

SECTOR UPDATE

Internet – China

Sell In May And Go Away? Assessing Major Risks Of China's Internet Sector

Last week, the US SEC added over 80 firms, including JD.com, to their watchlist under the provision of HFCAA. As the delisting has been largely priced in, we still expect the prolonged lockdown to dampen consumer spending in China. Even with the supportive regulatory measures to spur the recovery from the pandemic, we do not think the measures will do much to stimulate consumption in the near term. We maintain **MARKET WEIGHT** on the internet sector.

WHAT'S NEW

- **Recent update on HFCAA.** To date, the US SEC has added 139 companies into their watchlist with 116 companies still being able to submit evidence (ie to prove the companies are not owned or controlled by a governmental entity in the foreign jurisdiction) to dispute their cases; the remaining 23 companies have been included in the "conclusive list of issuers under the Holding Foreign Companies Accountable Act (HFCAA)". Regulators in the US and China have been negotiating on the audit inspection of Chinese companies that have been listed in the US for 15 years. China is now the only jurisdiction country to refuse to submit an independent audit to the Public Company Accounting Oversight Board (PCAOB).
- At the current stage, we understand that the discussion stage was near its final phase with news saying China had signalled its willingness to compromise in providing their US counterpart permission to inspect the listed companies' audited report. From the US side, the PCAOB mentioned that the speculation on the final agreement with China remains premature at this stage. Companies under our coverage like JD.com, Pinduoduo and Trip.com were added in the disputable list which means they still stand a chance to dispute their listing status. Overall, we do not rule out the possibility that the agreement will be implemented in the near term with China allowing full audit inspection to PCAOB for selected companies. There could be a preliminary trial conducted on selected companies before a full-scale inspection.
- **Dual-listed ADRs trading at lower valuations.** The imminent delisting risk for the Chinese American Depository Receipts (ADR) remain uncertain, however we favor companies which had been dual-listed in HKEX. We notice that dual-listed ADRs (such as BABA and JD.com) are currently trading at discounted valuations at around 13x 12-month forward PE compared with the peers in A shares (around 25x) and the Southbound universe (such as Tencent and Meituan) at about 21x. Therefore, we estimate a 35% upside for the existing secondary listings stocks in Hong Kong once they become Southbound eligible.
- **Various supportive measures by regulators.** We saw various supportive policies introduced by different governmental agencies to alleviate the burden of the SMEs brought by the disruption from the pandemic. The government has promised to step up policy support this year for its economy that has been struggling with COVID-19 outbreaks. The meeting urged the need to maintain the stable operation of the capital market to attract long-term investors, the need to promote healthy development and the rectification of the platform economy, implementation of comprehensive supervision, and introduction of specific measures to support the standardisation and healthy development of the platform economy. We are positive towards the relaxation on the policies towards China's platform economies. We expect valuation correction in the internet sector in the near term. Fundamentally, we expect a recovery in 2H22 when the lockdown eases and we think Meituan is well positioned to benefit from the relaxation of the lockdown.

PEER COMPARISON

Company	Tickers	Rec	Price @ 10 May 22 (LC\$)	Target Price (LC\$)	Upside/(Downside) To TP (%)	Market Cap (US\$m)	PE			EV/EBITDA			EV/Sales			ROE (%)
							2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	
Tencent	700 HK	BUY	341.20	502.00	47.1	417,790	12.2	21.8	17.9	15.7	17.3	13.0	5.1	4.7	4.1	14.9
Netease	9999 HK	BUY	138.60	187.00	34.9	57,983.0	21.2	19.7	16.8	15.4	14.0	12.0	3.5	3.1	2.8	7.7
Meituan	3690 HK	BUY	151.80	201.00	32.4	119,551.7	n.a.	n.a.	93.0	n.a.	n.a.	40.6	4.0	3.3	2.5	-9.8

Source: Bloomberg, UOB Kay Hian

MARKET WEIGHT (Maintained)

STOCK PICKS

Company	Ticker	Rec	Share Price (HK\$)	Target Price (HK\$)
Tencent	700 HK	BUY	341.20	502.00
Netease	9999 HK	BUY	138.60	187.00
Meituan	3690 HK	BUY	151.80	201.00

Source: Bloomberg, UOB Kay Hian

ANALYST(S)

Julia Pan Meng Yao
+8621 5404 7225 ext 808
juliapan@uobkayhian.com

Oong Chun Sung
+603 2147 1988
chunsung@uobkayhian.com

ESSENTIALS

- Macro weakness will be an economic drag.** Beijing had recently announced that it will temporarily close down 40 metro stations along the six key routes in order to curb the spread of the pandemic. The above measure was also said to prevent Beijing from entering into the likes of Shanghai lockdown should the daily confirmed cases go out of control. Given the absence of news on the easing of lockdown measures, we expect the upcoming retail sales numbers for April/May to continue to register negative yoy growth following Mar 22 (-3.5% yoy as the lockdown began in Mar 22). Fundamentally, this will continue to pressure on consumer sentiment as well as businesses' daily operations in the near term.

% OF SHARE SPLIT BETWEEN HK AND US

		% in US	% in HK	Total no. of shares mil (as per CCASS)
BABA US EQUITY	Alibaba	44.5%	55.5%	21,687
JD US EQUITY	JD.com Inc	21.9%	78.1%	3,130
BIDU US EQUITY	Baidu Inc	17.3%	82.7%	2,340
NTES US EQUITY	NetEase Inc	40.7%	59.3%	3,455
TCOM US EQUITY	Trip.com	7.8%	92.2%	637
WB US EQUITY	Weibo	74.3%	25.7%	243
Zhihu US EQUITY	Zhihu	71.9%	28.1%	326

Source: CCASS, UOB Kay Hian

- As such, under our top picks, we advocate companies which are less susceptible to the lockdown impact in the domestic market, namely Tencent and Netease** as they are supported by strong grossing growth in March/April. On top of that, we expect the resumption of new game approval to revitalise investor sentiment within the online game sector and encourage game companies to carry out R&D for new games.
- The HS Tech index and KWEB ETF have declined 32%/34% respectively ytd.** On top of the online game companies we mentioned above, we also advocate investors to stay selective for companies which have been dual listed in HKEX as well as being key beneficiaries once the lockdown measures ease such as Meituan (3690 HK).

SECTOR CATALYST AND RISK

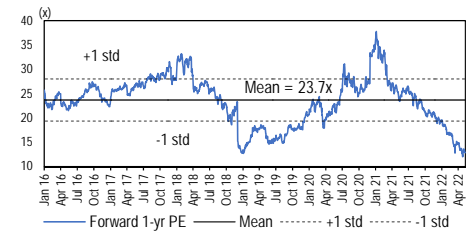
- Catalysts:** a) Supportive governmental policies, b) increasing online retail penetration driven by less developed areas and younger generations, and c) continued improvements in technology and e-commerce infrastructure.
- Risks:** a) Uncertain geopolitical risks, b) a challenging regulatory landscape, c) weak macro environment, d) high user acquisition expenses as well as increased competition as multiple players seek to increase market share with heavy investments in new retail, and e) local services strategy dragging down e-commerce companies' margins and ROEs.

PEER COMPARISON

Company	Ticker	Currency	Year End	Price (LC)	Mkt Cap (US\$m)	Calendarised PE			Calendarised EV/EBITDA			Calendarised EV/Sales			ROE 2022	EPS 25 3-yr CAGR	
						2021	2022	2023	2021	2022	2023	2021	2022	2023			
China Dual Listed Companies																	
ALIBABA GROUP HO	9988 HK	HKD	03/2021	86.0	237,596.5	n.a.	12.1	11.0	7.9	6.8	5.8	1.3	1.2	1.0	9.8	19%	
BAIDU INC-A	9888 HK	HKD	12/2021	109.5	38,561.3	n.a.	17.7	12.3	8.4	8.1	6.1	1.4	1.3	1.2	5.4	32%	
NIO INC-CLASS A	9866 HK	HKD	12/2021	109.6	23,322.8	n.a.	n.a.	n.a.	n.a.	n.a.	46.2	3.4	2.0	1.2	-23.0	n.a.	
YUM CHINA HOLDIN	9987 HK	HKD	12/2021	308.4	16,556.8	17.4	35.6	21.2	8.9	12.7	8.9	1.7	1.6	1.4	7.0	43%	
ZTO EXPRESS CAYM	2057 HK	HKD	12/2021	197.8	20,403.5	n.a.	21.4	15.6	15.9	12.0	9.3	4.1	3.5	2.9	11.9	n.a.	
HUAZHU GROUP LTD	1179 HK	HKD	12/2021	21.1	8,650.3	n.a.	181.9	27.2	56.1	45.7	18.9	7.3	6.5	5.1	3.4	151%	
GDS HOLDING-CL A	9698 HK	HKD	12/2021	26.7	5,175.4	n.a.	n.a.	n.a.	18.2	15.0	11.9	8.2	6.8	5.5	-5.6	n.a.	
ZAI LAB LTD	9688 HK	HKD	12/2021	22.1	2,750.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	9.6	5.7	3.3	-41.7	n.a.	
AUTOHOME INC-A	2518 HK	HKD	12/2021	51.0	3,262.6	n.a.	10.9	9.4	0.6	0.7	0.6	0.2	0.2	0.2	8.4	n.a.	
WEIBO CORP-CL A	9898 HK	HKD	12/2021	162.7	4,903.1	11.3	7.8	7.0	5.8	5.9	5.0	1.9	1.8	1.7	11.7	n.a.	
NEW ORIENTAL EDU	9901 HK	HKD	05/2021	8.5	1,846.1	n.a.	n.a.	9.5	34.6	8.2	n.a.	n.a.	n.a.	n.a.	-22.5	n.a.	
BAOZUN INC-A	9991 HK	HKD	12/2021	18.4	474.4	n.a.	10.0	6.3	7.5	8.8	5.5	0.4	0.4	0.3	3.7	42%	
Average							14.3	37.2	13.3	16.4	12.4	11.8	3.6	2.8	2.2	-2.6	58%
US Peers																	
APPLE INC	AAPL US	USD	09/2021	152.1	2,461,118.6	26.5	24.4	22.9	19.2	17.9	17.3	6.4	6.0	5.7	153.1	7%	
MICROSOFT CORP	MSFT US	USD	06/2021	264.6	1,978,802.6	30.1	26.1	22.7	21.3	18.3	15.9	10.6	9.1	8.0	43.8	17%	
TESLA INC	TSLA US	USD	12/2021	787.1	815,453.8	160.6	65.9	50.2	80.5	40.2	28.9	15.0	9.3	6.9	33.5	23%	
META PLATFORMS-A	FB US	USD	12/2021	196.2	531,007.7	14.2	14.3	12.4	8.9	8.7	7.4	4.3	4.0	3.4	26.1	20%	
AMAZON.COM INC	AMZN US	USD	12/2021	2,175.8	1,106,863.8	33.6	50.7	28.7	17.6	16.2	12.2	2.5	2.2	1.9	10.9	44%	
NETFLIX INC	NFLX US	USD	12/2021	173.1	76,903.8	15.4	15.5	14.0	13.5	12.4	11.2	3.0	2.7	2.5	26.3	16%	
Average							46.7	32.8	25.1	26.9	19.0	15.5	7.0	5.5	4.7	49.0	21%

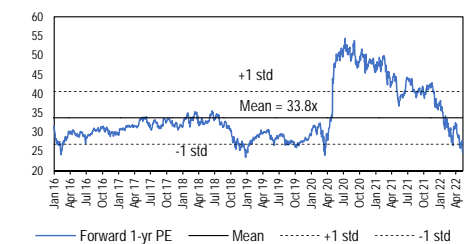
Source: Bloomberg, UOB Kay Hian

MSCI CHINA IT INDEX



Source: Bloomberg, UOB Kay Hian

NASDAQ CTA INTERNET TECH INDEX



Source: Bloomberg, UOB Kay Hian

KRANESHARES CSI CHINA INTERNET ETF



Source: Bloomberg, UOB Kay Hian

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