29 June 2018

Strategy - Hong Kong

Volatility To Persist

Stocks Covered: 80
Ratings (Buy/Neutral/Sell): 50 / 21 / 9

We see China's GDP set to continue on its steady growth path of 6.5%, supported by domestic consumption and investments. A potential threat represent the latest tariff proposals by the US. The actual impact would depend on China's retaliation moves and the pace of CNY depreciation.

- **As base-case, we expect the risk-off mode to persist and HSI to remain in 3Q18 within a trading range between 27,000 and 30,500 pts;**
- **A bottom of 25,500 pts (-1SD) could be reached only in a worst case scenario of a full-blown trade war;**
- **Under an optimistic scenario (softening of trade tensions between the US and China, etc.) HSI could return to c. 34,000 pts by the end of 2018.**

As safe havens during 3Q18, we recommend weighing on yield and domestic demand-driven plays. Longer term, valuation recovery is possible upon any softening on the trade tensions and other catalysts which may generate a return of capital inflow; this scenario is likely to happen only from 4Q18, at the earliest. We are positive on China banks and property.

Uncertainty remains, but on track of a normalizing economic growth path. We believe domestic consumption and gross capital formation will continue to be the driving force of China's economic growth going forward. A full-blown trade war, would probably lead to a reduction in GDP by 0.1-0.8% in 2018 and 0.2-1.6% in 2019. However, this worst case scenario does not take into consideration any retaliation from China, which would partially offset the negative impact on net exports through fewer imports. Moreover, an adjustment on the domestic front and a prolonged CNY depreciation could also play down the impact from the tariffs. Therefore, while the actual impact on China's GDP remains uncertain, it is probably less than our worst case.

Range trading amid a cautious sentiment continues in 3Q18. As trade frictions continue to escalate, we expect the market to remain volatile in 3Q18. The sectors directly involved in a trade war comprise c.13% of HSI. Therefore the index valuation will remain under pressure. HSI is currently trading at 10.7x forward-rolling P/E, roughly equivalent to -0.5SD from 10-year mean. We estimate the HSI trading range bound between 27,000 (-0.75SD) and 30,500 pts (-0.25SD) in near term. A bottom of 25,500 pts (-1SD) could be reached only in a worst case scenario of a full-blown trade war.

Valuation recovery likely in 4Q18. Longer term, any softening in the trade tensions between the US and China would represent a trigger for valuation to catch-up. A strengthening USD, the potential IPOs of heavyweight unicorns and the Chinese Depositary Receipts (CDRs) are also potential triggers for a capital inflow back into HK's equity market. On such an optimistic scenario, HSI could return to c.34,000 pts (+0.5SD from 10-year mean) by the end of 2018.

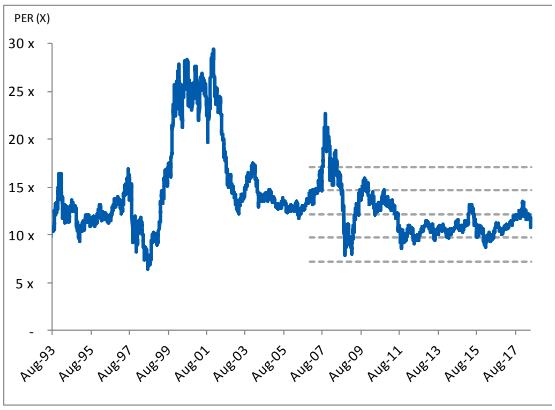
Positive on China banks and property. Near term, we suggest weighing on yield plays and domestic demand-driven plays as safe havens amid both internal and external uncertainties. We remain positive on China banks given a gradual NIM expansion and solid credit demand, with attractive dividend yields. ABC and BOC are our Top Picks. Also, we believe any refinancing or credit tightening concerns on China property sectors represent accumulating opportunities, as its solid contracted sales and earnings growth outlook remain intact. Finally, we regard Tencent's strengths unaffected by a trade war in the long term, therefore any short term headwinds provide good entry points.

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-19F	P/B (x) Dec-19F	Yield (%) Dec-19F
Agricultural Bank of China	BUY	HKD3.59	HKD5.80	61.6	4.4	0.6	6.9
Bank of China	BUY	HKD3.79	HKD5.90	55.7	4.8	0.6	6.5
China State Construction	BUY	HKD8.03	HKD13.20	64.4	4.9	0.8	5.7
Country Garden	BUY	HKD12.74	HKD22.00	72.7	5.5	1.9	6.3
Geely Automobile	BUY	HKD19.78	HKD29.00	46.6	8.3	2.5	2.3
Shimao Property	BUY	HKD20.20	HKD30.00	48.5	4.1	0.8	9.8
Tencent Holdings Ltd	BUY	HKD377.40	HKD529.00	40.2	26.7	9.4	0.1
China Overseas Grand Oceans Grc	SELL	HKD2.84	HKD2.30	(19.0)	4.8	0.3	3.1

Source: Company data, RHB

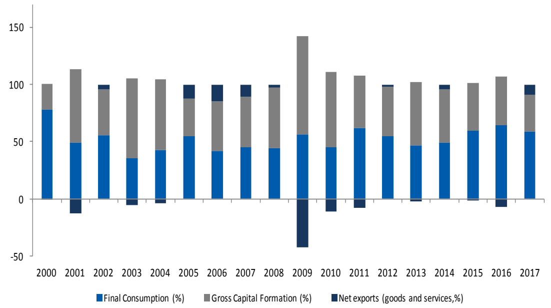
Top Picks	Target Price
Agricultural Bank of China (1288 HK) – BUY	HKD5.80
Shimao Property (813 HK) – BUY	HKD30.00
Tencent (700 HK) – BUY	HKD529.00

HSI may range between -0.75 and -0.25SD in 3Q18



Source: Bloomberg, RHB

Insignificant contribution from net exports to China's GDP growth (%)



Source: Bloomberg, RHB

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China Economy Still On Track

On track of normalising growth path, despite the trade dispute concerns

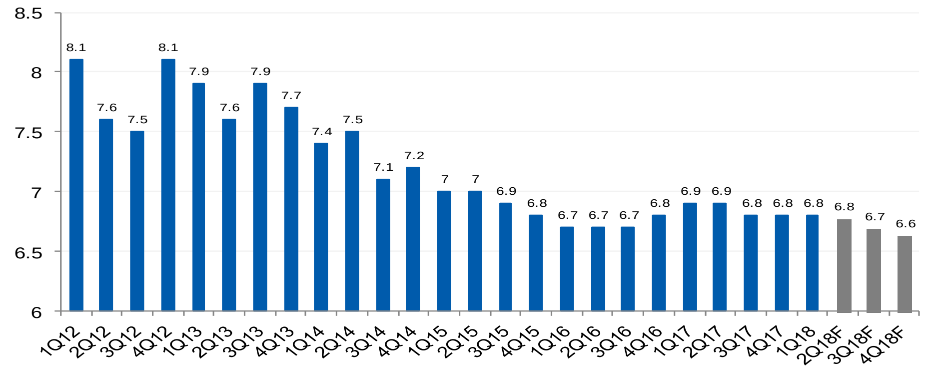
China's economic data YTD remained solid. The headline 1Q18 GDP came in at 6.8% YoY, well above the c.6.5% growth target stated in the 2018 Government Work Report. Headline fixed asset investment (FAI) growth dropped to 6.1% YoY for 5M18 as a slowdown in infrastructure investments was the major drag; nevertheless, we see a robust growth in real estate investments. Among the other components, manufacturing investments rebounded to 5.2% YoY YTD (from 4.8% in 2017), thanks to a solid corporate earnings growth. Meanwhile, inflation stayed muted YoY as both CPI and PPI grew by 3.7% and 2.0% for 5M18.

The ongoing US-China trade dispute grabbed the headlines and various estimates are circulated on the potential impact on China's GDP growth outlook. According to the latest tariff proposal at the time of writing, we estimate China's GDP in 2018 will, at worst, be affected by 0.1-0.8% in 2018 and 0.2-1.6% in 2019. However, this scenario does not include any retaliation from China. Therefore, as the actual impact on net exports remains uncertain the impact on GDP is probably less than the data stated above.

Moreover, we should be aware that China's reliance on exports has declined steadily (see Figure 6), where the contribution from exports to the US to the nominal GDP decreased from 22.9% in 2013 down to 18.8% in 2017 (see Figure 3). Also, we believe a negative impact on GDP from a trade dispute could be partially offset by adjustments on the domestic front, ie through consumption, real estate investments and manufacturers' capital expenditures.

All in all, except for a further deteriorating development on the US-China trade war "front", we anticipate China's GDP growth to reach 6.5% in 2018. While deleveraging shall continue to drag down the infrastructure spending, we envision a growth of consumption, real estate investments and manufacturers' capital expenditures. Consumption and gross capital formation would continue to be the economic growth drivers going forward and close the gap if there is any disappointment from net exports.

Figure 1: China's quarterly GDP growth (%)



Source: WIND, RHB

Figure 2: Summary of consensus economic forecasts

	2015	2016	2017	2018F	2019F
Real GDP growth (%YoY)	6.9	6.7	6.9	6.6	6.4
Nominal export growth (%YoY)	-2.8	-7.7	7.9	9.0	9.0
Nominal import growth (%YoY)	-14.1	-5.5	15.9	14.8	7.0
Trade balance (CNY bn)	3686.5	3347.3	2813.9	2772.2	3076.9
Industrial production growth (%YoY)	6.1	6.0	6.6	6.4	6.3
Fixed asset investment	10.0	8.1	7.2	6.3	6.5
Retail sales growth (%YoY)	10.7	10.4	10.2	9.7	10.2
M2 (%YoY)	13.3	11.3	8.2	8.4	8.2
CPI (%YoY)	1.4	2.0	1.6	2.2	2.2
PPI (%YoY)	-5.2	-1.4	6.3	3.6	1.9
USD/CNY	6.76	6.78	6.53	6.66	6.28

Source: WIND, RHB

A trade dispute may possibly derail exports; Net impact remains uncertain

At the time of this writing, US proposed a 25% tariff on USD50bn worth of imports from China, and a further tariff on an additional USD400bn worth of China's exports to the US if there are any retaliations from China.

The amount of USD50bn worth of Chinese goods subject to the new 25% tariff imposed by the US, represent 2.7% of Chinese total exports in 2017 and 0.4% of China's nominal GDP in 2018. Assuming a full-blown trade war to commence, an amount of USD450bn worth of Chinese goods (including the USD50bn announced) would be additionally taxed. This value represents 19.9% of Chinese total exports in 2017 and 3.2% of Chinese nominal GDP in 2018F. Assuming the price elasticity for these goods is equal to 0.5, theoretically, it implies the tariff would lead to a reduction in demand in the equivalent of 0.2-1.6% of China's GDP. The impact on GDP is halved in 2018 since it would be imposed in July at the earliest, with a full impact in 2019, in case these tariffs persist going forward.

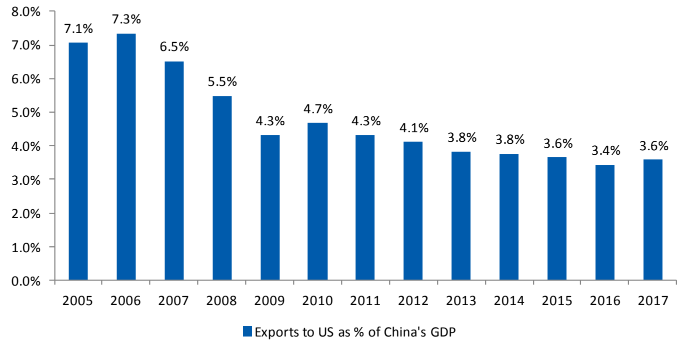
A reduction of China's GDP by up to 1.6% is definitely a serious hit. Nevertheless, this scenario is yet to take into account any retaliation from China. At the time of this writing, China stated it would impose a "similar package" in response to a US tariff. As a result, the actual impact on net exports and China's GDP remains uncertain, Nevertheless it is probably less than the 1.6% mentioned.

We note that the contribution from exports to GDP fell from 22.9% in 2013 to 18.8% in 2017 (Figure 3). Moreover, we believe a negative impact on GDP can be partially offset by adjustments on the domestic front such as on consumption, real estate investments and manufacturers' capital expenditures.

Figure 3: Exports as % of China's GDP

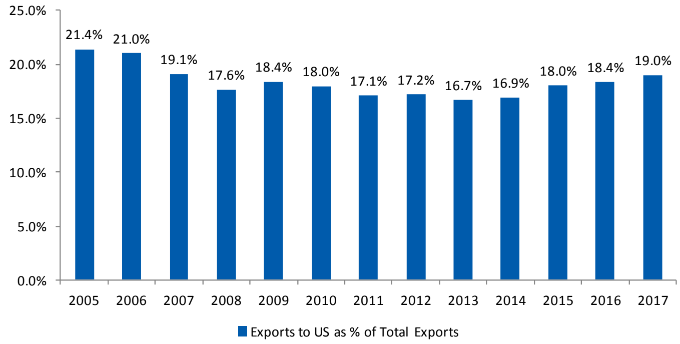
Source: WIND, RHB

Figure 4: Exports to the US as % of China's GDP



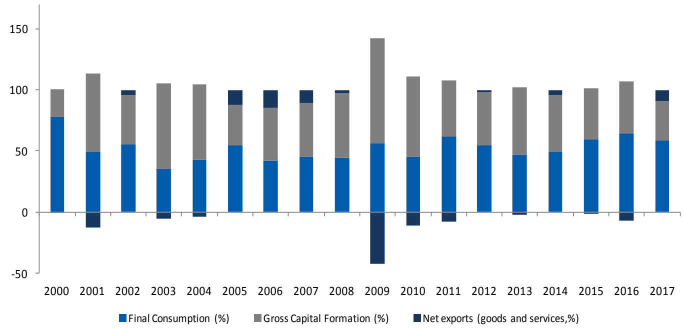
Source: WIND, RHB

Figure 5: Exports to the US as % of total exports



Source: WIND, RHB

Figure 6: Contribution to China's GDP growth (%)



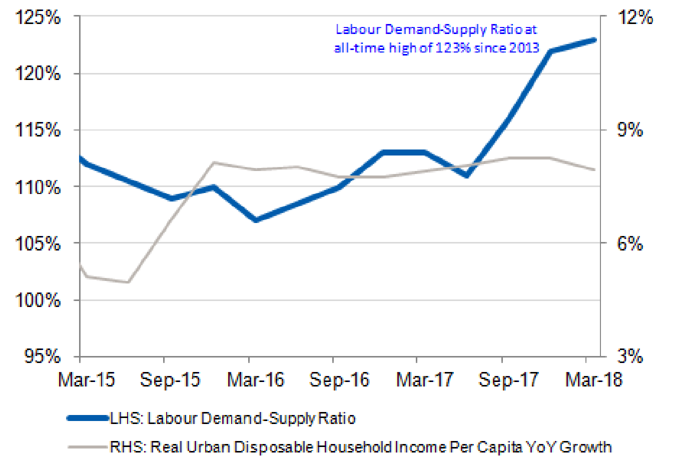
Source: WIND, RHB

Retail sales to regain momentum in 2H18

The lower-than-expected monthly retail sales growth of 8.5% YoY in May (vs a 9.6% YoY consensus growth) aroused some concerns on the sustainability of domestic consumption growth as the driving force of economic growth going forward. We believe it was simply due to the delayed consumption in response to the State Council's announcement to lower tariffs for imported consumer goods from 1 July onwards.

We believe the retail sales growth trend will remain at close to a double digit YoY growth rate in 2018. This would happen thanks to a relatively robust job market, where the labour demand-supply ratio peaked at an all-time high of 123% in Mar 2018, as well as a stable growth in real wages (see Figure 7 and 8). Qualitatively, the consumption upgrade and growing popularity of the e-commerce should also help boost the consumption value.

Figure 7: Robust job market to drive consumption



Source: CEIC, NBS, WIND, RHB

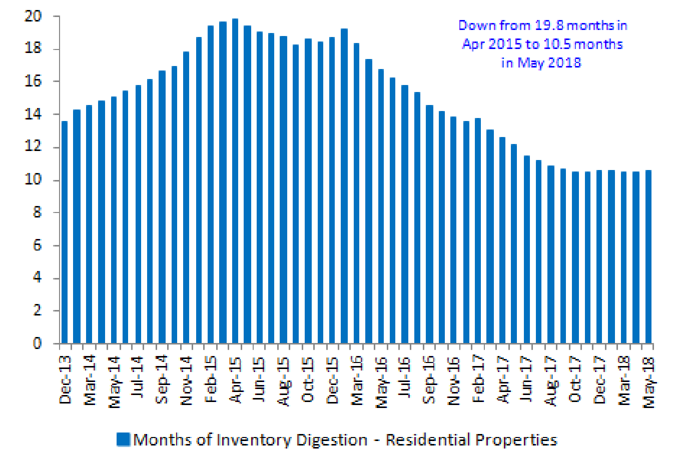
Figure 8: Retail sales growth to reaccelerate in 2H18 (%)

Source: NBS, RHB

Resilient FAI thanks to real estate investments and capital expenditures

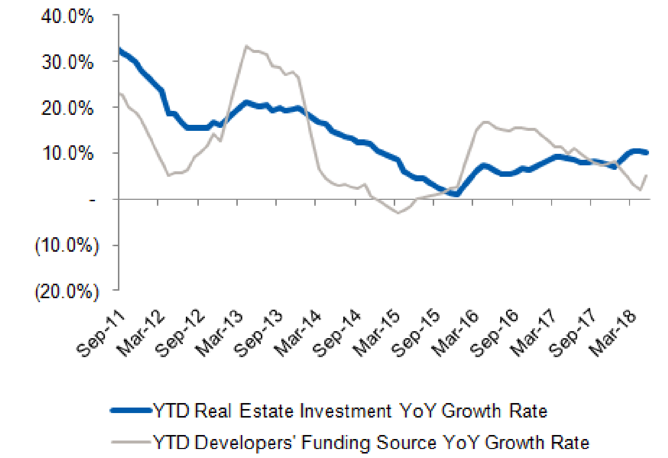
We see the growth momentum supported by a stable growth in property investments and an accelerating growth in the manufacturing capital expenditures. As housing inventory continued to decline, developers in general began to accelerate reinvestments (see Figure 9 and 10). Growth in real estate investments, new starts and land area sold shall further accelerate. Also, manufacturers' capital expenditures shall continue to accelerate on the back of a more positive sentiment in the sector per the latest PMI index in May at 51.9% (+0.5ppts MoM), steadily increasing the Producer Price Index (+4.1% in May vs +3.4% in Apr) and accelerating growth momentum in manufacturers' earnings (+12% YoY for 4M18 vs +8.2% YoY for 3M18).

Figure 9: Developers begin restocking as housing inventory hits 5-year low



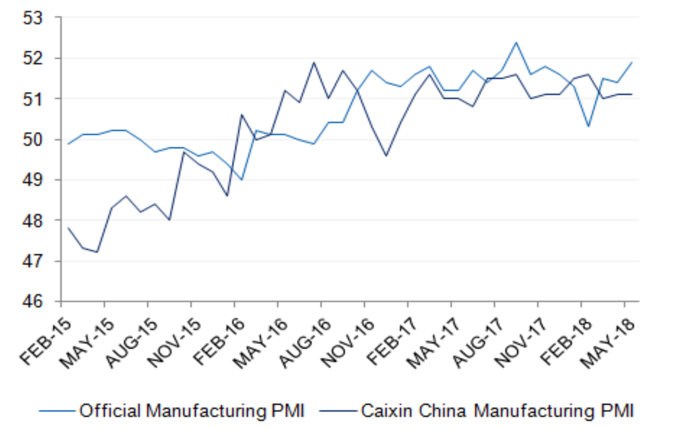
Source: NBS, WIND, RHB

Figure 10: Accelerating growth in REI as developers begin restocking and improving liquidity for developers



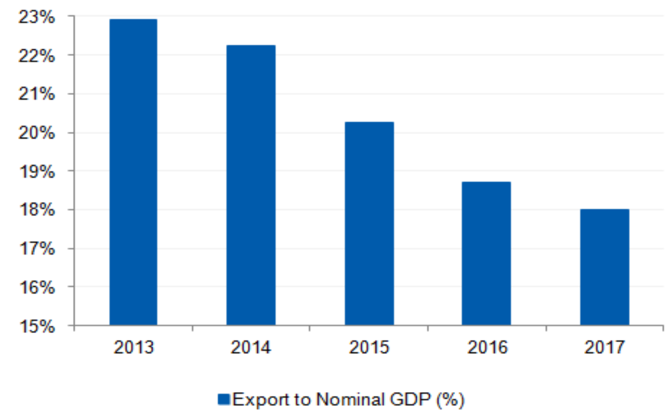
Source: NBS, WIND, RHB

Figure 11: Strong manufacturing sector to spur capital expenditures



Source: Bloomberg, RHB

Figure 12: China's reliance on exports is gradually diminishing

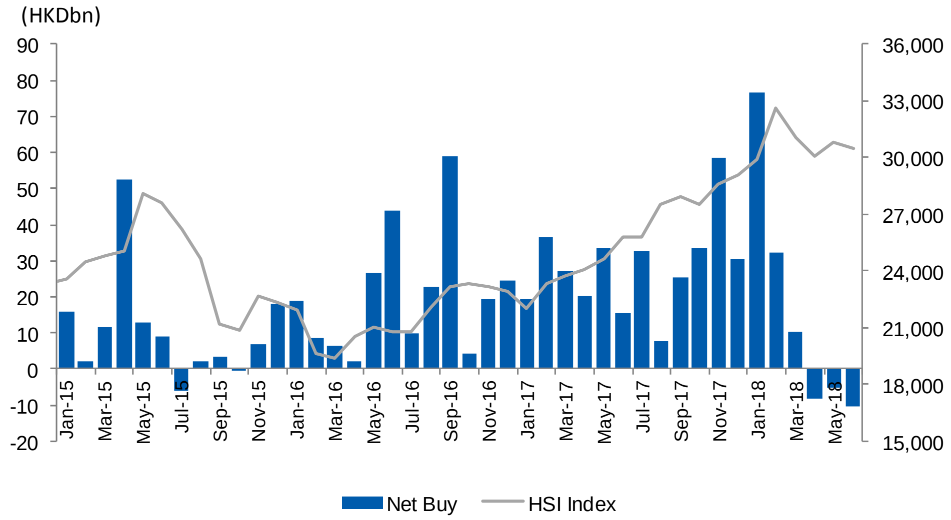


Source: IMF, WIND, RHB

Market Strategy: Volatility To Persist

In late January, the Hang Seng Index (HSI) reached a high of 33,154 pts. This level was only 2.5% away from the 34,000 pts target we suggested in our 2018 Strategy report from 14 Dec 2017: *Bumpy But Still On An Uptrend Path Ahead*. The HK market was dragged by a number of threats, including the surge of the US bond yield, the outbreak and worsening of the US-China trade war, widening interest rate spread between HKD and USD and the net outflow from the southbound capital through the Stock Connect scheme (since 2Q18). Consequently, the HSI retreated 14.5% from the peak and recorded a 5.2% YTD decline.

Figure 13: Southbound capital inflow vs HSI



Source: Bloomberg, RHB

Range trading amid cautious sentiment and uncertainties in 3Q18F

Going forward, we notice the sentiment remains cautious and fragile given concerns and uncertainties on the US-China trade issue, China's monetary policy direction and other geopolitical frictions. As mentioned, we estimate the impact on China's GDP from the trade war may not be as severe as it looks. However, it could post a more serious hit to specific sectors and companies, through bans on technology transfer, transactions on semiconductors, etc. Thus, we believe those sectors that could be impacted, such as the internet, handset components, auto, etc. would suffer a short period of valuation squeeze, before any softening of the tensions which may subsequently trigger a valuation catch-up.

Also, we foresee corporates to report decent earnings momentum in the upcoming interim reporting season in August. However, the focus would likely turn to their business outlook amid the ongoing trade war, the continuous US rate hike and CNY depreciation (vs the USD).

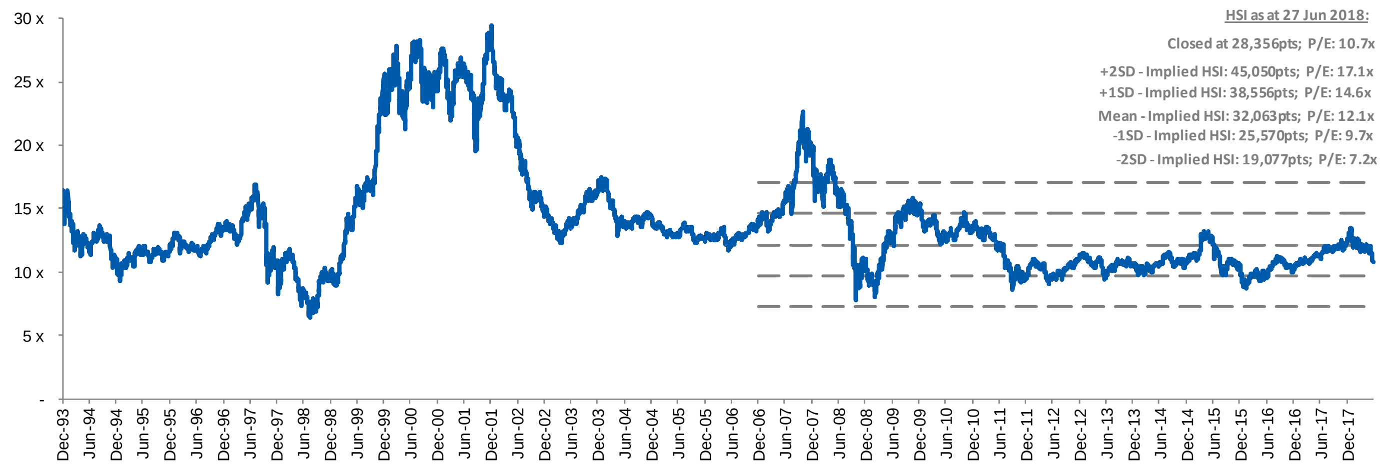
Therefore as the trade friction continues to escalate in the short term, we expect the market to remain volatile over the next 1-3 months. Given the sectors impacted in a trade war have a c.13% weighting in the HSI, the index valuation would be under pressure in 3Q18. As a result, we estimate the HSI trading range bound between 27,000 (-0.75SD from 10-year mean) to 30,500 (-0.25SD from 10-year mean).

Probable valuation catch-up going to 4Q18F

Longer term, however, any softening of the US-China trade dispute, especially ahead of the midterm elections in the US in November, would definitively serve as a strong catalyst for valuation catch-up. Besides, the strengthening USD and the probable IPOs of heavyweight unicorns and CDRs are also potential triggers for the return of capital inflow back into HK's equity market. Coupled with a steady economic growth and corporate earnings momentum, under an optimistic scenario, we believe these would push the HSI higher towards 33,000-34,000 pts (roughly +0.5SD from 10-year mean) by the end of 2018.

Given the uncertainties in relation to external macro events, we prefer sectors with strong earnings momentum and domestic-driven demand including China banks, China property as well as individual stocks such as Tencent. In addition, we also suggest weighing on yield plays in near term.

Figure 14: HSI & rolling forward P/E band (1993 - 2018YTD)



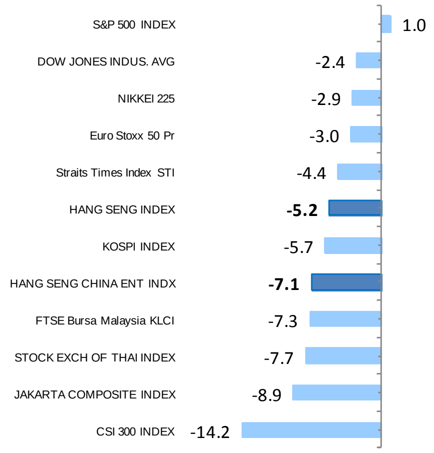
Source: Bloomberg, RHB

Figure 15: Comparison of major indices

INDEX	Price	2017 performance	2018 YTD performance	FY18F P/E	FY19F P/E	FY18F EPS YoY%	FY19F EPS YoY%	3-Yr EPS Cagr (%)	FY18F P/BV (x)	FY19F P/BV (x)	FY18F Div Yield (%)	FY19F Div Yield (%)
HANG SENG INDEX	28,356	36.0	(5.2)	10.8	10.2	5.5	5.8	7.3	1.2	1.1	3.7	3.9
HANG SENG CHINA ENT INDX	10,879	24.6	(7.1)	7.1	6.8	18.4	3.6	10.8	0.9	0.8	4.4	4.8
CSI 300 INDEX	3,459	21.8	(14.2)	11.4	10.1	15.2	12.8	14.7	1.5	1.4	2.6	3.0
Straits Times Index STI	3,255	18.1	(4.4)	12.8	11.9	(18.4)	7.5	(1.6)	1.1	1.1	4.0	4.2
JAKARTA COMPOSITE INDEX	5,788	17.8	(8.9)	11.6	13.1	77.1	(11.5)	19.6	2.2	2.0	2.3	2.6
FTSE Bursa Malaysia KLCI	1,666	9.4	(7.3)	15.6	15.0	10.1	4.0	7.2	1.7	1.6	3.4	3.6
STOCK EXCH OF THAI INDEX	1,619	13.7	(7.7)	14.7	13.5	11.2	8.8	9.4	1.8	1.7	3.2	3.5
KOSPI INDEX	2,327	21.8	(5.7)	8.7	8.4	28.7	3.4	12.0	1.0	0.9	2.1	2.2
NIKKEI 225	22,112	18.9	(2.9)	15.9	14.0	6.6	13.4	8.0	1.7	1.5	2.0	2.1
Euro Stoxx 50 Pr	3,397	7.1	(3.0)	13.3	12.4	16.5	7.7	10.9	1.5	1.4	3.8	4.0
DOW JONES INDUS. AVG	24,118	24.7	(2.4)	15.3	14.4	17.6	6.3	10.8	3.6	3.3	2.3	2.5
S&P 500 INDEX	2,700	18.9	1.0	16.5	15.4	24.7	7.1	13.8	3.1	2.9	2.0	2.1

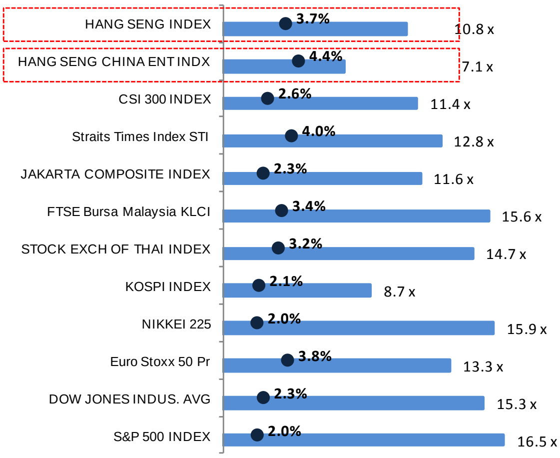
Source: Bloomberg, RHB

Figure 16: Major indices YTD performance (%)



Source: Bloomberg, RHB

Figure 17: Major indices 18F P/E & dividend yield



Source: RHB, Bloomberg

Selected Sectors At a Glance

China Banks – Policy environment to be more accommodative

Heading into 2H18, we expect the system credit growth to remain subdued amid ongoing financial deleveraging. However, the People's Banks of China (PBoC) may continue to implement marginal policy easing to cushion the impact from shadow banking clean-up. Liquidity tightness and favourable credit demand-supply status should underpin a further increase in banks' asset yields. Meanwhile, liability cost is also on the uptrend due to heightened deposit competition. Yet, potential cuts in reserve requirement ratio (RRR) would somewhat ease the funding cost pressure. As a result, large banks with solid deposit base will likely see gradual NIM expansion, while smaller banks may still face NIM fluctuation in coming quarters.

We believe the spill over effect from accelerating bond defaults to bank's loan book is limited. This is as recent bond defaults were mainly concentrated on companies with excess leverage, thus, unlikely to result in systemic risks. Moreover, China banks have actively disposed of NPLs and optimised their loan mix in the past few years.

We remain OVERWEIGHT and continue to favour the Big-4 banks with a solid funding base and less shadow banking exposure. Recent market corrections due to the China-US trade dispute offers a good opportunity to accumulate quality banks prior to their dividend payment in July/August. Our Top Picks are Agricultural Bank of China (1288 HK, BUY, TP: HKD5.80) and Bank of China (3988 HK, BUY, TP: HKD5.90).

China Property – Solid outlook despite bumpy sentiment

We expect the national property sales to remain resilient at 4.3% growth rate for 2018. The developers are set to report a decent 25-30% YoY growth in contracted sales, thanks to the accelerating pre-sales approval. Further reduction in the reserve requirement ratio (RRR) by the PBoC would also add liquidity to the property market and stimulate real estate investments as well as property sales growth. In short, despite a deleveraging backdrop, China property sector shall continue to maintain its stable growth.

Meanwhile, industry consolidation shall continue to intensify where we see listed developers to maintain a strong growth momentum (contracted sales and earnings to grow at 28.5% and 27.2% CAGR for FY17-20F) and improving ROEs (19.5% in FY18F vs 13.1% and 18.5% in FY16 and FY17). Despite solid fundamentals, China developers are now trading at an undemanding valuation with a 41% discount to end-FY18F ENAV (5-year historical mean) as concerns on tighter liquidity and rising funding cost appear to be overdone. However, as contracted sales accelerate in 2H18 alongside a strong 1H18 results, shall catalyse the share price appreciation in the next 3-6 months. Maintain OVERWEIGHT with Country Garden, Shimao Property and CIFI as our Top Picks.

Internet and software – still solid growth ahead

Short-video and news feed taking up more user time. As the internet and mobile phone penetration rate have reached a high level, competition for user time spent becomes increasingly important throughout 2018 and 2019 in our view, for key platforms to drive traffic growth. According to *Mary Meeker's 2018 Internet report*, the time spent on news and video has increased significantly compared with the time spent two years ago. The time spent decreased though for online games and social networking. Toutiao is becoming a media and entertainment powerhouse with its popular short-video app *Douyin* and news feed applications, a serious competitor to Tencent and other internet giants although Tencent and others are also aggressively investing in short-video applications.

Social advertising, one of the key monetization fields for the next two years. Social traffic has been under-monetized for the past few years. We see 2018 as the key year for players such as Tencent to speed up the monetization, in the form of advertising, among others.

Online-offline integration dominates the e-commerce trend; execution on the watch. With the online user acquisition cost increasing and delivery times issue existing for some categories of goods (such as those "fresh"), online-offline integration is probably the right solution. This should continue to dominate the e-commerce industry trend. Over the past two years, Alibaba and Tencent invested in a handful of offline retailers. Thus, the integration and execution would be critical and on close watch. We also see the AI, big data and other technologies play an increasing role in the online and offline retail.

PUBG game monetization is the key for the next two years. The mobile game market growth may largely depend on whether the PUBG games could be monetized. With some licence issues, while still popular among users, Tencent's PUBG games have not yet started monetization.

Software and IT service – cloud continues to penetrate. We see the IT service industry continue to move onto cloud. Key cloud application players such as Kingdee should benefit from the trend while other IT service providers, such as Chinasoft, should continue to increase its weight of cloud revenue.

Auto – remain selective

We expect growth in China's passenger vehicles market to decelerate to 3-5% YoY in 2H18, due to the diminishing benefit of purchase tax cuts. Although the sector growth would be stagnant, looking ahead, we expect the electric vehicles (EV) sales to outperform the industry average, and lead the growth of the whole industry. EV sales are driven by government subsidies, new energy vehicle (NEV) credit, lottery/bidding for number plates, and restrictions on number plates.

Meanwhile, we prefer market leaders. Although the whole auto market is currently sluggish, the auto brands are at a stage of transformation. As the planning of new car models requires a long period of time (ie a horizon of 5-8 years), we believe companies with a better market sense, flexibility and efficiency would be in stronger positions. On the other hand, traditional auto makers and mass market brands with a slow pipeline of new models may be under pressure. Also, the soft market would help eliminate uncompetitive players and in turn improve the industry concentration and market share expansion for key players. As a whole, as platform manufacturing enables brands to rapidly design new car models, we expect to see incremental sales growth from Geely.

Geely is our sector Top Pick due to its strong 2018 model portfolio, as well as margin improvement, driven by synergies with Volvo. We have a NEUTRAL on BYD; we like its strength in EVs and rapid shift into the monorail market, but remain cautious on the drop in its EV gross margins and the execution of its monorail business. Meanwhile, on Great Wall Motor (GWM) we have a SELL. We like its solid leadership in the SUV market, which should remain stable, but we are concerned over the deterioration of its margins.

Infrastructure and construction – focus on execution and earnings in 2H18

While we are expecting a slowdown in railway construction in 2H18, we note the growth in railway equipment. Based on the 2018 Railway Guidance, railway construction would experience a boom in 2019 and 2020. On the other hand, we also like the construction sector for its steadiness, driven by government support in both domestic and overseas markets.

We maintain our OVERWEIGHT call on the sector, underpinned by strong new orders from highways, property, and PPPs obtained since 2017, as well as cheap valuations for the stocks under our coverage. Our Top Pick is China State Construction (CSCI). Our TP of HKD13.20 reflects 10x FY18F P/E (-0.5SD from its 5-year average forward mean). The multiple is above the average 8x FY18F (Bloomberg consensus) for HK-listed peers, due to its better-than-peers' margin and higher ROE. Also, CSCI has a sturdy backlog of jobs and is transitioning into a major PPP player with good flexibility in picking projects.

Top Stock Picks

Figure 18: RHB Top Buys & Top Sells

Name	Ticker	Sector	Rating	Closing price	TP (HKD)	Mkt Cap (USDm)	FY18F P/E	FY18F EPS Growth	FY18F Yield	FY18F ND/E	52 week High	52 Week Low
AGRICULTURAL BANK OF CHINA	1288	China Banks	BUY	3.59	5.80	166,614	5.1	7.6%	6.0%	N/A	5.02	3.40
BANK OF CHINA	3988	China Banks	BUY	3.79	5.90	155,785	5.5	7.9%	5.6%	N/A	4.96	3.57
TENCENT	700	Tech - online/software	BUY	377.40	529.00	457,057	37.6	30.1%	0.1%	Net Cash	476.60	260.40
COUNTRY GARDEN HOLDINGS	2007	China Property	BUY	12.74	22.00	35,294	7.5	36.3%	4.7%	50.8%	18.23	8.24
SHIMAO PROPERTY HOLDINGS	813	China Property	BUY	20.20	30.00	8,718	5.9	47.2%	6.8%	72.9%	26.20	13.14
GEELY AUTOMOBILE HOLDINGS	175	Automobiles & Components	BUY	19.78	29.00	22,628	12.9	22.4%	1.5%	Net Cash	29.80	15.46
CHINA STATE CONSTRUCTION	3311	Construction & Engineering	BUY	8.03	13.20	5,166	6.0	21.1%	4.7%	31.7%	13.49	7.97
CHINA OVERSEAS GRAND OCEANS	81	China Property	SELL	2.84	2.30	1,239	5.7	0.1%	2.6%	21.6%	6.00	2.81

Source: Bloomberg, RHB

Top BUYs

Agricultural Bank of China: Capital overhang largely removed

A sector Top Pick, the Agricultural Bank of China (ABC) should enjoy a sustained margin expansion in the rising yield cycle, as its liquid balance sheet structure enables a stable credit expansion. Above peers LLC ratio implies a greater buffer to reduce credit costs and boost earnings. A-share private placement should ease the bank's long-standing capital overhang, despite a modest ROE dilution. A stable payout ratio suggests an attractive FY18F dividend yield of 6.1%.

BUY with a GGM-derived TP of HKD 5.80, which is based on a target P/BV of 1.02x, 25% higher than its historical mean since listing. We believe this is justified, given the bank's improving earnings prospects and a lower risk-profile.

Bank of China: Riding on faster overseas expansion

As the other sector Top Pick, Bank of China (BOC) enjoys better-than-peers' margin outlook amid US rate hikes, given its higher proportion of USD-denominated assets. The bank's traditional advantage in forex trading and cross-border settlement would ensure a stable fee growth, despite overhang from the wealth management business. Prudent NPL recognition and conservative provision charge will likely support earnings recovery ahead. We expect BOC to continue to capitalize on China's "One Belt One Road" Strategy, with a leading position in China banks' globalization process.

The bank offers a decent FY18F dividend yield of 5.8%. BUY with a GGM-derived TP of HKD 5.90, which is based on target P/BV of 0.98x.

Tencent: Short-term headwinds, but long-term strength

Tencent is facing some short-term headwinds. Its mobile game growth may see a slowdown as no monetization on PUBG games. Also, Tencent is experiences some loss in user time spent to Toutiao's news feed and short video apps. These concerns explain the recent weak stock performance, together with other macro and industry-wide factors.

However we think the long-term investment thesis remain intact as social traffic remains sticky. These short-term headwinds should create good entry points. BUY with HKD529 TP, implying a P/E of 50x and 37x for FY18 and FY19. The key growth driver for Tencent for the next couple of years is the Weixin monetization, in forms of advertising, subscriptions, e-commerce and others. Also we believe the short-term mobile game slowdown would not affect Tencent's overall strength in China's online game market; we still see it as the long-term beneficiary of the growing online games industry in China.

Country Garden: On a fast growing pace

We like Country Garden (CG) given its rampant asset turnover development model and expertise in Tier-3 to -5 markets, which offer the most visible growth outlook among companies in our coverage universe. Coupled with the largest land bank in the Greater

Bay Area amongst all developers, we see CG capable of delivering 29.5% and 28.5% CAGRs in contracted sales and earnings for FY17-20F.

We maintain BUY and HKD22.0 TP based on a 15% discount to end-FY18F ENAV of HKD25.80. Catalysts include better-than-expected contracted sales growth and better-than-expected property sales in lower tier markets.

Shimao Property: Buoyant outlook on favourable positioning

Riding on its favourable positioning strategy in both eastern and southern China, we like Shimao Property's explosive growth potential (earnings and contracted sales CAGRs of 39.8% and 35.5% in FY17-20F). Furthermore, we see its margins are bottoming out following a strong ASP growth of 14.8% for FY15-18F. This should allow Shimao's GPMs and NPMs to remain at 30.5-31.7% and 12.3-12.8% over FY18-20F (vs 28.5-30.4% and 9.8-10.8% for FY15-17).

We maintain BUY and HKD30.0 TP based on a 25% discount to end-FY18F ENAV of HKD40.0. Catalysts include better-than-expected margins and an upward revision of contracted sales target in 2H18.

Geely: Another big year of new model launches ahead

Geely is our Top Pick for the auto sector due to its solid earnings growth, which, in turn would stem from:

1. Its strong portfolio of new model launches in 2H18; there are seven new models in the pipeline, comprising of five models from the Geely brand and two from Lynk & Co;
2. Significant contribution of sales volume from Lynk & Co; earnings contributions are expected to start from 2019 meanwhile, Geely's own models are strong enough to support our estimated 27% YoY earnings growth in FY18F.

We maintain BUY and HKD29 TP based on 0.6x PEG of its 3-year CAGR of 29% which we believe is justified, considering 2017-2019F ROEs are sustained at 30%.

CSCI: Recovery ahead

Despite a tougher PPP market ahead, we believe CSCI may continue to deliver 20% earnings CAGR until 2020, driven by both recovering HK revenue and social housing contracts in China. We expect social housing projects growth to account for 30% YoY in 2018. Although there is concern that fundraising is a long-term overhang to sustain its 40% gearing ratio in 2019, we believe there is no immediate risk this year.

Maintain BUY and HKD13.20 TP which is based on FY18F recurring P/E of 10x or -0.5SD below 5-year forward mean. This is also above Bloomberg consensus' peer average of 8x for its HK-listed peers which we believe justified given CSCI's superior ROEs and margins. Risks to our call include inability to securitize assets and a slower-than-expected China PPP market.

Top Sells

China Overseas Grand Ocean: A possible disappointment in earnings

COGO is our Top Sell as we see danger of earnings disappointment in its FY18F results. We are bullish on developers with significant exposure in Tier 3 & 4 markets. However, we hold an opposite view on COGO given its relatively weak execution as measured by asset turnover and low sell-through rates.

We maintain SELL and HKD2.30 TP based on a 65% discount to end-FY18F ENAV of HKD6.60. Catalysts include slower-than-expected revenue recognized from property development and inability to capitalize on the boom in Tier 3 & 4 property markets.

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