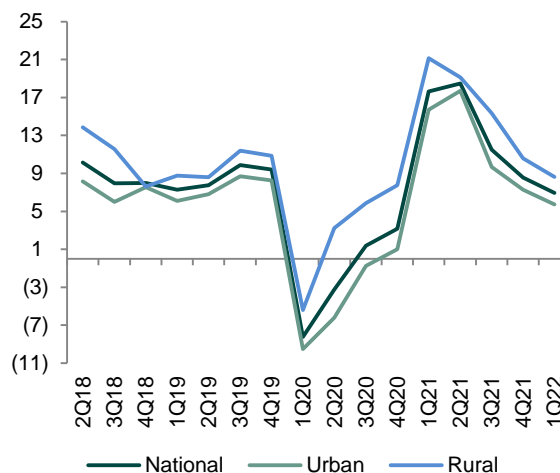
Source(s): NBS, ABCI Securities

Exhibit 4: Per capita income change (YoY %)



Source(s): NBS, ABCI Securities

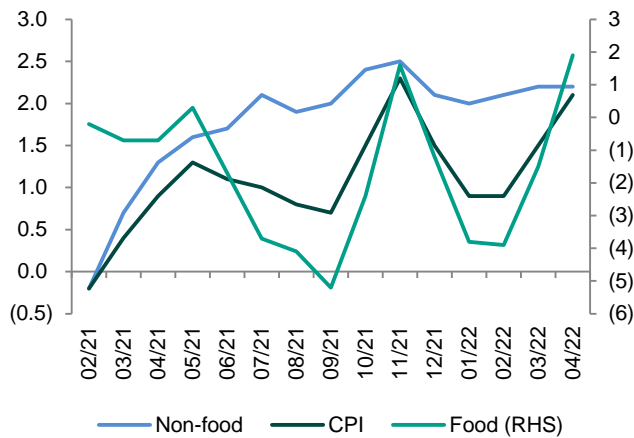
Exhibit 5: Per capita spending change (YoY %)



Source(s): NBS, ABCI Securities



Exhibit 6: CPI (YoY %)



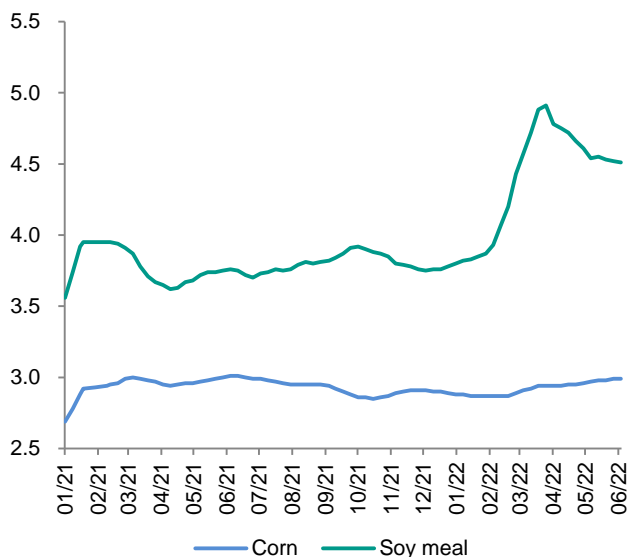
Source(s): NBS, ABCI Securities

Exhibit 7: Weekly average wholesale price of pork (RMB/kg)



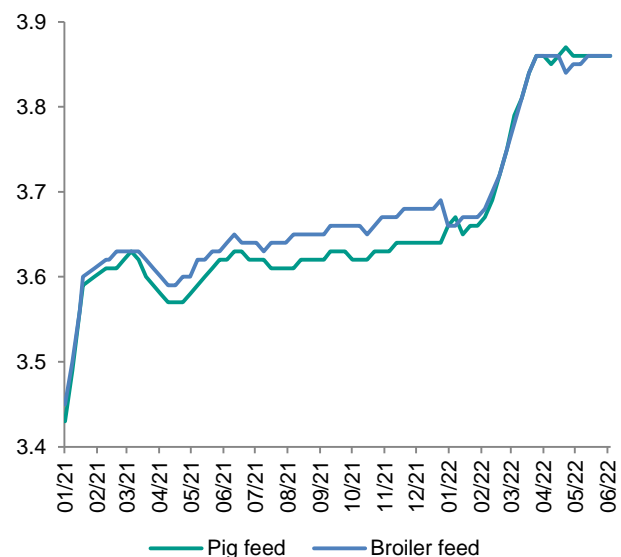
Source(s): MOA, ABCI Securities

Exhibit 8: Prices of corn and soy meal (RMB/kg)



Source(s): MOA, ABCI Securities

Exhibit 9: Prices of pig and broiler feeds (RMB/kg)



Source(s): MOA, ABCI Securities

Valuation of sector top picks (Data as of June 27, 2022)

Company	Ticker	Rating	TP	Upside (%)	FY22E P/E(x)	FY23E P/E (x)	FY22E P/B (x)	FY23E P/B (x)	FY22E Yield (%)	FY23E Yield (%)
Mengniu	2319 HK	BUY	HK\$48.1	23.5	26.41	20.81	3.25	2.92	1.16	1.46
Yili	600887 CH	BUY	RMB 44.6	15.2	20.92	16.56	4.13	3.84	3.36	4.26

Source(s): Bloomberg, ABCI Securities estimates



NEUTRAL

China Education Sector – Higher education remains favorable

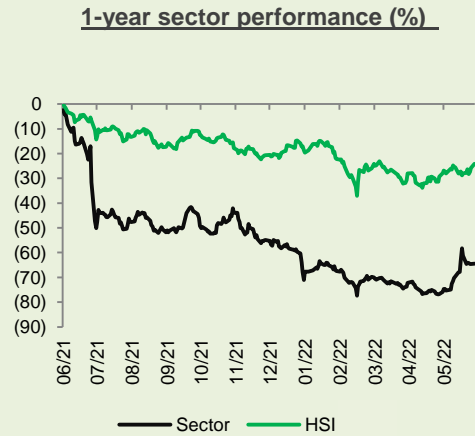
Paul Pan

Key Data		Sector Performance (relative to HSI)		Absolute (%)	Relative (%)
Avg. 22E P/E (x)	3.6	1-mth		53.8	43.3
Avg. 22E P/B(x)	0.6	3-mth		22.3	18.5
Avg. 22E div yield (%)	0.8	6-mth		(21.2)	(16.9)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities			
<div><div>➤ Higher education remains favorable under the current regulatory environment</div><div>➤ After-school education players are exploring new business areas, with some achieving initial success</div><div>➤ Our rating for the sector is NEUTRAL due to stringent regulations; our sector top pick is CEG (839 HK) due to its leading position in the higher education sub-segment</div></div>					

1-year sector performance (%)

Date	Sector (%)	HSI (%)
06/21	0	0
07/21	(50)	(10)
08/21	(55)	(15)
09/21	(50)	(15)
10/21	(55)	(15)
11/21	(50)	(15)
12/21	(55)	(15)
01/22	(60)	(15)
02/22	(70)	(15)
03/22	(75)	(15)
04/22	(70)	(15)
05/22	(75)	(15)

Source(s):Bloomberg, ABCI Securities



Policy environment remains favorable to higher education players. Even though the policy environment has been stable since end-2021, after-school education segment remains heavily regulated with a slew of restrictions in place for K-9 after-school academic subject tutoring; as a result, both New Oriental (EDU US/9901 HK) and TAL (TAL US) terminated their business in the area by end-2021. For formal education, higher education continues to enjoy a favorable policy environment with the “Revised Implementation Measures of the Law on the Promotion of Private Schools” (《中华人民共和国民办教育促进法实施条例》) announced in May 2021, the “Opinions on Promoting High-Quality Development of Modern Vocational Education” (《关于推动现代职业教育高质量发展的意见》) announced in Oct 2021, and the newly amended Vocational Education Law announced in Apr 2022. Higher education is more preferable than other education sub-segments amid the current regulatory environment. Several higher education players also reported sizeable increase in enrollment quota for the 2022/2023 academic year. CEG (839 HK) and Hope Education (1765 HK) saw 70% YoY / 158%YoY increase in their top-up degree program admission quota.

New business ventures by after-school education players. Many after-school education players have terminated K-9 after-school academic subject tutoring and venture into new business areas, some unrelated to education, in a bid to seek new income growth drivers. New Oriental (EDU US/9901 HK) has gained some initial success in livestreaming e-commerce with its unique sales techniques. We expect the after-school education players to explore new business areas, with some transitioning away from the education industry.

Long-term Outlook

Based on the current regulatory environment, we believe the sector is likely to face more regulatory scrutiny in the long run. Despite the large population base, further decline in newborns and birth rate may negatively impact the sector’s enrollment growth in the long term.

Short-term Outlook

Other than the higher education sub-segment, the sector would continue to face regulatory pressure in the short term. We believe the policy-favored higher education sub-segment would continue to enjoy growth. Other sub-segments would face more regulatory pressure and be driven to venture into new business areas.



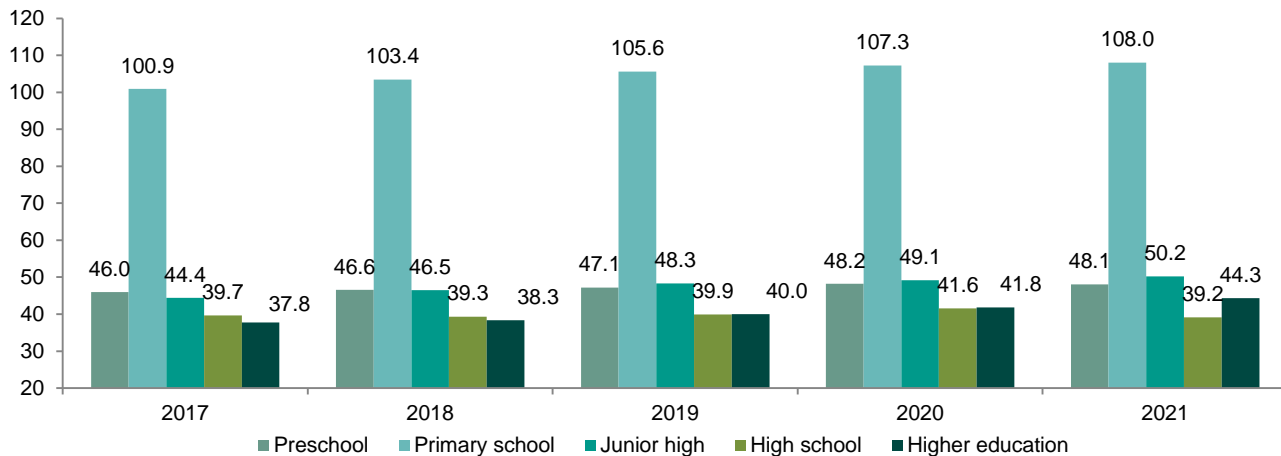
Stock Recommendation

We continue to favor the higher education players due to the favorable policy treatment. Some after-school education players enjoy initial success in their new ventures but the longer-term prospects are yet to be seen. Our sector top pick is **CEG (839 HK)** due to its leading position in the higher education sub-segment.

Risk Factors

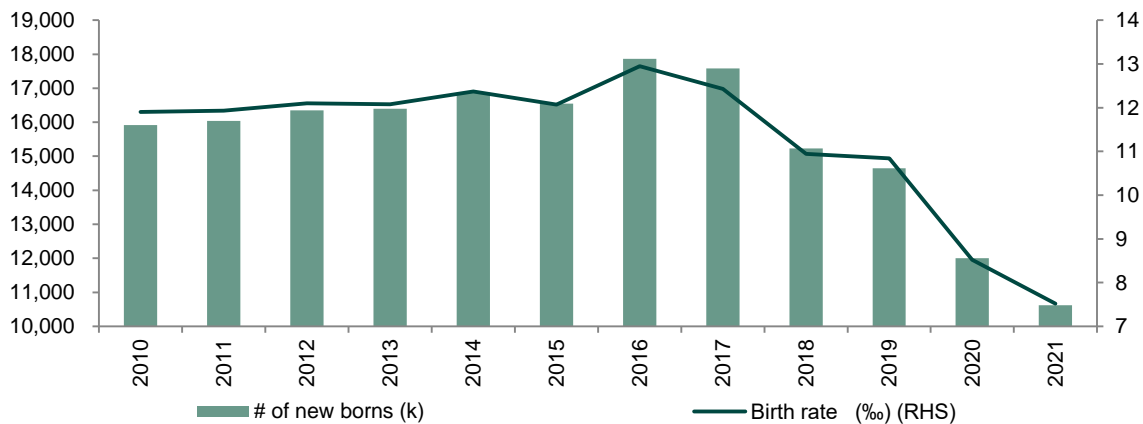
1) Macroeconomic risk; 2) Regulatory risk; 3) Education quality and student dropout risk; 4) Liquidity risk; 5) Prolonged pandemic risk.

Exhibit 1: National enrollment figures by education level (mn ppl)



Source(s): MOE, ABCI Securities

Exhibit 2: Number of newborns and birth rate in China



Source(s): NBS, ABCI Securities

Valuation of sector top picks (Data as of June 27, 2022)

Company	Ticker	Rating	TP (HK\$)	Upside (%)	FY22E P/E(x)	FY23E P/E (x)	FY22E P/B (x)	FY23E P/B (x)	FY22E Yield (%)	FY23E Yield (%)
CEG	839 HK	BUY	HK\$ 22.6	202	9.47	8.17	1.16	1.06	4.55	5.28

Source(s): Bloomberg, ABCI Securities estimates



OVERWEIGHT

China Telecom Sector – Growth from emerging business

Ricky Lai

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 22E P/E (x)	11.5	1-mth	1.6	(0.5)
Avg. 22E P/B(x)	1.10	3-mth	(31.5)	(19.2)
Avg. 22E div yield (%)	3.48	6-mth	(41.6)	(29.8)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		
<ul style="list-style-type: none">➤ Telecom operators are developing the emerging business (industrial internet, data center, cloud computing) will be a new driver for the sector➤ The no. of 5G base stations in China will reach 2.03mn in 2022E, benefiting the upper supply chain➤ China Mobile (941 HK/600941 CH) is our top pick for its high dividend yield, healthy balance sheet, and dominant position in China's telecom market				

1-year sector performance (%)

Source(s):Bloomberg, ABCI Securities



Contribution from emerging business is rising. The emerging businesses (industrial internet, data center, cloud computing) of telecom operators have been growing robustly. In Feb 2022, the NDRC introduced the scheme of “East-to-West Computing Resources Transfer” strategy to develop data centers in the West regions to improve data processing capacity and boost cloud computing adoption. As more corporations are adopting the cloud platforms to improve business efficiency and operation management, penetration rate of cloud usage will increase.

5G base stations are estimated to reach 2.03mn by end-2022E. We forecast the 5G user penetration rate to reach 30.0% by end-2022E. China Mobile maintains the dominant position in the 5G market, thanks to improved 5G network coverage, abundant resources, and efficient marketing strategies. For 2022E, we expect the total no. of 5G base stations to reach 2.03mn, including the 0.6mn new 5G base stations to be added during the year. Hence, the business of base stations equipment providers will be supported. Overall, mobile base stations are expected to reach 10.56mn in 2022E. Also, telecom operators are upgrading their 5G telecom network to the standalone standard for better network quality, which should catalyze earnings for the telecom equipment providers.

Telecom operators' CAPEX are expected to increase 2.8% YoY in 2022E for cloud computing, data center, 5G network, and fixed network. We estimate the 2022E aggregate CAPEX of the three major telecom operators (China Mobile / China Unicom / China Telecom) to be RMB 347.2 bn, up 2.8% YoY. The rise in CAPEX is expected to benefit the telecom equipment makers and service providers.

We forecast global smartphone shipments to drop 5.0% YoY in 2022E. According to IDC, global smartphone shipment declined 8.9% YoY in 1Q22, the third consecutive quarter with a YoY decline. The slowdown can be attributed to the logistics constraints and soured consumer sentiment. We expect global smartphone shipment to drop 5.0% YoY in 2022E due to unfavorable economic environment.



Long-term Outlook

In the long term, we expect telecom operators to benefit from 5G network development and emerging businesses. Increases in 5G user penetration rate, average mobile data usage per user, and mobile ARPU will help improve earnings. Also, supportive policies encouraging the adoption of 5G services and industrial and commercial digitalization will help boost 5G user penetration rate. In Feb 2022, the NDRC introduced the scheme of "East-to-West Computing Resources Transfer" strategy to promote the development of data centers in western China so as to improve data processing capacity and boost cloud computing adoption. Many companies are introducing 5G-related new applications such as internet of things, autonomous driving, smart home, AR/VR. Telecom operators can generate more value added service revenue with the launch of these innovative services. Telecom operators will speed up the 5G network development in China and increase CAPEX for network development since the 5G network requires a much denser base stations distribution and wider fiber network coverage. Equipment providers will benefit from the infrastructure improvement.

Short-term Outlook

Emerging business will be a new driver. More companies are transferring their businesses and data storage to the cloud platform. We expect mobile service revenue to increase, thanks to higher mobile ARPU resulted from increasing mobile data usage and 5G user base. Telecom operators are raising their CAPEX in 2022E to improve 5G network coverage, which can benefit the upstream telecom equipment supply chains.

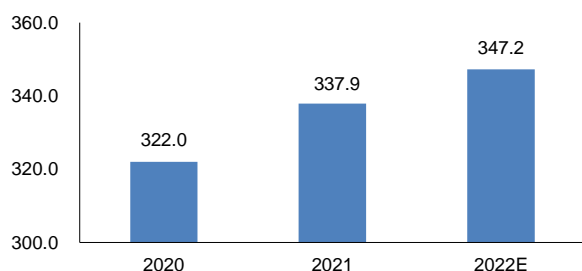
Stock Recommendation

China Mobile (941 HK/600941 CH) is our sector top pick. We expect China Mobile's mobile ARPU to rebound in 2022E on expanding 5G user base. China Mobile has been able to maintain the largest 5G market share in China, thanks to its network advantage with better coverage and resources. Our TP is HK\$ 85.00 for H-Share (941 HK), which implies 3.8x FY22E EV/EBITDA and RMB93.00 for A-Share (600941 CH), which implies 4.1x FY22E EV/EBITDA.

Risk Factors

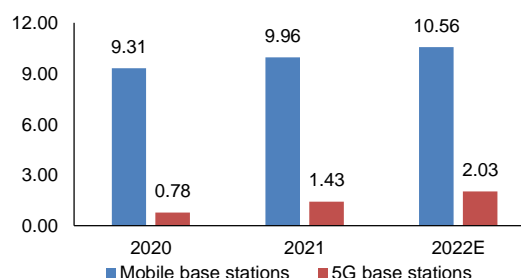
- 1) Further reduction in service tariff as requested by authorities;
- 2) User saturation;
- 3) Intensifying market competition;
- 4) Slower growth in smartphone shipments;
- 5) Slowdown in 5G network development.

Exhibit 1: Telecom operators' CAPEX (RMB bn)



Source(s): MIIT, ABCI Securities estimates

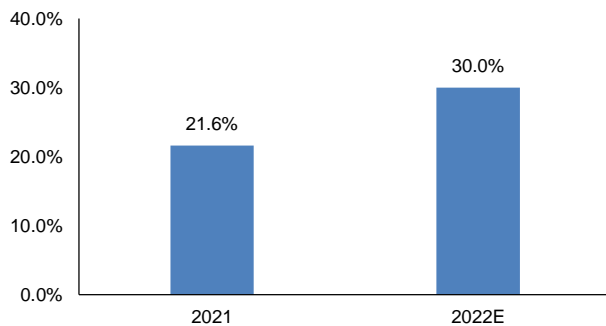
Exhibit 2: The no. of mobile and 5G base stations (mn)



Source(s): MIIT, ABCI Securities estimates

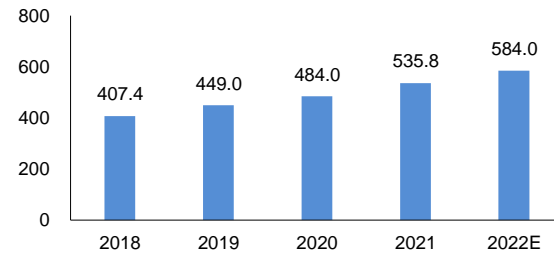


Exhibit 3: 5G User penetration rate in China



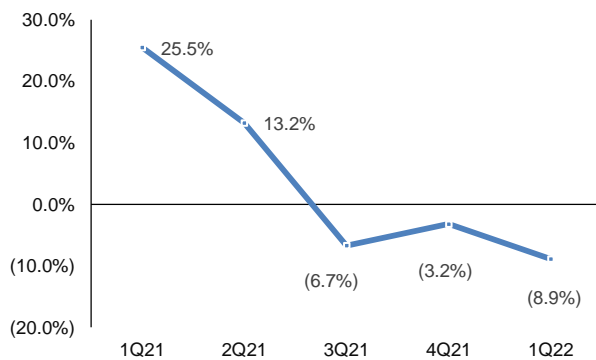
Source(s): MIIT, ABCI Securities estimates

Exhibit 4: Wireline broadband user (mn)



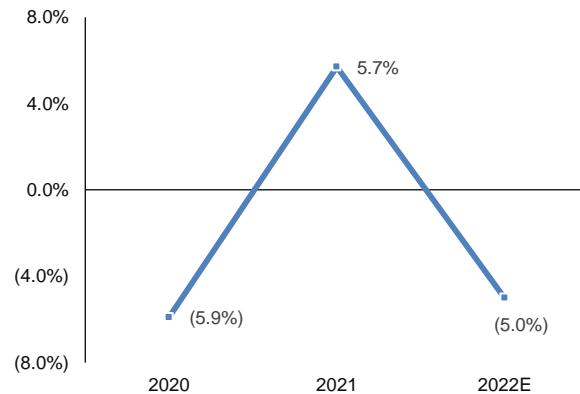
Source(s): MIIT, ABCI Securities estimates

Exhibit 5: Quarterly smartphone shipment growth (YoY)



Source(s): IDC

Exhibit 6: Yearly smartphone shipment growth (YoY)



Source(s): IDC, ABCI Securities estimates

Valuation of sector top picks (Data as of June 27, 2022)

Company	Ticker	Rating	TP	Upside (%)	FY22E P/E(x)	FY23E P/E (x)	FY22E P/B (x)	FY23E P/B (x)	FY22E Yield (%)	FY23E Yield (%)
China Mobile	941 HK	BUY	HK\$ 85.0	74.0	7.96	7.20	0.73	0.72	7.28	7.40
China Mobile	600941 CH	BUY	RMB 93.0	54.2	12.29	11.12	1.16	1.18	5.14	5.27

Source(s): Bloomberg, ABCI Securities estimates



Disclosures

Analyst Certification

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

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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 10\%$)
Hold	- Market return rate ($\sim 10\%$) \leq Stock return rate $<$ Market return rate ($\sim 10\%$)
Sell	Stock return $<$ - Market return ($\sim 10\%$)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (For reference: HSI total return index 2009-21 averaged at 9.2%)

Time horizon of share price target: 12-month

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

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