

STRATEGY - CHINA

Alpha Picks: July Conviction Calls

Chinese equity markets were mostly volatile in June, as concerns of slowing growth, tightening policy bias and pressures of a forthcoming Fed taper weighed on investors' sentiment. Outperforming sectors were in materials and communication services as investors rotated into laggards. Amidst the macro uncertainties, we expect the investing environment to remain challenging; we maintain a defensive bias in July.

WHAT'S NEW

- **Review of June.** The MSCI China Index and Hang Seng Index both declined 0.3% and 1.1% respectively in June 21. Within the MSCI China universe, the top outperformers were in materials and communication service, as investors rotated into laggards.
- **Maintain defensive bias in July.** We expect the equity market to remain volatile, due to policy headwinds, slowing growth and liquidity concerns. Moreover, the MSCI China index and HSI are still trading at 12-month forward PE of 15.0x and 13.0x respectively, which are slightly above 1SD. We therefore, similar to last month, do not expect significant upside from current levels and in fact see increasing risk for a pullback. As such, for our stock picks, we focus on: a) defensive names, b) names with strong cash flows, and c) reopening plays.

ACTION

- Maintain BUY on CCB (939 HK), CR Beer (291 HK), Kingboard Laminates (1888 HK), LINK REIT (823 HK), Mindray (300760 CH), SHKP (16 HK), Sino Biopharm (1177 HK), Trip.com (TCOM US), Wuliangye (000858 CH) and Wuxi App Tec (2359 HK).
- We drop China Gas (384), Feihe (6186 HK), Kingsoft (388 HK), Nine Dragons Paper (2689 HK) and JD.com (JD US) from our BUY list given that these five names have not performed as expected.
- We add Education Group (839 HK) to our BUY list as we expect the potential costs savings in student management fees (from EDU's schools being converted into independent schools) to have attractive future gains.

KEY RECOMMENDATIONS

Company	Rec	Share Price (lcy)	Target Price (lcy)	Upside/Downside to TP (%)
CCB	BUY	6.12	8.50	38.90
China Education Group	BUY	17.06	22.00	28.96
CR Beer	BUY	67.45	80.80	19.80
Kingboard Laminates	BUY	17.30	27.00	56.10
Link REIT	BUY	76.50	85.10	11.2
Mindray	BUY	495.99	530.00	6.9
SHKP	BUY	115.80	148.40	28.2
Sino Biopharm	BUY	7.62	13.00	70.60
Trip.com	BUY	35.49	52.00	46.52
Wuliangye	BUY	281.10	342.00	21.70
Wuxi AppTec	BUY	181.30	225.00	24.10

Source: UOB Kay Hian

CHANGE IN SHARE PRICE

Company	Rec	Jul 21 (%)	To-Date* (%)
CCB	BUY	-3.8	-3.2
China Education Group	BUY	16.2	n.a
CR Beer	BUY	-3.0	-3.4
Kingboard Laminates	BUY	4.3	2.2
Link REIT	BUY	3.0	2.4
Mindray	BUY	-7.7	-2.7
SHKP	BUY	-3.7	-1.2
Sino Biopharm	BUY	-15.1	-15.7
Trip.com	BUY	-11.7	-11.7
Wuliangye	BUY	-11.0	3.8
Wuxi Apptec	BUY	0.1	64.2
Hang Seng Index		-1.1	

*Share price change since stock was selected as alpha pick

Source: UOB Kay Hian

PORTFOLIO RETURN

(%)	2020	3Q20	4Q20	1Q21	2Q21
HSI return	-3.4	-4.0	16.1	4.2	1.6%
Alpha Picks Return					
- Price-weighted	12.0	19.0	5.0	4.8	-0.4%
- Market cap-weighted	10.5	15.4	5.3	4.5	-0.9%
- Equal-weighted	4.7	2.5	7.2	5.9	-0.5%

Assumptions for the 3 methodologies:

- 1) Price-weighted: Assuming the same number of shares for each stock, a higher share price will have a higher weighting.
- 2) Market cap-weighted: Weighting is based on the market cap at inception date, a higher market cap will have a higher weighting.
- 3) Equal-weighted: Assuming the same investment amount for each stock, every stock will have the same weighting.

Source: UOB Kay Hian

ANALYST(S)

Greater China Research Team
 +852 2236 6799
 researchhk@uobkayhian.com.hk

VALUATION OF ANALYSTS' ALPHA PICKS

Company	Ticker	Rec	Price	Target	Last Year	PE			Yield	ROE	Market Cap.	Price/NTA ps
			05 Jul 21 (lcy)	Price (lcy)		2021F (x)	2022F (x)	2023F (x)				
CCB	939 HK	BUY	6.12	8.50	Dec-20	0.5*	0.5*	0.5*	6.6	11.5	1,547,900	0.6
China Education Group	839 HK	BUY	17.06	22.00	Aug-21	20.3	17.1	16.3	2.5	15.2	4,992	3.2
CR Beer	291 HK	BUY	67.45	80.80	Dec-20	58.6	43.8	34.7	0.7	14.6	218,820	n.a.
Kingboard Laminates	1888 HK	BUY	17.30	27.00	Dec-20	7.9	7.8	8.8	5.6	48.7	53,976	3.93
Link REIT	823 HK	BUY	76.50	85.10	Mar-21	26.6	25.4	24.0	4.2	3.8	159,263	1.0
Mindray	300760 CH	BUY	453.98	530.00	Dec-20	66.8	56.2	46.8	0.6	31.8	551,900	26.6
SHKP	16 HK	BUY	115.80	148.40	Jun-20	10.6	10.2	9.5	4.3	5.4	335,561	1.0
Sino Biopharm	1177 HK	BUY	7.33	13.00	Dec-20	33.1	27.6	22.2	1.1	17.5	138,255	8.3
Trip.com	TCOM US	BUY	35.49	52.00	Dec-20	73.2	22.3	17.2	0.0	2.4	22,623	1.3
Wuliangye	000858 CH	BUY	281.10	342.00	Dec-20	44.2	37.2	32.4	1.1	26.5	1,091,163	n.a.
Wuxi AppTec	2359 HK	BUY	175.00	225.00	Dec-20	81.7	76.3	73.1	0.00	11.9	539,536	11.8

Source: Bloomberg, UOB Kay Hian

* Note: Using PB instead of PE valuation

China Construction Bank – BUY (Eric Wang Zhen/ Sabrina Soh)

- The PBOC has announced a deposit rate reform, which in our view will result in SOE outperforming JSBs. Banks with more term deposits will benefit more given that the potential rate cut will have limited impact on deposit costs. Therefore, among the big four SOE banks, we prefer CCB as it has: a) solid deposit growth, and b) stable asset quality. As at end-1Q21, CCB's deposits had risen 7.35% qoq, outstanding balance was Rmb22,130b and 52.5% of total deposits are current deposits. On the other hand, CCB's NPL ratio remained stable at 1.56%, unchanged qoq while NPL balance increased 5.2% qoq to Rmb274.3b. Provision coverage ratio also increased to 219.94%, up 135ppt qoq.
- With current market volatility, the banking sector offers a high level of defensiveness and sustainable dividend yield. On that note, the banking sector's risk-to-reward ratio remains underappreciated as the sector is currently trading at a four-year low P/B valuation (0.5x), which we believe is a cheaper option to consider.
- China Construction Bank (939 HK/BUY/Target: HK\$8.50) is our top pick. We expect CCB to maintain stable asset quality, and downside on NIM will be limited. Based on the Gordon Growth model, we derive a target price of HK\$8.50, which implies 0.70x 2021F and 0.65x 2022F P/B. CCB is trading below -1SD to its 3-year historical average P/B with a dividend yield of 6.4%, which is quite attractive for long-term investors. In our view, CCB is a good defensive play.

Share Price Catalyst

- **Event:** Defensive and banks benefitting from the on-going deposit rate cuts.
- **Timeline:** Late-Jul 21

China Education Group – BUY (Julia Pan/Oong Chun Sung)

- CEG expects its FY21 net profit attributable to shareholders to be Rmb1.4b-1.5b, which implies ~100% yoy growth, above consensus' estimate of Rmb1.3b. The company has seven acquisition targets (six universities and one junior college) in its pipeline with enrolment capacity of 10,000-20,000 around the Greater Bay Area (GBA). Given the high barriers to entry, a highly fragmented market and CEG's track record with a 100% success rate in M&A, management is confident it will eventually clinch the deal. In terms of ASP strategy moving forward, CEG will cautiously adjust its ASP in accordance with the schools' operating capabilities as well as the regional industry growth rate. CEG will also continue to launch quality courses such as dual degree programmes and internationally accredited degree and masters' programmes to attract students who wish to receive internationally recognised certificates by studying on their home soil.
- Management expects to grow organically via M&As as these generally offer greater return potential and a faster turnaround time as compared with the conventional expansion method (ie building new schools or expanding existing schools). CEG expects to fund most of its M&As via available cash (Rmb5.1b) and debt financing given the current low interest rate environment. CEG expects the profitability of the three universities (post conversion into full private universities) to achieve cost savings of up to Rmb92m in terms of royalty fees after conversion (accounting for 8-18% of the tuition fees of the three universities) at a total separation cost estimated at Rmb139m. We maintain BUY on the company with target price of HK\$22.00, which implies 23x 2022F PE, in line with its 3-year historical average.

Share Price Catalyst

- **Event:** Quality M&A acquisition announcement and improving margins
- **Timeline:** 2H21.

China Resources Beer – BUY (Shen Zhifeng)

- CR Beer's high-end products achieved 11.1% yoy shipment growth in 2020, and the company expects a >30% yoy increase in shipments of this segment in 2021. The

company recently revised up its high-end beer sales volume target for 2025 to 4.0b litres from 3.2b litres. The acceleration of upmarket push would continue to drive earnings growth ahead. We believe its strong distribution network would well buttress the sales of its high-end products. CR Beer also said it would raise selling prices in 2021; our channel checks confirmed that the retail prices of some of its products have been lifted. Maintain BUY with target price of HK\$80.80, implying 70.2x 2021F PE and 52.4x 2022F PE.

Share Price Catalyst

- **Event:** Expecting solid interim results; acceleration of upmarket push; potential ex-factory price hikes.
- **Timeline:** 2H21.

Kingboard Laminates (Johnny Yum)

- Demand for copper clad laminate (CCL) is in a super upcycle, driven by the recovery in shipments of all electronic devices, as well as the growing penetration of electric vehicles (EV), autonomous driving, and 5G related investments and applications. These growth drivers will not only provide robust growth in the near term, but also a secular demand in the coming 5-7 years given the significantly higher electronic components in IoT devices amid the 5G era. At the same time, the halted capacity expansion in 1H20 amid the pandemic and the robust demand growth have led to a severe shortage in CCL's upstream components, which led to spikes in ASP.
- Kingboard Laminates as the largest CCL manufacturer globally will be best positioned to capture the robust demand growth, while its unique full vertically-integrated supply chain will allow the company to enjoy a significantly lower material costs and thus margin expansion compared with its peers. We have a BUY recommendation and our target price of HK\$27.00 is based on 12x 2021F PE, 1SD above its historical average one-year forward mean. We now expect the company to announce a profit alert in 1H21, which should serve as a positive catalyst to share price.

Share Price Catalyst

- **Event:** Profit alert.
- **Timeline:** Jul 21.

Link REIT – BUY (Shaun Tan)

- Delays in relaxation of social distancing measures and overseas travel could sustain domestic spending activity in 3Q21, especially since the Hong Kong government's HK\$5,000 e-voucher support scheme is rolling out soon. Link REIT's tenant sales have now recovered to 85-90% of pre-COVID-19 levels. The government's e-voucher support scheme is expected to further boost their tenants' sales in 2H21, especially the general retail, convenience stores, F&B and supermarkets tenants. With rental reversions returning to positive territory this year and with the help of new rental contributions from newly-acquired assets, DPU growth is more visible now for Link REIT.
- We maintain BUY and our target price of HK\$85.10, which is based on the dividend discount model (required return: 6.1%, terminal growth: 2.0%). Link REIT currently trades at a FY22 yield of 4.0% with a 2.5% spread to the 10-year treasury yield (vs historical average spread of 1.6%).

Share Price Catalyst

- **Event:** Hong Kong government's e-voucher support scheme; FY21 earnings announcement.
- **Timeline:** 3Q21.

Mindray – BUY (Carol Dou/Sunny Chen)

- Mindray has seen steady and strong business expansion in both overseas and domestic markets in 1H21. Its overall revenue growth guidance remains at over 20% yoy for 2021. Management believes its key segments, eg in-vitro diagnosis (IVD) and medical imaging systems, previously negatively impacted by the pandemic, will recover significantly and deliver robust revenue growth in 2021.
- Meanwhile, management indicates that GPO tenders on IVD reagents are unlikely to take place in the near term given the complicated technical requirement of different IVD equipment, while orthopaedics GPO tender may bring considerable market share expansion opportunities. Maintain BUY and target price of Rmb530.00, based on 79x 2021F PE, or 3.4x PEG.

Share Price Catalyst

- **Event:** Expecting revenue growth of over 20% yoy in 2021; recent GPO tender on orthopaedics may offer market expansion opportunities.
- **Timeline:** 2H21

Sino Biopharm – BUY (Carol Dou/Sunny Chen)

- Management guided for Sino Biopharm's revenue to grow at c.15-20% yoy in 2021 and adjusted core earnings could grow at an even faster pace, mainly attributable to potential new product launches. The company expects to receive product approval for its PD-1 mAb Penpulimab (co-developed with Akesobio) in Jul 21, and for its Recombinant Coagulation Factor VIII for Injection and Adalimumab biosimilar in 2H21. Its innovative product launches will support a stronger earnings growth from 2021 onwards. Anlotinib is also expected to achieve double-digit revenue growth in 2021.
- The company won tenders for 11 products in the new round of group purchasing organisation (GPO) tender, including two blockbuster drugs, ie Budesonide and Iodixanol. Management believes the tender results will benefit Sino Biopharm with significant market share expansion opportunities. The savings on selling expenses for GPO drugs also allows it to maintain a relatively stable profit margin for these products.
- Moreover, management indicates that SinoVac has secured steady vaccine orders from the global market for 2021-22. Globalisation of SinoVac's vaccine business will continue to generate a substantial earnings contribution to Sino Biopharm in the next few years. We forecast an earnings contribution from SinoVac of Rmb6.0b/7.0b/8.0b in 2021F-23F. Maintain BUY and target price of HK\$13.00, based on SOTP valuation, comprising: a) HK\$4.63/share at 22x 2021F PE for existing drugs, and b) NAV-derived pipeline value of HK\$8.37/share (9.4% WACC, 5% perpetual growth rate).

Share Price Catalyst

- **Event:** Potential market approval for three blockbusters in 2H21; expecting positive impact caused by the fifth round of GPO tender; substantial earnings contribution from SinoVac.
- **Timeline:** 2H21.

Sun Hung Kai Properties – BUY (Shaun Tan)

- The Hong Kong residential market shows no sign of slowing down. Property prices are approaching historical highs (CCL index up 7% ytd) together with robust transaction volumes (monthly transactions in Apr 21 and May 21 up 47% and 42% vs average volume in 2020). We continue to like Sun Hung Kai Properties (SHKP) as a proxy for the overall property market in Hong Kong and for its ample new project launches in 2021. SHKP could be a defensive name to pick up as we expect results to remain resilient on the back of strong property sales. It currently provides a yield of 4.3%.
- We maintain BUY with a target price of HK\$148.40, based on a 30% discount to NAV of HK\$213.06.

Share Price Catalyst

- **Event:** Strong residential project sales in 3Q21.
- **Timeline:** 3Q21.

Trip.com – BUY (Julia Pan/Oong Chun Sung)

- During the recent Dragon Boat festival, Trip.com saw overall order volume achieve 83% yoy growth, of which tourism ticketing/car rental/theme park reservation exceeded 2019's level, and recorded 87%/153%/171% yoy growths. Flight ticket ASP registered 70% yoy growth, averaging at Rmb637. During the festive period, Trip.com had incorporated social interaction elements into its platform ie by introducing key opinion leaders' (KOL) tourist hotspots/hotels, introducing designated tagline/action at several tourist attractions as well as optimising its personalisation feeds for its OTA users.
- Management had guided for 2Q21 revenue to decline 30-35% vs 2Q19 as the domestic hotel and air-ticketing business had recovered to pre-pandemic level. In terms of ASP for domestic hotels, Trip.com still sees relatively subdued performance. However, air-ticketing ASP had surged to almost Rmb1,000 on average, higher than the similar period in 2019. In terms of growth by each business segment, Trip.com expects accommodation/transportation ticketing/package tour/corporate travel/others to see -25%/-40%/-65%/15-20%/15-20% yoy growth vs 2Q19. Management expects to register non-GAAP net income of Rmb300m-400m in 2Q21, representing about 7% of non-GAAP net profit margin. We maintain BUY, with target price of US\$52.00 (HK\$404.00) which implies 22x 2022F EV/EBITDA, vs its historical mean of 55x.

Share Price Catalyst

- **Events:** Positive vaccination progress, implementation of travel bubbles/easing of overseas travel restrictions.
- **Timeline:** 2H21.

Wuliangye – BUY (Shen Zhifeng)

- The wholesale price of Wuliangye further rose to Rmb990/bottle in early-Jul 21, indicating the ongoing strong customer demand. We expect wholesale prices to further rise in 2H21 as there will be more group purchase sales with a relatively high ex-factory price of Rmb999/bottle. The company plans to raise Wuliangye's shipment proportion for group purchases to 35% in 2021.

Share Price Catalyst

- **Events:** Expecting solid interim results; rising proportion of group purchase with higher ex-factory price; high wholesale prices would likely remain.
- **Timeline:** 2H21.

WuXi AppTec – BUY (Carol Dou/Sunny Chen)

- WuXi AppTec targets revenue growth of over 30% yoy in 2021. Robust growth of China-based operations and clinical research services regaining momentum point to a positive outlook. The company has also further strengthened its cell and gene therapy (CGT) service capability after the successful acquisition of OXGENE, and expects to file BLA (biologics license application) for 2-3 projects in 2021, marking a significant milestone for the CGT business segment.
- Meanwhile, US lab services and cell- and gene-therapy services have continued to recover rapidly on a qoq basis since 2H20. We expect the US operations to normalise in 3Q21. Moreover, the company plans to double its total site capacity from 838,000sqm as at end-20 to 1,657,000sqm by end-23. It will also actively seek M&A opportunities to further enhance its service and production capabilities and capacities. The total capex will

therefore increase from Rmb3b in 2020 to Rmb7b-8b in 2021. Maintain BUY and a target price of HK\$225.00, based on 85x 2021F PE, or 2.6x PEG.

Share Price Catalyst

- **Events:** Clinical research services regaining momentum with pandemic under control; leveraging off acquisition of OXGENE; US operations may normalise in 3Q21; potential M&A opportunities.
- **Timeline:** 2H21.

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