KGI

Market strategy

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4Q11 | China & Hong Kong

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Growth slows amid regional volatility; stay defensive

■ **Domestic consumption the only sure growth driver**

There is now little doubt that China's economic growth is moderating. We expect neither capital formation nor net exports to surprise investors on the upside. The only bright spot we see at present in China is the domestic consumption sector.

■ **Capital costs rising on tight policies; downside risk to corporate earnings**

While consumer prices and house prices have shown no sign of a downward inflection, continued macroeconomic tightening measures in China have driven up capital costs and, as a result, corporate financing costs. Against a backdrop of sluggish overseas demand, we have lowered our 2011 corporate earnings growth forecast by an average of 15%. Moreover, we now see potential for further downward revision.

■ **Europe debt crisis snowballing**

Euro zone authorities are not handling the Greek default crisis competently, in our view. Given the increasing likelihood that the European debt crisis will spread, creating another period of financial turmoil, we believe funds will flow back to US dollar-denominated assets, driven by risk aversion. On the one hand, this will deal a heavy blow to the Hong Kong stock market, but on the other hand it will prompt the Chinese government to loosen macro controls.

■ **Hang Seng Index under weak consolidation; A-shares more robust**

We forecast the Hang Seng Index (HSI) to trade between 17,500-21,500 points in 4Q11, implying a PE of 8-10x and PB of 1.25-1.5x. As the A-share market is relatively self-contained, we believe it will be stronger. We forecast the SSE Composite Index to consolidate between 2,300-2,700 points in 4Q11, implying a PE range of 13-15.0x.

Summary

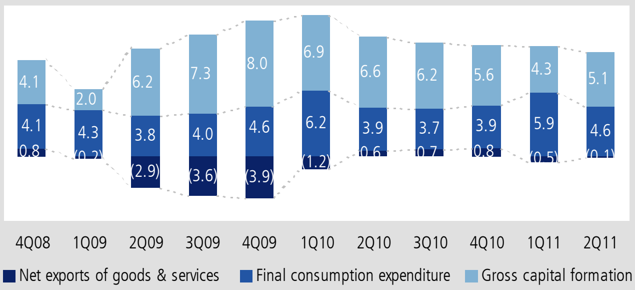
Growth slowing; stay defensive

Clear downtrend of economic growth in China

Based on statistics over the past two months, we don't expect a hard landing for China's economy. However, although GDP growth isn't likely to see a significant slump, there is also a marked absence of catalysts for economic growth. We now forecast China's GDP growth to decline to 8.9% in 4Q11, making it the fifth quarter of decline in a row since 4Q10. The slowing trend is clear. Overseas demand, a key economic growth driver for China, is diminishing. Net exports of goods and services dragged down GDP growth in 1Q-2Q11. Considering feeble US economic growth and uncertainties about Europe's debt crisis, we don't expect much contribution from overseas demand to China's economic growth in the near future.

Figure 1: **Contribution of overseas demand & investment to China's GDP falling**

Contribution to China GDP growth, percent



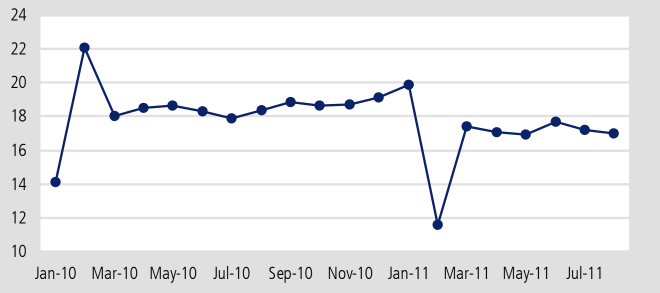
Source: Wind

Domestic consumption the only bright spot

We think domestic consumption is the only hope for GDP growth. Consumption as a share of GDP growth has rebounded for four straight quarters. Meanwhile, consumption growth was steady at around 17% in 1Q-2Q11, only 1.0 ppt below 2010. We have observed a steady trend on a sequential basis, in particular.

Figure 2: **Consumption steady, solid outlook for 4Q11**

China growth of national retail sales YoY, percent



Source: Wind

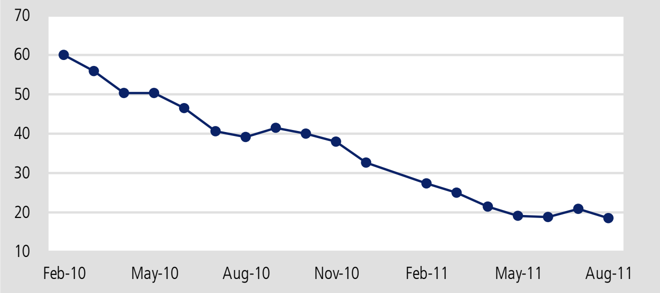
Consumption is driven by rapid growth of per capita income. Growth of per capita income in urban China has topped 7% since 2010. The labor shortage since 2010 is chiefly attributable to rising labor costs, in our view. The implementation of new labor regulations has also boosted per capita income. Consumer spending will likely be further fueled by the raising of the threshold for personal income tax levies this year.

Downside risk to corporate earnings on rising capital costs

China's central bank, the People's Bank of China (PBOC), has raised the benchmark rate five times and the required reserve ratio nine times since October 2010 in a bid to mop up liquidity. The current round of macroeconomic controls are aimed at containing inflation and real estate prices. However, both consumer and home prices remain firm. Macroeconomic tightening has led to a funds shortage, rising capital costs and soaring corporate financing expense. The financing expense of industrial enterprises spiked 30% in January-July, far higher than the growth of GDP and industrial added value, creating a heavy burden for enterprises. We have revised down our corporate earnings growth forecast by an average of 15% in 2011. Should tight capital persist, the trend for short-term funding will become more prevalent. Insufficient long-term funds, needed for corporate development, will severely hamstring growth. Hence our lowered corporate earnings forecast.

Figure 3: **State-owned enterprises earnings growth declining**

China state-owned enterprises earnings growth YoY, percent



Source: Wind

Hang Seng Index not likely to rally; we prefer defensive plays

Based on our analysis of the economy, liquidity and the market, we are cautious about equities in 4Q11. Among the three economic drivers, investment and net exports don't look very promising due to domestic macro controls and regional headwinds. However, we think the third driver, consumption, is a bright spot. Against the backdrop of lofty CPI, the rising cost of living will likely dampen demand for consumer goods. We prefer the theme of consumption upgrading, that is, stronger demand for higher-end consumer goods as per capita income rises. Meanwhile, economic uncertainties are re-emerging globally. The European debt crisis could lead to another round of global financial turmoil, and investors are doubtful of corporate earnings. Given these circumstances, our top picks are companies with clear earnings growth outlook that will better weather the current pervasive bearish market sentiment.

We forecast the Hang Seng Index (HSI) to trade between 17,500-21,500 points in 4Q11, implying a PE range of 8-10x and P/B range of 1.25-1.5x. We think the current valuation reflects investor pessimism. While bearish sentiment appears irreversible in 4Q11, we would expect the HSI to rebound over 10% if investor sentiment recovers even a little.

Figure 4: **Our top picks in 4Q11**

Company	Ticker	Sector	Company	Ticker	Sector
Silver Base	00886.HK	F&B	Tianneng Power	00819.HK	Lead-acid battery
Kingworld	01110.HK	Pharmaceuticals	Huadian Power	01071.HK	Energy
Golden Eagle	03308.HK	Department store	China Oilfield	02883.HK	Energy
ZhengTong	01728.HK	Retail			

Source: KGI Research

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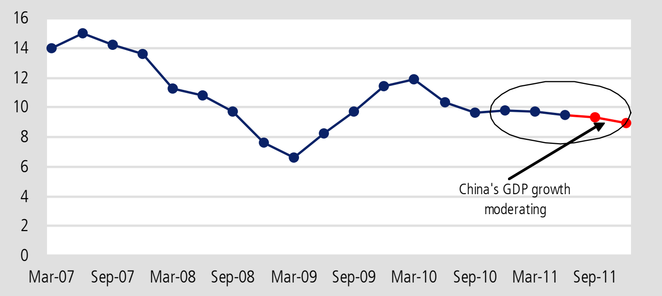
Strategy

Play defensive on slowing growth

Based on statistics over the past two months, we don't expect a hard landing for China's economy. However, although GDP growth isn't likely to see a significant slump, there is also a marked absence of catalysts for economic growth. We now forecast China's GDP growth to decline to 8.9% in 4Q11, making it the fifth quarter of decline in a row since 4Q10. The slowing trend is clear.

Figure 5: **China's GDP growth moderating**

China GDP growth, percent

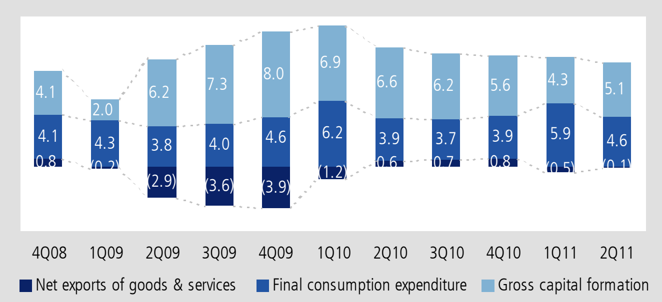


Source: Wind

Overseas demand, a key economic growth driver for China, is diminishing. Net exports of goods and services dragged down GDP growth in 1Q-2Q11. Considering feeble US economic growth and uncertainties about Europe's debt crisis, we don't expect much contribution from overseas demand to China's economic growth in the near future.

Figure 6: **Contribution of overseas demand & investment to China's GDP falling**

Contribution to China GDP growth, percent



Source: Wind

Major global financial institutions have trimmed their forecasts for global economic growth in 2011-12. The International Monetary Fund (IMF) on September 20 lowered its forecasts for 2011 and 2012 US GDP growth by 1.0 ppt to 1.5% and 0.9 ppts to 1.8%, respectively, and also cut its forecasts for eurozone GDP growth by 0.4 ppts to 1.6% and 0.6 ppts to 1.1%. In light of global economic conditions, we don't expect exports to boost China's economy much. When its foreign exchange reserves were only US$30bn, it was the natural course for China to strive to attract foreign investment and to boost exports in order to gain foreign currencies. Now, with reserves nearing the US$3.0tn mark, exports are no longer the best option for increasing economic activity.

Figure 7: **IMF has cut its economic growth forecasts**

	Revised economic growth forecasts (%)		Change from June forecasts (%)	
	2011F	2012F	2011F	2012F
Worldwide	4.0	4.0	(0.3)	(0.5)
US	1.5	1.8	(1.0)	(0.9)
Eurozone	1.6	1.1	(0.4)	(0.6)
China	9.5	9.0	(0.1)	(0.5)
India	7.8	7.5	(0.4)	(0.3)
Russia	4.3	4.1	(0.5)	(0.4)

Source: IMF

Economic restructuring in China a huge challenge

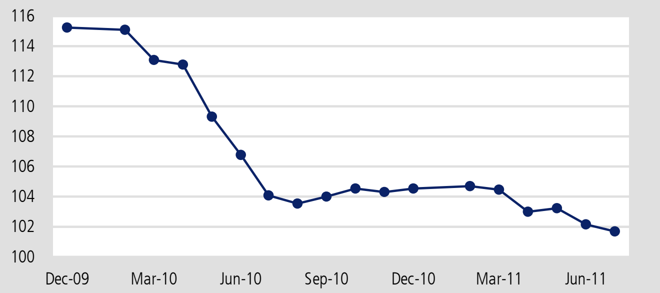
Post the 2008 financial crisis, while the cause of China's economic slowdown might be attributed to sluggish exports caused by weak foreign demand, we believe the problem lies with China being forced to shift its role in the global economy. The issues confronting the US and Europe now are not short-term but are the consequence of low-cost exports from Asian countries like China over the long term and highly-leveraged consumption in Europe and the US. Therefore, low-cost exports from major manufacturers like China will be unsustainable if high leverage proves unviable to Europe and the US. China will have to adopt a different role in the international division of labor. China's economy is expected to progress from real growth to intangible development. Financial resources are essential when it comes to intangible economic development. However, China has neither advantages in global distribution of financial resources nor any interest in it, as it has in natural resources. Therefore, the so-called economic restructuring in China is merely a smokescreen before the country makes meaningful headway in the international division of labor. In other words, economic restructuring can only take place by fine-tuning the current economic structure in the form of supporting some sectors while not supporting others.

Real estate controls yet to pay off

GDP growth via capital formation seems to have gradually lost steam. In the last decade, China's economic growth was chiefly propelled by capital formation, especially the real estate sector. However, living costs are soaring for average people amid the house price surge, highlighting increased social discord. The growing wealth gap has forced the central government to curb the real estate market and control rising property prices. Unfortunately, macro controls starting 2007 were abruptly put on hold in 2008 due to the financial crisis spreading from the US. The Chinese government's Rmb4.0tn stimulus package helped lay the foundation for across-the-board price hikes later. While macro-tightening was reintroduced nearly one year ago, consumer and house prices, the main targets of price controls, have shown no signs of softening. In particular, house prices remain firm, according to government price indices. While the YoY growth of property prices has moderated since mid-2010, it remains in positive territory. We don't expect to see further stimulus aimed at the real estate sector until price controls achieve satisfactory results, which will in turn weigh on fixed asset investment (FAI). While China has announced a massive hydraulic infrastructure program totaling Rmb4.0tn to be spent over 10 years (Rmb400bn per year), we believe massive government-led investment plays only a minor role in fueling downstream sectors, or even the entire economy.

Figure 8: **Real estate prices remain firm**

China home price index, points



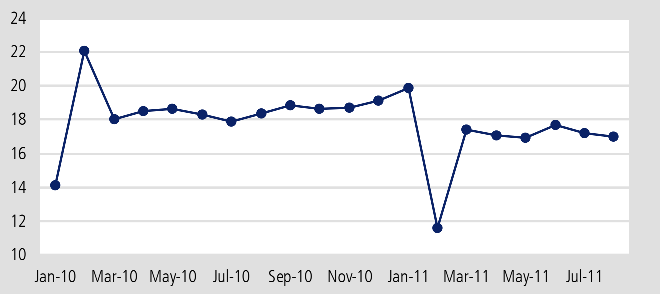
Source: Wind

Domestic consumption the only bright spot

We think domestic consumption is the only hope for GDP growth. Consumption as a share of GDP growth has rebounded for four straight quarters. Meanwhile, consumption growth was steady at around 17% in 1Q-2Q11, only 1.0 ppt below 2010. We have observed a steady trend on a sequential basis, in particular.

Figure 9: **Consumption steady, solid outlook for 4Q11**

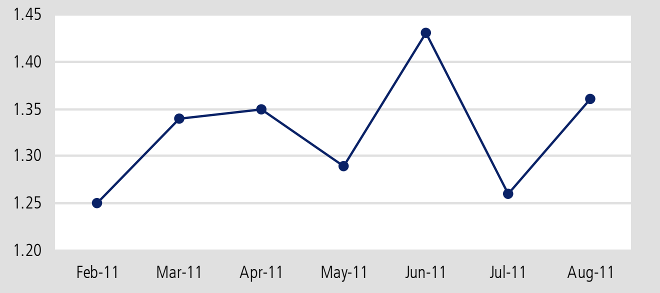
China growth of national retail sales YoY, percent



Source: Wind

Figure 10: **Consumption growth stable MoM**

China growth of national retail sales MoM, percent

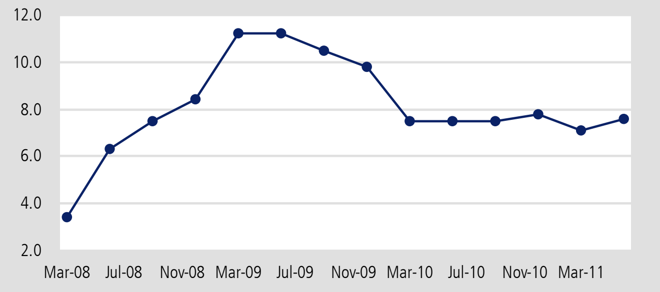


Source: Wind

Consumption is driven by rapid growth of per capita income. Growth of per capita income in urban China has topped 7% since 2010. The labor shortage since 2010 is chiefly attributable to rising labor costs, in our view. The implementation of new labor regulations has also boosted per capita income. Consumer spending will likely be further fueled by the raising of the threshold for personal income tax levies this year.

Figure 11: **Per capita income of urban residents up steadily**

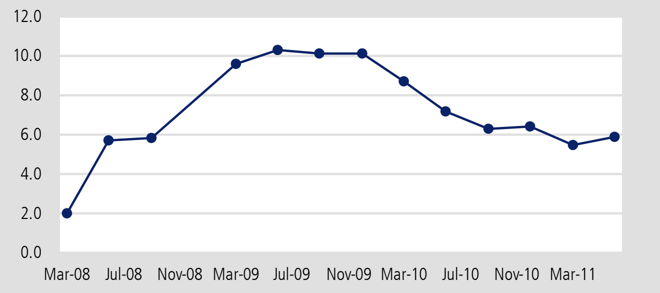
China growth of urban per capita income YoY, percent



Source: Wind

Figure 12: **Per capita spending of urban residents also up**

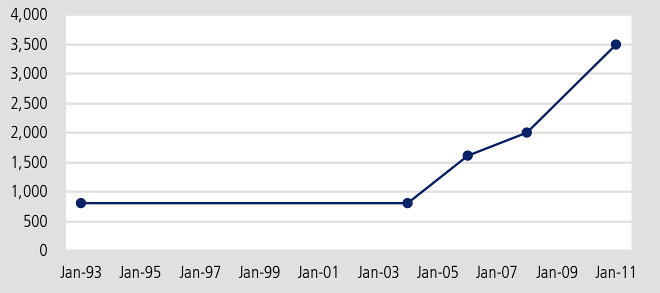
China growth of urban per capita expenditure YoY, percent



Source: Wind

Figure 13: **Individual income tax levy threshold raised again**

China threshold for monthly personal income tax levy, Rmb



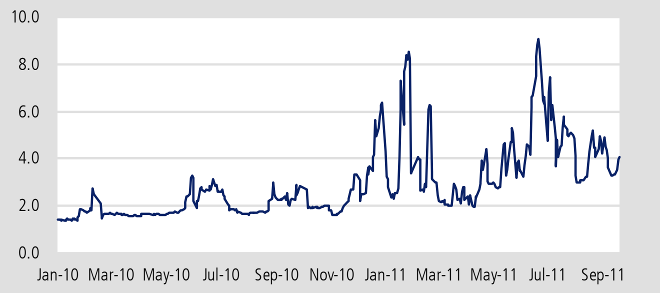
Source: Wind

Stringent macro tightening didn't affect house prices, but caused capital shortage

The PBOC has raised the benchmark rate five times and the required reserve ratio nine times since October 2010 in a bid to mop up liquidity. The current round of macroeconomic controls is aimed at containing inflation and real estate prices. However, both consumer and home prices remain firm. Macroeconomic tightening has led to a funds shortage, rising capital costs and soaring corporate financing expense.

Figure 14: **Industrial enterprises financing expense up strongly**

China industrial enterprises financing expense growth YoY, percent

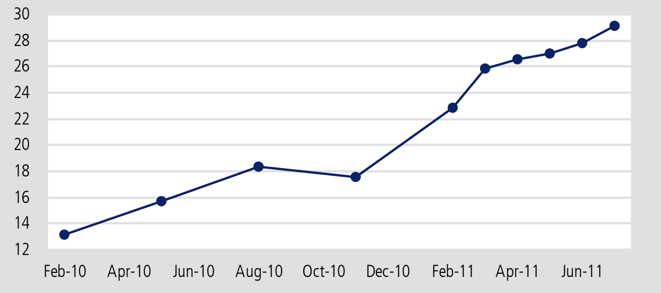


Source: Wind

Due to tight funds supply on the market, short-term and medium-term callable loans are flourishing. The annualized 1W SHIBOR rate is close to 4%, well above the two-year average of 2.9%. This undermines the attraction of running a business in terms of returns but boosts the attraction of lending. Some financial products offered by commercial banks guarantee an annual return of 8% and some guarantee 12%. Trust instruments are even sold with a pledged yield of around 18%. Non-public fundraising entails even higher costs. It is reported that loan interest rates in the private sector in Wenzhou have reached 40%. As to the question of what real projects can have such high returns to cover the costs of such high rates, no answer is forthcoming from any quarter. Thus, there is considerable financial risk in the private sector in China at present.

Figure 15: **Funding costs in China have skyrocketed**

China 1W SHIBOR annualized rate, percent

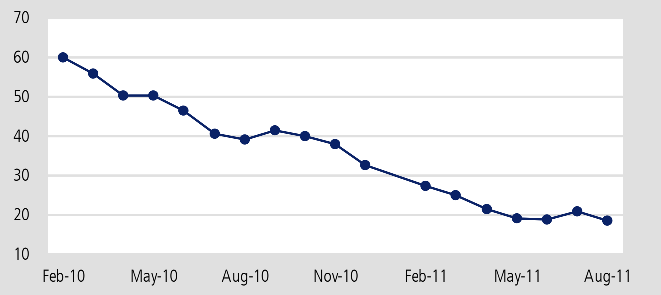


Source: Wind

With brisk demand for callable loans, the difficulty of obtaining corporate loans is increasing, especially for small and medium enterprises (SME). Under China's current financial system, we cannot see enterprises obtaining sufficient loan support if aggregate money supply is not loosened. Considering that SMEs create a lot of jobs, the current funding problem is stifling the country's longer-term growth potential. State-owned enterprises (SOE) with sound operations are a case in point. SOE earnings growth has declined from 40% a year ago to the current 18%. The earnings decline is likely more severe for other enterprises. In our strategy report on September 1, we predicted that downward revisions to corporate earnings were inevitable. And this is just the beginning. We have revised down our corporate earnings growth forecast by an average of 15% in 2011. Should tight capital persist, the trend for short-term funding will become more prevalent. Insufficient long-term funds, which are needed for corporate development, will severely hamper corporate growth. Hence our lowered corporate earnings forecast.

Figure 16: **SOE earnings growth moderating**

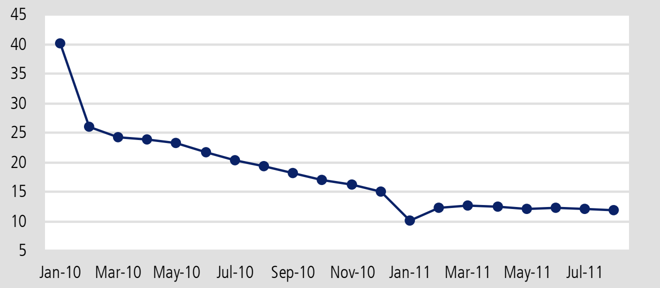
China growth of SOE earnings YoY, percent



Source: Wind

Figure 17: **Nationwide power consumption falling**

China power consumption growth YoY, percent



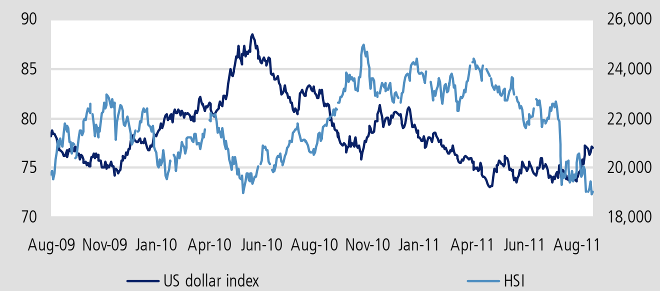
Source: Wind

International markets & economies volatile

The US and European credit crises are not going away, heightening regional uncertainties. There is a high likelihood that Greece will default on its debt. While Greece's debt will shrink if it exits the eurozone, even if this does happen sizable Greek bonds held by French and German banks and other European banks would render their bad debt problems irresolvable, unless France and Germany too exit the eurozone. Then the EU would disappear. Restatement of EU countries' balance sheets looks inevitable. Once the European debt crisis bursts, a new round of financial crises could well erupt, pummeling the world's already dismal economic outlook, despite global deleveraging since 2008. This would of course exacerbate risk-averse sentiment and lead to capital flowing back to US dollar-denominated assets. Should this happen, the Hong Kong market would be dealt a heavy blow.

Figure 18: **Capital flow back to the US dollar would hit HSI hard**

US dollar index, points (LHS); HSI, points (RHS)

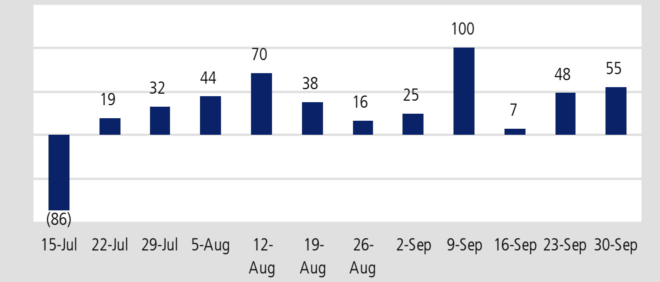


Source: Wind

However, the widening European debt crisis could prove favorable to China's A-share market, as the market is relatively closed and is thus less subject to overseas capital movement. While overseas volatility will have an impact on a psychological level, the actual impact will be much weaker than in Hong Kong. Although the A-share market slumped post the 2008 financial crisis, it began to stage a solid rebound after China loosened its tightening measures by injecting liquidity (the Rmb4.0tn stimulus package). We think current conditions are similar to those in 2008. Potential deterioration of the European debt crisis will very likely trigger significant fluctuation in financial markets. We expect China's government to loosen controls again. We note the PBOC has countered its tightening measures to some extent. It has reported a net increase in money supply through the open market for the eleventh successive week, for a total of Rmb454bn. If Europe's debt debacle worsens, across-the-board loosening in China is very likely.

Figure 19: **PBOC has increased money supply for eleven weeks**

PBOC net increase of money supply, Rmb bn



Source: Wind

Compared to the Europe situation, circumstances in the US are somewhat clearer, with the street focused on whether a third round of quantitative easing (QE3) will be rolled out and what the impact will be. We think QE3 would have a positive impact on financial markets in the near term, though less so than QE1 and QE2.

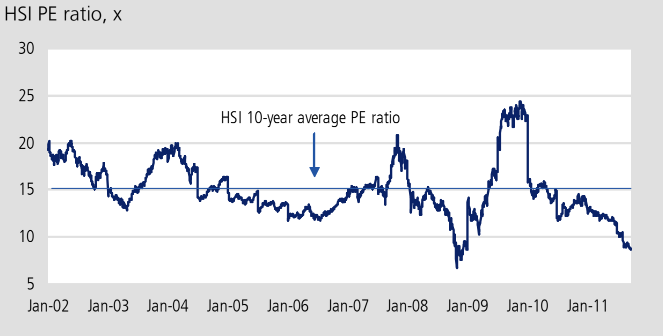
Equities unlikely to strengthen; play defensive

Based on our analysis of the economy, liquidity and the market, we are cautious about equities in 4Q11. Among the three economic drivers, investment and net exports don't look very promising due to domestic macro controls and regional headwinds. However, we think the third driver, consumption, is a bright spot. Against the backdrop of lofty CPI, the rising cost of living will likely dampen demand for consumer goods. We prefer the theme of consumption upgrading, that is, stronger demand for higher-end consumer goods as per capita income rises.

Meanwhile, economic uncertainties are re-emerging globally. The European debt crisis could lead to another round of global financial turmoil, and investors are doubtful of corporate earnings. Given these circumstances, our top picks are companies with clear earnings growth outlook that will better weather the current pervasive bearish market sentiment.

Fundamentally, further cuts to corporate earnings estimates are very likely as the global economy has yet to reach bottom. However, the market has been at a long-term low valuation. The current PE of HSI is only 8.67x. Even if we incorporate a 20% downward revision to corporate earnings, the corresponding PE multiple would be around 10x, versus the 10-year historical average of 15x.

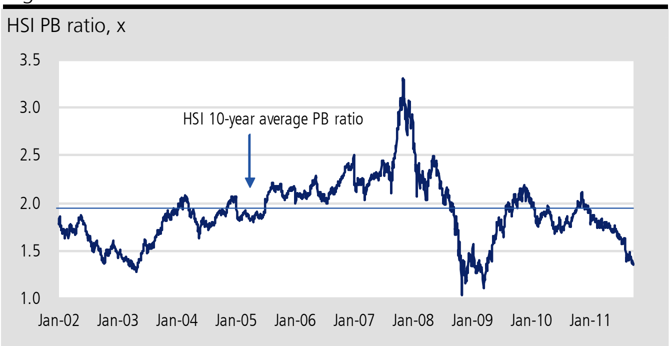
Figure 20: **HSI at a low PE even under earnings cuts**



Source: Bloomberg

We have reached a similar conclusion from the perspective of PB ratio. HSI is currently trading at a PB of only 1.35x, versus the 10-year historical average of 2.0x. For the long term, we think this valuation is low.

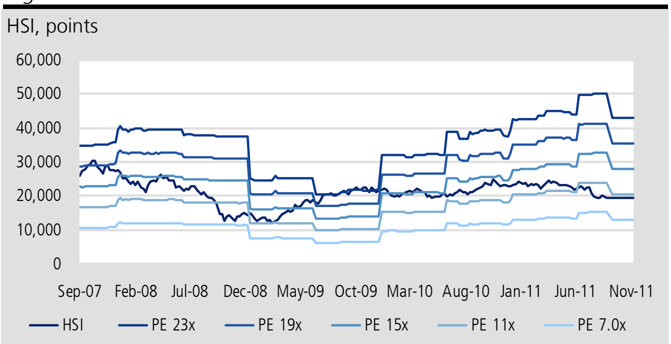
Figure 21: **HSI also low in terms of PB ratio**



Source: Bloomberg

We don't foresee much downside for HSI. As such, we forecast the index to trade between 17,500-21,500 points in 4Q11, implying a PE range of 8-10x and P/B range of 1.25-1.5x. We think the current valuation reflects investor pessimism. While bearish sentiment appears irreversible in 4Q11, we would expect the HSI to rebound over 10% if investor sentiment recovers even a little.

Figure 22: **HSI PE band**



Source: Bloomberg

We think the A-share market will be stronger and forecast the SSE Composite Index to trade between 2,300-2,700 points in 4Q11, implying a PE of 13-15x.

Our Top Picks

Figure 23: **Our top picks**

Company	Rating	Rationale
Tianneng Power	00189.HK	Production capacity was 49mn units as of end-2010. The company plans to expand capacity by 16mn units in 2011, 15mn units in 2012 and 6.6mn units in 2013, up around 20% over the three years. The weighting of outsourced polar plate will be reduced further in 2012. After the completion of plants in Anhui, Jiangsu and Wushan, Tianneng Power will supply all polar plate it requires in house, boosting gross margin by 3-4 ppts. We have adjusted our 2011 and 2012 EPS forecasts to a respective HK$0.64 and HK$0.88, equivalent to 5.2x and 3.8x the current share price. We expect profitability to rise significantly in 2H11. Based on the industry average PE of 8x, we derive a 12-month target price of HK$5.12. Reiterate Outperform.
Investment rating	Outperform	
Analyst	Jerry Weng	
Current price (HK$)	3.31	
12M target price (HK$)	5.12	
Upside/downside (%)	54.7	
Silver Base	00886.HK	We favor Silver Base as: (1) sales will grow fast with newly added products; (2) valuation is attractive at a 2011F PE of 10.4x, or a 44% discount to H-share luxury goods distributor peers; (3) the highest dividend among H-share F&B plays at as high as 9.8%; and (4) earnings release will likely beat market estimates. We forecast EPS of HK$0.82 in 2012. Maintain Outperform with a target price of HK$12.24, based on a 2012F PE of 15.0x, which implies 78.4% upside.
Investment rating	Outperform	
Analyst	Michelle Chen	
Current price (HK$)	6.86	
12M target price (HK$)	12.24	
Upside/downside (%)	78.4	
Huadian Power	01071.HK	Huadian Power's earnings are growing on increased coal output from mine acquisitions. Our conservative 2011 and 2012 coal output forecasts are 4.4mn metric tons (mt) and 8.1mn mt, respectively, contributing pretax profits of Rmb480mn and Rmb810mn, up 105% and 68%. We expect a significant reduction in losses if electricity tariffs are raised again this year. We also expect reforms to the power industry that will reduce losses of the coal-fired power business and likely improve the outlook over the medium to long term. We expect Huadian Power's business to improve over the long term, given: (1) higher sensitivity than peers to electricity price adjustments; and (2) higher weighting of coal operations. Shares are trading at a 2011 P/B of 0.4x, low historically. Our 12-month target price is HK$1.76, based on a forward P/B of 0.6x. Outperform maintained.
Investment rating	Outperform	
Analyst	Judith Chen	
Current price (HK$)	1.12	
12M target price (HK$)	1.76	
Upside/downside (%)	57.1	
Kingworld Medicines	01110.HK	We initiate coverage on Kingworld Medicines with an Outperform rating and a target price of HK$2.20 given: (1) Kingworld is not affected by government prescription drug price limitation as it is mainly engaged in OTC medicine distribution; (2) 2011 gross margin will rise on promotion of higher-margin medicines at kiosk of retail stores and renminbi appreciation; and (3) plans of acquiring regional sub-distributors with gross and net margins no less than Kingworld and end-market resources. We expect earnings contribution in 2H12.
Investment rating	Outperform	
Analyst	T.J. Hsu	
Current price (HK$)	1.31	
12M target price (HK$)	2.20	
Upside/downside (%)	67.9	
ZT Auto	01728.HK	We like ZT Auto: (1) for its big exposure to luxury brands, especially BMW. Despite slower growth for luxury brand sales from June due to a high comparison base last year, we are upbeat on the counter and see demand outstripping supply at retail end. We don't expect supply to greatly improve until 2012 when new plant and capacity is put into operation; (2) M&A will bring upside catalyst. We expect ZT Auto to complete SCAC acquisition in Nov. After the deal, ZT Auto will add Land Rover, Volvo and Jaguar into its brand portfolio, which will diversify its revenue stream and reduce its reliance on the BMW brand; and (3) the stock is undervalued at 18.4x 2011F PE and 8.9x 2012F PE. Target price unchanged at HK$13.9. Reiterate Outperform.
Investment rating	Outperform	
Analyst	Shen Wei	
Current price (HK$)	7.80	
12M target price (HK$)	13.90	
Upside/downside (%)	78.2	
China Oilfield Services	02883.HK	(1) In the short run earnings will grow as CNOOC will accelerate investment in 2H11; (2) new drilling ships will come on stream in 2H11, which bodes well for earnings growth; and (3) shares are now trading at a 2011 PE of 8x, well below its average PE. The booming sector will provide momentum for share valuation upside.
Investment rating	Outperform	
Analyst	Guo Zhang	
Current price (HK$)	8.90	
12M target price (HK$)	18.50	
Upside/downside (%)	107.9	
Golden Eagle	03308.HK	We like Golden Eagle for its: (1) dominant position in tier-1 and -2 cities in Jiangsu and clear expansion route focused on multi-stores to build up local dominance in key cities Nanjing, Hefei and Xi'an; (2) peer-beating cost control given its low rental cost at less than 1% of GSP as it owns 67% of store properties. D&A and staff expense are well contained at lowest peer level backed by peer-leading sales efficiency; and (3) we believe the solid growth outlook, strong margin delivery and proven track of operation justify a 0.9x PEG. Based on our 2011 EPS forecast of Rmb0.66, we maintain our target price of HK$22.22. Maintain Outperform.
Investment rating	Outperform	
Analyst	Jessie Guo	
Current price (HK$)	16.00	
12-M target price (HK$)	22.22	
Upside/downside (%)	38.9	

Source: KGI Research

Tianneng Power

(00819.HK/819 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Power | Hong Kong

Outperform
Maintained

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A leader to benefit most from market consolidation

■ Market share to rise on continued capacity expansion

Production capacity was 49mn units as of end-2010. The company plans to expand capacity by 16mn units in 2011, 15mn units in 2012 and 6.6mn units in 2013, equivalent to growth of around 20% over the three years.

■ Gross margin to jump to 27% in 2H11

A 150k-metric ton (mt) battery recycling plant in Wushan will commence full operation in 2012. The plant is expected to produce 10k mt of lead, meeting 5-6% of Tianneng Power's needs in 2012. The weighting of outsourced polar plate will be reduced further in 2012. After the completion of plants in Anhui, Jiangsu and Wushan, Tianneng Power will supply all polar plate it requires in house, boosting gross margin by 3-4 ppts.

■ ASP & sales volume both set to rise – Maintain Outperform

We have adjusted our 2011 and 2012 EPS forecasts to a respective HK$0.64 and HK$0.88, equivalent to 5.2x and 3.8x the current share price. We expect profitability to rise significantly in 2H11. Based on the industry average PE of 8.0x, we have derived a 12-month target price of HK$5.12. Reiterate Outperform.

Year to 31-Dec	Sales (Rmb mn)	Gross profit (Rmb mn)	EBIT (Rmb mn)	EBITDA (Rmb mn)	Net income (Rmb mn)	EPS (Rmb)
2009A	2,255	642	271	271	271	0.27
2010A	3,753	871	368	368	346	0.32
2011F	5,987	1,500	662	756	576	0.53
2012F	7,150	1,931	930	1,073	787	0.73
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2009A	1.1	14.0	9.0	10.3	1.4	18.5
2010A	1.0	10.7	10.7	11.8	1.6	19.0
2011F	0.7	6.4	5.6	6.6	1.3	26.0
2012F	0.5	4.1	3.6	4.8	1.0	27.5

Return

Price as of Sep 26, 2011 (HK$/shr)	3.31
12M target price (HK$/shr)	5.12
Upside/downside (%)	54.7
The percentile of excess return (%)	49
Dividend yield-12/11E (%)	N.A.

Balance Sheet

Book value/shr-12/11E (US$)	2.3
P/B-12/11E(x)	1.5
Net debt/equity-12/11E (%)	17.2

Trading

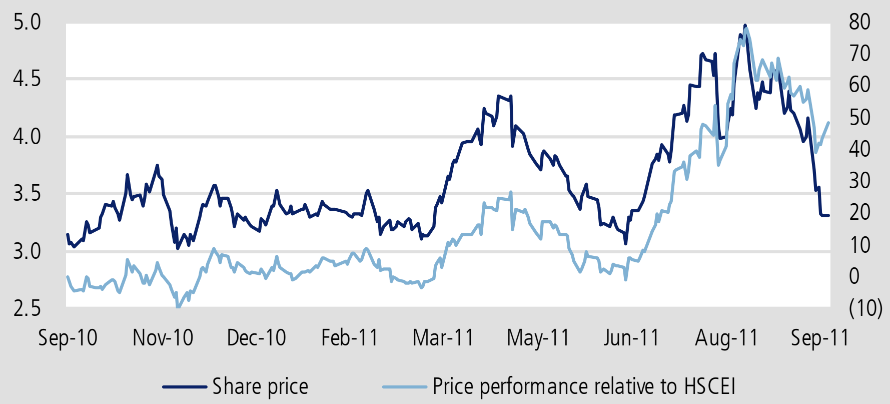
52-week trading range (HK$)	3 - 5
Mkt cap-HK$bn/US$mn	3.6/462
Outstanding shares (mn)	1,090
Free floating shares (mn)	63
The Largest Shareholder (%):	Mr zhang 37
3M avg. daily trading (mn)	9.4
Abs. performance (3,6,12M) (%)	-2.1; -8.8; 5.1
Rel. performance (3,6,12M) (%)	40; 35; 48

Company Description

Tianneng Power, reformed from Changxing Storage Battery which was established in 1986, is China's largest electric vehicle-use motive battery maker. Tianneng Power makes lead-acid, Ni-MH and lithium ion motive batteries. The company began making storage batteries for wind power and solar power in 2008.

Tianneng Power share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Balance Sheet

Year to 31 Dec (Rmb mn)	2008A	2009A	2010F	2011F	2012F
Total Assets	**1,668**	**2,258**	**3,085**	**4,177**	**5,141**
Current Assets	1,015	1,431	1,945	2,588	3,360
Cash & ST Investments	530	455	489	284	640
Inventories	339	599	819	1,246	1,430
Accounts Receivable	126	178	415	705	882
Others	20	199	222	352	409
Non-current Assets	653	827	1,140	1,589	1,780
LT Investments	0	0	2	0	0
Net fixed Assets	594	713	982	1,394	1,550
Others	60	115	156	195	230
Total Liabilities	**432**	**576**	**1,128**	**1,705**	**1,882**
Current Liabilities	412	576	1,098	1,670	1,848
Accounts Payable	83	241	272	516	644
ST Borrowings	172	120	515	674	642
Others	158	215	312	479	563
Long-term Liabilities	20	0	30	35	34
Long-term Debts	20	0	30	35	34
Others	0	0	0	0	0
Shareholders' Equity	**1,236**	**1,683**	**1,956**	**2,472**	**3,259**
Common Stock	99	106	106	106	106
Capital Surplus	557	839	897	897	897
Retained Earnings	581	738	953	1,469	2,256
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Dec (Rmb mn)	2008A	2009A	2010F	2011F	2012F
Growth (% YoY)					
Sales	32.3	(12.8)	66.4	59.5	19.4
OP	13.0	(2.1)	36.0	79.8	40.4
EBITDA	13.0	(2.1)	36.0	105.2	42.0
NP	15.4	15.6	27.9	66.3	36.7
EPS	(35.8)	13.7	20.2	66.4	36.5
Profitability (%)					
Gross Margin	22.5	28.5	23.2	25.1	27.0
Operating Margin	10.7	12.0	9.8	11.1	13.0
EBITDA Margin	10.7	12.0	9.8	12.6	15.0
Net Profit Margin	9.1	12.0	9.2	9.6	11.0
ROAA	14.0	13.8	13.0	15.9	16.9
ROAE	20.4	18.5	19.0	26.0	27.5
Stability					
Gross Debt/Equity (%)	15.5	7.1	27.9	28.7	20.7
Net Debt/Equity (%)	Net cash	Net cash	2.8	17.2	1.1
Interest Coverage (x)	2.6	4.7	6.8	5.2	6.2
Interest & ST Debt Coverage (x)	0.4	0.5	0.2	0.2	0.3
Cash Flow Interest Coverage (x)	19.4	(0.4)	(0.4)	7.4	21.0
Cash Flow/Interest & ST Debt (x)	2.7	(0.0)	(0.0)	0.3	1.1
Current Ratio (x)	2.5	2.5	1.8	1.5	1.8
Quick Ratio (x)	1.6	1.4	1.0	0.8	1.0
Net Debt (Rmb mn)	(202)	(337)	(140)	241	231
Per Share Data (Rmb)					
EPS	0.23	0.27	0.32	0.53	0.73
CFPS	0.23	0.27	0.32	0.62	0.86
BVPS	1.24	1.56	1.81	2.28	3.01
SPS	2.59	2.09	3.46	5.53	6.60
EBITDA/Share	0.28	0.27	0.34	0.61	0.86
DPS	N.D.	0.06	0.06	N.D.	N.D.
Activity					
Asset Turnover (x)	1.5	1.1	1.4	1.6	1.5
Days Receivables	17.8	28.8	40.4	43.0	45.0
Days Inventory	47.8	97.0	79.6	76.0	73.0
Days Payable	11.7	39.0	26.4	31.5	32.9
Cash Cycle	53.9	86.7	93.6	87.5	85.2

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Dec (Rmb mn)	2008A	2009A	2010F	2011F	2012F
Sales	**2,585**	**2,255**	**3,753**	**5,987**	**7,150**
Cost of Goods Sold	2,004	1,613	2,881	4,487	5,220
Gross Profit	**581**	**642**	**871**	**1,500**	**1,931**
Operating Expenses	305	371	503	838	1,001
Operating Profit	**277**	**271**	**368**	**662**	**930**
Net Interest Income	(22)	(2)	(11)	(28)	(30)
Interest Income	5	11	3	4	5
Interest Expense	28	13	14	31	35
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	24	51	72	72	66
Net Extraordinaries	279	320	429	707	966
Pretax Income	44	49	82	131	179
Income Taxes	0	0	0	0	0
Net Profit After Extraordinaries	**234**	**271**	**346**	**576**	**787**
EBITDA	277	271	368	756	1,073
EPS (Rmb)	**0.23**	**0.27**	**0.32**	**0.53**	**0.73**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Dec (Rmb mn)	2008A	2009A	2010F	2011F	2012F
Operating Cash Flow	**533**	**(5)**	**(6)**	**233**	**726**
Net Profit	234	271	346	576	787
Depreciation & Amortization	0	0	0	93	143
Change in Working Capital	299	(276)	(352)	(436)	(205)
Others	0	0	0	0	0
Investment Cash Flow	**(199)**	**(174)**	**(312)**	**(543)**	**(335)**
Net CAPEX	(185)	(119)	(269)	(506)	(300)
Change in LT Investment	0	0	(2)	2	0
Change in Other Assets	(14)	(55)	(41)	(39)	(35)
Free Cash Flow	**334**	**(179)**	**(318)**	**(310)**	**391**
Financing Cash Flow	**(245)**	**104**	**352**	**104**	**(35)**
Change in Share Capital	(60)	176	(73)	(60)	0
Net Change in Debt	(185)	(72)	425	165	(35)
Change in Other LT Liab.	0	0	0	0	0
Net Cash Flow	**89**	**(75)**	**34**	**(205)**	**356**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Dec	1- COGS / Revenue	+ Dep./Amortization / Revenue	+ SGA Exp. / Revenue	= Operating Margin
2008A	77.5%	0.0%	11.8%	10.7%
2009A	71.5%	0.0%	16.5%	12.0%
2010F	76.8%	0.0%	13.4%	9.8%
2011F	73.4%	1.6%	14.0%	11.1%
2012F	71.0%	2.0%	14.0%	13.0%
Year to 31-Dec	**1/ Operating Working capital / Revenue**	**+ Net PPE / Revenue**	**+ Other Assets / Revenue**	**= Capital Turnover**
2008A	0.1	0.2	0.0	2.5
2009A	0.3	0.3	0.1	1.5
2010F	0.3	0.3	0.0	1.7
2011F	0.3	0.2	0.0	1.9
2012F	0.3	0.2	0.0	2.0
Year to 31-Dec	**Operating Margin**	**x Capital Turnover**	**x Cash 1 - Tax Rate**	**= After-tax Return on Inv. Capital**
2008A	10.7%	2.5	84.1%	22.6%
2009A	12.0%	1.5	84.7%	15.7%
2010F	9.8%	1.7	80.8%	13.5%
2011F	11.1%	1.9	81.5%	17.0%
2012F	13.0%	2.0	81.5%	20.7%

Source: Company data; KGI Asia Limited estimates

Silver Base

(00886.HK/886 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Food & beverage	**Outperform**
Hong Kong	Maintained

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Sales to accelerate on new products

■ Sales growth to top 80% YoY in 1H12

We forecast sales will grow over 80% YoY in 1H12, the fastest growth among food and beverage H-shares. The main driver will be Fen Wine, which started sales in August 2011, and Yongfu Jiangjiu, which started sales in September 2010. We think the company's mid-term results will beat market consensus.

■ Valuation low at 10.4x 2012 earnings or 44% below peer average

Shares are now trading at a 2012F PE of 10.4x, around 44% lower than the average of luxury product distributors listed in Hong Kong. The 2012 PEG is an attractive 0.4x, compared with peers' 0.8x.

■ Target price implies 12.24% upside – Maintain Outperform

We are positive on Silver Base as: (1) its 2H12 earnings are expected to be the highest among peers; (2) valuation is attractive; and (3) midterm results beat market expectation. Shares are trading at a 2012F PE of 10.4x and a PEG of 0.4x. We maintain our target price of HK$12.24 (2012F PE of 15.0x), implying 78.5% upside. We reiterate Outperform.

Year to 31-Mar	Sales (HK$ mn)	Gross profit (HK$ mn)	EBIT (HK$ mn)	EBITDA (HK$ mn)	Net income (HK$ mn)	EPS (HK$)
2011A	2,217	1,021	751	751	585	0.49
2012F	4,027	1,772	1,256	1,256	971	0.82
2013F	5,110	2,197	1,543	1,543	1,188	1.00
2014F	6,157	2,647	1,859	1,859	1,419	1.19
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2011A	1.9	5.6	5.6	8.2	2.5	37.9
2012F	1.9	6.0	6.0	8.4	3.7	53.8
2013F	1.5	4.9	4.9	6.9	3.3	57.4
2014F	1.2	4.0	4.0	5.8	3.0	61.9

Return

Return	
Price as of Sep 26, 2011 (HK$/shr)	6.86
12M target price (HK$/shr)	12.24
Upside/downside (%)	78.5
The percentile of excess return (%)	69
Dividend yield-03/12E (%)	11.9

Balance Sheet

Balance Sheet	
Book value/shr-03/12E (US$)	1.6
P/B-03/12E (x)	4.2
Net debt/equity-03/12E (%)	Cash

Trading

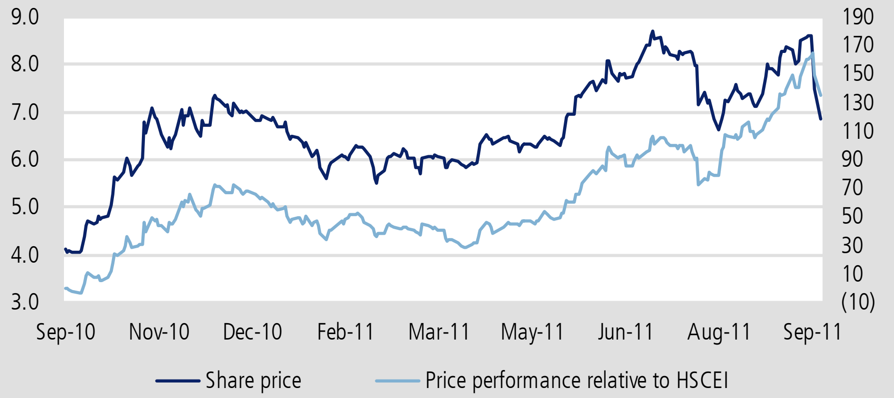
Trading	
52-week trading range (HK$)	4 - 8.7
Mkt cap-HK$bn/US$mn	8.2/1,049
Outstanding shares (mn)	1,190
Free floating shares (mn)	33
The Largest Shareholder (%):	Mr. Liang 66.7
3M avg. daily trading (mn)	4.6
Abs. performance (3,6,12M) (%)	-13; 18; 67
Rel. performance (3,6,12M) (%)	25; 74; 135

Company Description

Founded in 1997 as a spirits distributor, Silver Base initially engaged in selling liquors produced by Wuliangye Group in Southeast Asia. The company started exploring the China market in 2006 and is now China's largest spirits distributor. Silver Base is focused on the luxury spirits market, with a multi-brand, deep market penetration strategy for expansion. Since 2010, Silver Base has obtained global exclusive distributorships for Yongfu Jiangjiu, National Cellar 1573 and 40-year-old Guocang Fen Wine and 40-year-old Qinghua Fen Wine. In addition, Silver Base provides services to its VIP customers and group purchases through 80 Wine Kingdom specialty stores and 173 Wuliangye image stores.

Silver Base share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Balance Sheet

Year to 31 Mar (HK$ mn)	2010A	2011A	2012F	2013F	2014F
Total Assets	**1,647**	**2,000**	**2,537**	**2,901**	**3,271**
Current Assets	1,623	1,972	2,483	2,835	3,193
Cash & ST Investments	978	339	718	723	828
Inventories	315	480	867	1,120	1,350
Accounts Receivable	43	711	165	140	135
Others	288	441	732	852	880
Non-current Assets	24	29	54	66	79
LT Investments	8	8	8	8	8
Net fixed Assets	8	11	35	46	58
Others	7	10	11	12	13
Total Liabilities	**207**	**350**	**575**	**723**	**862**
Current Liabilities	207	350	575	723	862
Accounts Payable	27	1	6	8	10
ST Borrowings	97	63	65	77	83
Others	83	286	503	639	770
Long-term Liabilities	0	0	0	0	0
Long-term Debts	0	0	0	0	0
Others	0	0	0	0	0
Shareholders' Equity	**1,440**	**1,650**	**1,962**	**2,178**	**2,409**
Common Stock	119	119	119	119	119
Capital Surplus	869	699	699	699	699
Retained Earnings	452	832	1,143	1,360	1,591
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Mar (HK$ mn)	2010A	2011A	2012F	2013F	2014F
Growth (% YoY)					
Sales	5.3	68.1	81.6	26.9	20.5
OP	(9.0)	66.2	67.3	22.8	20.5
EBITDA	(9.0)	66.2	67.3	22.8	20.5
NP	(4.6)	47.7	66.0	22.3	19.5
EPS	(99.9)	8.9	66.3	22.3	19.5
Profitability (%)					
Gross Margin	47.2	46.1	44.0	43.0	43.0
Operating Margin	34.3	33.9	31.2	30.2	30.2
EBITDA Margin	34.3	33.9	31.2	30.2	30.2
Net Profit Margin	30.0	26.4	24.1	23.2	23.0
ROAA	38.5	32.1	42.8	43.7	46.0
ROAE	46.7	37.9	53.8	57.4	61.9
Stability					
Gross Debt/Equity (%)	6.7	3.8	3.3	3.5	3.5
Net Debt/Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Interest Coverage (x)	--	--	--	--	--
Interest & ST Debt Coverage (x)	0.9	2.7	4.4	4.9	5.4
Cash Flow Interest Coverage (x)	--	--	--	--	--
Cash Flow/Interest & ST Debt (x)	0.7	(3.6)	16.2	12.8	15.6
Current Ratio (x)	7.8	5.6	4.3	3.9	3.7
Quick Ratio (x)	6.3	4.3	2.8	2.4	2.1
Net Debt (HK$ mn)	(457)	(579)	(464)	(649)	(696)
Per Share Data (HK$)					
EPS	0.45	0.49	0.82	1.00	1.19
CFPS	0.45	0.49	0.82	1.00	1.19
BVPS	1.20	1.39	1.65	1.83	2.02
SPS	1.10	1.86	3.38	4.29	5.17
EBITDA/Share	0.51	0.63	1.06	1.30	1.56
DPS	0.55	0.55	0.82	1.00	1.19
Activity					
Asset Turnover (x)	1.3	1.2	1.8	1.9	2.0
Days Receivables	12.0	117.0	15.0	10.0	8.0
Days Inventory	87.0	79.1	78.6	80.0	80.0
Days Payable	7.5	0.1	0.6	0.6	0.6
Cash Cycle	91.5	196.0	93.1	89.4	87.4

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Mar (HK$ mn)	2010A	2011A	2012F	2013F	2014F
Sales	**1,319**	**2,217**	**4,027**	**5,110**	**6,157**
Cost of Goods Sold	696	1,196	2,255	2,913	3,509
Gross Profit	**623**	**1,021**	**1,772**	**2,197**	**2,647**
Operating Expenses	171	270	515	654	788
Operating Profit	**452**	**751**	**1,256**	**1,543**	**1,859**
Net Interest Income	1	1	1	14	2
Interest Income	1	1	1	14	2
Interest Expense	0	0	0	0	0
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	31	2	4	5	6
Net Extraordinaries	484	755	1,262	1,563	1,867
Pretax Income	87	170	290	375	448
Income Taxes	0	0	0	0	0
Net Profit After Extraordinaries	**396**	**585**	**971**	**1,188**	**1,419**
EBITDA	452	751	1,256	1,543	1,859
EPS (HK$)	**0.45**	**0.49**	**0.82**	**1.00**	**1.19**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Mar (HK$ mn)	2010A	2011A	2012F	2013F	2014F
Operating Cash Flow	**64**	**(225)**	**1,061**	**978**	**1,299**
Net Profit	396	585	971	1,188	1,419
Depreciation & Amortization	0	0	0	0	0
Change in Working Capital	(332)	(810)	90	(210)	(120)
Others	0	0	0	0	0
Investment Cash Flow	**(3)**	**(5)**	**(25)**	**(13)**	**(12)**
Net CAPEX	(4)	(3)	(23)	(12)	(11)
Change in LT Investment	0	0	(0)	0	0
Change in Other Assets	1	(3)	(1)	(1)	(1)
Free Cash Flow	**61**	**(230)**	**1,037**	**965**	**1,287**
Financing Cash Flow	**831**	**(408)**	**(658)**	**(960)**	**(1,181)**
Change in Share Capital	787	(375)	(660)	(971)	(1,188)
Net Change in Debt	44	(34)	3	11	7
Change in Other LT Liab.	0	0	(0)	0	0
Net Cash Flow	**892**	**(638)**	**379**	**5**	**106**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Mar	1- COGS / Revenue	+ Dep./Amortization / Revenue	+ SGA Exp. / Revenue	= Operating Margin
2010A	52.8%	0.0%	13.0%	34.3%
2011A	53.9%	0.0%	12.2%	33.9%
2012F	56.0%	0.0%	12.8%	31.2%
2013F	57.0%	0.0%	12.8%	30.2%
2014F	57.0%	0.0%	12.8%	30.2%

Year to 31-Mar	1/ Operating Working capital / Revenue	+ Net PPE / Revenue	+ Other Assets / Revenue	= Capital Turnover
2010A	0.5	0.0	0.0	2.1
2011A	0.7	0.0	0.0	1.5
2012F	0.4	0.0	0.0	2.7
2013F	0.3	0.0	0.0	2.9
2014F	0.3	0.0	0.0	3.1

Year to 31-Mar	Operating Margin	x Capital Turnover	x Cash 1 - Tax Rate	= After-tax Return on Inv. Capital
2010A	34.3%	2.1	81.9%	60.0%
2011A	33.9%	1.5	77.5%	39.4%
2012F	33.9%	1.5	77.0%	39.1%
2013F	31.2%	2.7	76.0%	63.6%
2014F	30.2%	2.9	76.0%	65.9%

Source: Company data; KGI Asia Limited estimates

KGI

Huadian Power

(01071.HK/1071 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Power	**Outperform**
Hong Kong	Maintained

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Coal output increase boosts profits

■ Mine acquisitions boost coal output & earnings

Huadian Power's earnings are growing on increased coal output from mine acquisitions. Our conservative 2011 and 2012 coal output forecasts are 4.4mn metric tons (mt) and 8.1mn mt, respectively, contributing pretax profits of Rmb480mn and Rmb810mn, up 105% and 68%.

■ Coal-fired business losses to decline in 2012 on rate hikes

We expect a significant reduction in losses if electricity tariffs are raised again this year. We also expect reforms to the power industry that will reduce losses of the coal-fired power business and likely improve the outlook over the medium to long term.

■ Shares undervalued – Maintain Outperform

We expect Huadian Power's business to improve over the long term, given: (1) higher-than-peers sensitivity to electricity price adjustments; and (2) higher weighting of coal operations. Shares are trading at a 2011 P/B ratio of 0.4x, low in historical terms. Our 12M target price is HK$1.76, based on a forward P/B of 0.6x. Outperform rating maintained.

Year to 31-Dec	Sales (Rmb mn)	Gross profit (Rmb mn)	EBIT (Rmb mn)	EBITDA (Rmb mn)	Net income (Rmb mn)	EPS (Rmb)
2010A	45,198	12,238	1,726	6,534	170	0.03
2011F	56,690	15,373	2,788	8,147	185	0.03
2012F	61,158	16,954	3,132	9,356	338	0.05
2013F	68,279	19,652	4,084	11,171	899	0.13
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2010A	2.2	52.0	15.2	64.9	0.8	1.1
2011F	1.9	37.9	13.0	33.7	0.8	1.1
2012F	1.9	36.6	12.2	18.4	0.8	2.0
2013F	1.8	30.5	11.1	6.9	0.8	5.2

Return

Price as of Sep 26, 2011 (HK$/shr)	1.12
12M target price (HK$/shr)	1.76
Upside/downside (%)	57.1
The percentile of excess return (%)	53
Dividend yield-12/11E (%)	N.A.

Balance Sheet

Book value/shr-12/11E (Rmb)	2.4
P/B-12/11E (x)	0.4
Net debt/equity-12/11E (%)	607.6

Trading

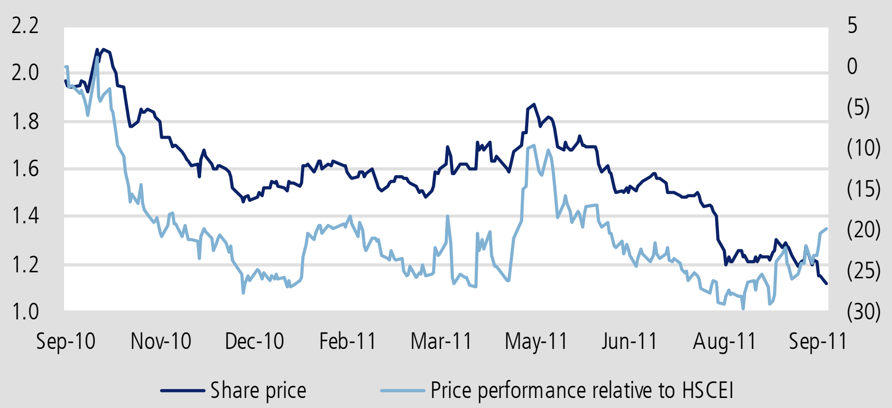
52-week trading range (HK$)	1.1 - 2.1
Mkt cap-HK$bn/US$mn	1.6/205
Outstanding shares (mn)	1,431
Free floating shares (mn)	6,621
The Largest Shareholder (%):	Huadian Group 57
3M avg. daily trading (mn)	3.4
Abs. performance (3,6,12M) (%)	-27; -34; -43
Rel. performance (3,6,12M) (%)	4.6; -1.9; -20.

Company Description

Huadian Power is the listed unit of Huadian Group, one of China's top five power operators. Since its listing, Huadian Power has continued expanding installed capacity through new plants and M&A. Average annual capacity growth is over 20%. Annual capacity was 28,708MW as of end-June, or 24,845MW on an equity basis. Around 45.5% of installed capacity is located in Shandong Province.

Huadian Power share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Balance Sheet

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Total Assets	**101,240**	**128,561**	**152,073**	**165,814**	**178,040**
Current Assets	7,558	9,605	17,617	19,310	20,092
Cash & ST Investments	1,244	1,266	8,758	9,721	9,294
Inventories	1,346	1,760	2,175	2,210	2,559
Accounts Receivable	3,583	3,981	4,504	5,027	5,612
Others	1,385	2,597	2,180	2,352	2,626
Non-current Assets	93,682	118,957	134,456	146,505	157,948
LT Investments	4,828	9,573	11,521	13,793	16,324
Net fixed Assets	84,819	97,527	104,935	114,711	123,624
Others	4,035	11,857	18,000	18,000	18,000
Total Liabilities	**85,154**	**112,385**	**135,712**	**149,115**	**160,441**
Current Liabilities	32,216	46,660	53,488	56,908	62,778
Accounts Payable	5,154	7,819	10,188	10,900	11,591
ST Borrowings	24,360	34,574	38,939	41,304	45,935
Others	2,702	4,267	4,361	4,704	5,252
Long-term Liabilities	52,938	65,725	82,225	92,207	97,663
Long-term Debts	45,410	55,506	69,225	76,707	81,663
Others	7,528	10,219	13,000	15,500	16,000
Shareholders' Equity	**16,086**	**16,176**	**16,361**	**16,699**	**17,599**
Common Stock	6,771	6,771	6,771	6,771	6,771
Capital Surplus	1,553	1,584	1,584	1,584	1,584
Retained Earnings	7,762	7,821	8,006	8,344	9,244
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Growth (% YoY)					
Sales	21.5	24.8	25.4	7.9	11.6
OP	N.A.	(59.6)	61.5	12.4	30.4
EBITDA	192.6	(27.0)	24.7	14.8	19.4
NP	N.A.	(85.3)	8.8	83.2	165.7
EPS	N.A.	(85.3)	8.8	83.2	165.7
Profitability (%)					
Gross Margin	37.5	27.1	27.1	27.7	28.8
Operating Margin	11.8	3.8	4.9	5.1	6.0
EBITDA Margin	24.7	14.5	14.4	15.3	16.4
Net Profit Margin	3.2	0.4	0.3	0.6	1.3
ROAA	1.2	0.1	0.1	0.2	0.5
ROAE	8.4	1.1	1.1	2.0	5.2
Stability					
Gross Debt/Equity (%)	433.7	556.9	661.1	706.7	725.0
Net Debt/Equity (%)	426.0	549.0	607.6	648.5	672.2
Interest Coverage (x)	1.4	1.1	1.1	1.1	1.2
Interest & ST Debt Coverage (x)	0.2	0.1	0.1	0.1	0.1
Cash Flow Interest Coverage (x)	1.2	1.8	1.4	1.0	1.1
Cash Flow/Interest & ST Debt (x)	0.1	0.2	0.1	0.1	0.1
Current Ratio (x)	0.2	0.2	0.3	0.3	0.3
Quick Ratio (x)	0.2	0.2	0.3	0.3	0.3
Net Debt (Rmb mn)	63,156	78,670	94,110	103,848	113,297
Per Share Data (Rmb)					
EPS	0.17	0.03	0.03	0.05	0.13
CFPS	0.84	0.74	0.82	0.97	1.18
BVPS	2.38	2.39	2.40	2.47	2.60
SPS	5.35	6.68	8.37	9.03	10.08
EBITDA/Share	0.63	0.25	0.41	0.46	0.60
DPS	N.D.	N.D.	N.D.	N.D.	N.D.
Activity					
Asset Turnover (x)	0.4	0.4	0.4	0.4	0.4
Days Receivables	36.1	32.1	29.0	30.0	30.0
Days Inventory	13.6	14.2	14.0	13.2	13.7
Days Payable	52.0	63.1	65.6	65.1	62.0
Cash Cycle	(2.3)	(16.8)	(22.6)	(21.9)	(18.3)

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Sales	**36,208**	**45,198**	**56,690**	**61,158**	**68,279**
Cost of Goods Sold	22,621	32,959	41,317	44,204	48,628
Gross Profit	**13,587**	**12,238**	**15,373**	**16,954**	**19,652**
Operating Expenses	9,316	10,512	12,585	13,822	15,568
Operating Profit	**4,271**	**1,726**	**2,788**	**3,132**	**4,084**
Net Interest Income	(2,971)	(3,289)	(4,335)	(4,754)	(5,052)
Interest Income	0	27	125	222	228
Interest Expense	2,971	3,315	4,460	4,976	5,281
Net Investment Income/(Loss)	0	1,437	1,448	1,772	2,031
Net other Non-op. Income/(Loss)	383	328	400	400	400
Net Extraordinaries	(425)	84	(41)	(74)	(197)
Pretax Income	1,258	286	260	476	1,265
Income Taxes	101	117	75	138	366
Net Profit After Extraordinaries	**1,157**	**170**	**185**	**338**	**899**
EBITDA	8,948	6,534	8,147	9,356	11,171
EPS (Rmb)	**0.17**	**0.03**	**0.03**	**0.05**	**0.13**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Operating Cash Flow	**3,434**	**5,808**	**6,038**	**5,115**	**5,987**
Net Profit	1,157	170	185	338	899
Depreciation & Amortization	4,517	4,808	5,359	6,223	7,087
Change in Working Capital	(2,239)	2,207	1,941	325	31
Others	0	(1,377)	(1,448)	(1,772)	(2,031)
Investment Cash Flow	**(19,337)**	**(28,706)**	**(19,411)**	**(16,500)**	**(16,500)**
Net CAPEX	(15,360)	(17,386)	(12,767)	(16,000)	(16,000)
Change in LT Investment	(2,135)	(3,368)	(500)	(500)	(500)
Change in Other Assets	(1,842)	(7,953)	(6,143)	0	0
Free Cash Flow	**(15,903)**	**(22,898)**	**(13,373)**	**(11,385)**	**(10,513)**
Financing Cash Flow	**15,272**	**22,921**	**20,865**	**12,348**	**10,087**
Change in Share Capital	3,503	(80)	0	(0)	0
Net Change in Debt	10,111	20,310	18,083	9,848	9,587
Change in Other LT Liab.	1,658	2,691	2,781	2,500	500
Net Cash Flow	**(630)**	**23**	**7,492**	**963**	**(427)**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Dec	1- COGS / Revenue	+ Dep./Amortization / Revenue	+ SGA Exp. / Revenue	= Operating Margin
2009A	49.6%	12.9%	25.7%	11.8%
2010A	62.3%	10.6%	23.3%	3.8%
2011F	63.4%	9.5%	22.2%	4.9%
2012F	62.1%	10.2%	22.6%	5.1%
2013F	60.8%	10.4%	22.8%	6.0%

Year to 31-Dec	1/ Operating Working capital / Revenue	+ Net PPE / Revenue	+ Other Assets / Revenue	= Capital Turnover
2009A	(0.0)	2.3	0.1	0.4
2010A	(0.1)	2.2	0.3	0.4
2011F	(0.1)	1.9	0.3	0.5
2012F	(0.0)	1.9	0.3	0.5
2013F	(0.0)	1.8	0.3	0.5

Year to 31-Dec	Operating Margin	x Capital Turnover	x Cash 1 - Tax Rate	= After-tax Return on Inv. Capital
2009A	11.8%	0.4	94.0%	4.5%
2010A	3.8%	0.4	42.4%	0.7%
2011F	4.9%	0.5	75.0%	1.7%
2012F	5.1%	0.5	75.0%	1.8%
2013F	6.0%	0.5	75.0%	2.2%

Source: Company data; KGI Asia Limited estimates

KGI

Kingworld Medicines

(01110.HK/1110 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Pharmaceuticals	**Outperform**
Hong Kong	Maintained

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Retail growth stock immune to drug price control

■ Shares oversold as price control has little effect on Kingworld

Kingworld specializes in the distribution of over-the-counter (OTC) drugs to pharmacies. As Kingworld's products are mainly health supplements for personal use instead of the prescription drugs sold in hospitals that the ongoing bout of price controls is focused on, we think the sell-off of Kingworld shares along other pharmaceutical counters was a mistake.

■ Renminbi appreciation and product mix upgrade to boost gross margin

Kingworld has 90% of its product procurement denominated in HK dollars, and for the next 12 months, we think the renminbi will continue to appreciate against the HK dollar, boosting corporate gross margin. Besides, the company's Kingworld's Home pharmacy counter project will aim for high-margin products to keep corporate profitability growing.

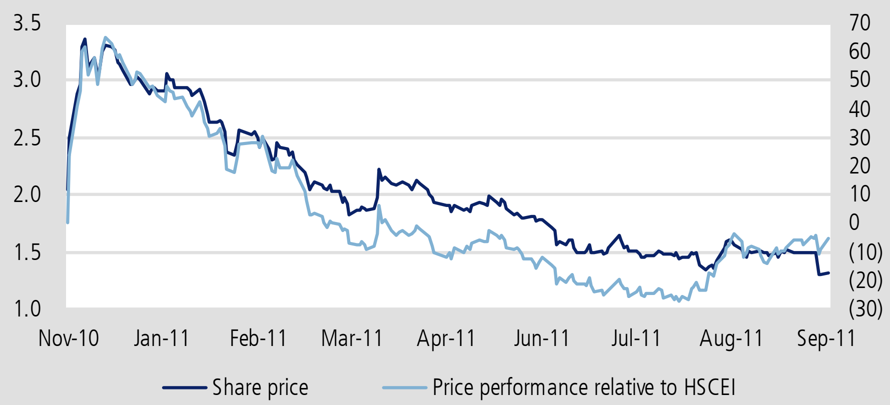
■ Distributor acquisitions to contribute in 2012 – Outperform maintained

Kingworld plans to buy regional distributors with gross margins at least as good as Kingworld's. Kingworld should pay less than 13x 2011F EPS for the distributors, which bodes well for its profitability. We expect the acquired companies to be consolidated into the financial statement in 2012 at the soonest and have meaningful contribution in 2013.

Year to 31-Dec	Sales (Rmb mn)	Gross profit (Rmb mn)	EBIT (Rmb mn)	EBITDA (Rmb mn)	Net income (Rmb mn)	EPS (Rmb)
2010A	638	140	45	46	43	0.07
2011F	772	176	66	66	58	0.09
2012F	1,086	256	103	116	74	0.12
2013F	1,473	349	142	157	105	0.17
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2010A	2.9	41.8	40.7	46.6	3.3	16.3
2011F	1.0	11.8	11.7	15.0	1.4	15.0
2012F	0.7	7.6	6.8	11.7	1.2	17.6
2013F	0.5	5.4	4.9	8.2	1.0	21.6

Kingworld Medicines Group share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Return	
Price as of Sep 26, 2011 (HK$/shr)	1.31
12M target price (HK$/shr)	2.20
Upside/downside (%)	67.9
The percentile of excess return (%)	60
Dividend yield-12/11E (%)	2.7

Balance Sheet	
Book value/shr-12/11E (Rmb)	0.6
P/B-12/11E (x)	2.2
Net debt/equity-12/11E (%)	Cash

Trading	
52-week trading range (HK$)	1.3 - 3.4
Mkt cap-HK$bn/US$mn	0.8/105
Outstanding shares (mn)	623
Free floating shares (mn)	27
The Largest Shareholder (%):	Mr. Zhao 73
3M avg. daily trading (mn)	1.3
Abs. performance (3,6,12M) (%)	-12; -34; -36
Rel. performance (3,6,12M) (%)	26; -1.6; -5.5

Company Description

Kingworld Medicines Group went public in November 2010 and specializes in distribution of over-the-counter (OTC) and nutrient supplements, including Nin Jiom Pei Pa Koa (herbal cough syrup), Mentholatum series, Kawai Liver Oil series, among other famous items in Hong Kong and Japan and other overseas markets. In 2009, Kingworld ranked 76th among Chinese drug and health supplement importers in terms of import value. Kingworld works with 600 distributors and has 2,000 counters across China. In the future, Kingworld plans on buying more downstream distributors to secure its presence in terminal pharmacy sector. Also, it's building a Shenzhen-based logistics center to meet own demand and serve third-party clients.

Balance Sheet

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Total Assets	**642**	**750**	**769**	**955**	**1,198**
Current Assets	585	684	594	773	1,021
Cash & ST Investments	333	404	247	285	359
Inventories	76	59	75	104	141
Accounts Receivable	111	205	254	357	484
Others	64	15	19	27	37
Non-current Assets	57	67	175	182	178
LT Investments	46	55	55	55	55
Net fixed Assets	4	4	120	127	123
Others	8	7	0	0	0
Total Liabilities	**486**	**380**	**374**	**509**	**671**
Current Liabilities	424	375	212	295	400
Accounts Payable	117	134	160	223	302
ST Borrowings	247	198	0	0	0
Others	60	43	51	72	98
Long-term Liabilities	62	5	162	213	271
Long-term Debts	60	0	156	206	264
Others	2	5	7	7	8
Shareholders' Equity	**156**	**370**	**396**	**447**	**527**
Common Stock	0	53	53	53	53
Capital Surplus	109	263	263	263	263
Retained Earnings	47	54	79	130	211
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Growth (% YoY)					
Sales	3.8	14.7	21.0	40.6	35.6
OP	(67.7)	7.6	45.9	57.1	38.1
EBITDA	(66.9)	7.8	42.9	75.9	35.7
NP	(65.6)	15.1	34.3	28.6	42.3
EPS	--	--	34.3	28.6	42.3
Profitability (%)					
Gross Margin	21.7	22.0	22.8	23.6	23.7
Operating Margin	7.5	7.1	8.5	9.5	9.7
EBITDA Margin	7.7	7.2	8.5	10.7	10.7
Net Profit Margin	6.7	6.7	7.5	6.8	7.2
ROAA	6.3	6.2	7.6	8.6	9.8
ROAE	43.7	16.3	15.0	17.6	21.6
Stability					
Gross Debt/Equity (%)	196.5	53.4	39.3	46.2	50.0
Net Debt/Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Interest Coverage (x)	5.9	8.3	14.4	18.8	20.3
Interest & ST Debt Coverage (x)	0.2	0.3	14.4	18.8	20.3
Cash Flow Interest Coverage (x)	16.7	1.8	4.2	5.1	6.6
Cash Flow/Interest & ST Debt (x)	0.6	0.1	4.2	5.1	6.6
Current Ratio (x)	1.4	1.8	2.8	2.6	2.6
Quick Ratio (x)	1.2	1.7	2.5	2.3	2.2
Net Debt (Rmb mn)	49	(116)	(148)	(85)	(87)
Per Share Data (Rmb)					
EPS	--	0.07	0.09	0.12	0.17
CFPS	--	0.07	0.09	0.14	0.19
BVPS	--	0.59	0.64	0.72	0.85
SPS	--	1.02	1.24	1.74	2.37
EBITDA/Share	--	0.07	0.11	0.17	0.23
DPS	--	0.05	0.04	0.04	0.04
Activity					
Asset Turnover (x)	0.9	0.9	1.0	1.3	1.4
Days Receivables	73.0	117.5	120.0	120.0	120.0
Days Inventory	49.8	33.9	35.2	34.9	34.8
Days Payable	76.9	76.7	75.7	74.9	74.8
Cash Cycle	45.8	74.7	79.6	80.0	80.0

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Sales	**556**	**638**	**772**	**1,086**	**1,473**
Cost of Goods Sold	436	498	596	830	1,125
Gross Profit	**121**	**140**	**176**	**256**	**349**
Operating Expenses	79	95	110	153	206
Operating Profit	**42**	**45**	**66**	**103**	**142**
Net Interest Income	(5)	(3)	(1)	(2)	(3)
Interest Income	4	5	5	4	5
Interest Expense	10	8	6	6	8
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	10	16	14	20	27
Net Extraordinaries	0	0	0	(15)	(17)
Pretax Income	47	58	78	106	149
Income Taxes	10	15	21	32	44
Net Profit After Extraordinaries	**37**	**43**	**58**	**74**	**105**
EBITDA	43	46	66	116	157
EPS (Rmb)	**--**	**0.07**	**0.09**	**0.12**	**0.17**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Operating Cash Flow	**161**	**15**	**25**	**30**	**52**
Net Profit	37	43	58	74	105
Depreciation & Amortization	1	1	0	13	15
Change in Working Capital	122	(29)	(33)	(57)	(69)
Others	0	0	0	0	0
Investment Cash Flow	**(9)**	**(11)**	**(109)**	**(20)**	**(10)**
Net CAPEX	(1)	(2)	(116)	(20)	(10)
Change in LT Investment	(1)	(9)	0	0	0
Change in Other Assets	(8)	(0)	7	(0)	(0)
Free Cash Flow	**151**	**4**	**(84)**	**10**	**41**
Financing Cash Flow	**152**	**66**	**(73)**	**28**	**33**
Change in Share Capital	104	171	(32)	(23)	(25)
Net Change in Debt	47	(109)	(42)	51	57
Change in Other LT Liab.	0	3	1	1	1
Net Cash Flow	**303**	**70**	**(157)**	**38**	**74**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Dec	1- COGS / Revenue	+ Dep./Amortization / Revenue	+ SGA Exp. / Revenue	= Operating Margin
2009A	78.1%	0.2%	14.2%	7.5%
2010A	77.9%	0.2%	14.9%	7.1%
2011F	77.2%	0.0%	14.3%	8.5%
2012F	75.2%	1.2%	14.1%	9.5%
2013F	75.3%	1.0%	14.0%	9.7%

Year to 31-Dec	1/ Operating Working capital / Revenue	+ Net PPE / Revenue	+ Other Assets / Revenue	= Capital Turnover
2009A	0.2	0.0	0.0	4.9
2010A	0.2	0.0	0.0	4.4
2011F	0.2	0.2	0.0	2.6
2012F	0.2	0.1	0.0	2.9
2013F	0.2	0.1	0.0	3.2

Year to 31-Dec	Operating Margin	x Capital Turnover	x Cash 1 - Tax Rate	= After-tax Return on Inv. Capital
2009A	7.5%	4.9	79.7%	29.6%
2010A	7.1%	4.4	73.5%	22.6%
2011F	8.5%	2.6	73.5%	16.4%
2012F	9.5%	2.9	73.5%	20.2%
2013F	9.7%	3.2	73.5%	22.9%

Source: Company data; KGI Asia Limited estimates

KGI

ZhengTong Auto

(01728.HK/1728 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Automobile

Hong Kong

Outperform

Maintained

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Luxury cars in shortage; M&A a share catalyst

■ High-end SUV & sedan in short supply; sales to accelerate in 2H11

The fourth quarter is the peak season. As demand for medium- and low-end cars remains weak, promotions have become aggressive. However, high-end SUV and sedan markets remain in short supply, with prices rising. The BMW 5-serires and X-series account for 68% of ZhengTong's total sales. We forecast sales growth volume to jump 102% YoY and 56% HoH in 2H11. We forecast sales value will grow 120% YoY and 79% HoH in 2H11 to Rmb10.8bn, vs. Rmb8.0bn in 2010.

■ Acquisition of SCAS a share catalyst

We expect ZhengTong to complete its acquisition of SCAS in November. SCAS has 25 4S stores, 16 of which are in Guangdong and the rest in Beijing, Tianjin, Hunan and Fujian. The acquisition will add Volvo, Jaguar and Land Rover to ZhengTong's product portfolio, further diversifying its revenue sources. The acquisition cost is Rmb5.5bn, implying a PE below 10x, which we think is reasonable. All told, we consider the deal a share catalyst.

■ Undervalued at 2012 PE of 7.7x, below peer Zhongsheng – Maintain Outperform

We forecast EPS of Rmb0.37 in 2011 and Rmb0.76 in 2012. Shares are trading at a 2011 PE of 15.9x and a 2012 PE of 7.7x. Our target price is HK$13.9, equivalent to a 2012 PE of 15x. Reiterate Outperform.

Year to 31-Dec	Sales (Rmb mn)	Gross profit (Rmb mn)	EBIT (Rmb mn)	EBITDA (Rmb mn)	Net income (Rmb mn)	EPS (Rmb)
2010A	8,034	726	359	403	276	0.18
2011F	16,808	1,718	978	1,130	782	0.37
2012F	37,812	3,800	2,023	2,374	1,663	0.76
2013F	55,407	5,852	3,248	3,777	2,602	1.18
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2010A	1.4	31.1	27.7	48.4	2.3	12.4
2011F	0.6	10.9	9.4	22.9	1.9	17.8
2012F	0.3	5.5	4.7	11.3	1.5	29.6
2013F	0.2	3.3	2.8	7.2	1.0	33.6

Return

Price as of Sep 26, 2011 (HK$/shr)	7.04
12M target price (HK$/shr)	13.9
Upside/downside (%)	97.4
The percentile of excess return (%)	89
Dividend yield-12/11E (%)	N.A.

Balance Sheet

Book value/shr-12/11E (Rmb)	3.1
P/B-12/11E (x)	2.7
Net debt/equity-12/11E (%)	Cash

Trading

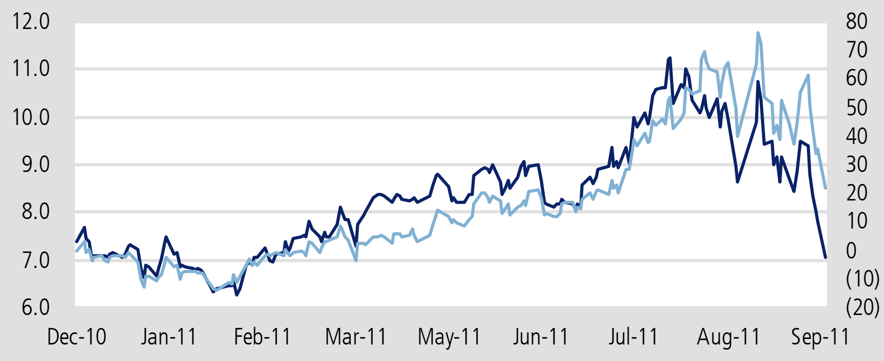
52-week trading range (HK$)	6.3 - 11.2
Mkt cap-HK$bn/US$mn	15.5/1,986
Outstanding shares (mn)	2,200
Free floating shares (mn)	38
The Largest Shareholder (%):	Joy Capital 62.0
3M avg. daily trading (mn)	13.7
Abs. performance (3,6,12M) (%)	-18; -9.2; -4.7
Rel. performance (3,6,12M) (%)	17; 34; 38

Company Description

ZhengTong Auto is a leading car dealership group in China, focused on luxury auto brands such as BMW, Mini and Audi. As of June 2011, it operated 27 4S stores and one downtown showroom, including 18 for luxury brands. It also offers after-sales services, logistics and lubricant oil trading business. In 2010, the company reported revenue of Rmb8.03bn and attributable profit of Rmb280mn.

ZhengTong share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Balance Sheet

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Total Assets	**2,509**	**6,732**	**9,437**	**15,398**	**21,556**
Current Assets	1,966	6,010	6,765	10,974	15,557
Cash & ST Investments	1,072	4,393	3,177	2,792	3,448
Inventories	295	749	1,677	3,779	5,506
Accounts Receivable	74	136	230	622	1,063
Others	525	733	1,681	3,781	5,541
Non-current Assets	543	722	2,672	4,424	5,999
LT Investments	39	120	200	250	300
Net fixed Assets	351	404	2,272	3,924	5,399
Others	153	197	200	250	300
Total Liabilities	**2,065**	**2,718**	**4,657**	**8,955**	**12,511**
Current Liabilities	2,043	2,641	4,607	8,905	12,461
Accounts Payable	1,205	1,555	3,307	7,455	10,861
ST Borrowings	349	721	800	900	1,000
Others	490	365	500	550	600
Long-term Liabilities	22	76	50	50	50
Long-term Debts	0	0	0	0	0
Others	22	76	50	50	50
Shareholders' Equity	**444**	**4,015**	**4,779**	**6,443**	**9,045**
Common Stock	224	171	171	171	171
Capital Surplus	32	2,912	2,912	2,912	2,912
Retained Earnings	189	932	1,696	3,360	5,962
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Growth (% YoY)					
Sales	63.6	61.3	109.2	125.0	46.5
OP	198.0	85.1	172.7	106.7	60.6
EBITDA	250.1	76.9	180.5	110.0	59.1
NP	331.5	89.2	183.3	112.8	56.4
EPS	--	--	106.4	103.1	56.4
Profitability (%)					
Gross Margin	8.3	9.0	10.2	10.0	10.6
Operating Margin	3.9	4.5	5.8	5.3	5.9
EBITDA Margin	4.6	5.0	6.7	6.3	6.8
Net Profit Margin	2.9	3.4	4.7	4.4	4.7
ROAA	7.4	6.0	9.7	13.4	14.1
ROAE	54.6	12.4	17.8	29.6	33.6
Stability					
Gross Debt/Equity (%)	78.5	18.0	16.7	14.0	11.1
Net Debt/Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Interest Coverage (x)	7.2	7.5	14.6	27.2	38.2
Interest & ST Debt Coverage (x)	0.6	0.5	1.3	2.3	3.3
Cash Flow Interest Coverage (x)	21.9	(3.2)	11.2	19.0	28.0
Cash Flow/Interest & ST Debt (x)	1.8	(0.2)	1.0	1.6	2.4
Current Ratio (x)	1.0	2.3	1.5	1.2	1.2
Quick Ratio (x)	0.8	2.0	1.1	0.8	0.8
Net Debt (Rmb mn)	(338)	(2,197)	(3,025)	(2,135)	(2,170)
Per Share Data (Rmb)					
EPS	--	0.18	0.37	0.76	1.18
CFPS	--	0.21	0.44	0.92	1.42
BVPS	--	2.62	3.12	4.21	5.91
SPS	--	5.25	10.99	24.71	36.21
EBITDA/Share	--	0.23	0.47	0.92	1.48
DPS	--	0.01	N.D.	N.D.	N.D.
Activity					
Asset Turnover (x)	2.5	1.7	2.1	3.0	3.0
Days Receivables	5.4	6.2	5.0	6.0	7.0
Days Inventory	21.6	34.0	36.4	36.5	36.3
Days Payable	88.3	70.7	71.8	72.0	71.6
Cash Cycle	(61.2)	(30.5)	(30.4)	(29.5)	(28.3)

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Sales	**4,981**	**8,034**	**16,808**	**37,812**	**55,407**
Cost of Goods Sold	4,567	7,308	15,090	34,012	49,555
Gross Profit	**415**	**726**	**1,718**	**3,800**	**5,852**
Operating Expenses	221	368	740	1,777	2,604
Operating Profit	**194**	**359**	**978**	**2,023**	**3,248**
Net Interest Income	(26)	(47)	(57)	(70)	(79)
Interest Income	5	9	19	15	16
Interest Expense	31	56	76	85	95
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	31	79	168	378	554
Net Extraordinaries	(4)	(23)	(57)	(108)	(190)
Pretax Income	194	367	1,032	2,223	3,533
Income Taxes	48	91	251	559	931
Net Profit After Extraordinaries	**146**	**276**	**782**	**1,663**	**2,602**
EBITDA	228	403	1,130	2,374	3,777
EPS (Rmb)	**--**	**0.18**	**0.37**	**0.76**	**1.18**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Operating Cash Flow	**690**	**(177)**	**851**	**1,618**	**2,660**
Net Profit	146	276	782	1,663	2,602
Depreciation & Amortization	34	44	152	351	529
Change in Working Capital	510	(497)	(83)	(397)	(471)
Others	0	0	--	--	--
Investment Cash Flow	**(133)**	**(224)**	**(2,022)**	**(2,053)**	**(2,054)**
Net CAPEX	(76)	(96)	(2,017)	(2,000)	(2,000)
Change in LT Investment	(39)	(82)	--	--	--
Change in Other Assets	(18)	(46)	(5)	(53)	(54)
Free Cash Flow	**557**	**(401)**	**(1,171)**	**(435)**	**606**
Financing Cash Flow	**226**	**3,722**	**35**	**100**	**100**
Change in Share Capital	208	3,295	(17)	0	(0)
Net Change in Debt	11	373	79	100	100
Change in Other LT Liab.	7	54	(26)	0	0
Net Cash Flow	**782**	**3,321**	**(1,136)**	**(335)**	**706**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Dec	1- COGS / Revenue	+	Dep./Amortization / Revenue	+	SGA Exp. / Revenue	=	Operating Margin
2009A	91.0%		0.7%		4.4%		3.9%
2010A	90.4%		0.6%		4.6%		4.5%
2011F	88.9%		0.9%		4.4%		5.8%
2012F	89.0%		0.6%		4.7%		5.7%
2013F	88.5%		0.6%		4.7%		6.3%
Year to 31-Dec	**1/ ;rating Working capi / Revenue**	**+**	**Net PPE / Revenue**	**+**	**Other Assets / Revenue**	**=**	**Capital Turnover**
2009A	(0.1)		0.1		0.0		(105.7)
2010A	0.0		0.1		0.0		11.5
2011F	0.0		0.1		0.0		5.4
2012F	0.1		0.1		0.0		6.1
2013F	0.1		0.1		0.0		6.1
Year to 31-Dec	**Operating Margin**	**x**	**Capital Turnover**	**x**	**Cash 1 - Tax Rate**	**=**	**After-tax Return on Inv. Capital**
2009A	3.9%		(105.7)		75.6%		(311.1%)
2010A	4.5%		11.5		76.8%		39.3%
2011F	4.5%		11.5		77.0%		39.4%
2012F	5.8%		5.4		76.0%		24.0%
2013F	5.7%		6.1		75.0%		26.0%

Source: Company data; KGI Asia Limited estimates

KGI

China Oilfield Services

(02883.HK/2883 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Oil	**Outperform**
Hong Kong	Maintained

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Performance improving; valuation undemanding

■ Increased investment in 2H11 to boost performance

In 1H11, China Oilfield Services Limited (COSL) investment in China's offshore oil rigging market, which contributes over 70% of sales to COSL, grew at a slower pace than expected to account for only 27% of COSL's annual investment in 2011. COSL's investment should accelerate in 2H11 to lend growth momentum to COSL's rigging and oilfield service businesses.

■ New rigging ships to contribute in 2H11

With downstream demand rising, COSL has called seven ships back into service from maintenance in August, which should increase working days of its rigging ships in 4Q11. The ramp-up of its high-end rigging ship COSL Pioneer on August 29 should especially bode well for corporate sales growth and lay a solid foundation for Innovator's launch next year.

■ Undervalued at 2012 PE of only 7.0x – Outperform maintained

We estimate 2011 and 2012 EPS of Rmb0.94 and Rmb1.20, respectively. Shares are trading at a 2011F PE of 14.0x and a 2012F PE of 10.9x, far lower than its historical average PE of 17x. We think the stock looks undervalued after the recent correction. On a target price of HK$18.5, maintain Outperform.

Year to 31-Dec	Sales (Rmb mn)	Gross profit (Rmb mn)	EBIT (Rmb mn)	EBITDA (Rmb mn)	Net income (Rmb mn)	EPS (Rmb)
2010A	17,561	5,844	4,976	7,316	4,128	0.92
2011F	19,686	6,299	5,610	8,115	4,210	0.94
2012F	22,825	7,395	6,619	9,344	5,397	1.20
2013F	23,953	7,904	7,066	9,891	5,849	1.30
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2010A	4.8	16.9	11.5	14.3	1.4	17.2
2011F	0.4	1.5	1.1	14.0	0.2	15.4
2012F	0.3	1.2	0.8	10.9	0.1	17.3
2013F	0.2	0.8	0.5	10.1	0.1	16.3

Return

Price as of Sep 26, 2011 (HK$/shr)	8.90
12M target price (HK$/shr)	18.5
Upside/downside (%)	107.9
The percentile of excess return (%)	81
Dividend yield-12/11E (%)	N.A.

Balance Sheet

Book value/shr-12/11E (Rmb)	6.4
P/B-12/11E (x)	1.4
Net debt/equity-12/11E (%)	29.9

Trading

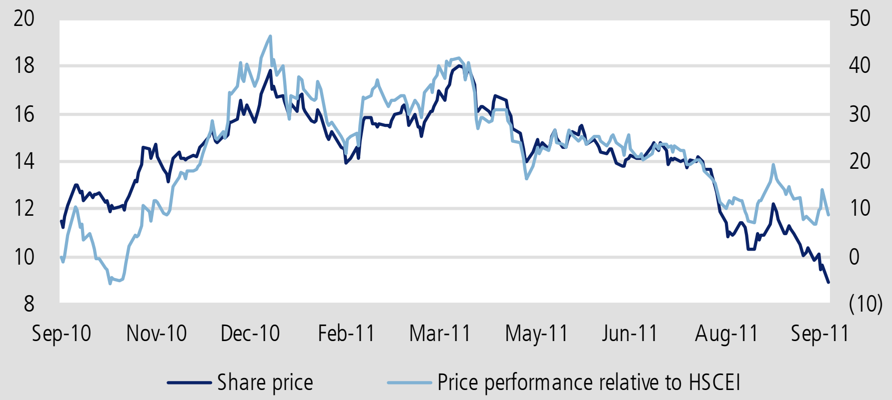
52-week trading range (HK$)	8.9 - 18
Mkt cap-HK$bn/US$mn	13.7/1,751
Outstanding shares (mn)	1,535
Free floating shares (mn)	2,085
The Largest Shareholder (%):	CNOOC 53.6
3M avg. daily trading (mn)	9.4
Abs. performance (3,6,12M) (%)	-37; -48; -23
Rel. performance (3,6,12M) (%)	-10; -23; 9

Company Description

China Oilfield Services Limited (COSL) is the largest supplier of integrated near-sea oilfield services in China, spanning such service sectors as offshore oil and gas exploration, development, and production. Its four service departments are geophysical services, drilling services, well services, and marine services.

China Oilfield Services share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Balance Sheet

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Total Assets	**60,777**	**63,497**	**54,864**	**59,378**	**63,242**
Current Assets	10,034	11,734	14,409	15,185	16,435
Cash & ST Investments	4,262	6,335	8,330	8,239	9,149
Inventories	821	816	892	1,057	1,107
Accounts Receivable	4,175	4,154	4,530	5,128	5,381
Others	776	430	656	761	798
Non-current Assets	50,743	51,763	40,455	44,194	46,807
LT Investments	560	488	520	520	520
Net fixed Assets	45,087	46,371	36,694	40,162	42,498
Others	5,096	4,904	3,241	3,512	3,789
Total Liabilities	**38,471**	**37,908**	**25,873**	**25,890**	**24,804**
Current Liabilities	5,071	6,642	7,255	7,943	8,056
Accounts Payable	4,224	4,436	4,768	5,411	5,628
ST Borrowings	283	1,224	1,700	1,600	1,450
Others	564	981	787	932	978
Long-term Liabilities	33,400	31,266	18,618	17,947	16,748
Long-term Debts	30,821	28,591	15,300	14,400	13,050
Others	2,579	2,676	3,318	3,547	3,698
Shareholders' Equity	**22,306**	**25,590**	**28,990**	**33,489**	**38,439**
Common Stock	4,495	4,495	4,495	4,495	4,495
Capital Surplus	1,357	1,494	1,494	1,494	1,494
Retained Earnings	16,453	19,600	23,001	27,500	32,449
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Growth (% YoY)					
Sales	47.2	(1.8)	12.1	15.9	4.9
OP	44.2	2.1	12.8	18.0	6.7
EBITDA	32.2	20.4	10.9	15.1	5.9
NP	(10.9)	31.7	2.0	28.2	8.4
EPS	(10.9)	31.7	2.0	28.2	8.4
Profitability (%)					
Gross Margin	34.6	33.3	32.0	32.4	33.0
Operating Margin	27.3	28.3	28.5	29.0	29.5
EBITDA Margin	34.0	41.7	41.2	40.9	41.3
Net Profit Margin	17.5	23.5	21.4	23.6	24.4
ROAA	5.4	6.6	7.1	9.4	9.5
ROAE	14.9	17.2	15.4	17.3	16.3
Stability					
Gross Debt/Equity (%)	139.4	116.5	58.6	47.8	37.7
Net Debt/Equity (%)	120.3	91.8	29.9	23.2	13.9
Interest Coverage (x)	5.5	8.2	4.8	7.9	9.3
Interest & ST Debt Coverage (x)	4.1	2.9	2.1	2.9	3.4
Cash Flow Interest Coverage (x)	4.8	10.9	4.6	8.5	10.0
Cash Flow/Interest & ST Debt (x)	3.6	3.9	2.0	3.1	3.7
Current Ratio (x)	2.0	1.8	2.0	1.9	2.0
Quick Ratio (x)	1.8	1.6	1.9	1.8	1.9
Net Debt (HK$ mn)	25,194	25,161	16,075	8,216	6,556
Per Share Data (Rmb)					
EPS	0.70	0.92	0.94	1.20	1.30
CFPS	0.97	1.44	1.49	1.81	1.93
BVPS	4.96	5.69	6.45	7.45	8.55
SPS	3.98	3.91	4.38	5.08	5.33
EBITDA/Share	1.08	1.11	1.25	1.47	1.57
DPS	0.14	0.18	0.20	0.20	0.21
Activity					
Asset Turnover (x)	0.3	0.3	0.3	0.4	0.4
Days Receivables	85.2	86.3	84.0	82.0	82.0
Days Inventory	16.8	17.0	16.5	16.9	16.9
Days Payable	86.2	92.2	88.4	86.5	85.8
Cash Cycle	15.8	11.1	12.1	12.4	13.1

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Sales	**17,879**	**17,561**	**19,686**	**22,825**	**23,953**
Cost of Goods Sold	11,689	11,717	13,386	15,430	16,048
Gross Profit	**6,190**	**5,844**	**6,299**	**7,395**	**7,904**
Operating Expenses	1,315	868	689	776	838
Operating Profit	**4,875**	**4,976**	**5,610**	**6,619**	**7,066**
Net Interest Income	(775)	(597)	(1,128)	(717)	(621)
Interest Income	60	77	183	207	217
Interest Expense	836	674	1,311	924	839
Net Investment Income/(Loss)	160	144	150	165	180
Net other Non-op. Income/(Loss)	(499)	312	320	320	330
Net Extraordinaries	0	0	0	0	0
Pretax Income	3,760	4,835	4,953	6,387	6,955
Income Taxes	624	706	743	990	1,106
Net Profit After Extraordinaries	**3,135**	**4,128**	**4,210**	**5,397**	**5,849**
EBITDA	6,079	7,316	8,115	9,344	9,891
EPS (Rmb)	**0.70**	**0.92**	**0.94**	**1.20**	**1.30**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Operating Cash Flow	**4,037**	**7,326**	**6,023**	**7,878**	**8,416**
Net Profit	3,135	4,128	4,210	5,397	5,849
Depreciation & Amortization	1,204	2,340	2,505	2,725	2,825
Change in Working Capital	(143)	1,002	(542)	(79)	(78)
Others	(160)	(144)	(150)	(165)	(180)
Investment Cash Flow	**(5,581)**	**(3,217)**	**8,954**	**(6,299)**	**(5,258)**
Net CAPEX	(5,849)	(3,565)	7,238	(6,128)	(5,096)
Change in LT Investment	254	216	118	165	180
Change in Other Assets	15	132	1,598	(336)	(342)
Free Cash Flow	**(1,544)**	**4,109**	**14,977**	**1,579**	**3,158**
Financing Cash Flow	**1,188**	**(2,037)**	**(12,982)**	**(1,670)**	**(2,248)**
Change in Share Capital	(628)	(845)	(809)	(899)	(899)
Net Change in Debt	2,942	(1,289)	(12,815)	(1,000)	(1,500)
Change in Other LT Liab.	(1,126)	97	642	229	151
Net Cash Flow	**(356)**	**2,073**	**1,995**	**(91)**	**910**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Dec	1- COGS / Revenue	+	Dep./Amortization / Revenue	+	SGA Exp. / Revenue	=	Operating Margin
2009A	58.6%		6.7%		7.4%		27.3%
2010A	53.4%		13.3%		4.9%		28.3%
2011F	55.3%		12.7%		3.5%		28.5%
2012F	55.7%		13.3%		3.4%		27.6%
2013F	55.2%		13.3%		3.5%		28.0%

Year to 31-Dec	1/ Operating Working capital / Revenue	+	Net PPE / Revenue	+	Other Assets / Revenue	=	Capital Turnover
2009A	0.1		2.5		0.3		0.3
2010A	0.0		2.6		0.3		0.3
2011F	0.1		1.9		0.2		0.5
2012F	0.1		1.8		0.2		0.5
2013F	0.1		1.8		0.2		0.5

Year to 31-Dec	Operating Margin	x	Capital Turnover	x	Cash 1 - Tax Rate	=	After-tax Return on Inv. Capital
2009A	27.3%		0.3		83.4%		7.8%
2010A	28.3%		0.3		85.4%		8.1%
2011F	28.3%		0.3		85.0%		8.1%
2012F	28.5%		0.5		84.5%		11.4%
2013F	27.6%		0.5		84.1%		11.7%

Source: Company data; KGI Asia Limited estimates

Golden Eagle

(03308.HK/3308 HK)

September 26, 2011

Institutional portal: http://research.kgi.com

Consumer	**Outperform**
Hong Kong	Maintained

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Strong growth sustainable on local dominance

- **Dominant positions in fast growing tier 1 & 2 cities in Jiangsu**

In 1H11, Golden Eagle's top six locally competitive stores accounted for 67% of gross sales profit and delivered same store sales growth of 33%, 4.6 ppts faster than the whole group. Golden Eagle is steadily opening new stores at a pace of 4-6 stores per year with a clear focus on multi-stores to build up its local dominance in key cities Nanjing, Hefei and Xi'an.

- **Best cost control among peers**

Golden Eagle enjoys low rental cost at less than 1% of gross sales profit as it owns 67% of its store properties. Depreciation & amortization and staff expense are well contained at lowest level among peers, backed by peer-leading sales efficiency.

- **Market leader with 38.8% upside – Outperform maintained**

We believe the solid growth outlook, strong margin delivery and proven track of operation justify a 0.9x PEG. Based on our 2011 EPS forecast of Rmb0.66, we maintain our target price at HK$22.2, implying 38.8% upside. Maintain Outperform.

Year to 31-Dec	Sales (Rmb mn)	Gross profit (Rmb mn)	EBIT (Rmb mn)	EBITDA (Rmb mn)	Net income (Rmb mn)	EPS (Rmb)
2010A	2,450	1,925	1,135	1,253	959	0.49
2011F	3,461	2,710	1,560	1,701	1,272	0.66
2012F	4,757	3,712	2,039	2,273	1,631	0.84
2013F	6,427	4,999	2,671	2,992	2,110	1.09
Year to 31-Dec	**EV/sales (X)**	**EV/EBIT (X)**	**EV/EBITDA (X)**	**P/E (X)**	**EV/Inv. C (X)**	**ROAE (%)**
2010A	14.0	30.3	27.4	38.1	8.1	29.1
2011F	11.0	24.5	22.4	30.9	7.3	30.2
2012F	8.1	18.9	17.0	24.1	5.9	30.1
2013F	6.0	14.4	12.8	18.7	4.6	30.1

Return

Price as of Sep. 26, 2011 (HK$/shr)	16.0
12M target price (HK$/shr)	22.20
Upside/downside (%)	38.8
The percentile of excess return (%)	33
Dividend yield-12/11E (%)	0.7

Balance Sheet

Book value/shr-12/11E (Rmb)	2.4
P/B-12/11E (x)	8.3
Net debt/equity-12/11E (%)	Cash

Trading

52-week trading range (HK$)	16 - 24.6
Mkt cap-HK$bn/US$mn	31.1/3,991
Outstanding shares (mn)	1,946
Free floating shares (mn)	32
The Largest Shareholder (%):	GEICO 68
3M avg. daily trading (mn)	4.4
Abs. performance (3,6,12M) (%)	-15; -3; -26
Rel. performance (3,6,12M) (%)	21; 44; 4.9

Company Description

Golden Eagle Retail Group, based in Nanjing, is the largest department store chain in Jiangsu Province. It currently operates 23 midrange and high-end department stores in Jiangsu, Shaanxi, Anhui and Yunnan Province. Nanjing is the primary revenue source contributing 35.6% of total GSP in 2010, with its flagship store Xinjiekou Store maintaining a strong growth of 14.7% after 14 years of operation.

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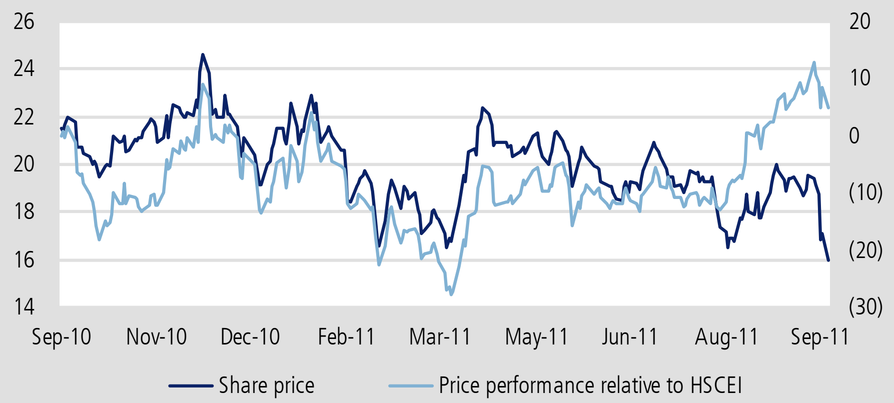
Golden Eagle share price chart

Share price, HK$ (LHS); price performance relative to HSCEI, percent (RHS)



Source: TEJ

Balance Sheet

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Total Assets	**5,983**	**7,979**	**9,524**	**11,625**	**14,355**
Current Assets	2,568	3,197	2,385	2,243	2,723
Cash & ST Investments	2,290	2,747	1,666	1,260	1,397
Inventories	156	213	304	423	578
Accounts Receivable	107	211	389	534	722
Others	15	27	27	27	27
Non-current Assets	3,415	4,783	7,138	9,381	11,632
LT Investments	12	76	76	76	76
Net fixed Assets	2,378	2,722	4,681	6,447	8,126
Others	1,026	1,985	2,381	2,858	3,429
Total Liabilities	**3,065**	**4,299**	**4,779**	**5,526**	**6,501**
Current Liabilities	2,995	4,204	4,779	5,526	6,501
Accounts Payable	996	1,337	1,912	2,658	3,633
ST Borrowings	269	458	458	458	458
Others	1,730	2,409	2,409	2,409	2,409
Long-term Liabilities	70	95	0	0	0
Long-term Debts	0	0	0	0	0
Others	70	95	0	0	0
Shareholders' Equity	**2,919**	**3,680**	**4,744**	**6,099**	**7,854**
Common Stock	197	197	197	197	197
Capital Surplus	2,222	2,382	2,382	2,382	2,382
Retained Earnings	499	1,101	2,165	3,520	5,275
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Asia Limited estimates

Key Ratios

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Growth (% YoY)					
Sales	29.7	32.4	41.3	37.4	35.1
OP	30.3	35.6	37.5	30.7	31.0
EBITDA	31.1	34.0	35.8	33.6	31.6
NP	N.A.	N.A.	32.7	28.2	29.4
EPS	24.2	17.6	32.6	28.1	29.4
Profitability (%)					
Gross Margin	78.4	78.6	78.3	78.0	77.8
Operating Margin	45.2	46.3	45.1	42.9	41.6
EBITDA Margin	50.5	51.1	49.2	47.8	46.6
Net Profit Margin	(14.4)	39.1	36.8	34.3	32.8
ROAA	(4.9)	13.7	14.5	15.4	16.2
ROAE	33.6	29.1	30.2	30.1	30.2
Stability					
Gross Debt/Equity (%)	9.2	12.5	9.7	7.5	5.8
Net Debt/Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Interest Coverage (x)	0.8	205.4	322.3	412.9	533.8
Interest & ST Debt Coverage (x)	0.1	2.8	3.8	4.8	6.2
Cash Flow Interest Coverage (x)	4.5	304.4	317.8	433.8	566.2
Cash Flow/Interest & ST Debt (x)	0.8	4.2	3.7	5.1	6.6
Current Ratio (x)	0.9	0.8	0.5	0.4	0.4
Quick Ratio (x)	0.8	0.7	0.4	0.3	0.3
Net Debt (Rmb mn)	(1,629)	(2,154)	(1,748)	(1,004)	(870)
Per Share Data (Rmb)					
EPS	0.42	0.49	0.66	0.84	1.09
CFPS	0.48	0.56	0.73	0.96	1.25
BVPS	1.50	1.89	2.44	3.14	4.04
SPS	0.95	1.26	1.78	2.45	3.31
EBITDA/Share	0.46	0.58	0.80	1.05	1.37
DPS	0.28	0.11	0.14	0.18	0.24
Activity					
Asset Turnover (x)	0.3	0.4	0.4	0.4	0.5
Days Receivables	21.1	31.4	41.0	41.0	41.0
Days Inventory	30.8	31.7	32.1	32.4	32.8
Days Payable	196.4	199.1	201.6	204.0	206.3
Cash Cycle	(144.5)	(136.0)	(128.5)	(130.5)	(132.5)

Source: Company data; KGI Asia Limited estimates

Profit & Loss

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Sales	**1,850**	**2,450**	**3,461**	**4,757**	**6,427**
Cost of Goods Sold	399	525	751	1,045	1,428
Gross Profit	**1,451**	**1,925**	**2,710**	**3,712**	**4,999**
Operating Expenses	614	790	1,150	1,672	2,328
Operating Profit	**837**	**1,135**	**1,560**	**2,039**	**2,671**
Net Interest Income	(6)	33	29	17	15
Interest Income	50	39	34	23	21
Interest Expense	56	6	5	5	5
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	(327)	129	149	171	196
Net Extraordinaries	(517)	0	0	0	0
Pretax Income	(13)	1,297	1,738	2,228	2,882
Income Taxes	253	337	466	597	772
Net Profit After Extraordinaries	**(266)**	**959**	**1,272**	**1,631**	**2,110**
EBITDA	935	1,253	1,701	2,273	2,992
EPS (Rmb)	**0.42**	**0.49**	**0.66**	**0.84**	**1.09**

Source: Company data; KGI Asia Limited estimates

Cash Flow

Year to 31 Dec (Rmb mn)	2009A	2010A	2011F	2012F	2013F
Operating Cash Flow	**248**	**1,931**	**1,719**	**2,347**	**3,063**
Net Profit	(266)	959	1,272	1,631	2,110
Depreciation & Amortization	104	123	141	233	321
Change in Working Capital	411	848	306	482	632
Others	0	0	0	0	0
Investment Cash Flow	**(1,008)**	**(1,491)**	**(2,497)**	**(2,476)**	**(2,572)**
Net CAPEX	(222)	(467)	(2,100)	(2,000)	(2,000)
Change in LT Investment	15	(65)	0	0	0
Change in Other Assets	(801)	(959)	(397)	(476)	(572)
Free Cash Flow	**(760)**	**440**	**(778)**	**(130)**	**491**
Financing Cash Flow	**(75)**	**17**	**(303)**	**(276)**	**(354)**
Change in Share Capital	493	(198)	(208)	(276)	(354)
Net Change in Debt	(584)	189	0	0	0
Change in Other LT Liab.	16	25	(95)	0	0
Net Cash Flow	**(835)**	**457**	**(1,081)**	**(406)**	**137**

Source: Company data; KGI Asia Limited estimates

Rates of Return on Invested Capital

Year to 31-Dec	1- COGS / Revenue	+ Dep./Amortization / Revenue	+ SGA Exp. / Revenue	= Operating Margin
2009A	16.2%	5.3%	33.2%	45.2%
2010A	16.6%	4.8%	32.3%	46.3%
2011F	17.6%	4.1%	33.2%	45.1%
2012F	17.1%	4.8%	35.2%	42.9%
2013F	17.2%	4.8%	36.2%	41.7%

Year to 31-Dec	1/ Operating Working capital / Revenue	+ Net PPE / Revenue	+ Other Assets / Revenue	= Capital Turnover
2009A	(1.3)	1.3	0.6	1.9
2010A	(1.3)	1.1	0.8	1.7
2011F	(1.0)	1.4	0.7	1.0
2012F	(0.9)	1.4	0.6	0.9
2013F	(0.7)	1.3	0.5	0.9

Year to 31-Dec	Operating Margin	x Capital Turnover	x Cash 1 - Tax Rate	= After-tax Return on Inv. Capital
2009A	45.2%	1.9	49.8%	43.6%
2010A	46.3%	1.7	74.0%	59.5%
2011F	45.1%	1.0	73.2%	33.0%
2012F	42.9%	0.9	73.2%	28.6%
2013F	41.7%	0.9	73.2%	28.7%

Source: Company data; KGI Asia Limited estimates

Sector Summary

Figure 24: **Our sector view – China**

Sector	Rationale	
Power	Fuel-fired power sector: While 4Q11 power consumption and utilization hours should rise, continued coal price hikes should eat at profit margins. As power tariffs could be raised again in 4Q11, opportunities exist for investors to profit from trading Huadian Power Int'l and Huaneng Power Int'l, two companies that are sensitive to changes in power tariffs. Due to slow progress in overall tariff reform, power enterprises' profits remain subject to coal prices. Therefore, we remain Neutral the fuel-fired power sector. Wind power sector: 4Q11 power generation will not grow as quickly as at the same time last year but will grow 46% YoY. The bad news is that wind turbine price has rebounded a little from the bottom and will lift turbine cost by 2% next year. We will keep watching if wind flows will meet expectation in 4Q11, as no major changes should turn up elsewhere. Overall, we remain Neutral the wind-power sector.	Huadian Power (01071.HK)
Real estate	The economy is showing signs of weakness in and out of China. The credit crunch contiunes and property setocr lacks catalysts in short term. Real estate investment and construction are both slowing while commodity home transactions remain low. Sector valuation has further downside risk before reaching the levels last seen in the 2008 financial crisis. We downgrade the property sector to Neutral and we recommend leading developers with strong presale ability and sound financial status.	
Coal	We believe overall restocking by power plants in 4Q11 will fare worse than in previous years in light of weak PMI across China and a retreat in power consumption growth since August, especially in the east. In addition, coal shortages are mainly occurring in central China and Shanxi, where coal-fired power businesses are suffering heavy losses and are cautious on restocking. Though current domestic and international coal prices are trending high, coal companies' net income is extremely sensitive to price fluctuations. Due to high economic uncertainties, we have downgraded China's coal sector from Overweight to Neutral.	
Nonferrous metals	Global base metal supply remained loose in 3Q11. Some rare metals will enter the peak season in 4Q11. However, nonferrous metal consumption will be hurt given weak PMI and negative economic outlook across the world's major economies. We therefore remain Neutral the nonferrous metals sector.	
Chemical engineering	We remain Neutral the chemical fertilizer sector. The fourth quarter, as the slow season for chemical fertilizer, will see market transaction turn lighter, while product prices should remain firm on cost support. We remain Neutral the fluorine chemical engineering sector. Refrigerant prices have corrected and stabilized, with R22 price staging a rebound. However, due to slow seasonality, product prices have limited upside. EO prices have kept rising on strong demand and tight supply. Prices have further upside. Maintain Overweight. Polyester sector: With the traditional high season, polyester sector chain has recently seen prices go up. For some time to come, we expect Terylene price to remain high on strong demand and high crude oil price that pins input costs aloft. Overall, we remain Overweight the polyester sector. Viscose prices have recently risen by some 10% from the trough in mid-July. In the high season of 4Q11, cotton prices will keep rising to further push up viscose and pulp prices. Upgrade to Overweight.	
Automobile	We rate the automobile sector Neutral on a weak economy and exit of policy incentives. But we favor mid- to high-end and luxury car themes. Retail channel survey shows that high-end cars remain in short supply and prices are being raised on strong demand. Zhengtong (01728.HK) is positioned in the high-end car segment and should complete the acquisition of SCAS in November, which should act as a catalyst. We remain Outperform on the counter on its undemanding valuation.	ZT Auto (01728.HK)
Shipping	We rate China's shipping sector Underweight given overcapacity in the dry bulk, container and oil shipping markets and the slowing global economy on the European sovereign debt crisis. We expect the shipping sector, a cyclical industry, will be under pressure unless the crisis eases. If an acceptable resolution to the crisis materializes, we expect share prices of China Shipping Development (01138.HK) and SITC (01308.HK) to rebound given their low sector valuations and comparatively healthy earnings.	
Coal machinery	China's coal FAI remained above 20% in August but was 5.6 ppts slower than in July. After the water leakage accident in Baowan coal mine in Shanxi Province, Chinese government has stepped up safety control, which should slow down coal investment in the near term. We have downgraded rating on China's coal machinery sector from Overweight to Neutral. Considering sector-wide uncertainty and valuation pressure, we have lowered our rating on International Mining Machinery (01683.HK) and Sany Heavy Equipment (00631.HK) to Neutral and Underperform.	
F & B	We are Overweight China's F &B sector given: (1) strong industry growth thanks to Chinese government's reformed distribution of personal income; (2) the sector is defensive during a market downturn; (3) valuation is undemanding at a 2011F PE of 22. 6x. We favor companies with rapid growth and attractive valuations such as Silver Base (0886.HK), which is emerging from the trough while its valuation lags Ajisen (0538.HK).	Silver Base (00886.HK)
Medical & pharmaceutical	We rate the H-share pharmaceutical sector Neutral for 4Q11 as policies remain restrictive, prices of medical-insurance and basic-type medicines are still under downward pressure, and basic drug tender reform and drug price unification won't be decided before 2012. While most companies' stock prices have fallen to the low end of their historical PE bands, they are unlikely to rebound in 4Q11 as pharmaceutical A-Shares should continue to struggle. We recommend watching how pharmaceutical companies will lobby the government on the matter of tender reform and the direction of government attitude. For 4Q11, we recommend Kingworld as it will be little affected by restrictive policies. Healthcare machinery/instrument makers seem safer investment choices, such as MicroPort Scientific (00853.HK) which will break into the local orthopaedic market in 2012.	Kingworld (01110.HK)
Wind power	As of September, the influence of policy factors has abated for wind power equipment makers. No severe restraint measures are foreseen near term. However, in the coming months the high installation comparison base in 4Q10 and the sharp price plunge since 4Q10 will factor into financial statements. We therefore don't expect wind power equipment shares to rebound in 4Q11 and maintain our Underweight rating.	
Lead-acid battery	Industrial Economics & Knowledge Center (IEK) estimates global lead-acid battery market size was US$36.2bn in 2010. Major consolidation in the lead-acid battery industry has severely impacted supply. According to our research, 70% of plants have been forced to shut down, while 13% have halted production for reorganization. As a result, only 17% of makers are in regular supply. The plants on shutdown are equivalent to about 35% of market supply, and 90% of them power battery plants. As such, factory prices of E-bike battery rose 16-20% in July and August, which should give a strong boost to suppliers' gross margins in 2H11. The 13% of makers that have halted production for reorganization may take 6-12 months to resume production. Therefore, we look for prices to trend up in short term. Survivors of lead-acid battery market consolidation will benefit from price hikes and shipment growth. We remain Overweight the lead-acid battery sector, and our top pick is industry leader Tianneng (00819.HK).	Tianneng Power (00819.HK)
Department stores	Maintain Outperform rating on the sector. (1) We remain positive on 4Q11 growth momentum backed by double-digit rise in ASP, stable disposable income grwoth outlook and earlier-than-usual Chinese New Year holidays. (2) Valuation undemanding at 19x median trailing PE, at a 29% discount to the five-year average. We prefer regional players with leading positions in fast-growing lower-tier cities. Out top pick is Golden Eagle (3308.HK).	Golden Eagle (03308.HK)
Petrochemicals	We remain Overweight the petrochemical and offshore oil service sectors for the following reasons. First, oil product pricing mechanism reform should make headway in end-2012 to help stabilize the profit margins of local refining enterprises. Second, a stabilizing economy in China bodes well for growth in petrochemical product demand. Third, the 12th Five-Year Plan has clear goals for the offshore oil rigging sector. In 1H11, China Oilfield Services completed only 29% of the scheduled investment and will quicken its investment pace in 2H11. Drafted on the assumption that oil price will remain above US$80/barrel, China Oilfield Services' investment plan should proceed quickly in 2011 and 2012. So far, the company has achieved the target of 50mn mt of oil equivalent as proposed by the 12th Five-Year Plan.	China Oilfield Services (02883.HK)

Source: KGI Research

Auto sector

Positive on high-end & luxury names amid slowdown

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- **We see strong upgrade demand for SUV and high-end sedan, but new car market looks weak**
- **ZT Auto and GAC are our top picks for 4Q11 for their high growth and undemanding valuations**
- **We like high-end & luxury players; remain Neutral China's auto sector in 4Q11**

Neutral on China auto market in 4Q11

We have lowered our 2011 passenger vehicle (PV) unit sales growth forecast to 5.0% from 5.8% using actual PV sales figures in the first eight months of 2011. Though we expect sales to pick up QoQ in 4Q11 on seasonality, the growth rate will slow on a YoY basis due to a high comparison base in 4Q11.

Figure 25: **PV sales to grow 5.0% for 2011**

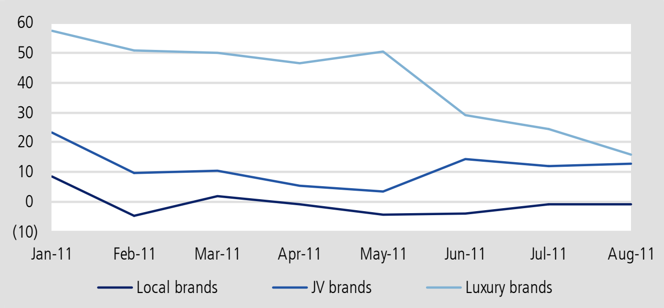
'000 units	Jan-Aug 2011 PV sales	As share of 2011F sales (%)	PV sales 2011F	PV sales 2010	YoY (%)
Base case scenario	9,245	64.0	14,446	13,758	5.0
Best case scenario	9,245	60.3	15,332	13,758	11.4
Worst case scenario	9,245	67.4	13,717	13,758	(0.3)

Note: We use avg. (adjusted), min. and max. ratio of unit sales in first 8 months of 2005-10 as percentage of whole-year sales for base, best and worse case scenarios.

Source: CAAM; KGI Asia Limited

Figure 26: **JV & luxury brands outperformed peers YTD**

YoY growth of unit sales in first 8 months of 2011, percent



Note: Luxury brands here refer to both locally manufactured and imported models of Audi, BMW and Mercedes-Benz sold in China market.

Source: CAAM; Company data; KGI Asia Limited

Positive on high-end & luxury, cautious on local players

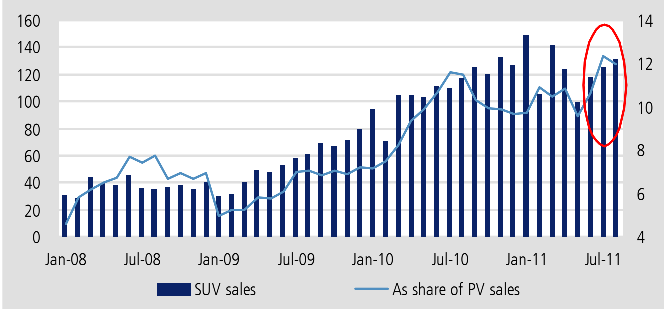
We remain positive on high-end and luxury brands during the current market downturn for the following reasons:

(1) Local brands affected most by stimulus change. Our channel checks suggest that the macro situation this year is even worse than it was in 2008-09 due to the absence of any stimulus package. Local brand customers generally have lower incomes than JV brand customers. They are more affected by high inflation and slower wealth growth, leading to deferred demand for mid-to-low-end autos. Besides, from October 1, 2011, China will tighten standards for the Rmb3,000 subsidy on oil-efficiency vehicles, so vehicles that do not meet the new standard will no longer be subsidized. We believe the new policy will impact local brands more as their customers are more price-sensitive.

(2) SUV & high-end sedan demand resilient. We see strong upgrade demand for SUV and high-end sedan going forward, in comparison to a weak new car market. In the first eight months of 2011, SUV sales grew 25% YoY, faster than 6% growth for overall PV sales during the same period. Meanwhile, sales of high-end sedan (including entry-level luxury cars such as Audi's A4L, BMW's 3-series and the Mercedes-Benz C class) have picked up since June when the impact of the Japan earthquake passed.

Figure 27: **SUV comprised 12% of PV sales in August**

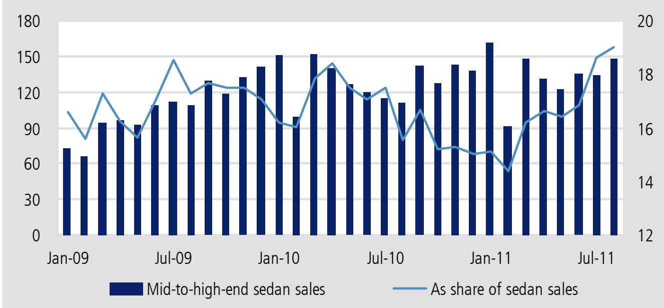
China SUV sales, '000 units (LHS) weighting, percent (RHS)



Source: CAAM; Company data; KGI Asia Limited

Figure 28: **High-end sedan weighting up in first eight months**

China mid-to-high-end sedan sales, '000 units (LHS); weighting, percent (RHS)



Source: CAAM; Company data; KGI Asia Limited

(3) JV and luxury brand sales on track to hit 2011 target: A look at the sales performance in first eight months suggests JV and luxury brands are more likely to meet or even exceed their 2011 unit sales targets than are local brand peers. The latter may lower their sales targets or hold big promotions for the rest of 2011, which would harm margins.

Figure 29: **Brilliance BMW, Dongfeng Nissan faster in achieving sales targets**

'000 units	Jan-Aug 2011 unit sales	2011F sales		Achievement rate (%)	
		Guidance	KGI estimate	Guidance	KGI estimate
JV brand					
Brilliance BMW	72	108	108	67	67
Dongfeng Nissan	507	800	792	63	64
Dongfeng Honda	160	246	269	65	59
Dongfeng PSA	243	425	398	57	61
GAC Toyota	165	290	304	57	54
GAC Honda	212	382	376	55	56
Local brand					
Great Wall Motor	288	490	480	59	60
Brilliance Minibus	56	95	91	59	62
Geely	261	480	N.A.	54	N.A.
BYD	288	600	N.A.	48	N.A.

Source: Company data; KGI Asia Limited

ZhengTong Auto and GAC our top picks

ZhengTong Auto (ZT Auto; 01728.HK) and GAC (02238.HK) are our top picks for 4Q11 on their high growth and low valuations.

We like ZT Auto for its big exposure to luxury brands, especially BMW. Despite slower growth of luxury brand sales from June due to a high comparison base, we remain upbeat on this counter and see demand exceeding supply at the retail end. We don't expect supply to greatly improve until 2012 when new plant and capacity is put into operation. We see M&A activities as another catalyst to the stock and we look for ZT Auto to complete its acquisition of SCAC in November. After the deal, ZT Auto will have Landrover, Volvo and Jaguar in its brand portfolio, diversifying its revenue stream and reducing its reliance on the BMW brand. We view the stock as undervalued at 18.4x 2011F PE and 8.9x 2012F PE. Our target price is unchanged at HK$13.9. We reiterate Outperform on this counter.

GAC is another top pick for 4Q11 as SUV and high-end sedan comprised a respective 19% and 46% of sales in the first eight months of 2011, which bodes well for strong unit sales going forward. The company will launch Camry upgrade in October with an engine upgraded from 2.4L to 2.5L and a new sportscar-style design. The new model should further help GAC cement its position in the high-end sedan market. Also, as GAC was greatly affected by the Japan quake, it is rushing to meet its annual sales target and we thus expect sales to be back-end loaded for 2011. The stock is trading at an undemanding 7.2x 2012F PE, offering a 37% discount to its historical average PE of 11.4x. Our target price is HK$10.7.

Valuation & Recommendations

We remain Neutral on the overall auto sector. We prefer big JV players GAC and Dongfeng Motor Group to their smaller peers as the latter are more vulnerable to tightening measures. We also like luxury auto dealer ZT Auto on China's robust demand for luxury cars.

Figure 30: **H-share automakers and dealers peer comparison – Valuation**

Company	Ticker	Share price (HK$)	Mkt Cap (US$mn)	Currency	EPS				PE (x)				2010-2013F EPS CAGR (%)	2012 PEG (x)	Dvd Yld (%)
					2010	2011F	2012F	2013F	2010	2011F	2012F	2013F			
H-share automakers															
Dongfeng Motor Group*	00489.HK	12.0	13,296	Rmb	1.27	1.17	1.25	1.60	7.7	8.4	7.9	6.2	7.9	1.0	1.8
GAC*	02238.HK	7.5	5,943	Rmb	0.92	0.62	0.85	1.03	6.7	9.9	7.2	6.0	3.9	1.9	3.2
Geely	00175.HK	1.9	1,857	Rmb	0.17	0.20	0.24	0.28	9.3	7.9	6.5	5.6	18.0	0.4	1.4
BYD	01211.HK	13.8	6,464	Rmb	1.11	0.54	0.78	0.92	10.2	21.0	14.6	12.3	(6.0)	(2.4)	0.0
Brilliance China*	01114.HK	7.3	4,664	Rmb	0.25	0.39	0.46	0.55	23.6	15.3	12.9	10.8	29.7	0.4	0.0
Great Wall Motor*	02333.HK	10.5	3,712	Rmb	0.99	1.38	1.47	1.74	8.7	6.2	5.9	4.9	20.7	0.3	2.3
H-share auto dealers															
Zhengtong Auto*	01728.HK	8.29	2,341	Rmb	0.18	0.37	0.76	1.18	37.7	18.4	8.9	5.8	87.2	0.1	0.0
Zhongsheng Group*	00881.HK	13.20	3,234	Rmb	0.56	0.64	0.96	1.45	19.3	16.9	11.3	7.5	37.3	0.3	0.9
DCH Group	01828.HK	9.29	2,173	HK$	0.78	0.84	1.04	1.29	11.9	11.1	8.9	7.2	18.4	0.5	2.9
Sparkle Roll	00970.HK	0.75	287	HK$	0.07	0.10	0.13	0.18	11.5	7.7	5.6	4.2	39.9	0.1	1.7
H-share auto parts supplier															
Minth Group*	00425.HK	9.38	1,296	Rmb	0.77	0.82	0.96	1.15	10.0	9.4	8.0	6.7	14.2	0.6	2.9

*Note: (1) * in our coverage universe; (2) Sparkle Roll fiscal year ends in March*

Source: Bloomberg; KGI Asia Limited

Chemicals sector

EO, polyester, viscose segments are top picks

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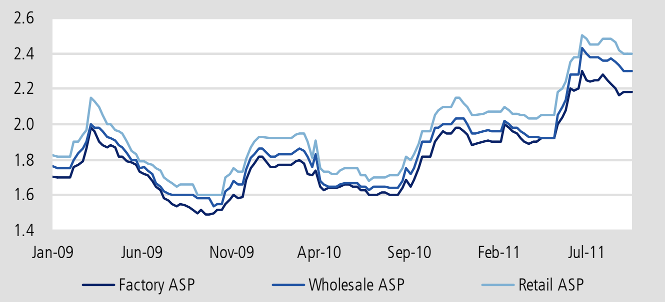
- **EO, polyester & viscose prices are firm on peak season; we rate these segments Overweight**
- **Fertilizer sector enters slow season but prices solid on cost support; we rate the fertilizer sector Neutral**
- **Fluorine chemicals segment in slow season but prices have stabilized, set to rebound; we rate Neutral**

Fertilizer sector – Neutral rating

In the slow 4Q11, we expect fertilizer market transactions to soften, while prices will remain firm on cost support. Regarding urea, 70% of China's capacity is reliant on coal as the raw material; YoY, anthracite prices are up 20-40%. In 2H11, we expect anthracite prices to remain high or rise further. Also, there will be hikes in electricity and labor costs. For now, main Chinese coal-based urea manufacturers have production costs of Rmb1,800/metric ton (mt) or higher, some higher than Rmb2,000/mt.

Figure 31: **China's urea prices remain high**

China urea price, Rmb/mt

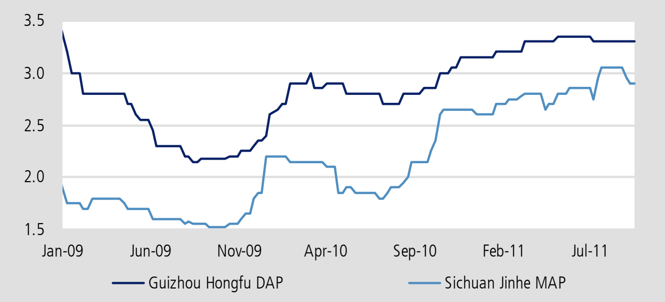


Source: www.ccmb360.com

For phosphorus fertilizer, main materials, such as phosphorus ore, sulfur and sulfuric acid, have seen prices remain high. Preliminary estimates place DAP and MAP production costs at Rmb3,300/mt and Rmb2,700/mt, which is keeping phosphorus prices high.

Figure 32: **Phosphorus fertilizer prices high**

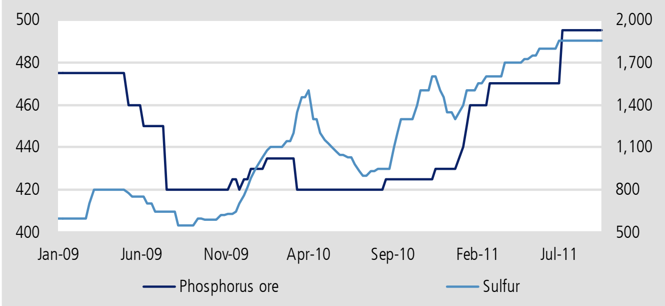
China phosphorus fertilizer price, Rmb'000/mt



Source: www.ccmb360.com

Figure 33: **Sulfur & phosphorus ore prices in uptrend**

Phosphorus ore price, Rmb/mt (LHS); sulfur price, Rmb/mt (RHS)

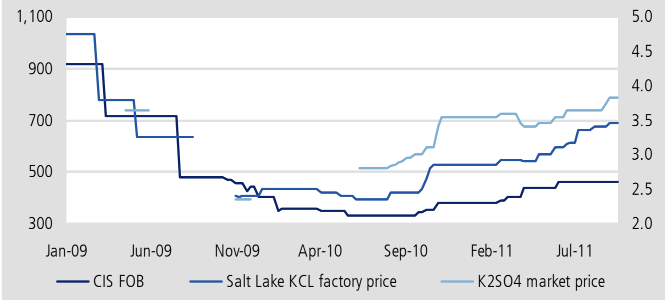


Source: www.ccmb360.com

Potash producers worldwide have recently raised potash price by another US$10-25/mt. In China, where the potash market is in the slow season, prices are stable. Historically, however, potash prices tend to be comparable inside and outside of China. As such, we think that next year when high-season demand kicks in, local potash prices will rise further.

Figure 34: **Potash prices steadily up in China & overseas**

International potassium chloride price, US$/mt (LHS); China potash price, Rmb'000/mt (RHS)



Source: www.ccmb360.com

As 4Q11 is the slow season for chemical fertilizer, both prices and costs may remain high. We don't therefore expect strong earnings performance. We are Neutral on the fertilizer sector.

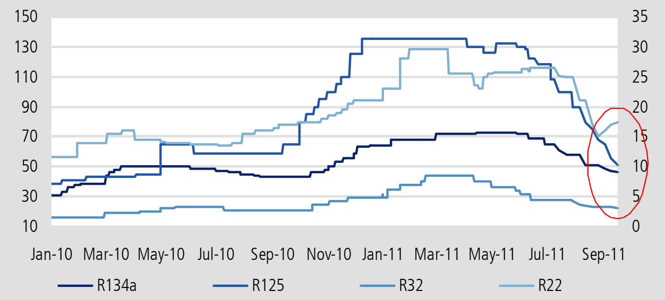
Fluorine segment – Neutral rating

The R22 price is doing better than expected, recently rising as some producers have enter maintenance phases, resulting in slower shipments. Meanwhile, promotional sales of air-conditioners and refrigerators during the October holidays have done their part to boost demand. R134a price has remained stable; PTFE price has remained high on support from strong material (R22) price and steady demand. PTFE prices should consolidate at a high level in 4Q11.

For the fluorine segment, we think there is little further upside to prices, mainly due to weak seasonality and demand. We are Neutral on China's fluorine market.

Figure 35: **R22 price has bottomed out & is rebounding**

Dongyue Group refrigerant factory price, Rmb'000/mt



Source: Baichuan Information

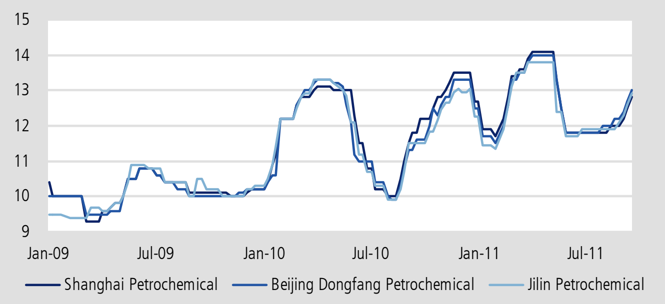
Dongyue Group (00189.HK) specializes in the manufacturing of refrigerant (mainly R22) and fluorine resin (mainly PTFE). Refrigerant prices have stabilized while fluorine resin prices remain lofty. For 2011, 2012, and 2013, we project EPS at Rmb1.1, Rmb1.21, and Rmb1.48, respectively. On undemanding valuation, we reiterate our Outperform rating on target price of HK$8.0.

EO segment – Overweight rating

Recently, EO prices have continued upward, last week rising Rmb300/mt in terms of national average, which is in line with our forecast. Further upside exists given: (1) downstream demand has resumed on falling temperatures; (2) Shanghai Petrochemical (00338.HK) is conducting maintenance, tightening supply; and (3) across China, most EO production shares capacity with EG, the strong price of which will support EO prices.

Figure 36: **EP price picks up**

China factory price, Rmb'000/mt



Source: Wind

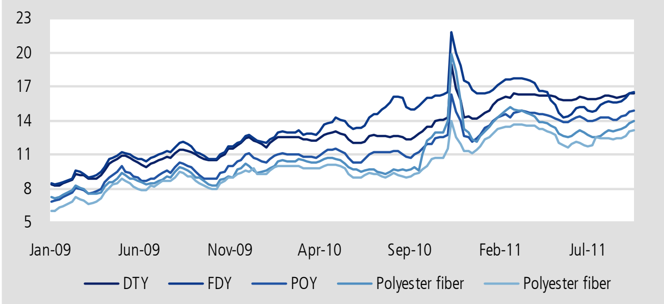
Sanjiang Fine Chemicals (02198.HK) specializes in the production of EO, which is selling well right now, with capacity utilization at 110%. As such, Sanjiang's EO output should be higher in 2H11 than in 1H11, and on EO price hikes, corporate earnings should rise by Rmb0.03/share HoH to Rmb0.18/share in 2H11. Going forward, the company's production capacity should keep rising. In 2012, the corporate capacity on equity-weighted basis should increase by 50kmt/year, 100k mt/year by 2013 and 200k mt/year by 2014. For 2011, 2012, and 2013, we project corporate EPS at Rmb0.33, Rmb0.43, and Rmb0.52, respectively. On attractive PE, we remain Outperform the counter with target price of HK$3.2.

Polyester segment – Overweight rating

With peak season arriving, the polyester supply chain has seen prices rise. The terylene market is now characterized by strong downstream demand, low market inventory, and tight market supply. Cost-wise, EG supply is down on suspension of Taiwan's Nanya Plastics, and its prices are thus pinned high. PTA prices have also remained high on low capacity utilization, low inventory, and tight supply. We expect terylene prices will stay high for some time on brisk demand and high raw material costs, thanks to firmness in crude oil prices. We are Overweight the polyester segment and recommend Yizheng Chemical Fibre (01033.HK).

Figure 37: **Polyester chip & polyester fiber price trends**

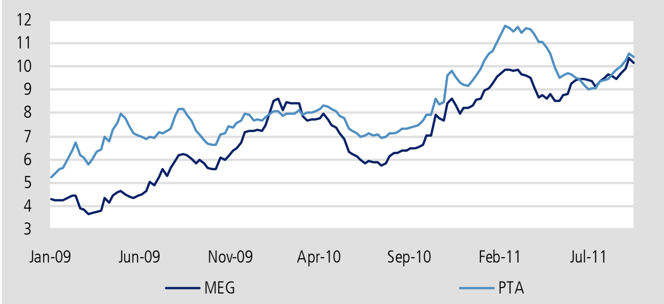
China price, Rmb'000/mt



Source: www.ccfei.com

Figure 38: **MEG & PTA prices rising**

China MEG & PTA price, Rmb'000/mt



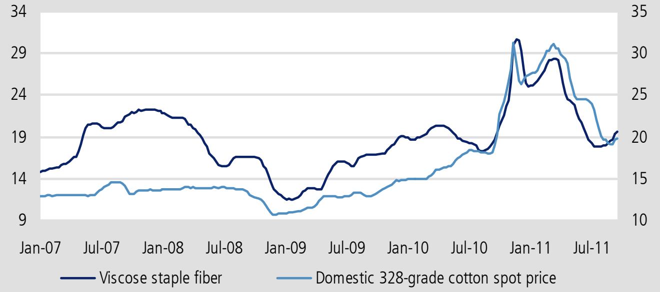
Source: www.ccfei.com

Viscose segment – Upgrade to Overweight

Viscose prices have recently kept rising, up by some 10% over the trough in mid-July on the following reasons. First, the downstream textiles segment has entered a boom season. Second, the viscose sector suffered significant losses recently, giving enterprises a strong motivated to turn things around. Third, while new cotton hits the market, the government has initiated a temporary procurement price of Rmb19,800/mt to support prices, thus the rebound continues. Due to cotton and viscose price hikes, prices of main materials like cotton linter, cotton pulp, and wood pulp have begun to rebound as well. In the peak season of 4Q11, cotton prices will continue to rise, while viscose and pulp prices will rise further as well. On the improved market conditions depicted above, we upgrade our rating to Overweight on the viscose segment.

Figure 39: **Viscose & cotton prices on the way back up**

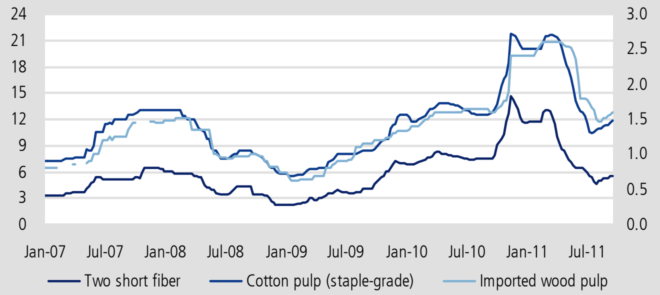
China viscose staple fiber price, Rmb'000/mt (LHS); 328-grade cotton spot price, Rmb'000/mt (RHS)



Source: www.ccfei.com; KGI Asia Limited

Figure 40: **Prices rebounding on viscose materials**

China linter & cotton pulp price, Rmb'000/mt (LHS); price of imported wood pulp, US$'000/mt (RHS)



Source: www.ccfei.com; KGI Asia Limited

Among related companies, Sateri Holdings (01768.HK) has annual capacity of 160k mt of viscose staple fiber, 485k mt of wood pulp, and a 150k-hector Eucalyptus tree plantation in Brazil. As such, unlike local peers that procure cotton linter and cotton pulp to make viscose, Sateri is immune to earnings erosion, explaining why it leads local peers in profitability.

Valuation & Recommendations

The EO, polyester and viscose segments have kicked off the peak season with strong demand and rising prices. We are Overweight these markets. Sanjiang Fine Chemicals (2198.HK, OP), as China's largest commodity EO producer, will see earnings grow 20% HoH in 2H11, and is currently trading at an attractive PE. We maintain our Outperform rating.

Though the fertilizer sector has entered the slow season, costs are supported by continued high product prices. We rate the sector Neutral, recommending China BlueChemical (03983.HK) on relatively stable costs and decent product price spreads. We reiterate our Outperform rating.

The fluorine segment has also entered slow season with refrigerant prices falling 40-50% from previous highs before stabilizing and rebounding slightly. We rate the sector Neutral, recommending leader Dongyue Group as slow seasonality has been priced into its valuation. We maintain our Outperform rating.

Figure 41: **Peer comparison – Valuation**

Company	Code	Rating	Share price (HK$)	EPS (Rmb) 2010	EPS (Rmb) 2011F	EPS (Rmb) 2012F	P/E (x) 2010	P/E (x) 2011F	P/E (x) 2012F
China BlueChemical	03983.HK	OP	5.40	0.25	0.47	0.51	19.4	10.3	9.5
Dongyue Group	00189.HK	OP	4.21	0.35	1.10	1.21	10.8	3.4	3.1
Sanjiang Fine Chemicals	02198.HK	OP	2.02	0.26	0.33	0.43	7.0	5.5	4.2
Yizheng Chemical Fibre	01033.HK	NR	1.51	0.31	0.49	0.61	4.4	2.8	2.2
Sateri Holdings	01768.HK	NR	2.12	0.72	0.60	0.57	3.0	3.5	3.7
Yingde Gases	02168.HK	NR	6.52	0.32	0.62	0.81	18.3	9.5	7.2
YIP'S Chemical	00408.HK	NR	5.87	0.70	0.48	0.81	7.5	11.0	6.5

Source: KGI; Wind

Petrochemicals sector

Rebound in the cards; offshore exploration quickens

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- **Oil refining & petrochemicals sectors shaping up in 4Q11**
- **Offshore exploration by CNOOC picks up pace; China's offshore oil rigging sector set for rebound in 4Q11**
- **Our top picks are Shanghai Petrochemical & China Oilfield Services**

Oil refining & petrochemicals shaping up in 4Q11

We estimate that in 4Q11, Brent oil will average US$105/barrel, down 8% QoQ, mainly as the global economy remains shaky. IMF has lowered estimates for world GDP growth from 4.3% in 2011 and 4.5% in 2012 to 4% and 4%, down by 0.3 ppt and 0.5 ppt, respectively. US 2011 and 2012 GDP growth has been revised down 1.0 ppt and 0.9 ppt, respectively, to 1.5% and 1.8%. Slower economic growth and less likelihood of a QE3 have prompted some to expect crude oil and other commodities prices to correct.

Oil price correction & new pricing mechanism for oil products to boost oil refining margins

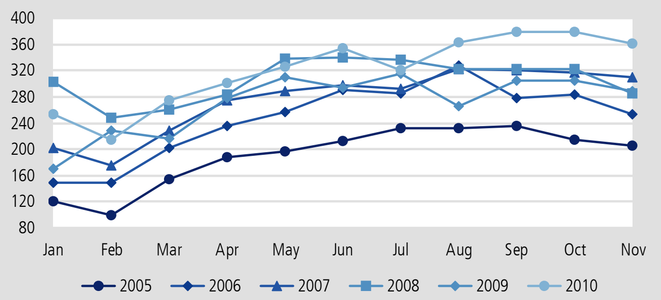
Due to fast rises in crude oil prices and the impact of government intervention on oil product prices, oil refining margin in China is down greatly. Shanghai Petrochemical (00338.HK) saw oil refining gross margin fall from 11.1% in 1H10 to 3.2% in 1H11. Considering the recent crude oil price correction and the fact that enterprises need 1-2 months to go from crude oil import to oil refining, we expect corporate performance to bottom in 3Q11 and get better in 4Q11 and 2012. The new oil product pricing mechanism set for launch toward the end of 2011, which will shorten the revaluation/adjustment cycle from 22 to 10 days and bestow pricing power to enterprises, is long-term good news for oil refining margins.

Downstream petrochemicals enter peak season

Plastic plate, sheet, box and container are in peak season demand.

Figure 42: **Peak season for plastic plate & sheet is 4Q11**

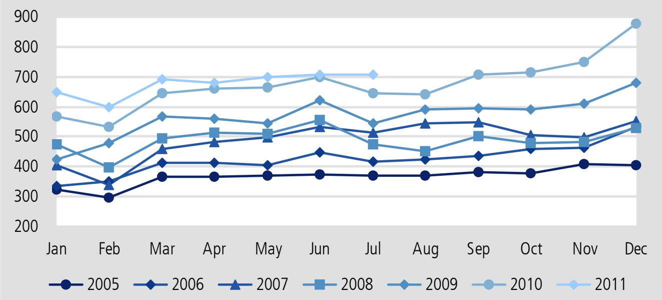
China plastic plate & sheet output, '000 mt



Source: Wind

Figure 43: **4Q11 also peak season for plastic film**

China plastic film output, '000 mt

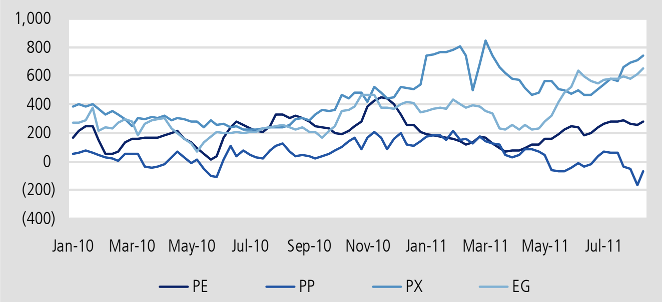


Source: Wind

Profitability for petrochemical intermediates is at relatively high levels. Such petrochemicals intermediates as PX, EG, EO, and BD are featuring decent profitability.

Figure 44: **PX and EG more profitable now than PE and PP**

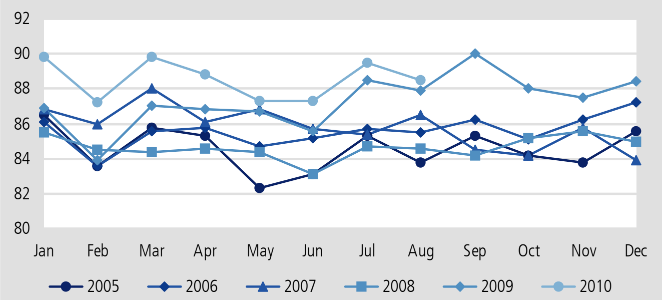
China cash margin of PE, PP, PX & EG, US$/mt



Source: Platts; KGI Asia Limited

Figure 45: **EO and BD profitability improving**

China cash margin of EO & BD, US$/mt



Source: Wind; KGI Asia Limited

Shanghai Petrochemical is located in eastern China where over 35% of China's plastics production takes place and where downstream demand is better. Also, Shanghai Petrochemical has higher exposure to intermediates with better margins in its petrochemicals product offering, which helps boost corporate performance. Crude oil price correction and the fact that oil product pricing reform should be introduced in 2011 are good news for the company's oil refining business.

Figure 46: **Shanghai Petrochemical's intermediates strong**

Output weighting, percent	2008	2009	2010	2011F	2012F	2013F	2014F
Synthetic fiber	9.0	7.4	6.0	6.0	5.9	5.6	4.5
Resin & plastic	47.4	46.7	38.0	37.7	37.7	36.0	28.7
Intermediates	43.6	45.9	56.0	56.3	56.4	58.4	66.8

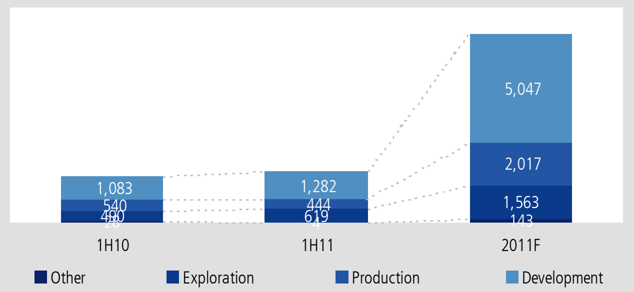
Source: KGI Asia Limited estimates

Offshore oil rig business to continue to rebound in 4Q11

Despite rather weak growth in daily rigging fees worldwide, China's offshore oil exploration business, led by CNOOC (00883.HK), will soldier on. In 1H11, CNOOC's investment was relatively stagnant finished only 26.8% of annual investment plan. In 2H11, CNOOC should speed up investment, benefiting China Oilfield Services (02883.HK) which derives some 70% of revenues from CNOOC. In August, China Oilfield Services called six rigging ships back into service from maintenance.

Figure 47: **CNOOC only 27% of 2011 target investment in 1H11**

CNOOC investment breakdown, US$mn



Source: KGI Asia Limited

China Oilfield Services is gradually ramping up its high-end rigging ships, which should help it better tap the stable high-end market. As of September 16, high-end semisubmersible rigging ships' utilization rate remained at 82%, higher than that of Jackup ships by 5.5 ppts. Number of rigging ships with working depths of 1,500 feet or more is seven for China Oilfield Services or 20.6% of its total rigging ships.

Figure 48: **Semisubmersible rigging ship utilization leads peers**

Rigging ship type	Sep. 16, 2011		Aug. 16, 2011		Mar. 16, 2011		Sep. 16, 2010	
	Utilization (%)	No. active/ available rigs	Utilization (%)	No. active/ available rigs	Utilization (%)	No. active/ available rigs	Utilization (%)	No. active/ available rigs
Drillbarge	80	8/10	80	8/10	80	8/10	80	8/10
Drillship	78.8	52/66	72.7	48/66	75	48/66	77.6	38/49
Jackup	76.5	283/370	77	284/369	75.6	273/361	77.6	274/253
Semisubmersible	82	146/178	83	146/176	82.7	139/168	83.4	136/163
Tender	78.6	22/28	82.1	23/28	78.6	22/28	75	21/28

Source: KGI Asia Limited

Valuation & Recommendations

With crude oil prices correcting, downstream demand entering the high season, and a new pricing mechanism coming into effect, we expect the petrochemicals sector to see a recovery in 4Q11 and we thus rate the sector Overweight. Shanghai Petrochemical is our top pick. We also like China Oilfield Services for its attractive valuation and as its business should pick up in 4Q11.

Figure 49: **Peer comparison – Valuation**

Company	Ticker	LCY	Share price	Market cap (mn)	EPS 2010	EPS 2011F	EPS 2012F	PE (x) 2010	PE (x) 2011F	PE (x) 2012F	P/B (x) 2011F	Dvd yld (%)
Transocean	Rig US	US$	52.5	128,987	2.99	26.62	46.06	7.6	15.2	8.8	0.8	0.0
Noble	Ne US	US$	32.2	62,742	3.03	13.42	30.50	11.8	18.5	8.2	1.0	3.4
Diamond Offshore	Do US	US$	59.5	63,562	6.87	48.63	38.96	10.0	9.4	11.7	1.9	6.0
Ensco (ADR)	Esv US	US$	44.6	80,063	4.06	27.35	45.74	14.0	12.7	7.6	0.8	3.1
Rowan	Edc US	US$	33.4	33,376	2.39	13.62	29.18	13.5	19.2	9.0	1.0	0.0
China Oilfield-h	02883.HK	HK$	9.9	70,177	0.92	0.94	1.20	9.0	8.8	6.9	0.9	2.3

Source: Bloomberg; KGI Asia Limited estimates

Coal sector

Restocking weak, unlikely to build momentum

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- **PMI weak, power consumption low across manufacturing industries along eastern coast**
- **Restocking momentum weaker than in previous years among power plants in east and central China**
- **Downgrade sector from Overweight to Neutral**

Downgrade from Overweight to Neutral

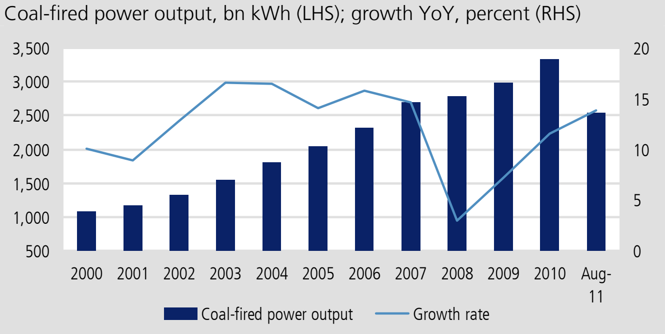
Due to the economic slowdown in China and lackluster restocking momentum, we downgrade China's coal sector to Neutral.

Power consumption growth slowing since August; usage down at east coast manufacturers

In January-August, China's power output rose 13% YoY to 3.07tn kWh, of which 2.54tn kWh was generated by coal-fired units, up 13.9% YoY. Nationwide power consumption climbed 11.9% YoY to 3.12tn kWh in the period, of which 2.34tn kWh was used in secondary industry, up 11.8% YoY, while 336.5bn kWh was used in tertiary industry, up 14.6% YoY. National power consumption growth fell from 11.8% in July to 9.1% in August. Also noteworthy is the power consumption downtick across industrial manufacturing sectors, in addition to the fact that growth in the fourth quarter could appear strong only due to last year's low comparison base. In east china, power consumption growth in Jiangsu and Zhejiang displayed a hefty pullback. Consumption in Jiangsu grew 10.9% YoY in July and 13.2% YoY in January-July, but grew less than 4% YoY in August. Meanwhile, New Export Orders PMI fell below the 50-point contraction mark, pointing to a recession in manufacturing activity in eastern China.

Figure 50: **China thermal power output up 13.9% in Jan-Aug**

Coal-fired power output, bn kWh (LHS); growth YoY, percent (RHS)



Source: Wind; KGI Asia Limited

Inventories sufficient in east & central; restocking weaker

In January-July, domestic raw coal output reached 2.46bn mt, up 14.1% YoY, as output grew more than 30% YoY in Inner-Mongolia and 20% in Shanxi. As of August 20, coal inventories at leading domestic power plants stood at 61mn mt, or 14 days of supply. Inventory levels are diverse regionally. As of end-July, inventories grew over 20% YoY for East China Grid Company and North China Grid Company, but dropped 10-20% YoY for Central China Grid Company and China Southern Power Grid Company. The five leading power groups currently have combined inventories of 7.45mn mt in coal-fired power plants in the southeast coastal area. The average inventory level is 16.9 days. Coal is mainly in shortage in central China and Shanxi, where coal-fired power businesses are suffering heavy losses, which has affected procurement of fuelling materials. However, if the government raises on-grid coal-fired power tariffs again, coal restocking among power plants in those areas could recover. Qinhuangdao mainly supplies coal to power plants in east and south China and areas along the river. Due to sufficient inventory levels in the southeast coastal areas, restocking activities in October may disappoint. We believe overall power plant restocking in 4Q11 will fare worse than in previous years.

Figure 51: **East China Grid coal inventory up 50% YoY in Jan-Aug**

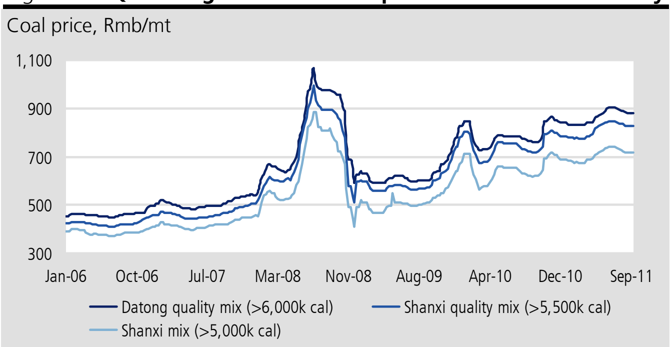
Inventory level at end-August, mn mt	Current	Last year	Growth YoY (%)
Leading power plants	61.7	58.6	5.3
North China Grid Company	17.2	15.3	12.6
Northeast China Grid Company	6.3	6.2	0.6
East China Grid Company	13.8	9.1	52.0
Central China Grid Company	13.0	13.1	(1.4)
Northwest China Grid Company	5.2	5.5	(4.7)
China Southern Power Grid Company	6.3	9.4	(33.3)

Source: China Coal Resource; KGI Asia Limited

Economic pullback, weak restocking weigh on coal prices

The price of Shanxi quality mix steam coal (>5,500k cal) has fallen from Rmb845/mt at end-July to the current Rmb825/mt, which has held flat for five consecutive weeks. Due to wintertime stockpiling and resource consolidation in Shanxi and Inner-Mongolia's coal districts, mine mouth price has led the rebound. Meanwhile, as recent mine accidents caused production halts and reorganizing, many large-scale coal enterprises have hiked steam coal prices by Rmb10-20/mt. Coal prices at Bohai-rim ports stopped a nine-week decline and the Bohai-Rim Steam-Coal Price Index rose. On September 19, average Qinhuangdao 5,500k cal steam coal price was Rmb830/mt, up Rmb5.0/mt WoW. As coal usage in the northern hemisphere peaks in the winter, coal imports are picking up in Japan and Korea. As of September 15, Australia's BJ steam coal price rose sequentially to US$123.7/mt, displaying strong momentum internationally during the fourth quarter peak season. On the other hand, we think Qinhuangdao's steam coal price, China's major steam coal price indicator, will display a seasonal uptrend in 4Q11. However, due to economic growth slowdown, in addition to sufficient inventories in east China and lagging power consumption, we are afraid Qinhuangdao's seasonal coal price hike will fare worse than it did last year.

Figure 52: **Qinhuangdao steam coal price to rise on seasonality**



Source: China Coal Resource; KGI Asia Limited

Figure 53: **Australia BJ steam coal price strong**

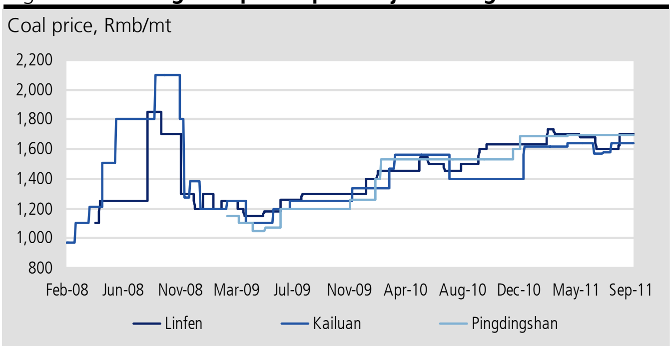
Source: Wind; KGI Asia Limited

Steel price retreating, coking coal price consolidating

China's crude steel output grew 10.6% YoY in January-August to 469mn mt and rose 13.8% YoY to 58.8mn mt in August alone, for average daily output of 1.90mn mt. Average daily output in the first half of September was 1.96mn mt, up 3.1% MoM. In August, China's crude steel output fell only 1.49mn mt from the peak of 60.2mn in May. Output has remained high thus far in September. In 2011, output has fluctuated little between peak and slow seasons. In early June, less than 30% of social housing was under construction. The rate surged to 86% by end-August to 8.68mn sets. The rapid launches have driven release of steel.

China produced 298mn mt of clean coking coal in January-August, up 4.0% YoY. In 2011, domestic output growth of crude steel has sustained higher than that of coking coal. Coking coal was in short supply in January-August, affected by coal resource consolidation in Hebei. Coking coal prices have edged up in Linfen Shanxi, with coking coal quoted at Rmb1,700/mt, up Rmb100/mt from end-July. Coking coal in Kailuan Hebei was quoted at Rmb1,640/mt, up Rmb65/mt from end-July. Australian metallurgical coal prices are retreating after a sharp rally. Per the agreement between Japanese steel mills and US/UK resource companies, 4Q11 coking coal contract price is down 10% QoQ to US$285/mt. Current Australian hard coking coal FOB is quoted at US$280/mt, down US$30/mt from July. In 4Q11, international coking coal prices will continue downward consolidation. Rmb1,800/mt is quoted for prime coking coal imports from Australia at Tianjin Port, Rmb500/mt higher than domestic prime coking coal. Domestic steel prices have retreated. In turn, rigid coking coal prices will encounter correction pressure.

Figure 54: **Coking coal price up in major coking coal districts**



Source: China Coal Resource; KGI Asia Limited

Recommendation

We believe overall restocking by power plants in 4Q11 will fare worse than in previous years in light of weak PMI across China and a retreat in power consumption growth since August, especially in the east. In addition, coal shortages are mainly occurring in central China and Shanxi, where coal-fired power businesses are suffering heavy losses and are cautious on restocking. Though current domestic and international coal prices are trending high, coal companies' net income is extremely sensitive to price fluctuations. Due to high economic uncertainties, we have downgraded China's coal sector from Overweight to Neutral.

Figure 55: **Major H-share coal companies – Valuation**

Company	Ticker	Share price	EPS (HK$)			PE (x)			BVPS (HK$)	P/B (x)
		(HK$)	2010	2011F	2012F	2010	2011F	2012F	2011F	2011F
Yanzhou Coal	01171.HK	17.60	2.27	2.26	2.29	7.8	7.8	7.7	10.6	1.7
China Shenhua	01088.HK	32.45	2.30	2.60	3.00	14.1	12.5	10.8	14.0	2.3
China Coal Energy	01898.HK	7.94	0.67	0.85	1.01	11.8	9.3	7.9	7.3	1.1
Hidili Industry	01393.HK	2.56	0.39	0.41	0.54	6.6	6.3	4.7	4.4	0.6
China Qinfa	00866.HK	1.98	0.43	0.61	0.86	4.6	3.2	2.3	2.0	1.0
Winsway Coking Coal	01733.HK	1.65	0.35	0.35	0.48	4.7	4.7	3.4	1.6	1.0
Shougang Resources	00639.HK	2.64	0.34	0.44	0.48	7.9	6.0	5.5	3.8	0.7
Average						**8.2**	**7.1**	**6.0**		**1.2**

Source: KGI Asia Limited

Mining machinery sector

Accidents a near-term headwind; sub-sectors overpriced

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- **Coal fixed-asset investment in China grew 22% in first eight months, despite rapid slowdown in August**
- **Coal mining construction interrupted as Baowan mine accidents lead authorities to either shut down or halt production on 10% of mines in Shanxi**
- **Mine machinery sub-sector valuations high, faced with downside pressure**

Sector rating downgraded from Overweight to Neutral

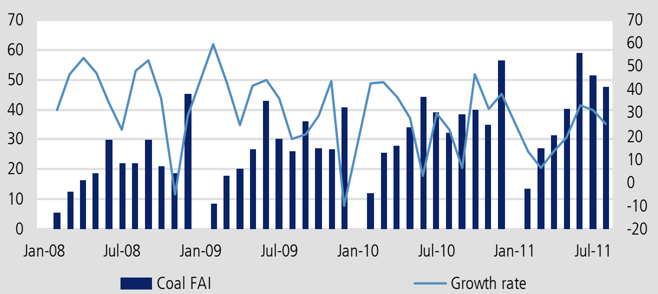
The Shanxi mine accidents have forced officials to strengthen mine site controls. Over 10% of coal pits in Shanxi Province are faced with shutdowns or production halts. Considering the current demanding valuations of mining machinery sub-sectors, we have downgraded our sector rating from Overweight to Neutral.

Growth pullback in coal fixed asset investment in China

Coal mine fixed asset investment (FAI) in China grew 22% YoY to Rmb269.7bn in the first eight months, in which Rmb474mn was achieved in August, down 7.8% MoM, while the 25.5% growth YoY is a 5.6 ppts pullback from July.

Figure 56: **Growth pullback in coal FAI in China**

China coal mining, washing industries FAI, Rmb bn (LHS); growth YoY, percent (RHS)



Source: Wind; KGI Asia Limited

Mine accidents to impact near-term investment

In light of security requirements regarding mining production and advanced mechanization, we think momentum will sustain mid to long term across the mining machinery sector. However, investment is shrinking short term due to strengthened regulation. On September 16, the flood in China Coal Energy's (601898.SS) Baowan coal mine in Shanxi killed at least 10 people. The provincial government immediately shut down all China Coal's mines and production in Shanxi as a reult. All integrated coal mines of China Coal Energy in Shanxi's Shuozhou City have also been shut down for reorganization. Since China Coal represents 10% of coal mines in Shanxi, over 10% of the area's total coal mines have either been shut down or undergone production halts. As such, the coal price has surged, while enterprises have sped up progress rates among coal projects. Subsequently, security concerns have risen, forcing the government to once again intensify regulation of operations. As a result, investment in coal construction projects has slowed for the near term.

Sub-sectors face correction pressure

Valuation of the mining machinery sub-sector is ranging relatively high compared to other machinery manufacturing peers. Nevertheless, it's faced with downside pressure amid conservative stances on the economic outlook. Based on closing prices on September, International Mining Machinery's (01683.HK) stock is 18.2x its 2011 PE forecast, while Sany International (00631.HK) is 18.8x, both far higher than the HK stocks average of 8.6x, and ranging relatively high compared to other machinery manufacturing sub-sectors. The average 2011 P/E forecast of HK's equipment manufacturing industries stands at just 8.0x, with the coal machinery subsector being the only one above 10x.

Figure 57: **Peer comparison of HK equipment manufacturing sub-sectors – Valuation**

Company	Ticker	LCY	Share price (HK$)	EPS		PE (x)		PB (x)
				2011F	2012F	2011F	2012F	2011F
Shandong Molong	00568.HK	Rmb	4.28	0.80	1.70	4.4	2.1	0.86
Weichai Power	02338.HK	Rmb	34.70	4.10	4.90	6.9	5.8	1.88
Ch Rongsheng	01101.HK	Rmb	2.16	0.50	0.60	3.5	3.0	0.68
Guangzhou Shipyard	00317.HK	Rmb	5.42	0.90	1.00	4.9	4.4	0.68
Zoomlion	01157.HK	Rmb	8.71	1.00	1.30	7.1	5.5	1.17
Lonking	03339.HK	Rmb	2.51	0.40	0.50	5.1	4.1	1.65
Sany International	00631.HK	Rmb	6.60	0.28	0.34	19.6	15.8	2.91
International Mining	01683.HK	Rmb	7.84	0.35	0.47	18.4	13.7	2.48
ERA Mining Machinery	08043.HK	HK$	0.43	0.04	0.06	11.4	7.3	1.63
SH Electric	02727.HK	Rmb	2.88	0.30	0.30	7.9	7.9	1.04
Wasion Group	03393.HK	Rmb	2.34	0.30	0.40	6.4	4.8	0.75
Goldwind	02208.HK	Rmb	3.79	0.80	0.70	3.9	4.4	0.55
C Transmission	00658.HK	Rmb	4.02	0.60	0.70	5.5	4.7	0.52
Average						**8.1**	**6.4**	**1.3**

Source: Bloomberg; Wind; KGI Asia Limited Estimates

We are downbeat on Sany & Int'l Mining Machinery

Considering the industry and valuation pressure, we see downside pressure across the mining machinery sub-sector. Accordingly, we have downgraded the ratings and forecasts of Sany International and International Mining Machinery.

(1) International Mining Machinery (IMM; 01683.HK)

In light of increasing industry uncertainties, we have cut our 2011-12 sales forecasts by 7.0% and 8.7% to Rmb2.44bn and Rmb3.0bn; 2011-12 earnings forecasts are lowered by 6.9% and 9.1% to Rmb453mn and Rmb611mn, for EPS of Rmb0.35 and Rmb0.47, respectively. Shares are currently trading at 2011-12 PE of 18.2.x and 13.5x, respectively.

Despite the volatile market, we believe Joy Global (US) will still succeed in its acquisition of IMM. The proposal is currently pending approval from the Ministry of Commerce. We think the acquisition price will buttress the company's share price to a degree. However, due to lowered forecast and continued bearish market news, we have cut our 12-month target price from HK$8.9 to HK$8.5, equivalent to 18.5x 2011 P/E forecast, implying 10.1% upside. In addition, we have downgraded the company's rating from Outperform to Neutral. We will closely monitor the main risk, namely the possible failure of the acquisition by Joy Global.

Figure 58: **IMM – Breakdown of 2011 & 2012 forecast revisions**

Rmb mn	2010	2011F			2012F		
		Previous	Revision	Chg. (%)	Previous	Revision	Chg. (%)
Sales	1,943	2,617	2,435	(7.0)	3,291	3,003	(8.7)
Gross margin (%)	43.4	44.3	44.3	0.0 ppts	44.4	44.3	(0.1) ppts
Gross profits	1,101	1,458	1,356	(7.0)	1,831	1,673	(8.6)
Net income	351	487	453	(6.9)	672	611	(9.1)
EPS (Rmb)	0.30	0.37	0.35	(6.9)	0.52	0.47	(9.1)

Source: Company data; KGI Asia Limited Estimates

(2) Sany International (00631.HK)

In light of increasing industry uncertainties, we have cut our 2011-12 sales forecasts by 3.7% and 14.4% to Rmb3.68bn and Rmb4.66bn; 2011-12 earnings forecasts were lowered by 11.8% and 20.6% to Rmb857mn and Rmb1.07bn, for EPS of Rmb0.28 and Rmb0.34, respectively.

Considering overall valuation pressure, we have lowered our target P/E from 24x to 15x, with 12-month target price at HK$5.13, implying 19.1% downside to the current share price. In addition, we have downgraded the company's rating from Neutral to Underperform.

Figure 59: **Sany – Breakdown of 2011 & 2012 forecast revisions**

Rmb mn	2010	2011F			2012F		
		Previous	Revision	Chg. (%)	Previous	Revision	Chg. (%)
Sales	2,683	3,817	3,676	(3.7)	5,439	4,656	(14.4)
Gross margin (%)	46.2	47.9	46.7	(1.1) ppts	47.6	45.7	(1.9) ppts
Gross profits	1,445	1,989	1,958	(1.6)	2,848	2,528	(11.2)
Net income	671	971	857	(11.8)	1,343	1,066	(20.6)
EPS (Rmb)	0.22	0.31	0.28	(11.8)	0.43	0.34	(20.6)

Source: Company data; KGI Asia Limited Estimates

Conclusion

Though the growth rate of coal fixed-asset investment in China sustained above 20% YoY in August, it still pulled back 5.6-ppts from July. Investment in coal construction projects will slow in the short term due to strengthened official controls since the flood in Baowan coal mine in Shanxi. We have downgraded our sector rating from Overweight to Neutral.

Given the industry and valuation pressure, we have cut the target prices of IMM and Sany to HK$8.5 and HK$5.13, and their ratings to Neutral and Underperform, respectively.

Figure 60: **Peer comparison of mining machinery sub-sectors – Valuation**

Company	Ticker	LCY	EPS			PE (x)			BVPS	PB
			2010	2011F	2012F	2010	2011F	2012F		(x)
Shandong Mining	002526.SZ	Rmb	0.68	0.72	1.23	32.5	30.5	18.0	6.9	3.2
Linzhou Heavy	002535.SZ	Rmb	0.67	0.48	0.82	24.5	34.4	20.1	4.1	4.0
Tian Di	600582.SS	Rmb	0.84	1.01	1.28	22.1	18.3	14.5	3.5	5.2
Zhengzhou	601717.SS	Rmb	1.43	1.72	2.20	18.2	15.1	11.8	7.9	3.3
Sany	00631.HK	Rmb	0.22	0.28	0.34	24.0	18.8	15.1	1.8	2.9
Int'l Mining	01683.HK	Rmb	0.30	0.35	0.47	21.0	18.2	13.5	2.5	2.5
ERA Mining	08043.HK	HK$	0.02	0.04	0.06	16.8	10.7	6.9	0.3	1.6
Bucyrus	BUCY.US	US$	3.96	5.27	6.49	19.8	17.5	14.2	25.1	3.6
Joy Global	JOYG.US	US$	4.47	5.93	7.20	16.1	10.8	8.9	13.1	5.4
Terex	TEX.US	US$		0.47	1.84		22.9	5.8	19.3	1.6
Average						**21.7**	**19.7**	**12.9**		**3.3**

Source: Bloomberg; Wind; KGI Asia Limited Estimates

Pharmaceuticals sector

Policies still restrictive; fundamentals remain weak

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- **Tender prices are worsening for medical insurance medicines & basic medicines; earnings & margin outlook for pharmaceuticals makers not positive**
- **Valuations low, but negatives not yet priced in; we expect further share price correction & looser policy stance**
- **We recommend defensive plays like Kingworld, an OTC drugs distributor, as it is immune to price cuts; we are Neutral on China's pharmaceuticals sector**

No improvement of fundamentals – Neutral rating

We have maintained our Neutral rating on China's pharmaceuticals sector for the six reasons discussed below.

(1) Policies remain restrictive

Negative fallout from the Anhui model of basic medicine tenders has been worse than we expected. To date, around one-third of China's provinces and cities have completed basic medicine tenders, with prices now all heading south. For remaining provinces, we don't expect winning bids to do any better. This leaves large-scale listed enterprises with a critical decision: they must either resort to price wars to shore up market share or maintain profitability at the expense of market share in the provincial markets of basic-level medications. We have observed that basic medicine leaders that are watching from the sidelines such as Shineway (02877.HK) and North China Pharmaceutical (600812.SS) are scrambling to compete with lower bids so as not to lose market share. This means that starting 2H11, listed pharmaceuticals companies will likely suffer severe ASP and gross margin declines. As tenders will continue through year-end, basic drug companies will face headwinds in 2012.

(2) Price downtrend is established

While tenders for medicines in the Medical Insurance catalogue may not see price cuts as severe as those for basic medicine tenders, the price downtrend is now established. In Fujian Province, the winning bid prices have been driven down by the authorities; it remains to be seen if this practice will spread to other provinces. We think it is quite possible.

(3) Unified pricing system

To address the issue of the winning bids for basic medicines being too low, NDRC is considering a unified pricing system. In our opinion, such a system will not come into being until after 2012 as the commercial interests involved are numerous and complex. Issues to be addressed include which medicines should apply, how should prices be decided and should winning bids from earlier tenders be excluded. Different parties (enterprises, governments) have a different take on these issues.

(4) Basic medicine tender reform debate

Debate on the reform of the basic medicine tender system centers around one that favors large players. However, as the current low bids are good for regional governments' finances, we see no reason why these governments would introduce new rules.

(5) Diagnosis-related group insurance reimbursement system

The diagnosis-related group (DRG) insurance reimbursement system, which is on pilot trial in Beijing, has also been introduced to Shanghai where pilot run could begin in the near future. The emergence of the DRG system will prevent physicians from over-prescribing drugs, slowing growth of the overall pharmaceuticals market. Auxiliary medicines in particular will be affected, boding ill for manufacturers of patented Chinese traditional herbal medicines.

(6) Antibiotics set for correction

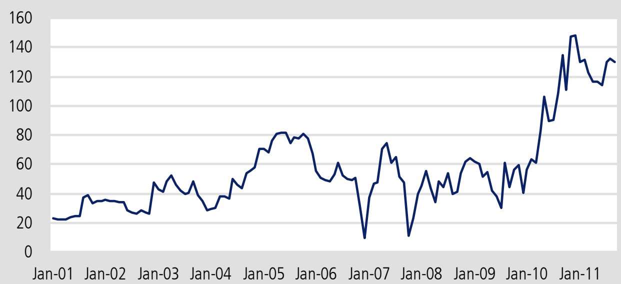
Antibiotics and large-capacity intravenous drips are notoriously overused in China and official efforts to counter the trend have begun, with the media also doing its part to educate people about how these two treatments may be unnecessary. Coupled with drug price controls, we believe shipments and prices of antibiotics are set for a correction.

Pharmaceuticals H-shares not overvalued, but upside limited by weakness in A-share peers

The pharmaceuticals sector is still at a 130% premium to the main index, indicating that these shares are 1.3x more expensive than the A-share market in terms of PE valuation. With fundamental improvement unlikely in 4Q11, we think pharmaceuticals A-shares have corrected to a fair level, though further downside is likely considering the overshooting of expectations of medical reform which fuelled the over-powered rally in 2010. Thus, a big sell-off is in the cards. Moreover, with business conditions generally unfavorable, the idea of pharmaceuticals shares being defensive against market corrections would appear to be overly optimistic. We see a bubble in pharmaceuticals A-shares and we don't expect a rebound until all negatives are fully priced in and good news is heard on the policy front.

Figure 61: **A-share pharmaceuticals valuation above index**

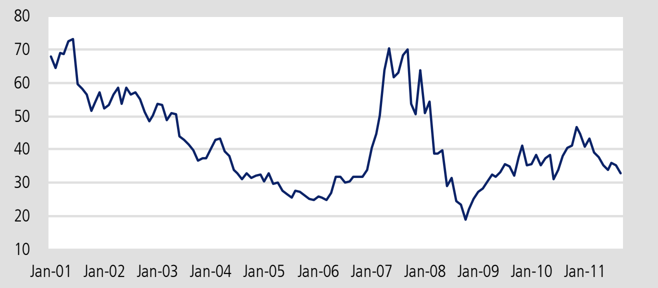
A-share pharmaceuticals valuation premium over main board, percent



Source: SWS Pharmaceutical Index; Wind

Figure 62: **A-share pharmaceuticals absolute valuation falling**

PE ratio, x

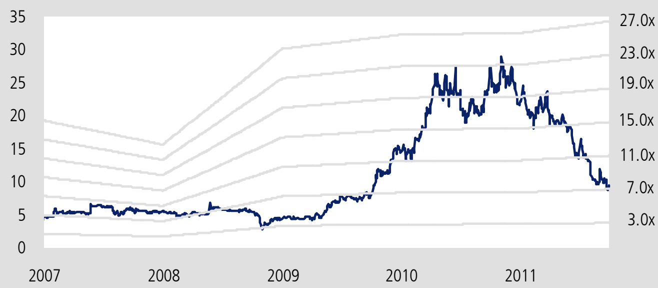


Source: SWS Pharmaceutical Index; Wind

As for pharmaceuticals H-shares, while attractive in terms of valuation, they aren't likely to do much in 4Q11 as they are burdened by the weakness of A-share peers. However, having fallen to an average PE of 11x, the mid- to low-end of the historical band, downside is limited. Thus, we are Neutral on China's overall pharmaceuticals sector.

Figure 63: **Shares of leaders like Shineway at historical lows**

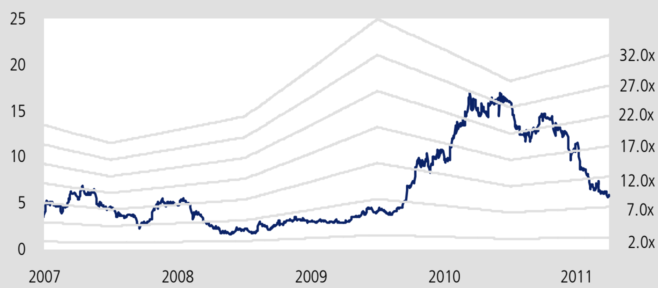
Shineway share price, Rmb (LHS); PE ratio, x (RHS)



Source: Bloomberg

Figure 64: **Shares of leaders like United Lab at historical lows**

United Lab share price, Rmb (LHS); PE ratio, x (RHS)



Source: Bloomberg

For defensive reasons, our top pick is Kingworld Medicines

We have initiated coverage of Kingworld Medicines Group (01110.HK) with an Outperform rating and target price of HK$2.20, which implies upside of 63% (from September 28 share price). Our rationale is explained below.

(1) Limited downside. We think the shares are oversold. The company specializes in the distribution of OTC medicines to pharmacies. Kingworld's products are mainly health supplements for personal use rather than prescription drugs sold in hospitals. Because the current round of price controls is focused on hospital-based prescription drugs, we think Kingworld is immune to any ill effects.

(2) Gross margin keeps rising. Fully 90% of sales are denominated in Hong Kong dollars. For the next 12 months, we expect the renminbi to appreciate against the Hong Kong dollar, boosting Kingworld's gross margin. In the case of flagship product Nin Jiom Pei Pa Koa (herbal cough syrup), which accounted for 75% of 1H11 sales, renminbi appreciation of 5% would lift Pei Pa Koa's gross margin by 3.8 ppts. Moreover, the company's Kingworld's Home pharmacy kiosk project is focused on high-margin products, which will also keep profitability growing.

(3) Acquisition of distributors. This will add to sales from 2012. Kingworld plans to buy regional distributors with gross margins at least as high as its own. Acquisition prices will likely be lower than 13x 2011 EPS estimates, which bodes well for its profitability. We expect acquired companies to be consolidated into financial statements in 2012.

(4) Multi-concept stock. Kingworld is both a medicine-concept and a consumption-concept stock. On target 2012 PE of 15x, the average of pharmaceuticals distributors Sinopharm Holding (01099.HK), Shanghai Pharmaceuticals (02067.HK) and consumer goods retailer Silver Base Group (00866.HK), we have derived for Kingworld a target price of HK$2.20. Outperform.

Conclusion and Recommendation

We rate the H-share pharmaceuticals sector Neutral for 4Q11 as policies are restrictive, prices of medical-insurance and basic medicines are still under downward pressure, and the questions of basic drugs tender reforms and drug price unification remain unresolved. While most companies have seen their shares fall to the low end of their historical PE bands, they aren't likely to rise much in 4Q11 as pharmaceuticals stocks continue to struggle in both Shanghai and Shenzhen. We are monitoring closely how pharmaceuticals companies are lobbying the government on matters of tender reform and in what direction the government will move. These issues will determine whether or not we upgrade our sector rating.

For 4Q11, we recommend Kingworld as it will be little affected by China's restrictive policies. We also see healthcare machinery and instrument makers as a more defensive investment choice. A case in point is MicroPort Scientific (00853.HK), which will penetrate the local orthopedics market in 2012.

Figure 65: **Peer comparison – Valuation**

Company	Code	Share price (HK$)	Market cap (HK$mn)	EPS 2010	EPS 2011F	EPS 2012F	PE (x) 2010	PE (x) 2011F	PE (x) 2012F	PB (x) 2011F
United Laboratories	03933.HK	6.27	8,160	0.78	0.57	0.69	8.0	10.9	9.0	1.5
Dawnrays	02348.HK	2.43	1,940	0.21	0.28	0.34	11.5	8.8	7.2	1.6
Lijun Int'l	02005.HK	0.91	2,225	0.11	0.11	0.14	8.1	8.1	6.6	0.8
Sihuan	00460.HK	3.01	15,577	0.13	0.20	0.26	23.1	14.8	11.7	1.8
Sino Bio	01177.HK	2.25	11,125	0.12	0.12	0.15	19.3	19.6	15.3	2.7
Lee's	00950.HK	2.48	1,164	0.13	0.17	0.23	19.4	14.6	10.8	3.8
Lansen	00503.HK	1.90	789	0.03	0.23	0.26	70.4	8.4	7.4	1.0
China Pharma	01093.HK	2.01	3,075	0.49	0.35	0.38	4.1	5.7	5.3	0.5
Shineway	02877.HK	10.32	8,535	0.99	1.23	1.39	10.4	8.4	7.4	1.9
Tong Ren Tang	01666.HK	7.60	2,817	0.34	0.52	0.65	22.6	14.7	11.7	2.1
Weigao	01066.HK	9.03	40,422	0.19	0.28	0.37	48.8	32.1	24.5	5.9
Golden Meditech	00801.HK	1.10	2,252	0.20	0.10	0.10	5.5	11.6	11.6	0.7
Mingyuan Medicare	00233.HK	0.33	1,339	0.03	0.04	0.04	9.7	9.4	7.9	0.7
Trauson	00325.HK	2.60	2,013	0.16	0.21	0.25	16.3	12.3	10.3	1.5
MicroPort	00853.HK	3.89	5,617	0.20	0.28	0.30	19.5	14.1	12.8	2.0
Sinopharm	01099.HK	20.60	49,494	0.53	0.81	1.04	38.9	25.4	19.8	2.7
SH Pharma	02607.HK	18.46	50,860	0.69	0.92	1.12	26.8	20.0	16.5	1.7
China Medical	00867.HK	5.63	9,063	0.02	0.31	0.42	229.8	18.2	13.5	3.1
China NT	01011.HK	1.29	1,396	N.A.	0.27	0.23	N.A.	4.8	5.7	0.7
Kingworld	01110.HK	1.49	928	0.09	0.12	0.14	16.2	12.8	10.6	1.9
Real Nutriceutical	02010.HK	2.95	3,316	0.35	0.53	0.66	8.5	5.6	4.5	1.0

Source: Bloomberg

Nonferrous metals sector

Out of favour amid weak economy

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- **Sector unlikely to turn around on weak PMI across major economies**
- **Rare metals market to consolidate, poor economy to affect consumption**
- **We are Neutral on the nonferrous metals sector**

We reiterate Neutral rating on the sector

Global base metals market remained loose in 3Q11. Certain rare metals will enter the peak season in 4Q11. However, given weak purchasing managers' index (PMI) and negative economic outlook across major global economies, we remain Neutral on China's nonferrous metals sector.

Weak PMI prevents market from turning around

In August, China's PMI was 50.9 points, up 0.2 points MoM. The rise was mainly boosted by order backlog and higher production index. New order index was flat MoM in August, while new export order index fell 2.1 points MoM. Inventory digestion continued. And the overall PMI indicated flat domestic demand while foreign demand remained weak. The US manufacturing PMI fell 0.3 ppts to 50.6 points in August, slightly better than the market had expected. However, the US economy is still weak. In the eurozone, manufacturing PMI dropped below the 50-point threshold in August for the first time in two years, to 49.0 points. Japan also saw manufacturing PMI decline in August, by 0.3 points to 51.9 points, although the sector was still expanding. As the major world economies all experienced manufacturing PMI declines in August, and such downturn looks set to continue for a period, the nonferrous metals market is unlikely to turn around soon.

Base metal prices hit by slow season, poor economic outlook

According to June data published by the World Bureau of Metal Statistics (WBMS), global copper, aluminum, lead and zinc supplies remained in a glut, while the supplies of tin and nickel were balanced. LME aluminum inventory is now at a near 10-year high, and there is no sign of decline. Affected by power rationing, electrolytic aluminum inventory in China is comparatively good, down 70% from early 2011. Global copper consumption has passed its peak season, with LME copper inventory leveling off, though remaining high. Shanghai Futures copper inventory rose markedly after the peak season, up 40% from mid-June. LME lead inventory now stands at a 10-year high, and will likely trend higher in 4Q11. LME zinc inventory has fallen, while China's zinc inventory has risen 30% since the start of the year. We expect global zinc supply to remain in a glut. The tin market has entered the peak season. However, due to weaker demand across the electronics sector YoY, LME tin inventory has fallen. Given this and the resumption of private tin mining in Indonesia, we think tin prices will be flattish in the upcoming peak season. Global nickel supply became tight in 2010. Although nickel inventory has been in decline since early 2011, the market will be in oversupply as production will remain robust in 2012. The fourth quarter is the slow season for nonferrous metals. Given this and slowing economic growth both in China and overseas, base metal prices will face downward pressure.

Figure 66: **Global base metal supply abundant in 2010**

000 mt	2008	2009	2010	2011				
				Jan-Feb	Jan-Mar	Jan-Apr	Jan-May	Jan-Jun
Copper	443.0	410.0	(14.0)	118.0	118.0	116.9	74.1	107.4
Aluminum	1,251.0	580.0	577.0	302.0	252.0	180.9	396.4	221.3
Lead	(14.0)	42.0	(18.0)	118.0	166.0	284.0	341.0	427.0
Zinc	148.0	254.0	402.0	33.9	24.0	67.6	96.4	14.1
Tin	(5.0)	10.0	(16.0)	(0.5)	(0.2)	7.7	1.1	2.2
Nickel	73.0	22.0	(1.0)	(3.7)	6.3	1.6	(8.2)	4.1

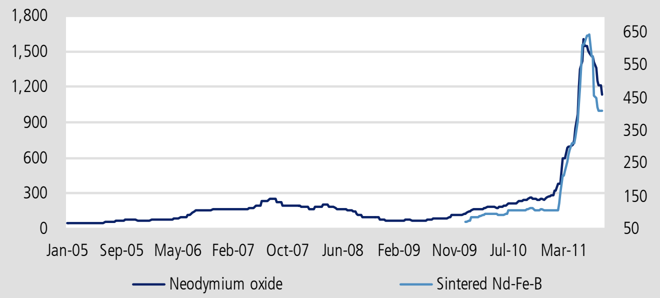
Source: WBMS; KGI Asia Limited

Rare earth prices fall to reasonable levels on lower output

Three major production bases of tungsten and other rare earth metals in Jiangxi Province were ordered by the local government in August to halt production by end-2011. As the output target has now been reached, these three mining regions are effectively not operating. In addition, many rare earth separation and smelting plants in the province have halted production due to an upcoming environmental protection inspection and special examination. Thus, we don't expect the tight supply of rare earth metals prompted by the production standstill in Jiangxi Province to ease until October when the market enters the peak season and mining resumes.

Figure 67: **China's rare earth metal prices plunged in 3Q11**

Neodymium oxide price, Rmb'000/mt (LHS); neodymium magnet price, Rmb/kg (RHS)



Source: Baichuan Info; KGI Asia Limited

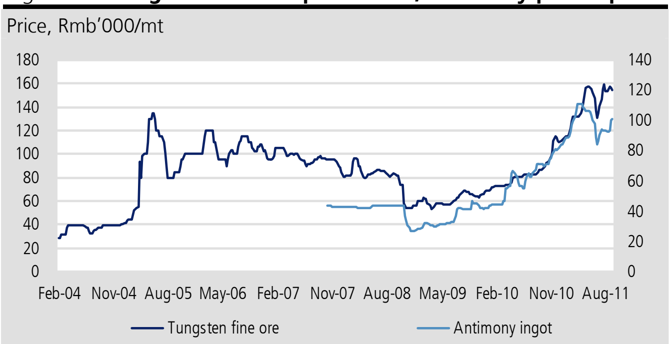
Rare earth prices in China began falling in late June following a spike since early this year. The average price of neodymium oxide fell 27% to Rmb1.07mn/mt in mid-September from Rmb1.48mn/mt. The prices of other rare earths have fallen by around 30%. Given the steep fall in raw material costs, neodymium magnet makers cut their prices from Rmb645/kilogram (kg) in mid-July to the current Rmb410/kg. Baosteel International Trading, an affiliate of Baotou Steel Rare-Earth (600111.SS), will buy praseodymium oxide products at no more than

Rmb900k/mt on September 19 from government-designated manufacturers. This price may be considered as the floor benchmark for the rare earth products after the market surge. We think rare earth metal prices are returning to reasonable levels.

Tungsten price adjustment continues; antimony prices boosted by environment protection policy

China produced 79.9k mt of tungsten fine ore in January-August, up 4.9% YoY. In August, the output was 11k mt, down 3.8% YoY. According to China Nonferrous Metals Information Network, hard alloy output was 15k mt in 1Q-3Q11, up 15% YoY, which was slower than the 20% YoY in 1H11. As high-speed steel prices grew 26% YoY in January-July, we forecast China's tungsten consumption growth to top 10% in 1Q-3Q11. Currently, the domestic spot market is tight. But mining firms are hoarding output as purchases are lukewarm. Prices are stable as a result. The reference prices of black tungsten fine ore, APT and medium-particle tungsten power in Ganzhou, Jiangxi Province were Rmb155k/mt, Rmb240k/mt and Rmb370/kg in September, respectively, flat MoM. As of September 16, Hunan Province 65% black tungsten fine ore was quoted at Rmb154k/mt, up Rmb23k/mt from the low in early June. The tungsten market will enter the peak season in 4Q11. However, given the poor domestic and global economic outlooks, tungsten fine ore prices could fall.

Figure 68: **Tungsten fine ore prices firm, antimony picks up**



Source: Wind; KGI Asia Limited

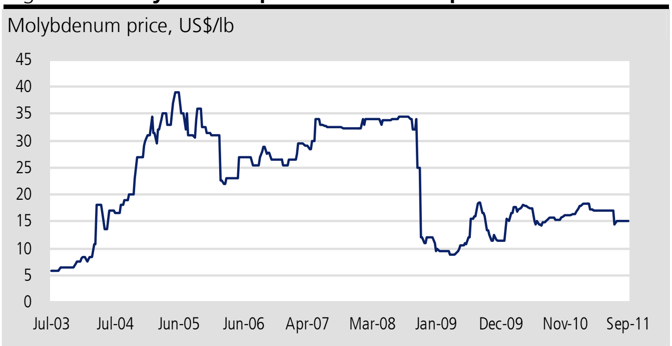
China's antimony output grew 3.9% YoY in January-August to 76.5k mt and fell 9.4% YoY in August to 8,951 mt. According to China Nonferrous Metals Information Network, antimony imports were around 37k mt in January-July, up 51.4% YoY, while antimony exports totaled 28.3k mt, down 15.4% YoY. High antimony prices and an expected slowing economy have affected overseas antimony consumption. Lengshuijiang City, Hunan Province will conduct the second round of environment protection inspections in late September, affecting antimony supply in China. This will underpin the antimony price.

Oversupply of molybdenum continues on spiking output

In January-August, China made 156k mt of molybdenum fine ore, up 16.73% YoY. In August, molybdenum fine ore output was 19.8k mt, up 20.8% YoY. The supply of molybdenum fine ore continues to grow rapidly. By region, Hebei Province grew molybdenum fine ore output by 30.5% YoY in January-August; Inner Mongolia by 27.4% YoY,; Henan Province by 13.6% YoY; but Shaanxi Province saw output fall 2.3% YoY.

In 1H11, China's imports of molybdenum were 4,427 mt, down 58% YoY, and exports of molybdenum were 9,408 mt, down 5.8% YoY. Higher molybdenum exports have eased oversupply in China but intensified oversupply in the global market. In Europe, molybdenum oxide was quoted at US$14.4-14.7/lb on September 14, at the low end of the yearly range. China's molybdenum fine ore quote dropped to Rmb2,040/mt on September 16, also at the low end of the yearly band and close to mining costs. Miners are now more willing to make quotes, but buyers are more prudent, keeping molybdenum prices low.

Figure 69: **Molybdenum prices low in Europe**



Source: Baichuan Info; KGI Asia Limited

Conclusion

Global base metal supply remained loose in 3Q11. Some rare metals will enter the peak season in 4Q11. However, nonferrous metal consumption will be hurt given weak PMI and negative economic outlook across the world's major economies. We therefore remain Neutral the nonferrous metals sector.

Figure 70: **Peer comparison – Valuation**

Company	Ticker	Closing price (9/26) (HK$)	EPS (HK$) 2010	EPS (HK$) 2011F	EPS (HK$) 2012F	P/E (x) 2010	P/E (x) 2011F	P/E (x) 2012F	BVPS (HK$) 2011F	P/B (x) 2011F
Zhaojin Mining	01818.HK	11.52	0.49	0.70	0.76	23.4	16.6	15.2	2.89	4.0
China Molybdenum	03993.HK	3.16	0.24	0.31	0.34	13.2	10.1	9.4	2.96	1.1
Hunan Nonferrous Metals	02626.HK	1.35	0.00	0.14	0.16	340.9	9.4	8.7	1.66	0.8
Citic Dameng	01091.HK	0.88	0.13	0.25	0.26	6.8	3.5	3.4	1.45	0.6
Jiangxi Copper	00358.HK	12.52	1.91	2.94	3.05	6.6	4.3	4.1	14.16	0.9
Min Resources	01208.HK	2.66	1.08	1.17	1.20	2.5	2.3	2.2	2.73	1.0
China Aluminum	02600.HK	3.58	0.07	0.07	0.09	49.7	49.7	39.8	4.62	0.8
China VTM Mining	00893.HK	1.18	0.31	0.32	0.39	3.8	3.6	3.0	1.72	0.7
Average						**125.8**	**12.0**	**11.1**		**2.0**

Source: Bloomberg; KGI Asia Limited

Real estate sector

Industry consolidation lasts longer than expected

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- **On weak economy, credit crunch and policy uncertainty, property sector lacks catalysts**
- **Market concentrated; leaders enjoy record-high gross margin and have enough cash to ride out the bad times, making them safer bets**
- **Compared with historical trough, sector valuation could see downside; sector downgraded to Neutral**

On weak economy & continued credit tightening, sector downgraded to Neutral

With the global economy weak, Chinese property developers are dealing with weakened real reinvestment, more constrictive policy control, and fewer transactions. The China Banking Regulatory Commission has pledged to step up credit control, which will further test developers' capital sufficiency. The current sector valuation has further downside risk to the levels seen in the 2008 financial crisis. We thus downgrade China's property sector to Neutral.

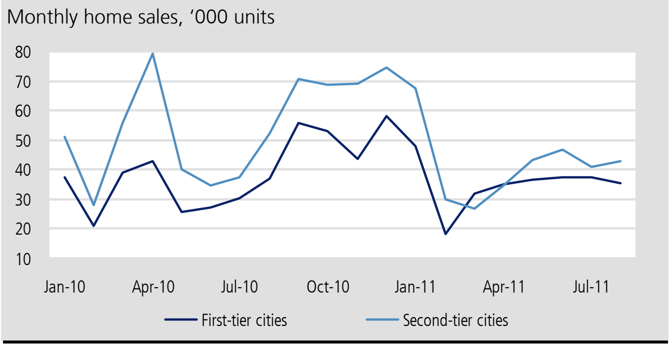
Real estate investment growth slows; construction slackens

In the first eight months of 2011, China real estate investment grew 33.2% YoY, down 0.4 ppt from the first seven months, to Rmb3.78tn. We expect growth to keep decelerating in the next few months. On one hand, year-on-year growth of floor area of projects under construction has fallen for six straight months since March. On the other hand, construction should slow due to weather constraints in northern China in 4Q11, thereby stalling overall real estate investment growth. In the first eight months of 2011, new started floor area rose 25.8% YoY. The ratio of new started floor area to that of properties sold rose to 1.91x, higher than the historical average of 1.1x and close to the level seen in 2Q08. Though new started floor area is showing faster growth, growth of property completion area remains low, indicating that developers have slowed construction to cope with stagnant market demand.

Property sales low in August, home price growth eases

In August, property sales were up 5.5% and down 4.5% MoM, respectively, in the four first-tier and six second-tier cities we track. As developers have not significantly increased project launches or essentially lowered housing prices, buyers remain on the sidelines, souring overall market sentiment. For the first eight months of 2011, the top 10 cities saw monthly property sales fall 16.8%， compared with the average level seen in 2010. Going forward, with new supply increasing and discounts becoming more prevalent, property transaction is likely to bounce back.

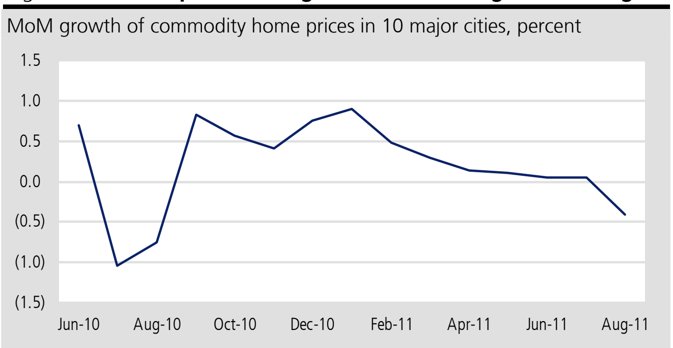
Figure 71: **Property sales remained low in first eight months**



Source: National Bureau of Statistics

Most cities have seen housing price growth slow. In August, the ten cities we track saw the average housing price fall MoM by 0.41% to Rmb15,773, marking the first decline since September 2010. In cities where inventory is high and housing price growth is over fast, such as Hangzhou, and where restrictions on housing purchase are strict, such as Beijing, housing prices are set to fall back.

Figure 72: **Home price MoM growth turned negative in August**



Source: National Bureau of Statistics

New restrictions impact limited, policy concerns remain

It's been two months since the central government expanded the areas facing home purchase restrictions in mid-July, but only Taizhou and Quzhou cities in Zhejiang Province have followed the instructions. In September, Shaoguan of Guangdong and Dandong of Liaoning placed caps on home price increases. We think price restrictions are more acceptable to market participants than restrictions on purchases. For one, upgraded demand will not be hurt as seriously by price limits as by restrictions on purchases. Also, price limits will have less impact on overall home market transactions to dint local governments' tax revenues less seriously while keeping home price surges in check. As the new round of home purchase restrictions has not been fully implemented and home prices have yet to correct significantly, we think the policy grips will not loosen up while the market at large will watch on the sidelines. Overall, we think it will take longer than previously expected for the property market consolidation.

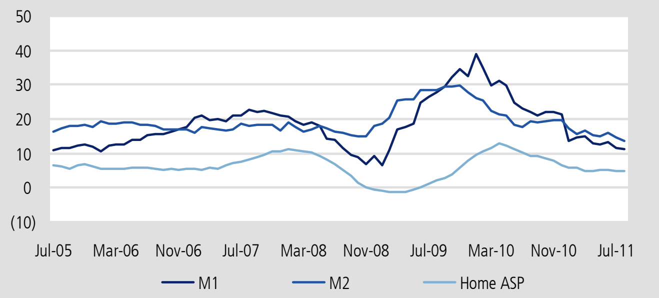
Little sign of loosening monetary supply

The real estate sector is tied closely with the financing environment. Since the financial crisis in 2008, the central government has dished out economic stimuli, causing M2 to grow by over 20% YoY from February 2009 to May 2010. In 2009, property transactions grew 43.6% YoY while housing prices in first-tier cities grew over 45%.

Meanwhile, CPI YoY growth is also on the way up, and China's central bank has been tightening credit since 2Q10, kicking off a new round of interest rate hikes in October 2010. As a result, loans to developers and homebuyers have fallen significantly since 2Q10; correspondingly, property sales have been weak for months.

Figure 73: **M1 and M2 YoY trending down since 2Q11**

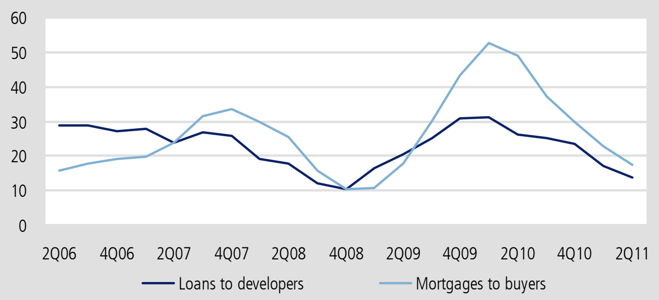
Change YoY in M1, M2 and home ASP, percent



Source: National Bureau of Statistics; KGI Asia Limited

Figure 74: **Credit crunch worsens for real estate sector**

Change YoY in mortgage issuance, percent



Source: National Bureau of Statistics

In August 2011, China M2 growth fell to a recent low of 13.5% YoY. CPI YoY peaked at 6.5% in July and then decelerated to 6.2%, which is far higher than the People's Bank of China's benchmark interest rate of 3.5%. Thus, real-term interest rates remain negative. Looking forward, China's central government is unlikely to loosen its grip on credit lines in the next two to three months, reasons being the following. First, the central government remains under grave inflation pressure. Second, compared to the last credit crunch in 2007, when the reserve requirement ratio was raised 10 times and benchmark interest rates were raised six times to inhibit liquidity and inflation, this round of credit tightening has not been especially constricting, leaving room for further rate hikes.

Leading developers with strong presale ability and sound financial position are safer bets

At present, top 10 developers' average PE is 5.1x, which is lower than the sector PE of 7.4x and the previous low of 5.7x in October 2008. With commodity home inventory being digested at a slower pace and the financing environment still tight, we think leading developers will outperform the industry.

Figure 75: **Leading developers' valuations near 2008 trough**

Company	Code	PE (x)			P/B (x)		
		Current	2008 trough	2009 median	Current	2008 trough	2009 median
Agile Property	03383.HK	3.9	1.1	15.8	0.8	0.5	2.2
Shimao Property	00813.HK	3.9	3.2	33.9	0.6	0.5	1.8
China Res Land	01109.Hk	8.5	14.0	31.3	0.9	1.0	2.3
China Overseas	00688.HK	7.5	10.0	22.2	1.5	1.7	3.4
Longfor Properties	00960.HK	7.5	N.A.	18.3	1.6	N.A.	3.2
Sino Ocean Land	03377.HK	4.7	9.3	18.3	0.4	0.4	1.6
Guangzhou R&F	02777.HK	3.2	1.3	19.0	0.7	0.6	2.5
Greentown China	03900.HK	2.4	2.2	24.5	0.4	0.3	1.6
Evergrande Real Estate	03333.HK	4.0	N.A.	36.9	1.2	N.A.	4.3
Country Garden	02007.HK	5.6	4.2	19.5	1.0	0.8	2.0
Average		**5.1**	**5.7**	**24.0**	**0.9**	**0.7**	**2.5**
Sector average		**7.4**	**3.6**	**17.9**	**0.6**	**0.3**	**1.0**

Source: Bloomberg; KGI Asia Limited

Leading developers' sales decent; market concentrated

Although commodity home sales in first- and second-tier cities are down, higher transactions in lower-tier cities lifted January-August national home sales by 13.1% YoY to 540mn sqm. Leading developers have resorted to a balanced project mix, a flexible product strategy (more units with small floor area), and a high-turnover business model to achieve decent sales. In the first eight months of 2011, the top 10 home developers saw average contracted sales rise 50.8% YoY and combined market share rise from 10.8% in 2010 to 14%. Also, the top 10 developers average gross margin rise to a record high 41.3% in mid-2011 results.

Figure 76: **Market further concentrated amid downturn**

Company	Code	Jan-Aug 2011 contracted sales (Rmb bn)	YoY (%)	Annual target (Rmb bn)	Achievement ratio (%)	Market share (%)	2010 market share (%)
China Overseas Land	00688.HK	64.74	70.1	80	80.9	2.3	1.5
Evergrande Real Estate	03333.HK	60.1	97.1	70	85.9	2.2	1.1
Poly Real Estate Group	600048.SS	50.54	56.6	80	63.2	1.8	1.5
China Vanke	000002.SZ	84.57	50.4	140	60.4	3.0	2.5
Longfor Properties	00960.HK	24.02	59.8	40	60.1	0.9	0.8
Shimao Property Holdings	00813.HK	20.9	30.0	36	58.1	0.8	0.7
Agile Property Holdings	03383.HK	20.1	43.0	37	54.3	0.7	0.7
Sino-Ocean Land Holdings	03377.HK	15.5	38.0	30	51.7	0.6	0.5
Country Garden Holdings	02007.HK	29.8	62.0	43	69.3	1.1	0.7
Guangzhou R&F Properties	02777.HK	18.45	1.0	40	46.1	0.7	0.7
Average/Total					**63.0**	**14.0**	**10.8**

Source: KGI Asia Limited

Figure 77: **Leading developers enjoy record-high gross margins**

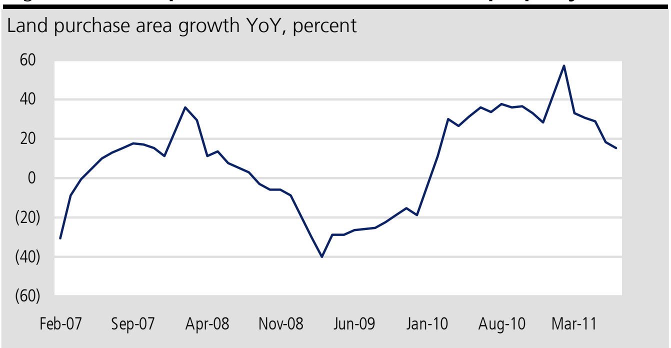
Gross margin, percent	Code	2007	2008	2009	2010	1H11
Agile Property Holdings	03383.HK	50.5	36.8	37.2	45.8	52.4
Shimao Property Holdings	00813.HK	42.7	44.9	34.5	36.6	42.1
China Vanke	000002.SZ	34.4	28.0	25.0	34.7	37.1
Longfor Properties	00960.HK	34.0	25.8	29.3	33.8	54.7
Sino-Ocean Land Holdings	03377.HK	33.2	43.5	30.1	30.1	30.0
Guangzhou R&F Properties	02777.HK	37.5	33.6	31.6	37.7	49.1
Poly Real Estate Group	600048.SS	31.4	32.1	30.4	26.8	34.9
Evergrande Real Estate Group	03333.HK	38.6	41.1	34.0	29.2	35.1
Country Garden Holdings	02007.HK	46.1	44.7	26.3	32.4	32.5
China Overseas Land	00688.HK	50.5	46.2	33.1	42.0	45.0
Average		**39.9**	**37.7**	**31.1**	**34.9**	**41.3**

Source: Bloomberg; KGI Asia Limited

Despite headwinds, leading developers expanding

After a brief boom in June, land market transactions have cooled off in the past two months. For the first eight months of 2011, 133 cities in China saw urban residential land supply and transaction fall 12.1% and 6% YoY, respectively. On one hand, the Chinese government has released land at a slower pace due to less market interest. On the other hand, developers have grown more cautious with land purchases.

Figure 78: **Land purchases cautious on slower property sales**



Source: National Bureau of Statistics

As buyers are experiencing more difficulties getting mortgages, developers are also finding financing harder to come by with presale revenues taking longer to be booked. While most developers have cut land purchase budgets this year, some rich leading developers are still looking for land fit for development, in the hope of acquiring land at a bargain. Vanke (000002.SZ) and China Overseas Land & Investment (00688.HK) both spent over Rmb2.0bn on land purchases in August. That's over 20% of their contracted sales on the month.

Valuation & Recommendations

The economy is showing signs of weakness in and out of China. The credit crunch continues while the debt crisis in Europe threatens to spread. Real estate investment and construction are both slowing while commodity transactions remain low. Sector valuation has further downside risk before reaching the levels last seen in the 2008 financial crisis. We downgrade the property sector to Neutral and we recommend leading developers with strong presale ability and sound financial status.

Figure 79: **Real estate developer peer comparison – Earnings & valuation**

Company	Code	Share price	Market cap	EPS (HK$)				PE (x)				P/B (x)	Dvd Yld
		(HK$)	(HK$mn)	2010	2011F	2012F	2013F	2010	2011F	2012F	2013F		(%)
Developers													
Agile Property Holdings	03383.HK	5.95	21,323	1.96	1.53	1.87	2.15	5.7	3.9	3.2	2.8	0.78	5.6
Shimao Property Holdings	00813.HK	5.99	21,583	1.51	1.52	1.71	2.06	7.6	3.9	3.5	2.9	0.60	7.7
China Resources Land	01109.HK	8.9	48,707	1.20	1.05	1.27	1.59	11.9	8.5	7.0	5.6	0.94	3.4
Longfor Properties	00960.HK	7.8	41,240	0.92	1.05	1.38	1.80	11.4	7.5	5.6	4.3	1.65	1.5
Sino-Ocean Land Holdings	03377.HK	2.57	14,894	0.50	0.55	0.67	0.79	10.0	4.7	3.9	3.3	0.35	5.0
Guangzhou R&F Properties	02777.HK	5.57	18,915	1.55	1.72	1.95	2.26	7.0	3.2	2.9	2.5	0.69	12.5
Greentown China Holdings	03900.HK	3.96	6,576	1.07	1.68	2.50	3.10	7.8	2.4	1.6	1.3	0.45	10.5
Evergrande Real Estate Group	03333.HK	3.01	45,276	0.58	0.75	0.96	1.18	6.3	4.0	3.1	2.6	1.22	5.1
Country Garden Holdings	02007.HK	2.09	36,404	0.30	0.37	0.48	0.59	9.8	5.6	4.4	3.5	1.05	5.4
China Overseas Land & Investment	00688.HK	11.42	94,147	1.51	1.53	1.78	2.13	9.5	7.5	6.4	5.4	1.46	2.6
Shui On Land	00272.HK	1.88	10,319	0.63	0.30	0.37	0.51	5.8	6.2	5.0	3.7	0.32	3.8
KWG Property Holding	01813.HK	2.6	7,754	0.51	0.77	0.99	1.27	11.4	3.4	2.6	2.1	0.48	5.0
Residential property developer average								8.7	5.1	4.1	3.3	0.8	5.7
Commercial property developer													
SOHO China	00410.HK	5.02	26,618	0.80	0.42	1.04	1.23	7.0	12.0	4.8	4.1	1.09	6.7
Powerlong Real Estate Holdings	01238.HK	1.4	5,737	0.83	0.40	0.55	0.83	3.0	3.5	2.5	1.7	0.34	5.2
Renhe Commercial Holdings	01387.HK	0.79	17,553	0.20	0.26	0.30	0.42	6.6	3.1	2.6	1.9	0.88	10.6
Commercial property developer average								**5.5**	**6.2**	**3.3**	**2.5**	**0.8**	**7.5**

Source: Bloomberg; KGI Asia Limited

Power sector

Eyes on on-grid power price hike in 4Q11

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- **For the coal-fired power sector, we foresee trading opportunities in 4Q11 on potential electricity price hikes; we like beneficiary Huadian Power**
- **Overall, we are Neutral the coal-fired power sector in 4Q11 given a mixed news flow**
- **Wind power output to grow 46% YoY in 4Q11; turbine prices rebounding from trough, pushing up wind farm costs by 2%; shares at fair valuations; we are Neutral on the wind power sector**

Coal-fired power sector – Neutral rating

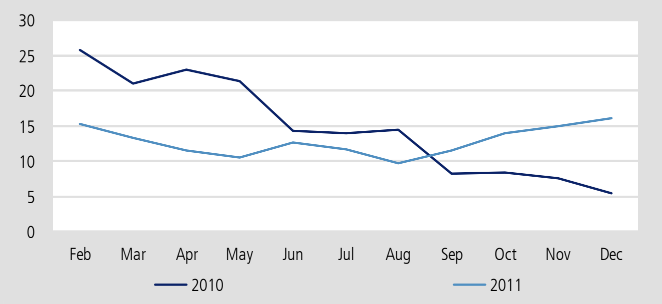
We anticipate mixed news flow in 4Q11 for the coal-fired sector with potential electricity price hikes and bottom-line erosion from coal price increases. We are therefore Neutral on the coal-fired sector for 4Q11 and foresee trading opportunities on rising expectation of electricity price hikes. We have identified four key themes for the coal-fired power sector in 4Q11.

(1) Power output to grow markedly

Due to the impact from high temperatures and power rationing, national power consumption grew 9.7% YoY in August, 2.0 ppts slower than 11.7% in July. However, we forecast 4Q11 power consumption to grow a brisk 15% YoY given a low comparison base associated with energy-conservation and emission-reduction measures implemented in late 2010, versus 10.9% in 3Q11 and 7.1% in 4Q10.

Figure 80: **Power consumption to accelerate in 4Q11**

Growth of national power consumption YoY, percent



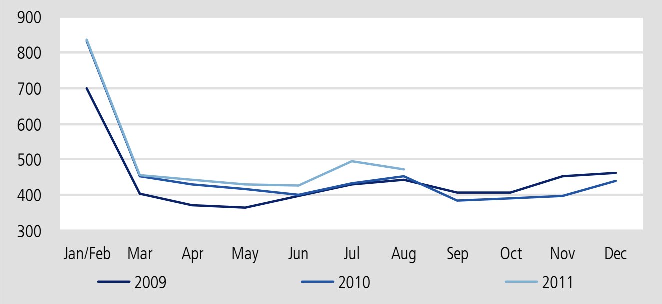
Source: China Electricity Council

(2) Low water at hydropower stations favors coal-fired power plants

On the impact of drought and rapid power consumption growth, utilization hours at coal-fired generation units have risen YoY since May. In January-August, utilization hours of coal-fired generation units were up 4% YoY, or 138 hours. With power consumption expected to grow by a faster pace in 4Q11, coupled with slower hydropower output due to inadequate water storage during the traditional high flow period in 3Q11, utilization hours of coal-fired generation units should grow more rapidly in 4Q11. For full-year 2011, growth of utilization hours will likely top 5%.

Figure 81: **Coal-fired unit utilization hours set to rise in 4Q11**

Utilization hours at coal-fired units



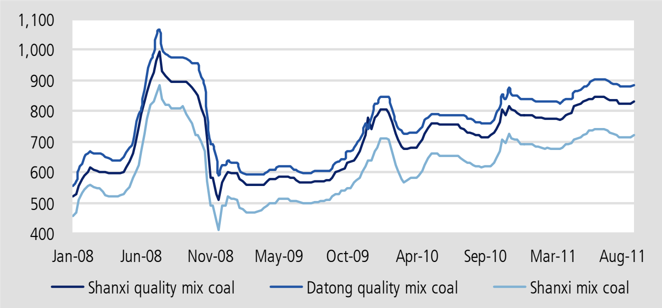
Source: China Electricity Council

(3) Coal prices to gain 6%

Following a two-month consolidation, coal prices rebounded in the week starting September 19. Shanxi quality mix coal at Qinhuangdao closed at Rmb830/metric ton (mt) on September 19, up 16% YoY. We expect coal prices to strengthen further in 4Q11 on seasonality. Shanxi quality mix coal should gain some 6% YoY to Rmb860/mt.

Figure 82: **Coal prices to continue trending up in 4Q11**

Coal exit price, Rmb/mt



Source: Wind

(4) Further electricity price hikes likely

The effect of electricity price hikes in 1H11 was offset by higher coal prices in 2Q11 on seasonality. Coal-fired power plants in over 10 provinces remained loss-making in July. Losses from the thermal generation business should widen in 4Q11 in the event of further coal price increases. Owing to inadequate water inflow this year, coupled with coal-fired power operators' low generation sentiment amid lofty coal prices, severe power shortages occurred across southern and central China in the summer. In the peak power consumption season, hydropower output could fall YoY due to insufficient reservoir space during the high flow period. As a result, China's power demand will be primarily met by coal-fired power. To boost thermal power operators' sentiment, further hikes in coal-fired power tariffs look likely in 4Q11 before winter arrives.

We recommend Huadian for its high sensitivity to price hikes

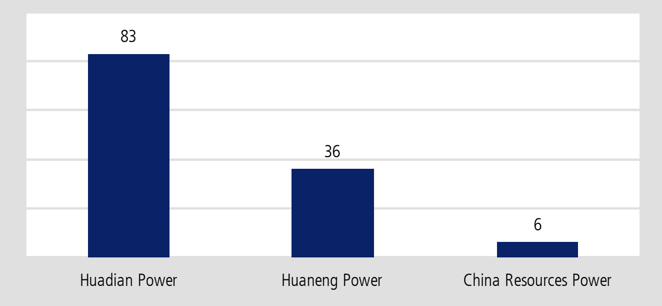
Given the high likelihood of electricity price hikes in 4Q11, we foresee a trading opportunity in coal-fired power operators. We favor Huadian Power (01071.HK) for three reasons.

(1) Higher sensitivity to electricity price rises than peers

Huadian's bottom line tends to vary with electricity pricing. We estimate an increase of Rmb340mn, or 83%, in its 2012 net income for every 1% electricity price rise. Over the longer term, thermal power operators are less likely to see a substantial earnings decline in the future with rising expectations for power industry reform.

Figure 83: **Electricity pricing leads Huadian's earnings**

Estimated earnings growth for every 1% increase in power price, percent



Source: KGI Asia Limited estimates

(2) Better operations on improving business structure

Huadian's increasing coal production should boost its bottom line. We forecast the coal business to contribute pretax profit of Rmb480mn in 2011 and Rmb810mn in 2012, up a respective 105% and 68%. The company will escalate investment in coal operations, for planned coal output of 20mn mt in 2015 (on an equity basis), which translates into profit of Rmb2.0bn (versus pretax profit of Rmb0.2bn in 2010) based on profit of Rmb100/mt.

Figure 84: **Earnings from coal operations to increase further**

Rmb mn	2010	2011F	2012F	2013F
Investment income from equity disposal or dilution	457	668	200	200
Earnings from coal operations	236	485	815	1,073
Earnings from power and other operations	(491)	(852)	(464)	189
Pretax profit	202	300	550	1,462

Source: KGI Asia Limited estimates

(3) Valuation near historical low

Huadian's shares are now trading at 0.4x our 2011 BVPS estimate of Rmb2.4, which is the lowest valuation among thermal power operators and near the low end of the stock's historical P/B band.

Considering higher sensitivity to electricity price changes and increasing coal self-sufficiency, which should buttress a long-term operating uptrend, we have set our 12-month target price at HK$1.76 based on a forward P/B of 0.6x, compared to China Resources Power's (00836.HK) with 30% coal self-sufficiency and a P/B of 1.3x and Datang International Power Generation's (00991.HK) with 20% coal self-sufficiency and a P/B of 0.6x.

Figure 85: **Huadian trading at a historically low valuation**

Huadian Power P/B ratio, x

Source: KGI Asia Limited estimates

Figure 86: **Coal-fired power peer comparison – Valuation**

Company	Ticker	Rating	Share price (HK$)	EPS (Rmb) 2011F	EPS (Rmb) 2012F	PE (x) 2011	PE (x) 2012F	2011F BVPS (HK$)	P/B (x)
Huaneng Power	00902.HK	N	3.12	0.17	0.19	15.0	13.5	3.76	0.7
Huadian Power	01071.HK	OP	1.12	0.03	0.05	29.61	18.36	2.4	0.4
China Resources	00836.HK	N	11.48	1.09	1.24	10.5	9.3	9.6	1.3
China Power	02380.HK	N	1.25	0.12	0.17	8.5	6.0	2.52	0.4
Datang Power	00991.HK	NR	1.97	0.23	0.29	7.0	5.6	2.91	0.6
Average			3.79	0.33	0.39	14.15	10.53	4.2	0.7

Source: KGI Asia Limited estimates

Wind power sector – Neutral rating

The wind power industry usually heats up in the fourth quarter. We forecast wind power output to grow an impressive 46%, though this still slower than the historical pattern. Wind turbine prices troughed in September. We believe higher wind turbine prices will lead investment in wind farms to increase 2%. We are Neutral on the wind power sector for two reasons.

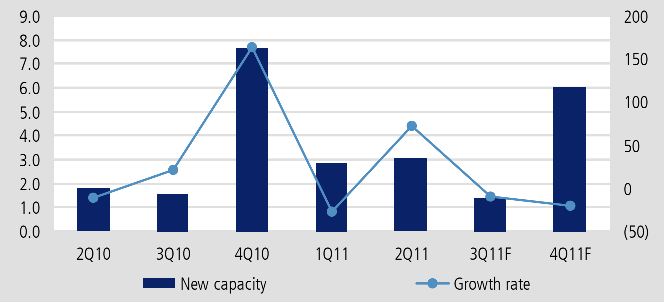
(1) New installed capacity to drop 20% in 4Q11

China Electricity Council announced new installed wind power capacity of only 0.38GW in August, down 24% YoY. For the first eight months of 2011, new installed wind power capacity totaled 6.9GW, up 1.8% YoY. As of end-August, cumulative installed wind power capacity jumped 65.7% YoY to 38GW across China, versus 67.7% in January-July. Slower capacity installation is attributable to: (1) earlier suspension of project review and approval; and (2) lower wind speed in August and possible loss-making scenario after project completion. Therefore, wind power capacity installation usually slows in the third quarter.

In early August, the National Energy Administration announced the first batch of wind power projects approved under the 12th Five-Year Plan, for a total of 26.8GW. Wind power projects will need to be ratified by local governments going forward. We anticipate intensive capacity installation in 4Q11. Moreover, the administration will likely announce the second batch of wind power project approvals totaling 10GW at end-2011, indicating government support for the wind power sector. We expect additional capacity coming on line to peak at 6GW in 4Q11, up 330% QoQ but down 20% YoY. We maintain our forecast of 44.4GW for nationwide grid-connected wind power installation, up 43.1% YoY.

Figure 87: **New capacity to amount to 6GW in 4Q11**

New capacity, GW (LHS); growth YoY, percent (RHS)



Source: Wind

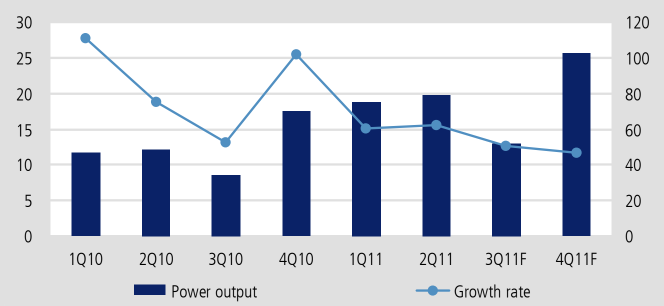
(2) Utilization & output growth to decline in 4Q11 despite peak wind season

China's wind power output reached 3.87bn kWh in August, down 3.4% MoM but up 41.3% YoY, versus 50.3% YoY in July. We attribute slower sequential growth of power output to poorer wind conditions. For instance, wind power output in Liaoning, Jilin and Heilongjiang in Northeastern China fell 13%, 19% and 11%, respectively, on lower wind velocity. Falling utilization hours can also be explained by an increased weighting of projects in areas not rich in wind resources.

Wind power utilization hours should rebound on improving wind conditions in September with wind power output expected to peak in 4Q11. Given an increased weighting of installation in provinces not rich in wind resources, coupled with laggard power grid construction and thus idle wind power capacity, we expect annual growth of utilization hours to decline further in 4Q11. For full-year 2011, we now forecast utilization hours to decline 6.4%, versus our earlier forecast of 4%. Overall, wind power output should grow 46.7% YoY in 4Q11, down 3.8 ppts from 3Q11.

Figure 88: **Wind power output to spike 46.7% YoY in 4Q11**

Power output, bn kWh (LHS); growth YoY, percent (RHS)



Source: Wind

Shares of the three wind power operators on average have rebounded 20% from the trough in 3Q11 on positive news flow. They are trading at average 2011 and 2012 PE ratios of 9.2x and 7.4x, respectively, implying fair valuations. We remain Neutral on the wind power sector and do not recommend any individual stocks for now.

Figure 89: **Wind power peer comparison – Valuation**

Company	Ticker	Market cap (HK$bn)	Share price (HK$)	EPS (Rmb) 2011F	EPS (Rmb) 2012F	PE (x) 2011	PE (x) 2012F	2011F BVPS (Rmb)	P/B (x)
Longyuan	00916.HK	47.5	5.8	0.39	0.5	12.2	9.5	3.5	1.4
Datang	01798.HK	10.3	1.15	0.13	0.17	7.3	5.5	1.4	0.7
Huaneng	00958.HK	17.4	1.71	0.17	0.2	8.2	7.0	1.4	1.0
Average		25.1	2.89	0.23	0.29	9.2	7.4	2.1	1.0

Source: KGI Asia Limited estimates

Wind power equipment sector

Visibility clear, pending turnaround

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- **We estimate 20% YoY decline of equipment installation in China in 4Q11 despite peak season**
- **Uptick in wind turbine prices in August not much help in 3Q11; weak wind turbine margin extends into 4Q11**
- **We have maintained our Underweight rating on China's wind power equipment sector**

Wind power equipment sector – Maintain Underweight

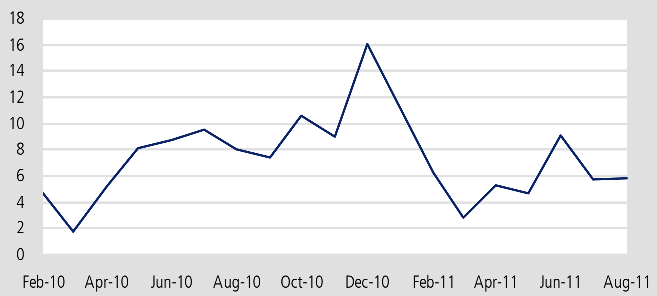
As of September, the influence of policy factors have abated for wind power equipment makers. No severe restraint measures are foreseen near term. However, in coming months the high installation comparison base in 4Q10 and the sharp price plunge since 4Q10 will factor in financial statements. We therefore don't expect wind power equipment shares to rebound in 4Q11 and have maintained our Underweight rating. We have identified two key themes for the sector in 4Q11.

(1) Installation to fall 20% YoY in 4Q11 despite peak season

China Electricity Council announced new installed wind power capacity in January-August rose 1.6% YoY, despite project suspension in July and August (we discuss this topic in depth in our wind power operator report). We estimate new capacity installation in China to reach around 15GW in 2011, of which the 7GW to be added in 4Q11 is down 20% YoY from 9.6GW in 4Q10 and flat with 3Q10. The YoY decline comes despite the 300% growth QoQ. Thus, we expect negative revenue growth YoY to continue in 4Q11 for equipment makers. As such, there is still no turnaround in sight for the sector.

Figure 90: **Wind power investment in January-August fell 13%**

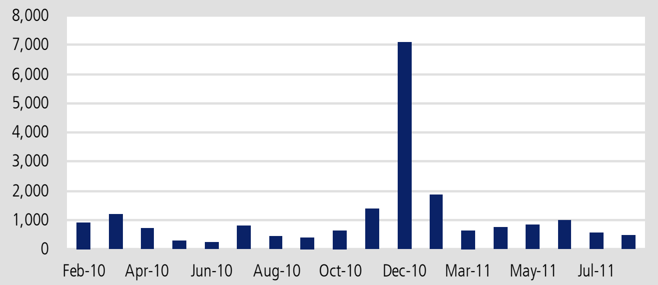
China wind power investment, Rmb bn



Source: China Electricity Council

Figure 91: **Pace of wind power installation unaffected by project suspension in July-August**

China wind power capacity installation, MWH



Source: China Electricity Council

(2) Uptick in wind turbine prices in August not much help in 3Q11; weak wind turbine margin extends into 4Q11

Due to the overly rapid hike of rare earth permanent magnet prices and increased costs on additional low voltage ride through (LVRT) construction, wind turbine prices rebounded in August by Rmb150-200/KW. Wind turbine makers are likely to continue to raise prices as they anticipate gross margins to retreat to single digits in 4Q11. We expect ASP to recover to Rmb3,900-4,200/KW.

However, meaningful gains from price hikes in coming months are unlikely. This is due to the strong trend for price cutting since 2H11, especially the low price offers following the offshore wind power project approval bids, which will begin to price in during 4Q11. Price cutting was only moderately influential in shipments prices in 1H11, when companies like Goldwind (02208.HK) could maintain wind turbine shipments price at around Rmb4,200/KW. In 2H11, however, ASP is expected to fall to Rmb3,800-4,000/KW. Consequently, wind power equipment makers are facing gross margin contraction risk in 4Q11.

Figure 92: **Peer comparison – Weak margins extend into 2H11**

		1H11 sales (Rmb mn)	YoY (%)	Gross margin (%) 1H11	1H10	YoY (ppts)
Xiangtan Electric-A	600416.SS	2,089	0.9	8.0	14.1	(6.1)
Huayi Electric-A	600290.SS	277	(30.3)	17.8	14.3	3.5
Shanghai Electric-A	601727.SS	1,340	33.5	9.7	12.6	(2.9)
Dongfang Electric-A	600875.SS	3,480	1.5	16.5	18.0	(1.5)
Sinoma Science-A	002080.SZ	1,111	6.7	22.2	32.9	(10.7)
Titan Wind-A	002531.SZ	390	69.0	20.1	29.3	(9.2)
Shanghai Taisheng-A	300129.SZ	284	18.5	13.1	36.1	(23.0)
Goldwind-H	02208.HK	5,194	(17.6)	21.2	24.6	(3.4)
Sinovel Wind-A	601558.SS	5,325	(29.4)	19.7	22.5	(2.9)
China High Speed Tran	00658.HK	3,183	2.8	27.0	30.4	(3.4)

Source: China Electricity Council

Conclusion

Low wind turbine prices and ineffective cost shifting will continue to weigh on already-low gross margins for wind power equipment makers. Shanghai Electric (02727.HK) and XEMC Windpower (600416.SS) both saw gross margins decline to 8-9% in their wind turbine operations in 1H11. We expect to see the same for peers in 4Q11. Despite China's now-definite sector policy, sector profitability has far from bottomed out. We therefore do not recommend individual stocks and remain Underweight the wind power equipment sector.

Figure 93: **Peer comparison – Valuation**

Company	Ticker	Solar product	Rating	LCY	Sep. 28 share price	12M Target price	Up/Down (%)	Sep. 28 market cap (US$mn)	EPS (LCY)		BVPS (LCY)		P/E (x)		P/B (x)		ROE (%)	
									2011F	2012F	2011F	2012F	2011F	2012F	2011F	2012F	2011F	2012F
Sinoma Scinece & technology	002080 CH	Leaf	NR	Rmb	15.02	N.A.	N.A.	940	0.51	0.72	11.7	12.6	29.7	20.9	1.3	1.2	7.1	8.8
Hyde	002184 CH	Converter	NR	Rmb	9.50	N.A.	N.A.	327	0.42	0.69	N.A.	N.A.	22.6	13.8	N.A.	N.A.	N.A.	N.A.
Jiuzhou Electric	300040 CH	Converter	NR	Rmb	12.25	N.A.	N.A.	266	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Huayi Elecrtric	600290 CH	Turbine	NR	Rmb	9.29	N.A.	N.A.	766	0.46	0.61	N.A.	N.A.	20.2	15.2	N.A.	N.A.	N.A.	N.A.
Xiangtan Electric	600416 CH	Turbine	NR	Rmb	9.02	N.A.	N.A.	858	0.64	0.92	5.6	6.5	14.1	9.8	1.6	1.4	11.5	14.7
Sinovel	601558 CH	Turbine	NR	Rmb	22.44	N.A.	N.A.	7,055	2.04	2.84	9.1	11.5	11.0	7.9	2.5	2.0	20.1	20.5
China high speed	658 HK	Gear-box	Neutral	Rmb	3.80	10.98	189	664	0.71	0.77	5.9	6.5	4.4	4.1	0.5	0.5	13.3	13.5
Comtec Solar	712 HK	Wafer	NR	Rmb	1.13	N.A.	N.A.	164	0.16	0.23	1.7	1.9	5.8	4.0	0.5	0.5	10.2	12.4
China Singyes	750 HK	System	Outperform	Rmb	3.58	7.40	107	241	0.60	0.81	2.8	3.7	4.9	3.6	1.0	0.8	25.1	25.0
Solargiga	757 HK	Wafer	NR	Rmb	0.76	N.A.	N.A.	219	0.11	0.16	0.9	1.1	5.7	3.9	0.7	0.6	12.7	16.1
Longyuan Power	916 HK	Operator	Neutral	Rmb	6.32	7.68	22	6,052	0.47	0.54	4.3	4.8	13.4	11.7	1.5	1.3	11.7	12.0
Datang Renewable Power	1798 HK	Operator	NR	Rmb	1.17	N.A.	N.A.	1,094	0.13	0.17	1.4	1.5	7.4	5.7	0.7	0.6	9.7	11.6
Xingda	1899 HK	Wire saw	NR	Rmb	4.09	N.A.	N.A.	800	0.50	0.62	3.9	4.6	6.8	5.4	0.9	0.7	13.4	14.9
Gold Wind	2208 HK	Turbine	NR	Rmb	3.75	N.A.	N.A.	3,789	0.38	0.37	5.0	5.3	8.2	8.2	0.6	0.6	6.4	6.6
Trony	2468 HK	Thin film module	NR	Rmb	1.40	N.A.	N.A.	285	0.44	0.48	2.1	2.5	2.6	2.4	0.6	0.5	29.9	21.4
GCL Poly	3800 HK	Polysilicon	NR	Rmb	2.25	N.A.	N.A.	4,469	0.45	0.50	1.5	1.9	5.1	4.5	1.5	1.2	33.6	28.5

Source: Bloomberg

Lead-acid battery sector

Survivors of market consolidation to gain in 2H11

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- **Survivors of lead-acid battery market consolidation in China to benefit from price hikes and shipments growth**
- **E-bike power battery the strongest subsector**
- **Our top pick is industry leader Tianneng; we are Overweight the lead-acid battery sector**

Lead-acid battery sector – Overweight

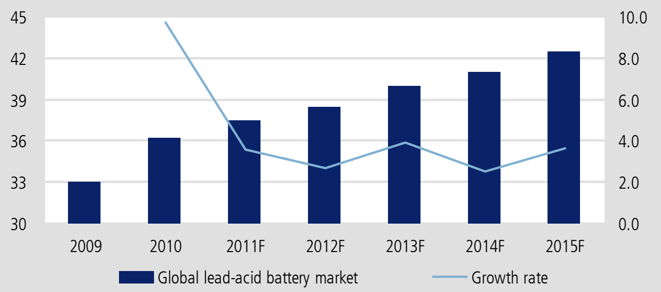
Survivors of lead-acid battery market consolidation will benefit from price hikes and shipment growth. We remain Overweight the lead-acid battery sector, and our top pick is industry leader Tianneng (00819.HK).

Survivors of consolidation to increase prices & shipments

Industrial Economics & Knowledge Center (IEK) estimates global lead-acid battery market size was US$36.2bn in 2010. Major consolidation in the lead-acid battery industry has severely impacted supply. According to our research, 70% of plants have been forced to shut down, while 13% have halted production for reorganization. As a result, only 17% of makers are in regular supply.

Figure 94: **Global market growth 3-5%; China 1/3 of market**

Global lead-acid battery market value, US$bn (LHS); growth rate, percent



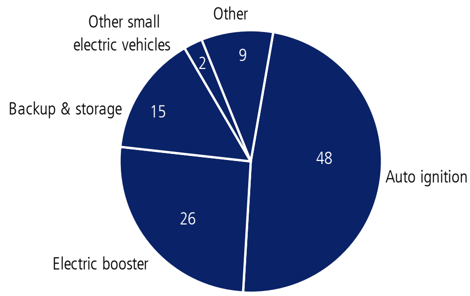
Source: KGI Asia Limited estimates

E-bike power battery the strongest subsector

The plants on shutdown are equivalent to about 35% of market supply, and 90% of them power battery plants. As such, factory prices of E-bike battery rose 16-20% in July and August, which should give a strong boost to suppliers' gross margins in 2H11. The 13% of makers who have halted production for reorganization may take 6-12 months to resume production. Therefore, we look for prices to trend up in short term.

Figure 95: **E-bike battery plant shutdowns benefit survivors**

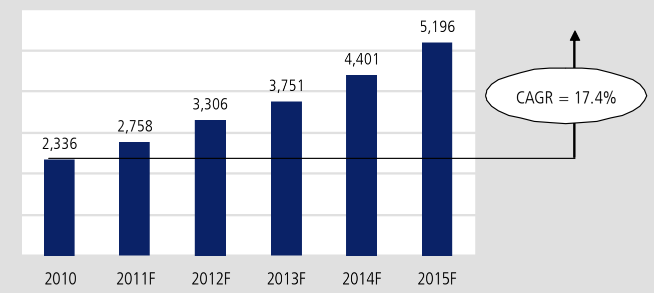
China lead-acid battery application weightings, percent



Source: KGI Asia Limited estimates

Figure 96: **China E-bike battery capacity up at a CAGR of 17.4%**

China E-bike lead-acid battery market value, US$mn



Source: KGI Asia Limited estimates

Industry leader Tianneng wins on market consolidation

The largest supplier in China, Tianneng Power boasts domestic lead-acid battery market share of 23%. The company will be the greatest beneficiary of the recent industry consolidation. Higher prices for lead-acid battery will boost gross margin in 2H11 by around 4 ppts. Moreover, we don't exclude the possibility of a further price rise in 4Q11. In addition, Tianneng is aggressively expanding capacity. In 2011 and 2012 is expected to reach 65mn and 80mn units, up 32.6% and 23% YoY, respectively. We forecast 2011 and 2012 EPS of HK$0.64 and HK$0.88, respectively. Considering the company's substantial improvement in profitability in 2H11, we set our 12-month target price at HK$5.12 with a rating of Outperform.

Figure 97: **Peer comparison – Valuation**

Company	Ticker	Share price (HK$)	Market cap (HK$mn)	EPS (HK$)			PE (x)			P/B (x)
				2010	2011F	2012F	2010	2011F	2012F	2011F
Tienneng Power	00819.HK	3.53	3,880	0.32	0.66	0.93	8.6	5.4	3.8	1.3
Leoch Int'l	00842.HK	3.12	4,293	0.25	0.42	0.66	14.0	7.7	4.9	1.5
Chaowei Power	00951.HK	3.69	3,669	0.31	0.65	0.84	6.0	5.6	4.4	1.7

Source: KGI Asia Limited estimates

Shipping sector

Outlook poor on weak economy & severe oversupply

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- **Dry bulk shipping – Freight edged up in 3Q11, but still below forecast; long-term oversupply unresolved**
- **Container shipping – Freight to continue to fall in 4Q11**
- **Oil shipping – Capacity growth well above demand growth**

Shipping sector – Underweight

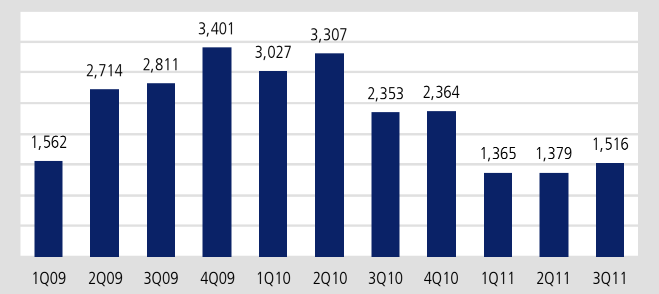
In light of oversupply in the dry bulk, container and oil shipping markets and slowing global economic growth due to the European sovereign debt crisis, we have reiterated our Underweight rating on China's shipping sector in 4Q11.

Dry bulk shipping – Freight edged up in 3Q11, but still below forecast; long-term oversupply unresolved

The Baltic Dry Index (BDI) averaged 1,516 points in 3Q11 (up to September 27), up 9.9% QoQ but down 35.5% YoY. Dry bulk shipping freight remained low in 3Q11. A dry bulk ship breaks even when the BDI is around 1,500 points. Given shipping firms mainly operated on vessels leased in 2007-08 at high costs, which usually break even when the BDI is over 2,500 points, most were still in the red in 3Q11.

Figure 98: **BDI picked up slightly in 3Q11**

BDI, points

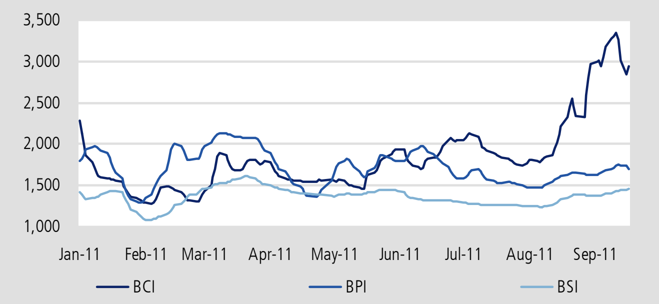


Source: Wind; KGI Asia Limited

Shipping freight rebounded in 3Q11 due to structural factors and seasonality as increased coal and iron ore exports from Australia led to a short-term supply shortage of capesize vessels. In July, Australia exported 38.2mn metric tons (mt) of iron ore, up 7.1% MoM, or 2.56mn mt. Exports of iron ore from Port Healand, Australia were 20.2mn mt in August, up 15% MoM and a new monthly high. This explains why the freight rate of a capesize ship surged over 80% within a month. Another factor that drove up the rate was September-October being peak season for grain exports from N. America and the start of the storage of coal in winter.

Figure 99: **BCI rise the strongest**

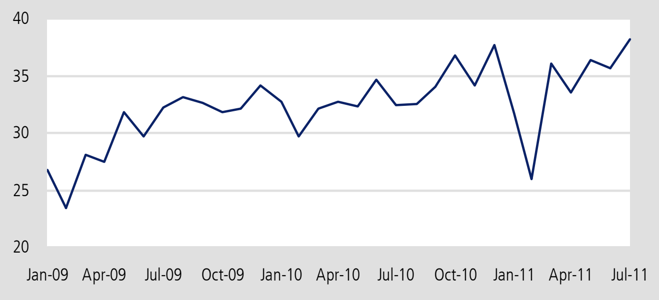
Freight rate index, points



Source: Wind; KGI Asia Limited

Figure 100: **Australia's iron ore exports up 7.1% MoM in July**

Australia iron ore exports, mn mt



Source: KGI Asia Limited

In 4Q11, grain shipping from N. America will start to level off from the peak and iron ore shipping will reduce on the European debt crisis. Dry bulk shipping freight will slip again as a result. Over the medium- to long-term, the dry bulk shipping market will be dominated by the overcapacity issue. Global dry bulk shipping capacity grew 17% YoY in 2010. We forecast the growth rate will be 13% YoY in 2011. We forecast global demand for dry bulk shipping will grow 4-6% YoY in 2011, well below dry bulk shipping capacity expansion, affected by the economic slowdown. Given shipbuilding orders now account for 53% of total capacity, rising capacity will negatively impact the market. As we are negative about shipping freight in 4Q11 and due to oversupply pressure over the medium- and long-term, we are Underweight the dry bulk shipping market.

Figure 101: **Global dry bulk shipping capacity up 13% in 2011**

	2010		2011F	
	Year-end supply (mn dwt)	Growth YoY (%)	Year-end supply (mn dwt)	Growth YoY (%)
Handysize	81.7	8	87.1	7
Order/ existing fleet (%)	34			
Handymax	109.1	19	122.6	12
Order/ existing fleet (%)	46			
Panamax	137.2	13	154.6	13
Order/ existing fleet (%)	56			
Capesize	212.2	23	244.1	15
Order/ existing fleet (%)	61			
Total	**540.2**	**17**	**608.5**	**13**

Source: Clarkson; KGI Asia Limited

Container shipping – Slow peak season in 3Q11, freight to continue to fall in 4Q11

The third quarter is the peak season for container shipping, but not this year, with Europe-bound freight falling in 3Q11 and Americas-bound freight falling again after a brief rise. China's export container shipping freight index was 1,020 points on September 16, down 4.1% from a month earlier and down 10.5% from the beginning of the year. The freight from Shanghai to Europe was quoted at US$793/TEU on September 16, down 4.7% and 43.6% from a month ago and the beginning of the year, respectively.

Figure 102: **Container shipping freight trending lower**

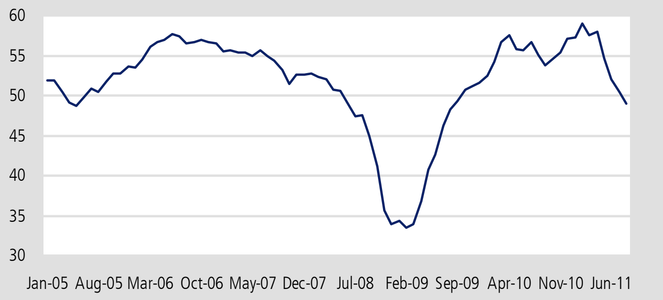
		Early 2011 07-Jan	One month ago 19-Aug	One week ago 09-Sep	Latest 19-Sep	Change YTD (%)	Change MoM (%)	Change WoW (%)
Index	**Points**	**1,127**	**1,064**	**1,041**	**1,020**	**(10.5)**	**(4.1)**	**(2.0)**
Route								
Mediterranean sea (base port)	US$/TEU	1,233	1,049	1,128	1,096	(12.1)	4.5	(2.8)
Europe (base port)	US$/TEU	1,381	832	821	793	(43.6)	(4.7)	(3.4)
Eastern US (base port)	US$/TEU	3,240	3,343	3,285	3,209	(2.0)	(4.0)	(2.3)
Western US (base port)	US$/TEU	2,016	1,769	1,675	1,633	(20.0)	(7.7)	(2.5)
Persian Gulf (Dubai)	US$/TEU	823	937	868	849	2.2	(9.4)	(2.2)
Australia (Melbourne)	US$/TEU	876	861	801	753	(15.0)	(12.5)	(6.0)
Kansai, Japan (base port)	US$/TEU	312	334	333	333	5.7	(0.3)	0.0
SE Asia (Singapore)	US$/TEU	153	215	213	213	38.2	(0.9)	0.0
S. Korea (Busan)	US$/TEU	155	235	236	236	51.3	0.4	0.0

Source: Shanghai Shipping Exchange, Wind; KGI Asia Limited

The fourth quarter, especially after Christmas, is the slow season of container shipping. Freight usually falls on seasonal factors. Apart from seasonality, the economic situation is also bad for the container shipping market. Leading economic indicators in the euro zone, the US and China are all weak, leading to negative outlook for the shipping sector. In August, PMI in the euro zone was 49 points, down 1.4 points from July and below the expansion-contraction threshold. In the US, PMI was 50.3 points in August, down 0.6 points from July. The US reading has been in decline since March. Affected by external demand, China's new export order index fell 2.1 points MoM in August to 48.3 points, below the expansion-contraction threshold of 50 points, indicating China's export growth will slow markedly or even turn negative in the coming 3-6 months. In light of slow season in the fourth quarter and weak economic fundamentals, we are Underweight China's container shipping segment.

Figure 103: **Euro zone PMI below expansion-contraction threshold**

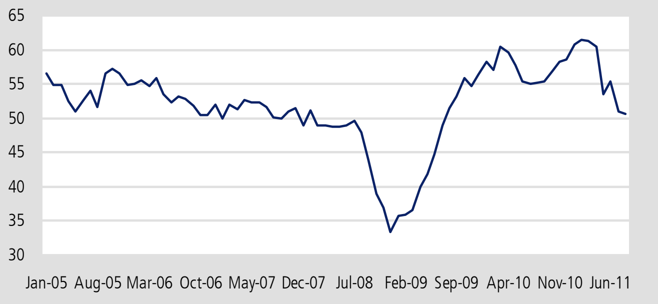
Euro zone PMI, points



Source: Wind; KGI Asia Limited

Figure 104: **US PMI continues to fall**

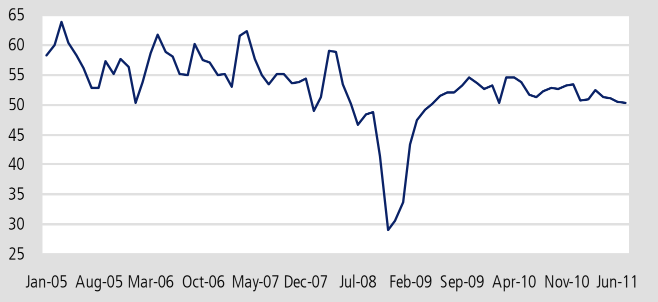
US PMI, points



Source: Wind; KGI Asia Limited

Figure 105: **China's new export order index below 50 points**

China new export order index, points



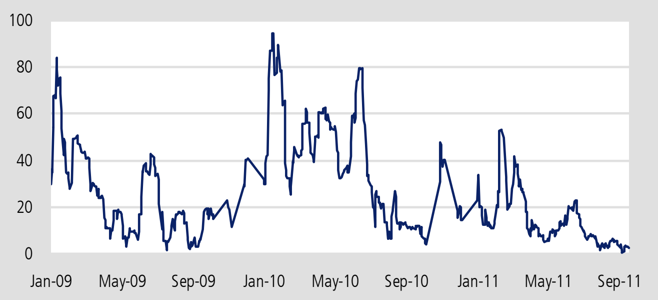
Source: Wind; KGI Asia Limited

Oil shipping – Capacity growth outpaces demand growth

The rental of very large crude oil carriers (VLCC) from the Middle East to the Far East has been under US$10k a day in 3Q11, well below the breakeven point of US$20-23k a day of a shipping firm. IEA predicts global demand for crude oil will grow 1.5% YoY in 2011 to 89.3mn mt/day. Global demand for oil shipping is normally twice the growth of oil demand. Thus, we estimate demand for oil shipping will grow around 3% in 2011. We forecast oil shipping capacity will grow 7-8% in 2011, well above demand growth. Winter is the peak season for oil shipping. We therefore think oil shipping freight could pick up in 4Q11. However, as the overall demand-supply landscape bodes ill for oil shipping operators, we have reiterated our Underweight rating on China's oil tanker market.

Figure 106: **Daily VLCC rental well below breakeven point**

Rental of VLCC from Middle East to Far East, US$'000/day



Source: Bloomberg; KGI Asia Limited

Conclusion

We rate China's shipping sector Underweight given overcapacity in the dry bulk, container and oil shipping markets and the slowing global economy on the European sovereign debt crisis. We expect the shipping sector, a cyclical industry, will be under pressure unless the crisis eases. If an acceptable resolution to the crisis is forthcoming, we expect to see share prices rebound in the near term for China Shipping Development (01138.HK) and SITC (01308.HK), given their low sector valuations and comparatively healthy earnings.

Figure 107: **Peer comparison – Valuation**

Company	Ticker	LCY	EPS			PE (x)			BVPS	P/B	2011F
			2010	2011F	2012F	2010	2011F	2012F		(x)	ROE (%)
China Shipping	01138.HK	Rmb	0.50	0.37	0.43	8.8	11.9	10.2	6.8	0.6	5.5
China COSCO	01919.HK	Rmb	0.67	(0.43)	(0.06)	4.0	(6.2)	(42.4)	4.1	0.7	N.A.
CSCL	02866.HK	Rmb	0.36	0.05	0.13	2.8	20.1	7.9	2.5	0.4	2.0
OOIL	00316.HK	US$	2.98	0.14	0.51	1.4	29.6	8.4	6.7	0.6	1.6
SITC	01308.HK	US$	0.04	0.05	0.06	5.3	5.0	3.9	0.3	0.8	18.1
Sinotrans Ship	00368.HK	US$	0.03	0.03	0.03	7.1	9.1	7.8	0.5	0.4	5.3
Pacific Basin	02343.HK	US$	0.05	0.03	0.03	7.3	15.1	12.7	0.8	0.5	3.5
Average						**5.2**	**12.1**	**1.2**		**0.6**	**6.0**

Source: Bloomberg; KGI Asia Limited estimates

Food & beverage sector

Fast-growing & turnaround plays are top picks

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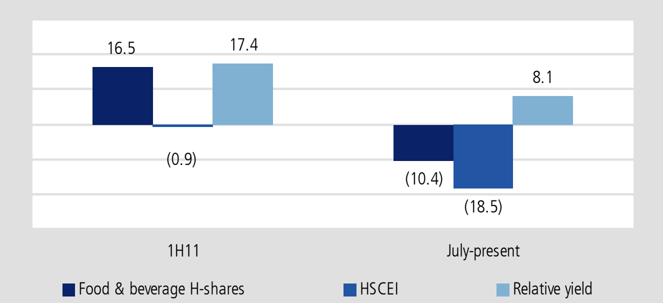
- **Defensiveness of food & beverage sector stands out amid economic weakness**
- **We like fast-growing & turnaround plays in 4Q11**
- **Our top picks are Silver Base & Ajisen in 4Q11; we are Overweight China's food & beverage sector**

Sector has defensive value – Overweight

Food and beverage H-shares have outperformed the HSCEI by 8.1 ppts in 3Q11. The food and beverage sectors in major Asian countries have also seen gains since markets started weakening. In the US, Wal-Mart, which generated 54% and 11% of sales from daily necessities and personal hygiene products in 2010, respectively, and which is considered a benchmark of the necessities sector, saw same store sales growth in the US outpace US GDP growth during the financial crisis. This indicates that the necessities sector has strong defensive characteristics. We think the defensive nature of the food and beverage market, which is one of the necessities sectors, will continue to stand out amid pessimistic market sentiment. We remain Overweight the F&B sector.

Figure 108: **F&B sector outperforms broader market in 3Q11**

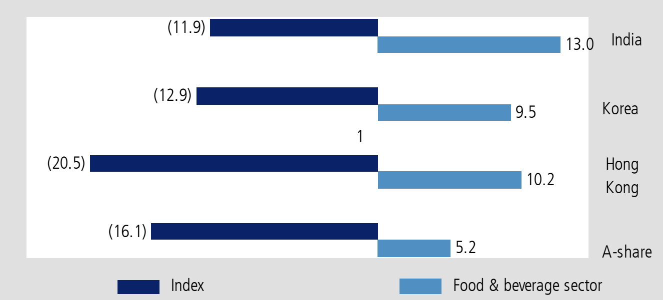
Yield, percent



Source: KGI Asia Limited

Figure 109: **Sector posts positive yield amid weak markets**

Yield (April 1-September 21, 2011), percent

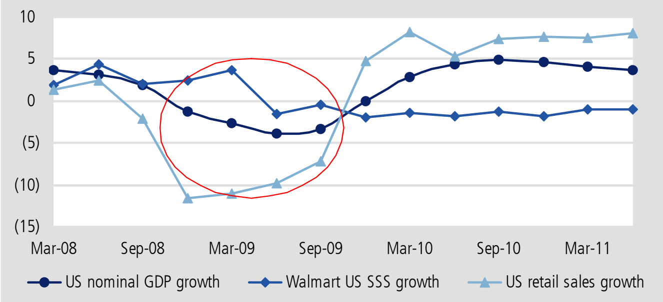


Note: A-share – SHCOMP index; Hong Kong – HSI; South Korea – KOSPI; India – SENSEX index

Source: KGI Asia Limited

Figure 110: **Wal-Mart proves defensiveness of daily necessities sector during economic downturn**

Annual growth, percent



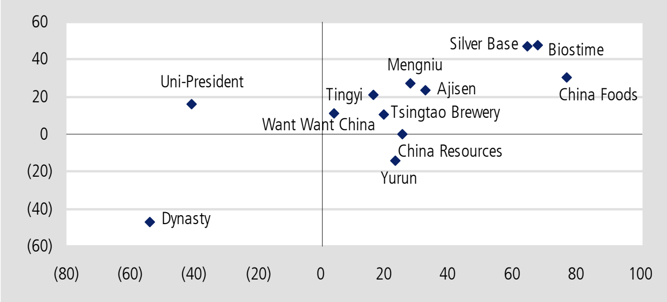
Source: KGI Asia Limited

Fast-growing firms have better stock yield; market leaders have higher risk-reward ratio

In China's food and beverage sector, fast-growing plays outperformed in 1H11 in terms of stock yield, namely Biostime (01112.HK) and Silver Base (00886.HK). These companies led in 1H11 earnings growth, at 68% and 64%, respectively. Both boasted a 47% stock yield, among the highest in the sector.

Figure 111: **Firms with higher earnings growth in 1H11 saw higher stock yields**

Net profit change YoY in 1H11, percent (x-axis); stock yield in 1H11, percent (y-axis)



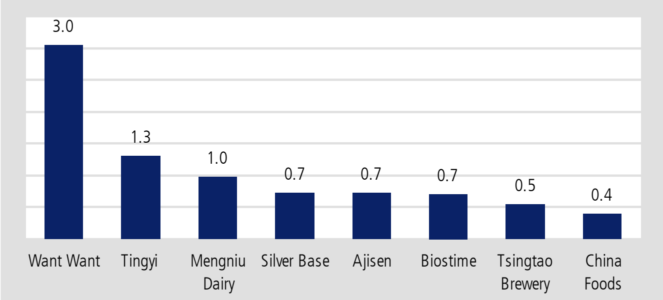
Note: Silver Base's FY ends March

Source: KGI Asia Limited

Market leaders have higher risk-reward ratios, such as Want Want China (00151.HK) and Tingyi Holding (00322.HK). In 1H11, a rise of 1% in net profits boosted the risk-reward ratios of Want Want and Tingyi by a respective 1.3 ppts and 1.0 ppts, higher than their H-share counterparts.

Figure 112: **Market leaders enjoy higher risk-reward ratios**

Risk-reward ratio increase from 1% rise in net profits, 1H11, points



Source: KGI Asia Limited

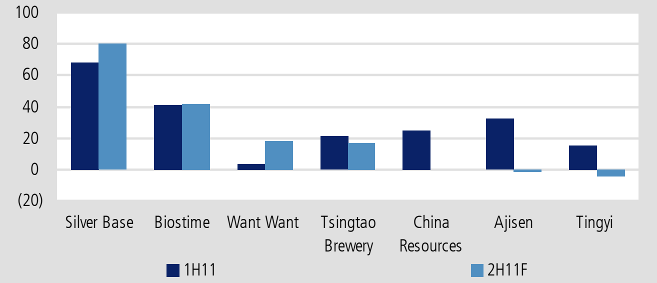
We like fast-growing & turnaround plays in 4Q11

We are positive on Silver Base, a fast-growing manufacturer, for: (1) high growth. We forecast sales will soar over 80% YoY in 1H FY12 (FY ends March), topping H-share peers. Fen Wine (sales started August 2011) and Yongfu Jiangjiu (sales started September 2010) will be main drivers; (2) low valuation. Silver Base shares are trading at a FY12 PE of 9.2x, around 50% below HK-listed luxury product distributors. FY12 PEG of 0.4x is much more attractive as compared with the 0.8x of peers; and (3) medium-term earnings could beat consensus.

We reiterate our Outperform rating on Silver Base. Our target price is HK$12.24 (FY12 PE of 15.0x), implying 63% upside.

Figure 113: **Silver Base earnings growth to pick up in 2H11**

Net profit change YoY, 2H11, percent

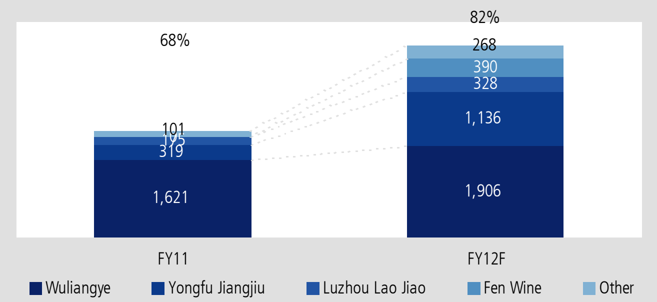


Note: Silver Base's FY ends March

Source: KGI Asia Limited

Figure 114: **Silver Base growing fast in FY11-12**

Silver Base sales by product, HK$mn; annual sales growth, percent

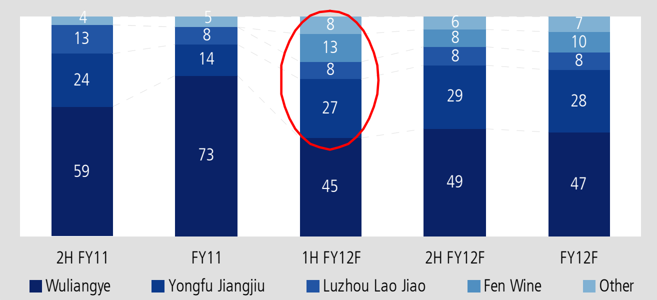


Note: Silver Base's FY ends March

Source: KGI Asia Limited

Figure 115: **Yongfu Jiangjiu & Fen Wine drivers for Silver Base**

Silver Base sales weighting by product, percent



Note: Silver Base's FY ends March

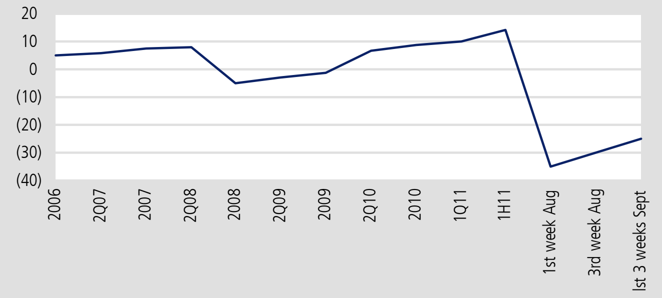
Source: KGI Asia Limited

We are also positive on Ajisen (0538.HK), a turnaround play, for: (1) bottoming out of same store sales growth. In Shanghai, Ajisen's same store sales growth improved from -35% (first week of August) to -30% (third week of August), and -25% (the first three weeks of September); and (2) low share valuation. Ajisen shares are trading at a 2011 PE of 19.4x, at the low end of the historical PE band and 31.5% below three-month average.

We reiterate our Outperform rating on Ajisen. Our target price is HK$13.65 (2011-13 PEG of 1.2x), implying 48.9% upside.

Figure 116: **Ajisen's same store sales growth has rebounded**

Ajisen same store sales growth, percent

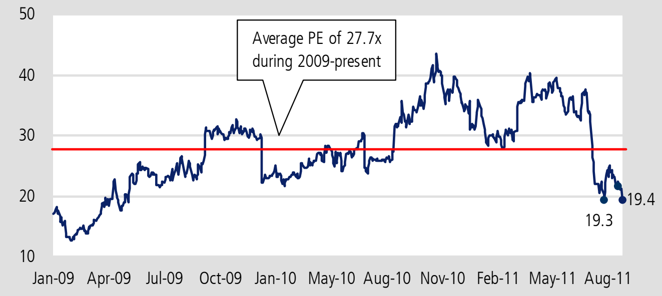


Note: Same store sales growth in China through 1H11; otherwise, same store sales growth in Shanghai

Source: KGI Asia Limited

Figure 117: **Ajisen shares at trough levels**

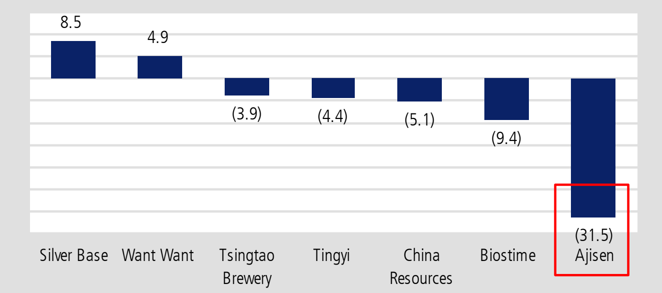
Ajisen PE ratio, x



Source: KGI Asia Limited

Figure 118: **Ajisen's 2011 PE 31.5% below three-month avg.**

2011 PE premium/ discount on three-month average, percent



*Note: Premium/ discount = current share 2011 PE/ average PE over last three months-1)*100; closing price September 23, 2011*

Source: KGI Asia Limited

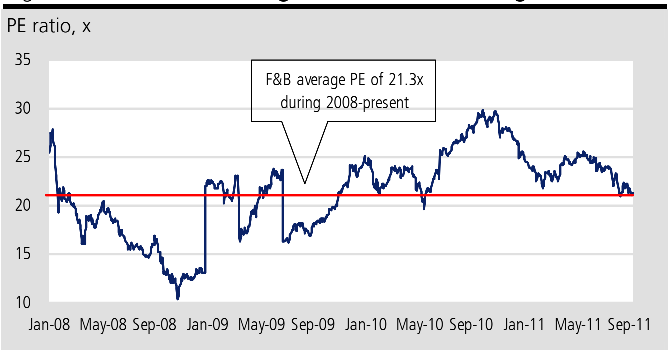
Conclusion

We think China's food and beverage sector will continue to offer protection to investors amid expected market weakness. Sector average 2011 PE is now 21.1x. We are Overweight the sector.

We recommend investors keep tabs on Silver Base on the back of: (1) higher-than-peers net profit growth in 2H FY11; (2) attractive share valuation; and (3) likelihood of medium-term earnings beating market consensus. Silver Base shares are trading at FY12 PE of 9.2x and PEG of 0.4x. We maintain our target price of HK$12.24 (FY12 PE of 15.0x), implying 63% upside, and Outperform rating.

We also like Ajisen because: (1) same store sales growth continues to improve; and (2) shares are lingering near bottom, now trading at a 2011 PE of 19.4x. Our target price is maintained at HK$13.65 (2011-13 PEG of 1.2x), implying 48.9% upside. Outperform.

Figure 119: **Food & beverage H-share 2011 average PE at 21.1x**



Note: PE estimates are Bloomberg

Source: KGI Asia Limited

Figure 120: **Peer comparison – Valuation**

Company	Ticker	Share price (LCY)	Market cap (US$mn)	EPS 2010	EPS 2011F	EPS 2012F	EPS 2013F	PE (x) 2009	PE (x) 2010	PE (x) 2011F	PE (x) 2012F	PE (x) 2013F	2010-13F EPS CAGR (%)	PEG (x) 2011F	Dvd yld (%) 2011F
Food															
Tingyi	00322.HK	20.90	14,971	0.09	0.09	0.11	0.14	42.3	31.5	30.2	23.5	18.6	19.6	1.7	1.6
Want Want*	00151.HK	6.52	11,045	0.03	0.03	0.04	0.05	40.0	30.9	26.1	20.4	16.4	21.3	1.4	2.3
Yurun Food	01068.HK	10.88	2,544	1.55	1.68	2.03	2.53	13.0	7.0	6.5	5.3	4.3	19.4	0.4	3.9
Ajisen	00538.HK	9.17	1,261	0.41	0.47	0.60	0.73	35.5	22.1	19.4	15.4	12.6	20.2	1.1	1.1
Uni-President	00220.HK	4.22	1,946	0.14	0.12	0.18	0.26	17.8	24.0	28.8	18.9	13.3	21.9	1.3	1.3
Average - Food								**32.8**	**23.1**	**22.2**	**16.7**	**13.0**	**20.5**	**1.2**	**2.0**
Dairy															
Mengniu Dairy	02319.HK	24.00	5,404	0.71	0.95	1.20	1.48	31.9	27.7	20.8	16.3	13.3	28.5	0.8	0.8
Biostime*	01112.HK	12.86	993	0.58	0.66	0.92	1.38	N.M.	18.2	16.0	11.4	7.6	40.8	0.4	1.6
Average - Dairy								**21.6**	**22.9**	**18.4**	**13.9**	**10.5**	**34.6**	**0.6**	**1.2**
Beverage															
Tsingtao Brewery	00168.HK	40.40	6,887	1.13	1.34	1.72	2.04	38.3	29.5	24.7	19.3	16.2	18.6	1.5	N.A.
China Resources Enterprises	00291.HK	27.20	8,362	1.11	1.25	1.44	1.76	25.8	24.5	21.8	18.8	15.5	16.4	1.5	1.9
China Foods	00506.HK	6.29	2,251	0.15	0.24	0.31	0.39	30.1	41.1	26.8	20.6	16.2	36.8	0.7	N.A.
Huiyuan Juice	01886.HK	2.28	432	0.11	0.21	0.25	0.30	17.1	16.7	8.7	7.4	6.3	28.3	0.4	1.8
Dynasty Wines	00828.HK	1.83	293	0.13	0.07	0.10	0.13	17.0	14.4	29.5	21.0	16.6	5.4	5.5	2.3
Silver Base	00886.HK	7.50	1,144	0.33	0.49	0.82	1.00	17.9	22.6	15.3	9.2	7.5	40.7	0.4	6.5
Average - Beverage								**36.4**	**24.8**	**21.1**	**16.1**	**13.1**	**24.3**	**1.7**	**3.1**
Average - Food & beverage H-shares									**23.9**	**21.1**	**16.0**	**12.7**	**24.4**	**1.3**	**2.3**

*Note: * KGI estimates, otherwise Bloomberg*

Source: Bloomberg; KGI Asia Limited

Retail sector

Momentum to sustain; local dominance wins out

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- **We expect department stores in China to deliver over 20% growth in 4Q11**
- **Major department stores trading at 19x median trailing PE, or a 29% discount to five-year average**
- **We prefer regional players with leading positions in fast-growing lower-tier cities; our top pick is Golden Eagle; we remain Overweight the sector**

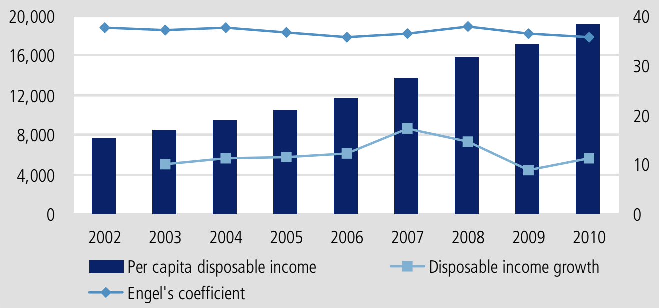
The fourth quarter is the peak season for department stores, accounting for 28% of full-year sales. We remain positive on 4Q11 growth on rising ASP, a solid demand outlook, and the Chinese New Year holiday coming earlier than usual. We think the current median trailing PE of 19x, or a 29% discount to the 5-year average, is undemanding. We remain Overweight the sector.

Sales momentum to sustain into 4Q11

We expect sales momentum to sustain into 4Q11 due to: (1) ASP for key categories apparel and cosmetics are expected to see double-digit growth in 4Q11; (2) discretionary expenditure is expanding on the back of rising disposable income (11% CAGR in 2005-10) and a downtrend in proportion of income spent on food (Engel's coefficient down to 35.7% in 2010 from 37.9% in 2008); and (3) the Chinese New Year holiday will be earlier than usual in 2012, which should usher in consumer spending momentum as early as 4Q11.

Figure 121: **Discretionary spending up; Engel's coefficient trending down**

Per capita disposable income, Rmb (LHS); growth rate and Engel's coefficient, percent (RHS)



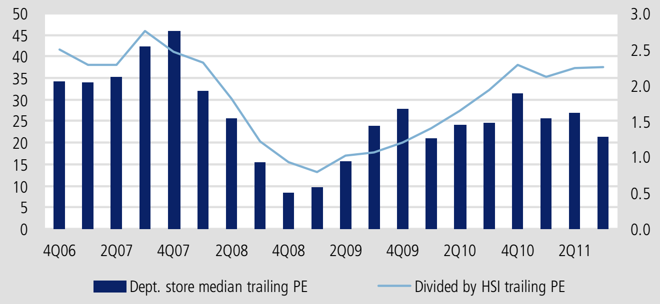
Source: Wind; KGI Asia Limited

Valuation undemanding at 29% discount to 5-year average

Major department stores are currently trading at a median trailing PE of 19x, or a 29% discount to the five-year average. Historically, 4Q PE enjoys a premium over 3Q PE during a rising economic cycle (18% on average in 2007, 2009 and 2010) and a premium over HSI (0.9x-2.5x of HSI in 2005-10), showing upside potential and good defensiveness. We think the current valuation is undemanding and expect department stores to trade up on strong sales in 4Q11.

Figure 122: **Dept. stores usually enjoy a PE premium in 4Q**

Dept. store median trailing PE, x (LHS); divided by HSI trailing PE, x (RHS)



Source: Bloomberg; KGI Asia Limited

Local dominance an edge; we prefer regional players

We see local dominance as a key driver for sustainable growth since stores with local dominant positions: (1) can better cater to local tastes; (2) face fewer barriers in introducing new brands, which diminishes national players' brand sourcing advantage as regional players scale up; and (3) have strong local connections, with pre-paid card or group shopping contributing 30-40% of sales.

Top pick – Golden Eagle (03308.HK)

We like Golden Eagle for the following reasons:

Dominant positions in tier 1 and 2 cities in Jiangsu

Golden Eagle's six most locally competitive stores account for 67% of gross sales proceeds (GSP) and delivered 33% same store sales growth in 1H11, 4.6 ppts higher than the group total.

Figure 123: **Golden Eagle derives 67% of GSP from leading stores with above-average SSS growth at 33%**

Province	Store	Years of operation	1H11 Sales contribution (%)	1H11 SSS growth (%)
Jiangsu	Nanjing Xinjiekou	15.5	27.4	16.4
Jiangsu	Xuzhou Store	7.8	13.5	31.8
Jiangsu	Yangzhou Store	10.0	11.2	24.1
Jiangsu	Taizhou Store	4.8	5.7	25.8
Jiangsu	Yancheng Store	2.7	6.2	73.1
Jiangsu	Huai'an Store	2.9	2.8	28.7
Total/Average		**7.3**	**66.7**	**33.3**

Source: Company data; KGI Asia Limited

Clear expansion route and strong execution

Golden Eagle is opening new stores at a steady pace of 4-6 stores per year with a clear focus on multi-stores to build up local dominance in key cities Nanjing, Hefei and Xi'an.

Figure 124: **Golden Eagle's expansion plan clearly laid out to enhance local dominance**

City	Current no. of stores	2013F no. of stores	Positioning	2013F GSP contribution (%)
Nanjing	4	7	Midrange to high-end; midrange; trendy; discount	21.6
Other Jiangsu Cities	8	15	Midrange to high-end; midrange; trendy; discount	50.7
Hefei	3	3	High end; midrange to high-end	6.3
Xi'an	1	3	Midrange to high-end	10.2
Kunming	2	3	Midrange to high-end	5.3
Other cities	3	3	High end; midrange to high-end; midrange; trendy	5.9

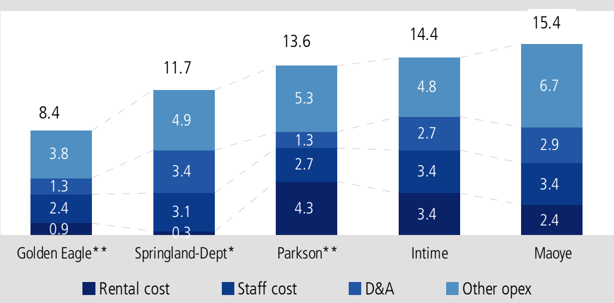
Source: Company data; KGI Asia Limited

Best cost control among peers

Golden Eagle enjoys low rental cost at less than 1% of GSP as it owns 67% of store properties. D&A and staff expense are well contained at lowest peer level backed by peer-leading sales efficiency.

Figure 125: **Lowest opex-to-GSP ratio among peers**

Breakdown of operating expenses as share of GSP, 2010, percent



**Note: Springland uses group average*

***Note: Golden Eagle and Parkson GSP is adjusted post VAT, excl other operating revenue*

Source: Company data; KGI Asia Limited

Shares of Golden Eagle are currently trading at 0.7x 2011 PEG, in the middle of its historical band. We view the valuation undemanding. We believe the solid growth outlook, strong margin delivery and proven track record justify a 0.9x PEG. Based on our 2011 EPS forecast of Rmb0.66, we maintain our target price of HK$22.22, implying 27% upside. Maintain Outperform.

Conclusion

We expect department store sales to grow over 20% grow in 4Q11, likely boosting their share prices. We remain Overweight China's department store sector on the back of solid sales momentum and undemanding valuation. We prefer regional players with leading positions in fast-growing lower-tier cities. Our top pick is Golden Eagle (03308.HK) with a 12-month target price of HK$22.2, implying 27% upside.

Figure 126: **Peer comparison – Valuation (as of Sept 29)**

Name	Ticker	FY ends	LCY	Share price (LCY)	Mkt Cap (US$mn)	PE (x) 2010	PE (x) 2011F	PE (x) 2012F	PEG (x) 2011F	P/B (x) 2011F	P/B (x) 2012F	ROE (%) 2011F	ROE (%) 2012F	Div. yield (%) 2011F
CN/HK Department Stores - HK-listed														
Golden Eagle*	03308.HK	Dec	HK$	17.50	4,368	29.1	21.8	16.9	0.71	6.3	5.0	30.1	31.3	1.0
Intime*	01833.HK	Dec	HK$	9.30	2,287	19.7	17.0	12.4	0.69	2.5	2.3	15.3	17.5	2.0
Parkson*	03368.HK	Dec	HK$	9.81	3,537	22.8	19.8	15.8	0.94	4.3	3.7	23.9	24.7	2.1
Springland	01700.HK	Dec	HK$	5.13	1,645	29.4	17.7	14.1	0.62	2.5	2.2	14.7	16.8	1.4
Maoye	00848.HK	Dec	HK$	1.71	1,197	27.1	11.0	7.6	0.33	1.6	1.5	14.3	17.8	0.0
NWDS China	00825.HK	June	HK$	4.56	986	20.9	11.0	9.5	0.87	1.5	1.3	12.8	12.4	3.4
Shirble	00312.HK	Dec	HK$	0.83	266	14.2	7.2	5.9	0.63	1.0	0.9	14.4	16.0	0.6
PCD	00331.HK	Dec	HK$	1.06	575	24.9	9.3	7.2	0.35	1.4	1.3	16.8	19.2	3.9
Lifestyle	01212.HK	Dec	HK$	20.00	4,317	22.8	20.2	17.2	1.16	4.0	3.5	21.2	21.8	1.9
Aeon	00984.HK	Dec	HK$	18.00	600	14.8	14.8	12.4	1.09	3.1	2.8	28.5	23.4	3.2
Average						**22.6**	**15.0**	**11.9**	**0.74**	**2.8**	**2.5**	**19.2**	**20.1**	**2.0**
CN Department Stores - A-listed														
Wenfeng	601010.SS	Dec	Rmb	19.12	1,473	NA	20.7	16.7	1.47	2.9	2.7	15.7	16.3	3.8
Wuxi Commercial	600327.SS	Dec	Rmb	7.81	637	27.9	15.2	11.9	0.60	3.1	2.5	20.5	21.7	N.A.
Rainbow Dept	002419.SS	Dec	Rmb	22.10	2,764	37.3	25.3	19.6	0.82	3.0	2.5	17.4	19.4	1.4
Hefei Dept	000417.SS	Dec	Rmb	18.48	1,502	32.6	19.5	18.9	0.72	4.1	3.5	23.2	19.4	N.A.
Beijing Wangfujing	600859.SS	Dec	Rmb	39.20	2,559	54.8	27.2	21.3	0.92	3.5	3.2	13.9	16.4	N.A.
Dashang	600694.SS	Dec	Rmb	41.21	1,892	115.6	30.0	23.4	0.56	NA	NA	NA	NA	N.A.
Wuhan Dept	000501.SS	Dec	Rmb	17.12	1,357	31.7	23.8	18.7	0.85	3.9	3.2	17.7	18.9	N.A.
Average						**50.0**	**23.1**	**18.7**	**0.85**	**3.4**	**2.9**	**19.5**	**19.4**	**2.6**
Overseas Dept														
Far Eastern	2903.Tw	Dec	NT$	39.90	1,727	23.3	18.3	15.7	1.42	1.9	1.8	10.3	11.5	2.3
Rakuten Inc	4755.JP	Dec	JPY	91,800	15,810	25.5	N.A.	22.4	NM	5.2	4.1	2.3	21.3	N.A.
Aeon Co Ltd	8267.JP	Feb	JPY	1,046	10,944	22.5	N.A.	12.2	NM	0.9	0.9	6.4	5.3	N.A.
Isetan Mitsukoshi	3099.JP	Mar	JPY	787	4,050	N.A.	N.A.	14.2	NM	0.8	0.7	3.4	7.2	N.A.
Lotte Shopping Co	23530.KS	Dec	KRW	403,500	9,948	13.6	10.8	8.2	0.71	0.8	0.8	8.2	8.6	0.4
Macy'S Inc	M.US	Jan	US$	27.18	11,609	11.7	10.2	9.0	0.79	2.1	1.9	16.5	19.2	1.1
J.C. Penney Co Inc	JCP.US	Jan	US$	27.55	5,877	19.9	15.0	12.6	1.59	1.3	1.3	7.8	7.4	2.9
Saks Inc	SKS.US	Jan	US$	9.35	1,496	NA	24.8	19.4	0.68	1.2	1.4	2.1	6.1	0.0
Average						**19.4**	**15.8**	**14.2**	**1.04**	**1.8**	**1.4**	**8.5**	**11.8**	**1.3**

**Note: Denotes KGI estimates*

Source: Bloomberg; KGI Asia Limited

Economic conditions: Downtrend to continue in 4Q11; policy to shift in 2012

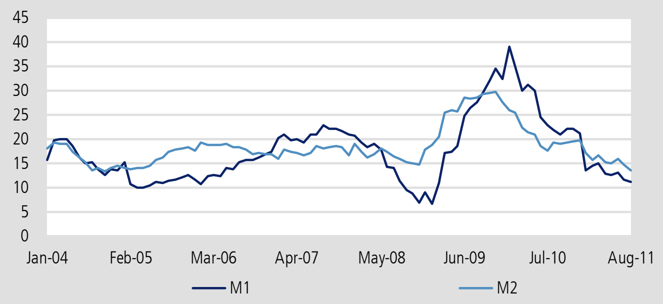
Analysis and comments

Liquidity still tight, but policy not excessively tight

Since China's central bank raised its policy rate two and a half months ago in early July and the central bank began issuing notes at a higher rate in August, the market has been expecting another rate hike. However, as we predicted, this has not materialized as the central bank must also consider high inflation and a worsening economy at home and abroad. Such expectation is now dissipating. Although the central bank will keep monetary policy tight in 4Q11, we don't think it will raise interest rates or the reserve requirement ratio as the global economic environment has become increasingly complex and an economic downturn in China continues. Keeping inflation in check will be the central bank's top priority in 4Q11, and liquidity will remain tight. We forecast YoY growth of M2 and M1 at a low 10-16%, with M2 growth to outpace that of M1. As such, economic growth will slow further in 4Q11.

Figure 127: **Money supply growth plummets to 2004 low**

Growth of money supply, YoY, percent



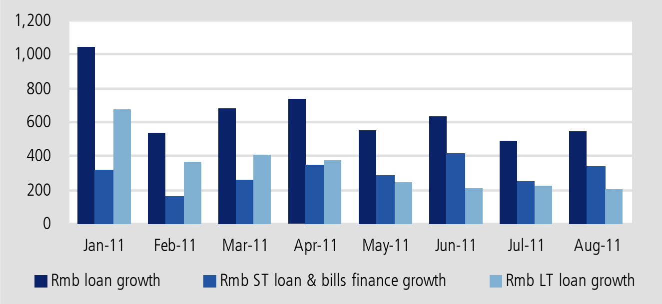
Source: People's Bank of China; KGI Asia Limited

GDP growth to bottom out in 1Q12

We expect the current tight monetary policy to shift gears in 1Q12. China will face a tough economic situation in 4Q11 and 1Q12 on: (1) continuing European sovereign debt crisis. Irrespective how the crisis ends, the euro zone economy will be gloomier in 4Q11. And the effect will linger at least until 1Q12. In addition, the US economy is recovering slowly. We don't expect any significant upside surprise in 4Q11. Sluggishness in Europe and the US will negatively affect China's exports; (2) enterprises face funding pressure in the near term and their willingness for long-term investment is decreasing, as evidenced by inadequate long-term loan growth and growing short-term lending. This points to an economy with little growth momentum in 4Q11; (3) high financing expenses, which have become a heavy burden especially to small- and medium-sized firms, will continue to erode corporate earnings. The default risk of runaway private borrowings could bite in 4Q11 amid continued economic slowdown, further impacting the China economy; and (4) China's central bank will maintain its tight monetary policy in 4Q11 as inflation remains its focus. Demand will contract further as a result. Thus, we forecast GDP growth of 8.9% in 4Q11 and 8.4% in 1Q12.

Figure 128: **Long-term loan growth slowing**

Loan growth, Rmb bn



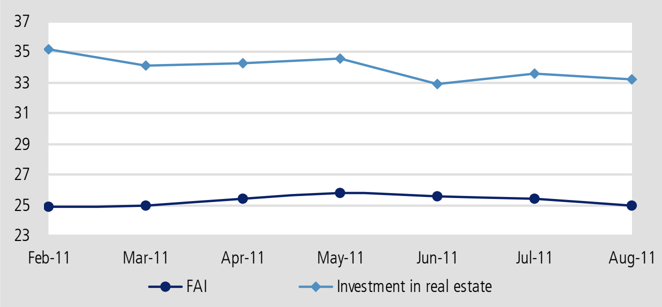
Source: People's Bank of China; KGI Asia Limited

FAI growth unsustainable

The growth of fixed-asset investment (FAI) has been falling YoY since May. We predict slower real estate investment in 4Q11 will drag down FAI growth. Affected by macroeconomic controls and credit tightening policy, investment in the real estate market is slowing. Real estate investment growth declined from 33.6% in January-July to 33.2% in January-August. Real estate investment accounted for 25.5% of FAI in 1H11. Despite some support of social housing investment, we expect real estate investment growth to continue to slow in 4Q11 on lower commodity housing investment, pulling down FAI growth. According to National Audit Office, regional government debt exceeded Rmb10tn as of end-2010, accounting for 25% of GDP in 2010. We believe such debt has become heavier in 2011 (no data available). In a bid to control risks, regional governments will cut investments. Enterprises, affected by slowing demand and rising financing costs, will also slow investments. Nonetheless, investment, being China's biggest economic growth driver, will remain high. We forecast it will grow 23.6% in 2011.

Figure 129: **FAI growth slides on slower real estate investment**

FAI and real estate investment growth, YoY, percent



Source: National Bureau of Statistics; KGI Asia Limited

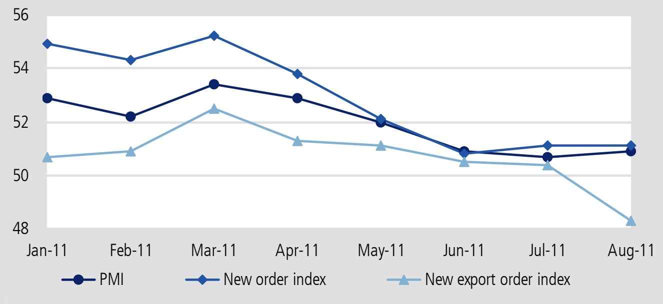
PMI to stay low, industrial output growth to slow

The purchasing managers' index (PMI) has stayed around 50% for three consecutive months. The new export orders index fell below the threshold of 50% in August. Falling purchase and inventory MoM means enterprises prefer to keep inventories low in the face of uncertainty. We forecast PMI will remain at the low level of

50-52% in 4Q11. Industrial output growth has been falling since June when it last rebounded. Affected by weak demand, major industries such as cement, power and ethylene have seen output growth fall YoY. As FAI growth will continue to fall in 4Q11, dampening demand for industrial products, we forecast industrial output will continue to decrease as well.

Figure 130: **PMI lingering at low levels**

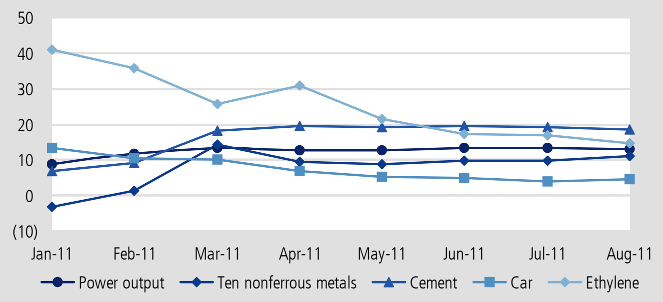
PMI, new order index and new export order index, percent



Source: Wind; KGI Asia Limited

Figure 131: **Major industrial output growth low**

Industrial output growth, YoY, percent



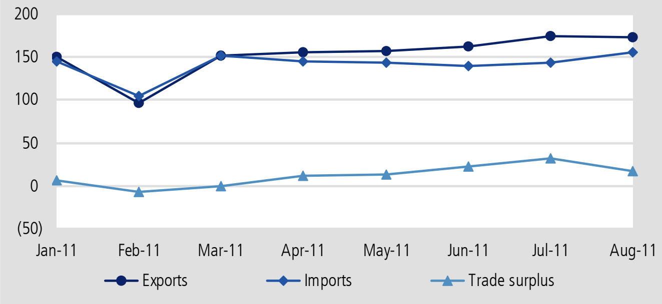
Source: Wind; KGI Asia Limited

Export growth to slip in 4Q11

In August, China's exports grew 24.5% YoY, faster than the 20.4% in July. In the first eight months of the year, exports to the US grew just 15.1% YoY, a 19-month low. Exports to EU grew 18.5% in January-August, up 0.7 ppts from January-July. However, the growth of exports to crisis-stricken countries such as Italy continued to slip. China's imports jumped 30.2% YoY in August, 7.3 ppts higher than that in July. As a result, trade surplus contracted from US$31.5bn in July to US$17.8bn in August, especially as commodity prices fell and inventory remained low at many enterprises. We think consumers and producers alike will turn more prudent as both the US and EU are in dire economic situations, potentially slowing demand for China-made products in 4Q11. We forecast the renminbi will appreciate significantly in 4Q11, hitting Rmb6.25 against the US dollar by the end of the year. Import growth will remain high as a result. While import growth will continue to outpace export growth in 4Q11, the trade surplus will remain high on seasonality.

Figure 132: **Imports & exports converging**

China imports & exports, US$bn



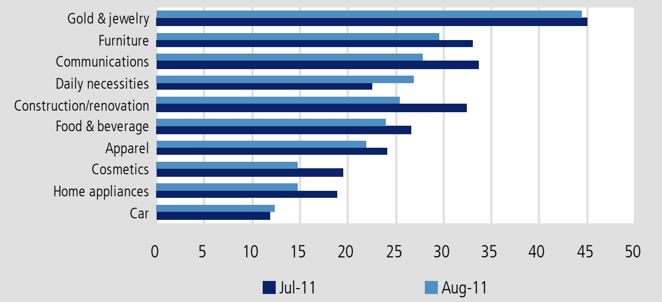
Source: Wind; KGI Asia Limited

Domestic demand stable in 4Q11

Despite the peak season, annual consumption growth could slow in 4Q11 from 1H11 for the following reasons: (1) consumers will reduce expenditures on products with higher income elasticity out of fear of inflation and future income. However, retail sales growth in gold and jewellery, which are of investment as well as consumption nature, will remain high; (2) car sales growth will remain low in 4Q11, as in January-August; and (3) sales of real estate related products such as renovation/ decoration materials will slow in 4Q11 on slower real estate investment. However, the implementation of a new tax code could leave medium-income group with higher disposable income, underpinning consumption. As such, domestic consumption growth will fall only moderately. We forecast retail sales will grow 16.7%, 16.3% and 16.4% YoY in October, November and December, respectively.

Figure 133: **Consumption of major products slowed in August**

Growth of consumption of major products, YoY, percent

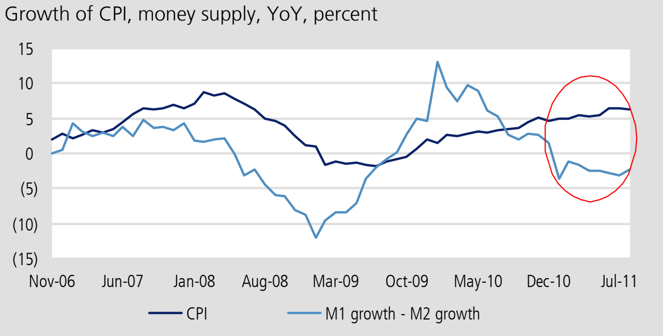


Source: Wind; KGI Asia Limited

CPI growth to fall below 5% YoY in 4Q11

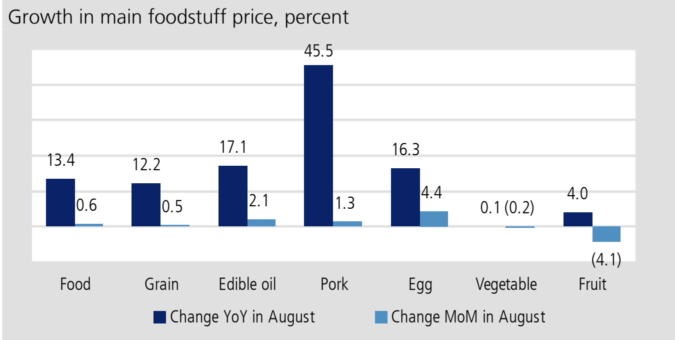
While China's CPI growth slowed in August, the prices of foodstuff, especially pork, remain high. Market speculates that eggs and edible oil will become new CPI drivers going forward. However, we think as long as the central bank keeps its monetary policy tight, annual growth of M2 will continue to outpace that of M1. Historically, when M2 growth outpaces M1 growth, CPI growth falls. Although M2 growth has outpaced M1 growth for eight straight months, CPI growth did not start slowing until the recent month due to previous excess money supply. Nonetheless, CPI is set to trend lower. This means the movements of CPI and money supply are returning to normal. And food price rise prompted by seasonality in September and October won't last long. Driven by rising profitability, hog supply will grow significantly in 4Q11. The supply of other foodstuffs such as eggs will also rise. Consequently, overall food prices will fall. We forecast CPI growth will fall below 5% YoY in 4Q11, average 5.5% in 2011 and fall to around 3% in 1H12.

Figure 134: **CPI to slow as M2 growth outpaces M1 growth**



Source: Wind; KGI Asia Limited

Figure 135: **Main foodstuff price growth slowed MoM in August**



Source: Wind; KGI Asia Limited

Figure 136: **Summary of key China economic indicators**

		Unit	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11F	Oct-11F	Nov-11F	Dec-11F	2012F
Exchange rates & interest rates	Average exchange rates	Rmb/US$	6.60	6.58	6.57	6.53	6.50	6.48	6.46	6.40	6.39	6.36	6.31	6.28	5.84
	SHIBOR: overnight: monthly	%	4.11	2.52	1.81	2.07	2.95	4.72	4.35	3.20					
	Term deposit: one-year	%	2.75	3.00	3.00	3.25	3.25	3.25	3.50	3.50	3.50	3.50	3.50	3.50	2.75
	Term deposit: three-year'	%	4.15	4.50	4.50	4.75	4.75	4.75	5.00	5.00	5.00	5.00	5.00	5.00	4.25
Foreign trade	Export value: monthly	US$100mn	1,507	967	1,522	1,557	1,572	1,620	1,751	1,733	1,775	1,610	1,774	1,853	21,370.2
	Import value: monthly	US$100mn	1,443	1,040	1,521	1,443	1,441	1,397	1,436	1,556	1,629	1,388	1,574	1,770	20,095.9
	Export value: monthly	%	37.7	2.4	35.8	29.9	19.4	17.9	20.4	24.5	22.5	18.5	15.8	20.3	11.1
	Import value: monthly	%	51.0	19.4	27.3	21.8	28.4	19.3	22.9	30.2	26.9	27.1	20.2	25.1	13.9
	Trade surplus: monthly	US$100mn	65	(73)	1	114	131	223	315	178	147	222	200	83	1,273.3
Investment, production & employment	IVA: YoY	%		14.9	14.8	13.4	13.3	15.1	14.0	13.5	13.2	12.8	12.3	12.1	12.5
	Accumulative FAI completion: YoY	%		24.9	25.0	25.4	25.8	25.6	25.4	25.0	24.6	24.4	23.8	23.6	21.0
	Urban unemployment rate	%			4.1			4.1			4.2			4.3	4.2
Consumption	National retail sales of consumer goods: YoY	%	19.9	11.6	17.4	17.1	16.9	17.7	17.2	17.0	17.1	16.7	16.3	16.4	17.2
Prices & monetary aggregates	CPI: YoY	%	4.9	4.9	5.4	5.3	5.5	6.4	6.5	6.2	6.0	5.6	4.8	4.6	3.3
	M0: YoY	%	42.5	10.3	14.8	14.7	15.4	14.4	14.3	14.7					
	M1: YoY	%	13.6	14.5	15.0	12.9	12.7	13.1	11.6	11.2	11.5	11.9	12.2	11.5	14.5
	M2: YoY	%	17.2	15.7	16.6	15.3	15.1	15.9	14.7	13.5	13.5	14.2	14.5	14.9	16.0
Economic cycle indicator	Macroeconomic indicator: leading indicators		108.0	108.0	105.3	105.3	105.3	109.3							
	Business Climate Index				133.8			135.6							
	PMI	%	52.9	52.2	53.4	52.9	52.0	50.9	50.7	50.9	50.7	50.5	50.3	50.5	51.5
	Consumer confidence index: monthly		99.9	99.6	107.6	106.6	105.8	108.1	111.8						
	Entrepreneur confidence index				137.4			132.4							
GDP	Quarterly GDP: YoY	%			9.7			9.5			9.3			8.9	8.8
	Real-term accumulative urban per capita disposable income: YoY	%			7.1			7.6			7.5			7.4	8.1

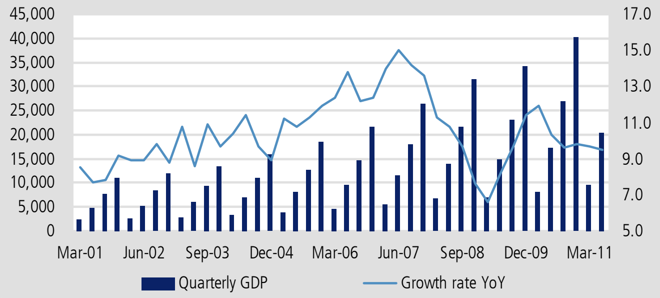
Note: Growth rates of GDP, IVA and per capita disposable income are based on constant price; those of other indicators are based on current price.

Source: Wind; KGI Asia Limited

Appendix I – China Economic Indicators

Figure 137: **GDP growth rate**

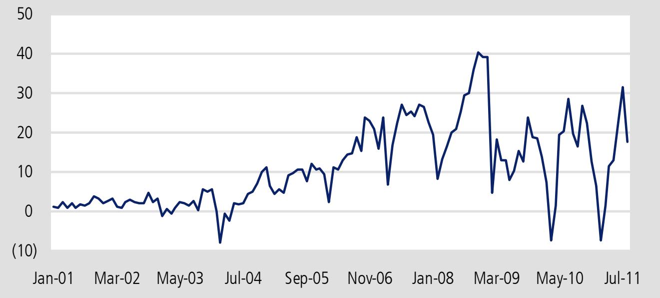
GDP, Rmb bn (LHS); growth rate, percent (RHS)



Source: Wind; KGI Asia Limited

Figure 141: **Trade surplus**

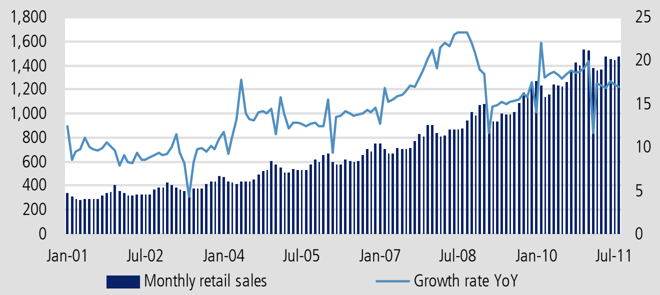
Trade surplus, US$bn



Source: Wind; KGI Asia Limited

Figure 138: **Retail sales**

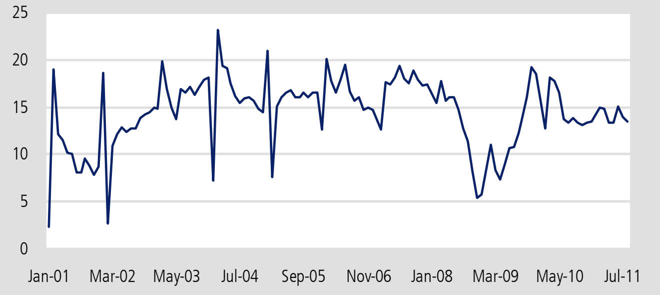
Retail sales, Rmb bn (LHS); growth rate, percent (RHS)



Source: Wind; KGI Asia Limited

Figure 142: **Industry value added (IVA)**

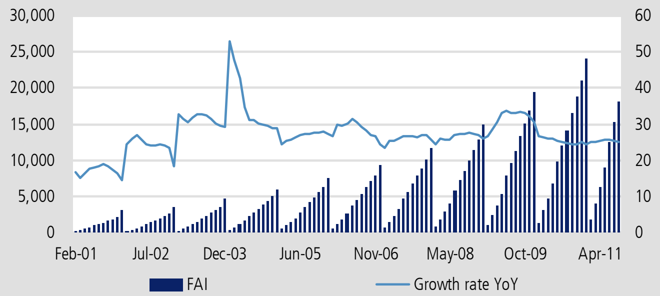
IVA growth rate, percent



Source: Wind; KGI Asia Limited

Figure 139: **FAI**

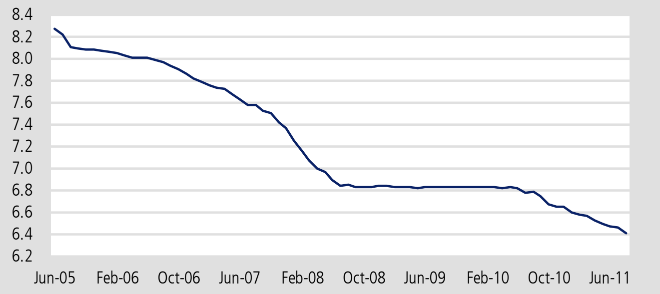
FAI, Rmb bn (LHS); growth rate, percent (RHS)



Source: Wind; KGI Asia Limited

Figure 143: **Renminbi exchange rate against the US dollar**

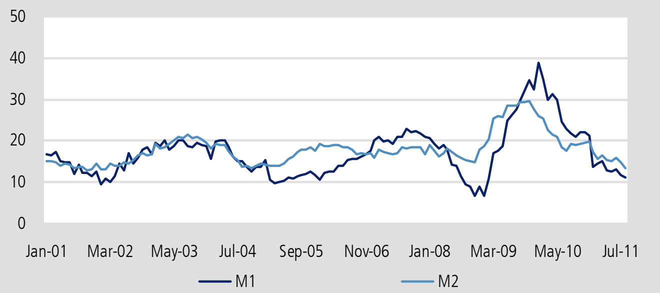
Renminbi per US dollar



Source: Wind; KGI Asia Limited

Figure 140: **Money supply**

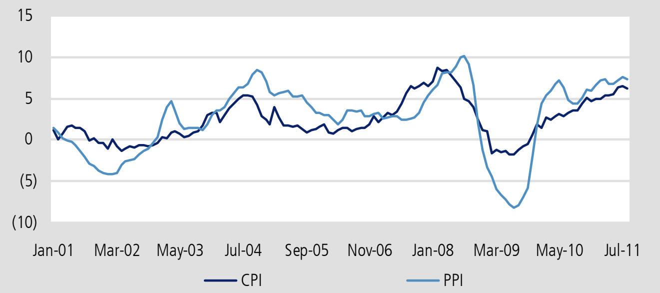
M1 and M2 growth rates, percent



Source: Wind; KGI Asia Limited

Figure 144: **Prices**

CPI and PPI growth rates, percent



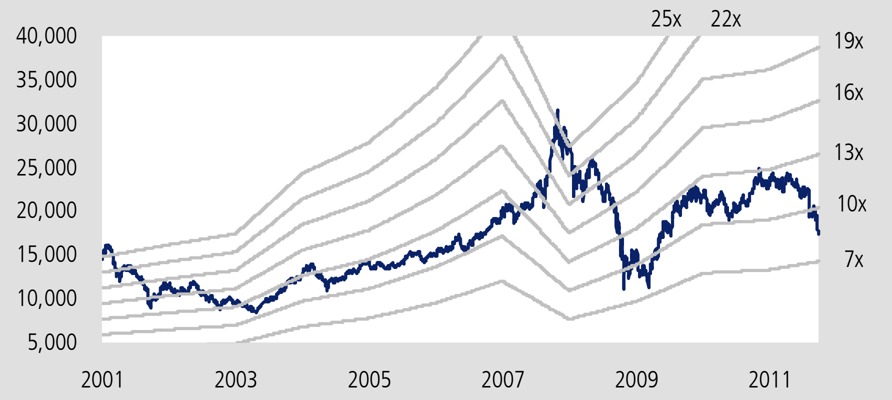
Source: Wind; KGI Asia Limited

Appendix II: Market Valuation

Current PE is 8.67x. Even if earnings are lowered by 20%, the PE will be just around 10x, compared with the average of 15x over the past ten years.

Figure 145: **Market PE chart – Hong Kong**

HSI, points (LHS); PE ratio, x (RHS)

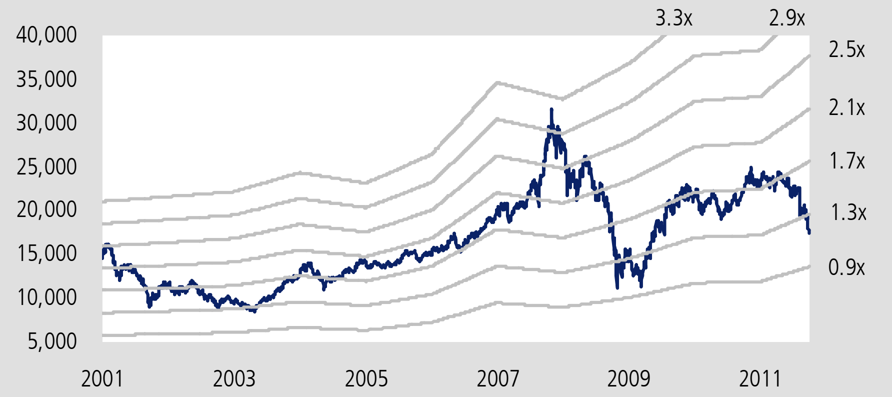


Source: Wind; KGI Research

At present, the Hang Seng market's P/B ratio is just around 1.35x, compared with a 10-year average of around 2.0x. The current P/B level is very low from a long term perspective.

Figure 146: **Market P/B chart –Hong Kong**

HSI, points (LHS); P/B ratio, x (RHS)

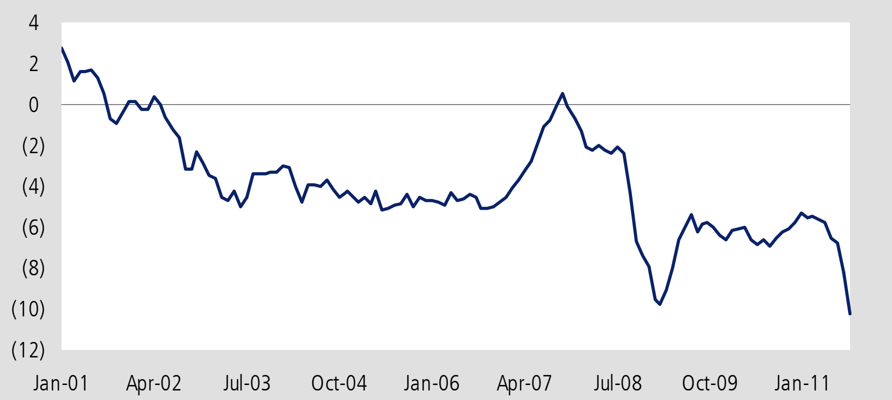


Source: Wind; KGI Research

Based on valuation, the Hang Seng Index looks attractive. However, rising risk propensity will weigh on market performance.

Figure 147: **Market yield gap chart – Hong Kong**

Percent



Source: Wind; KGI Research

Appendix III: Changes to Earnings Estimates

Figure 148: **Changes to earnings estimates**

Company	Code	Analyst	Date of revision	Revision to EPS est. (%) 2011F	2012F	Revised EPS est. (HK$) 2011F	2012F	Rationale
Dongyue Group	00189.HK	Nico Zhang	2-Aug	5.4	7.0	0.58	0.76	Fluorine chemicals market leader
Dongyue Group	00189.HK	Nico Zhang	1-Sep			1.10	1.21	Fluorine chemicals outlook good; valuation low
Tingyi	00322.HK	Michelle Chen	2-Sep	(8.2)	(8.1)	0.09	0.11	Fundamentals improve in 3Q11; valuation unattractive
Dongfeng Motor	00489.HK	Wei Shen	2-Sep	2.0	(11.0)	1.18	1.25	Gross margin to pick up in 2H11, cautious on opex
Lansen Pharmaceutical	00503.HK	T.J.Hsu	5-Sep	(9.4)	(15.4)	2.90	3.30	Outlook mediocre on cost & policy pressures
Ajisen (China)	00538.HK	Michelle Chen	18-Aug	(13.0)	(23)	0.47	0.53	Initial coverage
Ajisen (China)	00538.HK	Michelle Chen	31-Aug		13.2		0.60	Bottoming out
Shangdong Molong	00568.HK	Guo Zhanag	31-Aug	(18.2)	(47.0)	0.56	0.73	Sector recovery underway; valuation on low side
Sun King Power	00580.HK	Jerry Weng	8-Sep	(81.3)	(58.1)	0.01	0.04	Forex & cost pressures easing in 2H11
Tianneng Power	00819.HK	Jerry Weng	15-Sep	29.5	33.1	0.53	0.73	Price & shipments uptrend to continue through 2012
China Resources Power	00836.HK	Judith Chen	24-Aug	(9.3)	(13.7)	1.09	1.24	Coal cost hikes greater than expected
Microport Scientific Corp.	00853.HK	T.J.Hsu	31-Aug	9.5	(8.0)	0.23	0.23	1H11 earnings beat; 2012 capped by low bid prices
Microport Scientific Corp.	00853.HK	T.J.Hsu	14-Sep		0.04		0.24	Building orthopedic products platform via acquisition
Zhongsheng Group	00881.HK	Wei Shen	19-Aug	(13.5)	(15.8)	0.64	0.96	EPS cut on higher SG&A and minority interest
Huaneng International	00902.HK	Judith Chen	12-Aug	35.0		0.17		Gains rest on power tariff reform
Longyuan Power	00916.HK	Judith Chen	31-Aug		(10.0)		0.45	1H11 net income slightly ahead of consensus
Huadian Power	01071.HK	Judith Chen	19-Sep		25.0		0.05	Coal output increase boosts profits
Biostime Int'l	01112.HK	Michelle Chen	30-Aug	3.1	(0.6)	0.66	0.92	Strong same store sales in 2H11
China Shipping Dev.	01138.HK	Zharlen Zhang	22-Aug	(16.0)		0.37		1H11 results disappointing; negatives priced in
Yanzhou Coal	01171.HK	David Yang	26-Aug	4.7	21	2.02	1.91	1H11 earnings hit by costs; long-term positives
Hidili Industry	01393.HK	David Yang	30-Aug	(33.0)	(27.0)	0.34	0.45	Shares reflect negatives; coking coal capacity rising
Boer Power	01685.HK	Jerry Weng	8-Jul	(13.2)	(9.8)	0.33	0.46	Hi-speed rail issue pressures 1H11 revenue; may affect full-year results
Zhengtong Auto	01728.HK	Wei Shen	31-Aug	2.8	16.9	0.37	0.76	1H11 earnings in line, aggressive expansion ahead
China Sanjiang Fine Chemical	02198.HK	Nico Zhang	6-Jul	19.0		0.26		Epoxyethane prices stabilizing
China Sanjiang Fine Chemical	02198.HK	Nico Zhang	29-Aug	6.4	(4.4)	0.33	0.43	EO prices might rise further; restructuring with expansion
Greatwall Motor	02333.HK	Guo Zhanag	23-Aug	0.2	0.4	1.38	1.47	Valuation low
China Power	02380.HK		23-Sep	27.0	26.7	0.12	0.17	Hydropower affected by drought; lackluster near term
Shineway Pharm	02877.HK	T.J.Hsu	2-Sep	(10.7)	(19.5)	1.22	1.31	Leading generic drugs supplier under pricing pressure
Shineway Pharm	02877.HK	T.J.Hsu	9-Sep	(10.7)	(19.5)	1.00	1.07	Conservative outlook on policy-induced ASP erosion
Dalian Port	02880.HK	Zharlen Zhang	2-Sep		(0.05)		0.18	1H11 results in line; business divisions mixed
Waison Group	03393.HK	Jerry Weng	2-Sep	(1.0)	(0.1)	0.27	0.35	Orders up; opening European market with Siemens
China Bluechem	03983.HK	Nico Zhang	1-Sep	11.0	4.0	0.47	0.51	Firm prices lead to bright outlook for 2H11
China Molybdenum	03993.HK	David Yang	25-Aug	21	26	0.26	0.28	Tungsten earnings fail to offset slow core business

Source: KGI Research

Appendix IV: Changes to Investment Ratings

Figure 149: **Changes to investment ratings**

Company	Code	Date of revision	Rating Previous	Rating Revised	Rationale
Dongfeng Motor	00151.HK	01-Jul		Outperform	Initial coverage
China Qinfa	00168.HK	04-Jul		Outperform	Initial coverage
GAC	00291.HK	07-Jul		Neutral	Initial coverage
Tingyi	00322.HK	11-Jul		Outperform	Initial coverage
Int'l Mining Machine	00338.HK	20-Jul		Neutral	Resume coverage (market share winner of industry consolidation)
Zhengtong Auto	00489.HK	21-Jul		Outperform	Initial coverage
Golden Eagle	00538.HK	22-Jul		Outperform	Resume coverage (solid growth story)
Ajisen (China)	00842.HK	26-Jul		Neutral	Initial coverage
Want Want China	00866.HK	01-Aug		Outperform	Resume coverage (share pullback a good entry point)
Intime Department Store	00881.HK	03-Aug		Outperform	Resume coverage (growth on track)
China Power	00886.HK	04-Aug		Outperform	Initial coverage
Huiyuan Juice	01110.HK	05-Aug		Outperform	Initial coverage
Zhongsheng Group	01114.HK	09-Aug		Outperform	Initial coverage
Weichai Power	01361.HK	15-Aug		Outperform	Initial coverage
China Resource	01698.HK	16-Aug		Outperform	Initial coverage
Parkson	01728.HK	17-Aug		Neutral	Initial coverage
361 Degree	01833.HK	25-Aug		Outperform	Resume coverage (FY11 results beat market expectation)
Leoch	01886.HK	26-Aug		Outperform	Initial coverage
Brilliance China	01919.HK	06-Sep		Neutral	Initial coverage
Boshiwa	02238.HK	06-Sep		Outperform	Initial coverage
Ajile	02338.HK	06-Sep		Outperform	Initial coverage
China COSCO	02380.HK	07-Sep		Neutral	Resume coverage (outlook weaker)
Sliver Base	03308.HK	14-Sep		Outperform	Initial coverage
China Fiber Optic	03368.HK	21-Sep		Outperform	Initial coverage
Kingworld Medicines Group	03383.HK	22-Sep		Outperform	Initial coverage
Shanghai Petrochemical	03777.HK	26-Sep		Outperform	Resume coverage (earnings to rebound in 4Q11)

Source: KGI Research

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	Shanghai Room 1907-1909, Tower A, No. 100 Zunyi Road, Shanghai,PRC200051 **Shenzhen** Room 24D1, 24/F, A Unit, Zhen Ye Building, 2014 Bao'annan Road, Shenzhen PRC 518008	**Taipei** 700 Mingshui Road, Taipei, Taiwan Telephone 886.2.2181.8888 Facsimile 886.2.8501.1691
	Hong Kong	**Thailand**
	41/F Central Plaza, 18 Harbour Road, Wanchai, Hong Kong Telephone 852.2878.6888 Facsimile 852.2878.6800	**Bangkok** 8th - 11th floors, Asia Centre Building 173 South Sathorn Road, Bangkok 10120, Thailand Telephone 66.2658.8888 Facsimile 66.2658.8014

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	Outperform (OP)	The stock's excess return over the next twelve months is ranked in the top 40% of KGI's coverage universe in the related market (e.g. Taiwan).
	Neutral (N)	The stock's excess return over the next twelve months is ranked in the range between the top 40% and the bottom 40% of KGI's coverage universe in the related market (e.g. Taiwan).
	Underperform (U)	The stock's excess return over the next twelve months is ranked in the bottom 40% of KGI's coverage universe in the related market (e.g. Taiwan).
	Not Rated (NR)	The stock is not rated by KGI.
	Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances. *Excess return = 12M target price/current price-1*
	Note	When an analyst publishes a new report on a covered stock, we rank the stock's excess return with those of other stocks in KGI's coverage universe in the related market. We will assign a rating based on its ranking. If an analyst does not publish a new report on a covered stock, its rating will not be changed automatically.

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