招銀国际
CMB INTERNATIONAL

2024

China Strategy Outlook

A silver lining ahead

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Macro

2024 US Economic Outlook

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Between a soft landing and a mild recession

The US economy greatly beats expectations in 2023 as the aggressive policy rate hikes have not curbed the expansion of household consumption, business capex and government spending. However, the economy may slow down in 2024 due to continuous credit tightening, weakening employment, a falling fiscal deficit ratio, and exhaustion of excess savings. Real estate and durables have already contracted since last year, while service may soften next year. The unsynchronized downturn across various sectors and a strong balance sheet of the real sector tend to reduce the risk of an economic recession. Inflation is expected to further decline thanks to moderating rents, wage growth and commodity prices. The Fed may start a cycle of interest rate cuts in May or June next year, which could lead to a moderate decline in the US dollar index.

- The US economy could come between a soft landing and a mild recession with nominal and real GDP growth respectively down from 6.2% and 2.3% in 2023 to 3.1% and 0.8% (market consensus at 3.6% and 1%) in 2024. It may see a slight QoQ decline in 1H24.
- Real growth of household consumption may slow from 2% in 2023 to 0.8% (market consensus at 1%) in 2024 because of a cooling job market, rising savings rate, excess savings depletion and consumer credit tightening.
- Housing sales dropped while supply shortage prevented price declines. Housing sales may modestly improve in 2024 due to falling interest rates and supply improvements, but it is unlikely to enter a new boom cycle. Commercial real estate market especially office buildings may continue to face pressure.
- Business investment especially in manufacturing construction has been strong in 2023 as the government has tried to revitalize manufacturing with subsidies. Due to credit tightening, high-cost pressure, softening aggregate demand and diminishing effects of policy stimulus, however, business investment growth is likely to moderate from 3.3% in 2023 to 1.8% in 2024.
- Export growth is expected to decrease from 2.8% in 2023 to 1.1% (market consensus at 0.5%) in 2024 while import growth is estimated to increase from -1.9% in 2023 to 1.4% (market consensus at 0.4%) in 2024. The base effect, ending of the inventory destocking cycle, industrial price recovery and improvement in China & Europe economies should support a pick-up in global trade in 2024.
- The disinflation should continue with PCE and core PCE inflation respectively down from 3.8% and 4.2% in 2023 to 2.3% and 2.4% (market consensus at 2.6% and 2.7%) in 2024. Major contribution is from the base effect, rent inflation decline, labor market cooling and low commodity prices.
- Government spending growth is projected to fall from 3.4% in 2023 to 1.3% in 2024 with federal deficit ratio down from 6% in 2023 to 5.8% in 2024 due to the base effect and Congressional constraint on a further rise of federal deficit ratio. The Fed may cut rates by 150bps (market consensus at 90-100bps) in 2024.
- The 10-year Treasury yield is expected to decline from 4.5% at end-2023 to 3.9% (market consensus 3.74) at end-2024. As the US-EU growth gap may narrow with potential easing of the Russia-Ukraine conflict, the US dollar index is expected to fall 5% from 103 at end-2023 to 97.8% at end-2024.

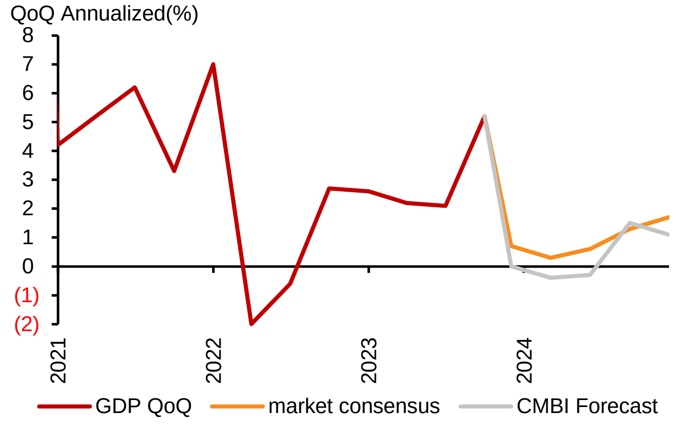
Figure 1: US economic forecast

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD	Decade Average	Bloomberg Median 2023F	Bloomberg Median 2024F	Bloomberg Median 2025F	CMBI Forecast 2023F	CMBI Forecast 2024F	CMBI Forecast 2025F
Nominal GDP (US$trn)	16.9	17.6	18.3	18.8	19.6	20.7	21.5	21.3	23.6	25.7	27.2	-	27.3	28.3	29.4	27.3	28.2	29.4
GDP per Capita (US$th)	53.2	55.1	56.8	57.9	60.0	62.8	65.1	64.3	71.0	77.2	81.1	-	81.6	84.2	87.0	81.6	83.7	86.8
Real GDP (YoY %)	2.1	2.5	3.0	1.8	2.5	3.0	2.5	-2.2	5.9	2.0	2.3	**2.3**	2.3	1.0	1.8	2.3	0.8	2.2
Consumer Spending (YoY %)	1.7	2.8	3.4	2.5	2.6	2.7	2.0	-2.5	8.6	2.6	2.1	**2.6**	2.2	1.0	1.8	2.0	0.8	2.2
Private Investment (YoY %)	7.4	6.5	6.3	-0.1	4.4	5.8	3.1	-4.7	9.1	5.0	-2.2	**4.3**	-1.9	1.0	3.0	-1.8	0.9	3.6
Residential	12.8	4.3	10.6	7.1	4.3	-0.7	-0.9	7.2	11.3	-9.0	-13.8	**4.7**	-	-	-	-13.5	-3.5	5.0
Non-residential	4.7	8.1	3.3	1.8	4.6	6.9	3.7	-4.7	6.0	5.2	4.3	**4.0**	-	-	-	3.3	1.8	3.2
Exports (YoY %)	3.0	3.9	0.3	0.5	4.1	2.9	0.5	-13.1	7.1	7.0	3.1	**1.6**	2.3	0.5	3.0	2.8	1.1	2.0
Imports (YoY %)	1.2	5.2	5.2	1.5	4.7	4.0	1.2	-9.0	15.2	8.7	-2.1	**3.8**	-2.3	0.4	3.0	-1.9	1.4	2.6
Government spending (YoY %)	-2.4	-0.9	2.0	2.0	0.6	2.0	3.9	3.2	-0.3	-0.9	3.8	**0.9**	3.3	1.3	0.9	3.4	1.3	1.0
Federal Deficit Ratio (%)	4.1	2.8	2.4	3.2	3.5	3.8	4.6	14.9	12.3	5.5	4.7	**5.7**	6.1	5.8	6.0	6.0	5.8	6.1
PCE (YoY %)	1.3	1.4	0.2	1.0	1.7	2.0	1.4	1.1	4.2	6.5	4.1	**2.1**	3.8	2.6	2.1	3.8	2.3	2.0
Core PCE (YoY %)	1.5	1.5	1.2	1.6	1.6	1.9	1.6	1.3	3.6	5.2	4.5	**2.1**	4.2	2.7	2.2	4.2	2.4	2.1
Unemployment rate (%)	6.7	5.6	5.0	4.7	4.1	3.9	3.6	6.7	3.9	3.5	3.9	**4.8**	3.7	4.3	4.2	4.0	4.7	4.2
Federal Fund Rate (YoY %)	0.1	0.1	0.2	0.6	1.3	2.4	1.6	0.1	0.1	4.3	5.3	**1.07**	5.33	4.33	3.33	5.33	3.83	3.33
10-Year Note (%)	3.0	2.2	2.3	2.5	2.4	2.7	1.9	0.9	1.5	3.9	4.4	**2.33**	4.52	3.74	3.60	4.50	3.90	3.55
US$ Index	80.2	90.3	98.7	102.4	92.3	96.1	96.4	90.0	96.0	103.5	103.8	**94.6**	105.7	100.2	96.8	104.0	98.8	97.3

Source: Wind, Bloomberg, CMBIGM estimates

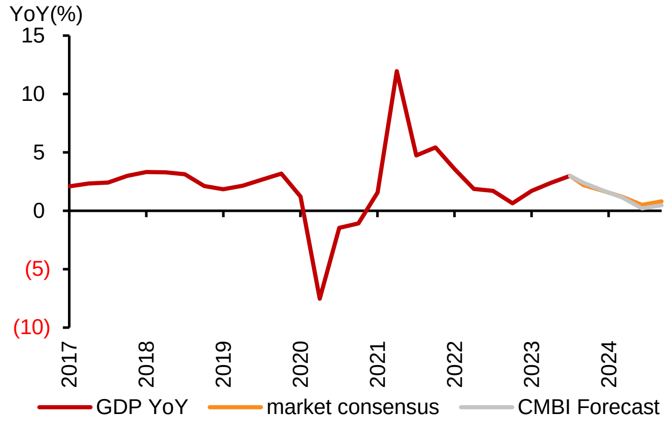
Note: Consumption, investment, exports, imports and government spending are in real-term growth rates.

Figure 2: GDP QoQ growth rate



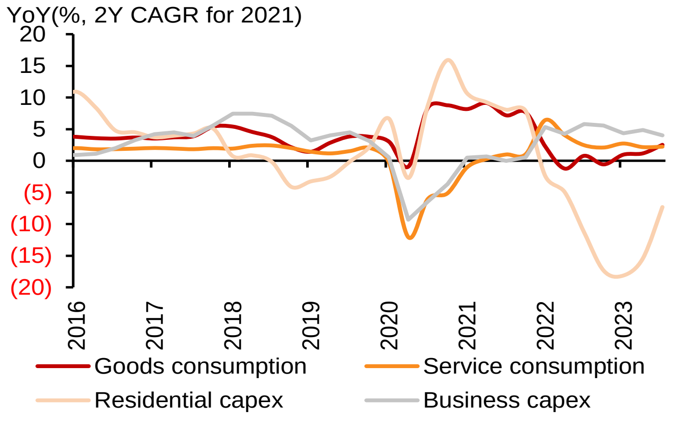
Source: Bloomberg, Wind, CMBIGM estimates

Figure 3: GDP YoY growth rate



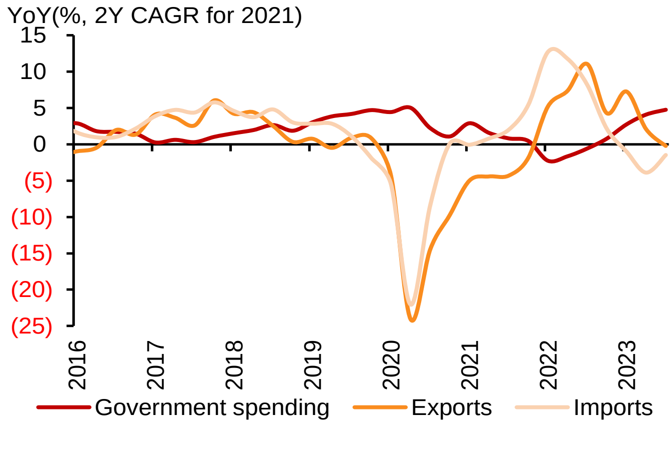
Source: Bloomberg, Wind, CMBIGM estimates

Figure 4: Consumption and investment growth



Source: Bloomberg, Wind, CMBIGM estimates

Figure 5: Government spending & export growth



Source: Bloomberg, Wind, CMBIGM estimates

The Resilience and Hidden Concerns of Consumption

The robust growth of household consumption has been a key driver for US economic outperformance in 2023. Consumer spending at constant price rose 2.1% YoY (all on a YoY basis unless specified) in 9M23, down from 2.6% in 2022 yet higher than 2% in 2019. Goods consumption picked up 1.6% in 9M23 after rising 0.3% in 2022, down from the average growth of 8.2% in 2020-2021 with hot stay-at-home economy. Auto consumption surged by 5.7% thanks to supply chain restoration and demand upgrading towards new energy & intelligent vehicles, while furniture and home appliance purchases rebounded by rising 0.6% amid inventory normalization and mild housing market recovery. Entertainment goods consumption maintained a robust growth rate of 6%. However, spending on computers and consumer electronics weakened by declining 1.2%. Apparel consumption saw a modest increase of 0.5% and expenditure on energy products picked up 1.3% stimulated by falling energy prices. Service consumption continued to expand 2.4% in 9M23, down from 3.8% in 2022 yet well above the growth in 2020-2022. Household services, entertainment, accommodation & food services and medical care respectively rose 2.8%, 4%, 4% and 5.5%, significantly surpassing the average growth rates in 2017-2019.

Five factors contributed household consumption resilience in 2023, in our view.

1) The strength in employment and rapid wage growth. The job vacancy-to-unemployment ratio reached 150% at end-3Q23, above the average level of 110% in 2017-2019. Nominal wage growth decreased from 4.9% in 2022 to 4.5% in 9M23, but real growth rose from 0.6% to 1.8% as inflation receded more significantly. Labor supply-demand gap has remained. Labor demand was supported by rising share of labor-intensive service sector in the economy and labor hoarding by some enterprises. Labor supply remained below the pre-pandemic trend as some old workers may have opted for early retirement due to the pandemic, large-scale fiscal subsidies, and the asset boom cycle. In addition, Trump-era immigration policies and the pandemic led to a decline of immigrant labor inflow in 2018-2021 as foreign-born workers accounted for over 15% in labor supply.

2) The release of excess savings. Households accumulated over US$2trn in excess savings in 2020-2021 due to the large scale of fiscal stimulus at 25% of GDP and impaired offline consumption during the pandemic. Consumers started to use those excess savings in 2022-2023, providing strong support to consumption performance.

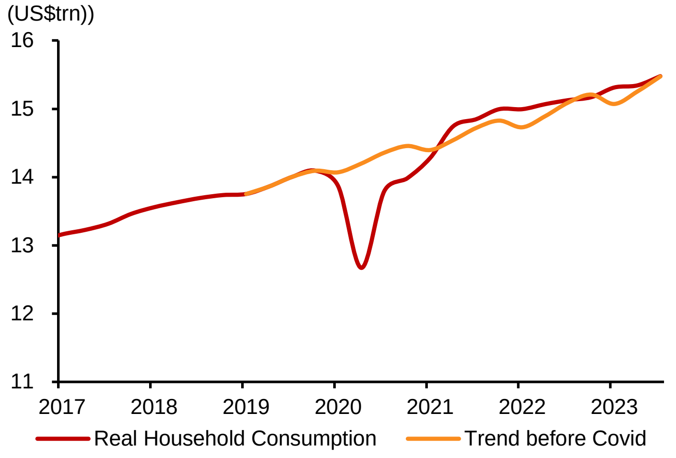
3) The wealth effect of the asset price boom. Super-loose policies in 2020-2021 drove significant increases in stock price, housing price and pension asset value. Household wealth hit a new high of US$154.3trn by mid-year, 32.2% higher than the value at end-2019.

4) Most households were locked in low-fixed-rate mortgages as their debt burden only increased mildly after the aggressive policy rate hikes. While interest rates of 30-year fixed-rate mortgage loans rose from 3.08% in 4Q21 to over 7% in 3Q23, average interest rates on existing mortgage loans only climbed from 3.4% to 3.7%. Many households refinanced their mortgages with fixed-rate contracts during the low interest rate period in 2009-2021. Nearly 90% of mortgage applications in that period were fixed-rate loans. Household debt service ratio only slightly rose from 8.3% in 1Q21 to 9.8% in 2Q23.

5) Strong consumer confidence. The savings rate was at 3.8% in 3Q23, significantly lower than 11.1% in 2021 and 7.4% in 2019.

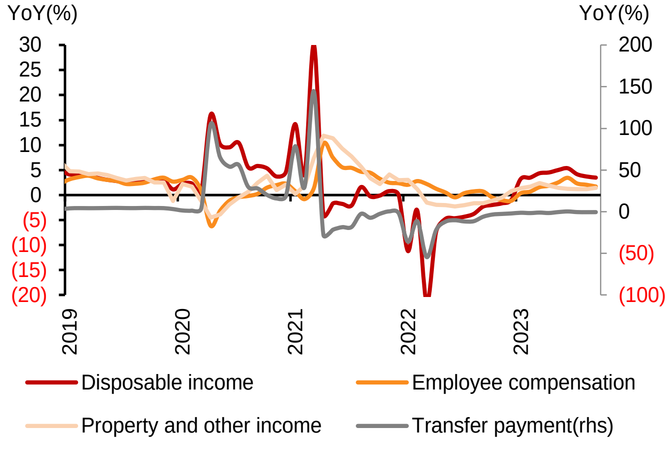
Household consumption is expected to slow in 2024 due to tightening credit conditions, rising financial pressure, a cooling labor market and softening income growth. The annualized QoQ growth of consumer loans dropped from 15.9% in March 2022 to 1.1% in July 2023, before a modest rebound at 3.9% between August and October. Households with refinancing needs will face significantly higher financing costs as each percentage point increase in existing mortgage rates would raise household debt service ratio by 0.6ppt. Labor demand may soften as businesses faces credit tightening, cost pressure and demand uncertainty, while labor supply may gradually resume as labor participation and immigration inflow recovers. The excess savings are nearly exhausted while the savings rate may rise moderately as employment and income uncertainty increases. Overall, household financial conditions are likely to deteriorate, causing downward pressure on consumption growth.

Figure 6: Household consumption at constant price



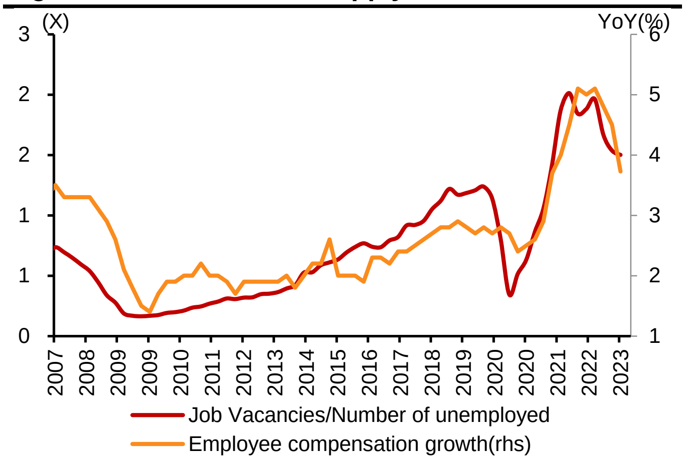
Source: Bloomberg, Wind, CMBIGM estimates

Figure 7: Real growth of household incomes



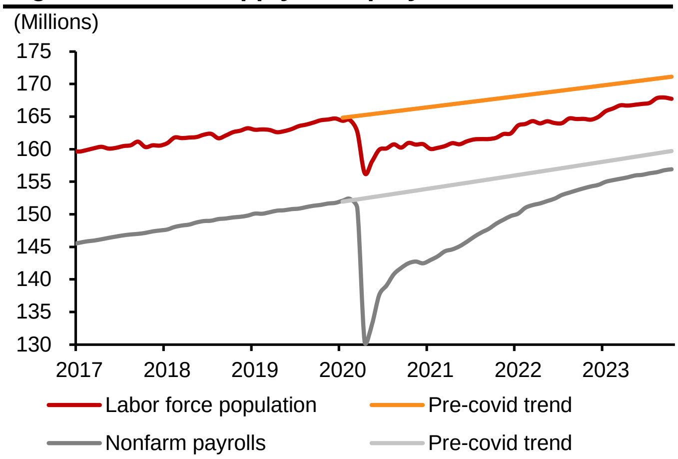
Source: Bloomberg, Wind, CMBIGM estimates

Figure 8: Labor demand-supply ratio



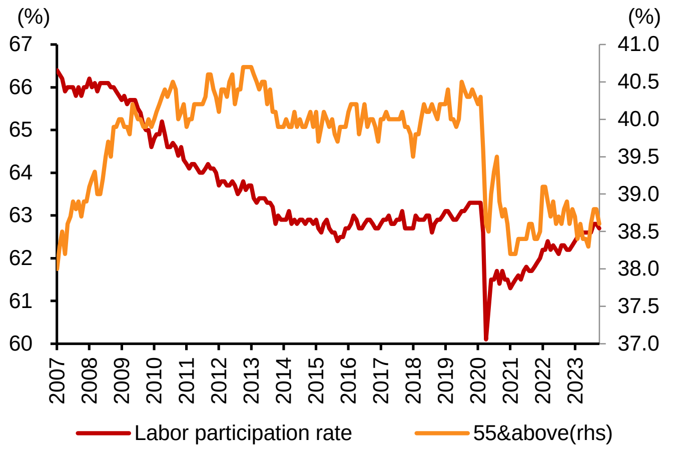
Source: Bloomberg, Wind, CMBIGM estimates

Figure 9: Labor supply & employment



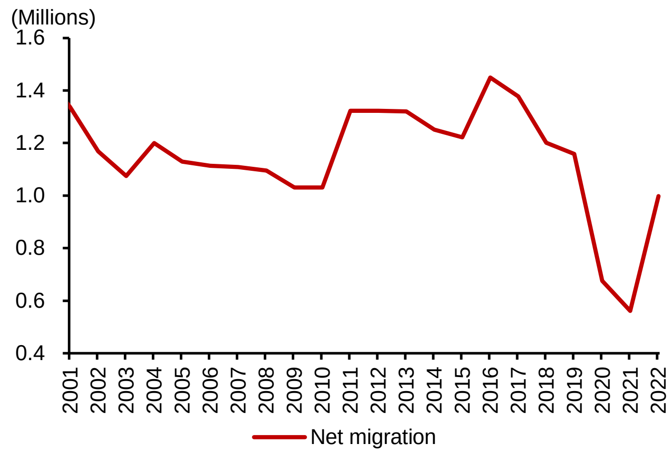
Source: Bloomberg, Wind, CMBIGM estimates

Figure 10: Labor participation rate



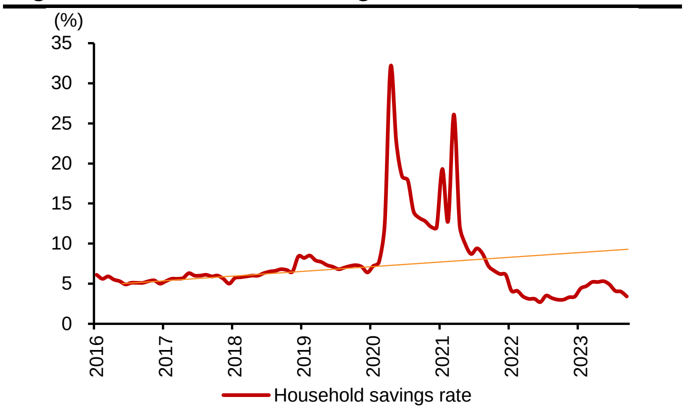
Source: Bloomberg, Wind, CMBIGM estimates

Figure 11: Number of net immigration inflow



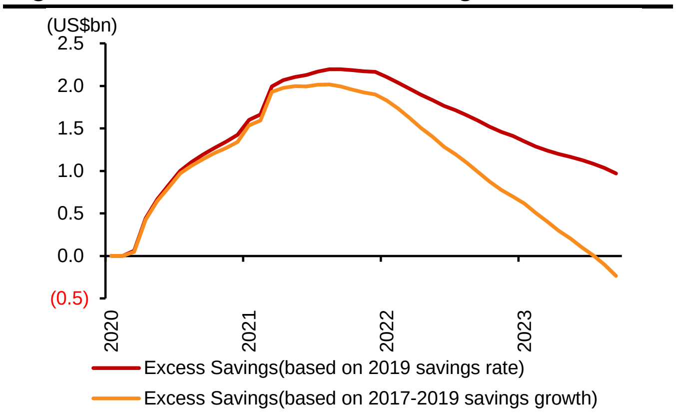
Source: Bloomberg, Wind, CMBIGM estimates

Figure 12: Household savings rate



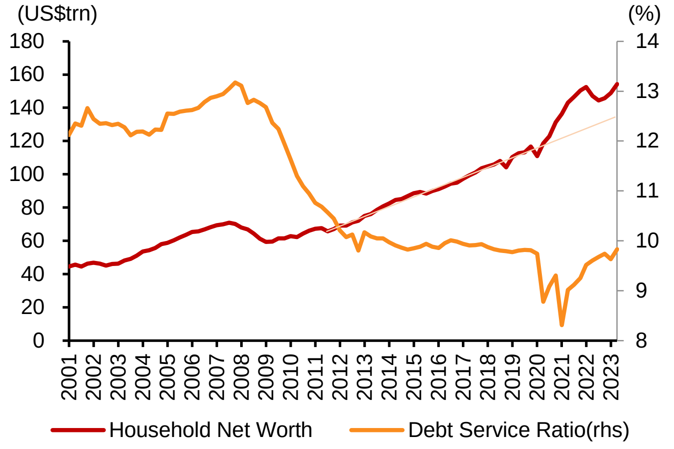
Source: Bloomberg, Wind, CMBIGM estimates

Figure 13: Cumulative excess savings



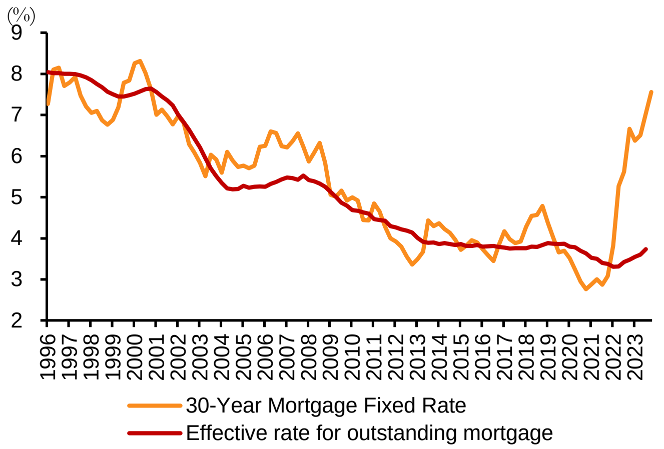
Source: Bloomberg, Wind, CMBIGM estimates

Figure 14: Household wealth and debt service ratio



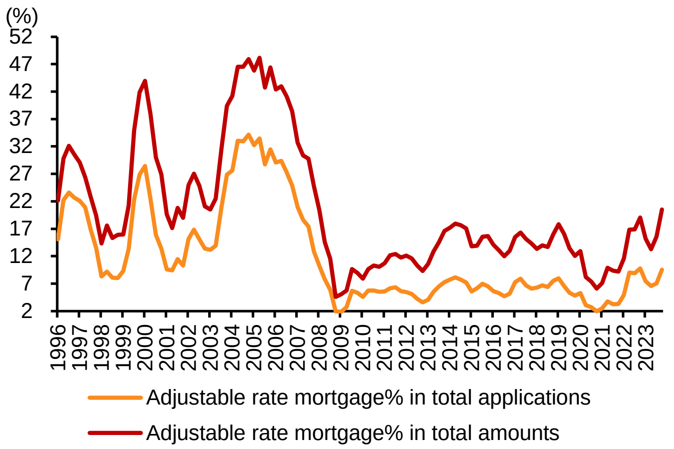
Source: Bloomberg, Wind, CMBIGM estimates

Figure 15: Golden handcuffs in existing mortgage



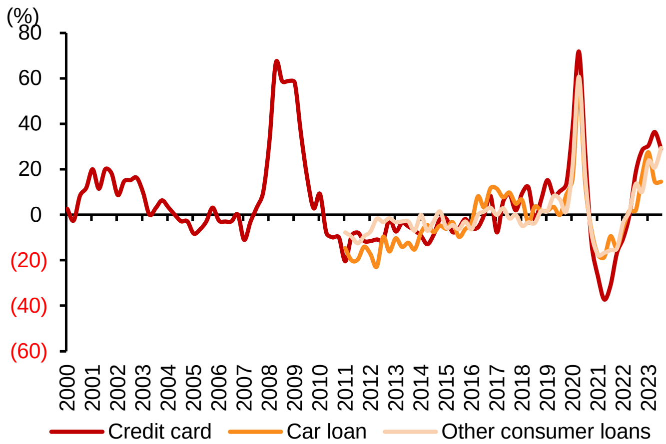
Source: Bloomberg, Wind, CMBIGM estimates

Figure 16: Proportion of ARM in mortgage application



Source: Bloomberg, Wind, CMBIGM estimates

Figure 17: Net % of banks tightening loan standard



Source: Bloomberg, Wind, CMBIGM estimates

Narrowing Decline in Real Estate

The property sector is sensitive to interest rates due to its high leverage. Property sales have shrunk after the aggressive interest rate hikes. New home sales, housing start approvals and existing home sales respectively fell by 17.2%, 4.2% and 17.1% in 2022. While new home sales rebounded by 5.3%, housing start approvals and existing home sales further decreased by 16.3% and 21.9% in 9M23. The commercial real estate market experienced even sharper declines as its transaction volume dropped by half in 2022-2023.

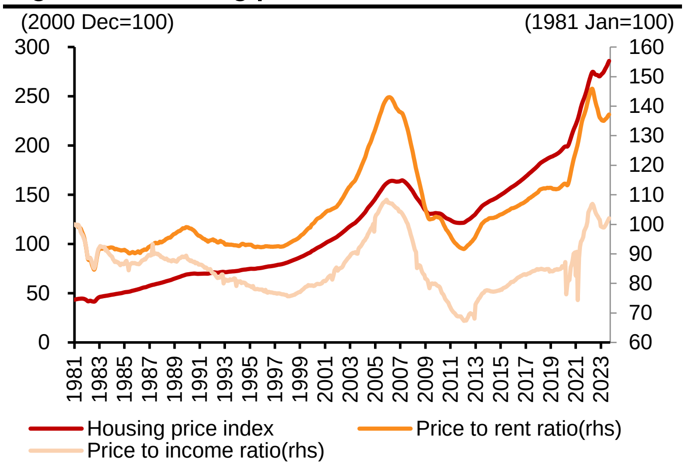
Housing price has softened yet a shortage of supply especially in existing homes has prevented a sharp correction of housing prices. Monthly average inventory of existing homes dropped from 1.74 million units in 2019 to 1.1 million units in 2022 and 1.06 million units in 9M23. The average period of supply available for sale dropped from 3.9 months in 2019 to 2.7 months in 2022 and 3 months in 9M23. The shortage of existing homes has constricted sales, pushed up prices and shifted more housing demand to the rental market, which supported rent inflation. The Fannie Mae House Price Index significantly increased 31.6% from end-2019 to end-2021, followed by a rise of 6.5% in 1H22 and a decline of 1.6% in 2H22. However, it rose again by 5.8% in 9M23. The Zillow Market Rent Index increased by an average of 7.8% MoM in 2022 and 2.6% MoM in 10M23.

The supply shortage of existing homes is primarily due to the 'golden handcuffs' effect in existing mortgage loans. Many homeowners have been locked in low-fixed-rate mortgages as they are unwilling to sell their homes to buy a new one with new mortgage rates up to over 7%. As of September 2023, the average interest rate for existing mortgage loans was at 3.74% while the interest rate for 30-year new mortgage loans was at over 7%. According to a Zillow survey, lowering mortgage rates to 5% could double homeowners' willingness to sell. According to John Burns Research & Consulting, 71% of potential homebuyers with a mortgage application plan believe that rates above 5.5% are unacceptable. It seems that 5%-5.5% is a critical threshold for mortgage rates, but it will take time for new home mortgage rates to fall to 5%-5.5% or existing mortgage loan rates to rise to the critical level.

The housing market may mildly improve in 2024, but it is unlikely to see a new boom cycle. Housing sales would benefit from likely moderate cuts in the policy rate and a gradual improvement of housing supply. However, mortgage rates may remain at restrictive levels and household financial conditions may deteriorate in 2024. As new home inventory has been high in 2023, housing starts may continue to decline in 2024. Multi-family housing may face oversupply pressure as private multi-family housing construction value grew 22.1% YoY in 9M23 and there were nearly 1 million apartments under construction in September. The matured amount of multi-family housing loans will rise from US$185bn in 2023 to an annual average of US$250bn in 2024-2025, with an increase of refinancing cost pressure in future.

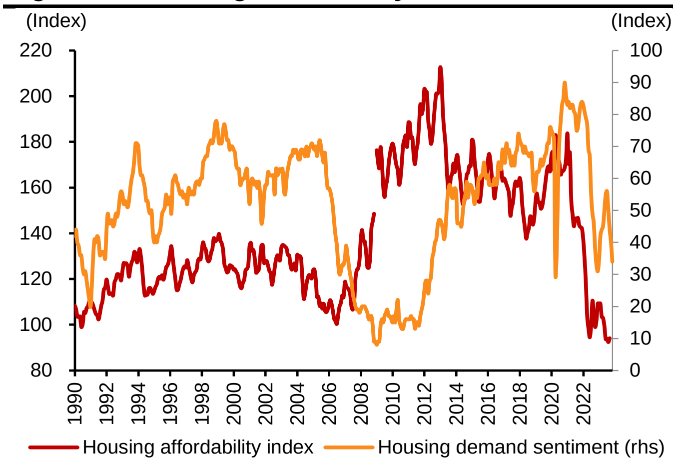
The commercial real estate market may continue to be under pressure in 2024, with office buildings likely to see the most significant strain. The pandemic has popularized remote working and reduced demand for office spaces. However, construction and supply have continued to grow. In 9M23, private office building construction value increased 7.4% YoY. The vacancy rate for U.S. office buildings reached 17.8% in October 2023. Commercial real estate prices had cumulatively fallen by over 15% since peaking in March 2022. According to a Bloomberg survey, over 70% of institutional investors believed commercial real estate prices may not see the bottom until 2H24 or later. As of the end of October 2023, outstanding commercial real estate loans was nearly US$3trn, with an annual maturing volume of US$600bn over the next two years. The weakness in commercial real estate market has a greater drag on small banks than large banks, with large banks and small banks having commercial real estate loan balances of US$0.9trn and US$2trn, respectively, as of October 2023.

Figure 18: Housing price and bubble index



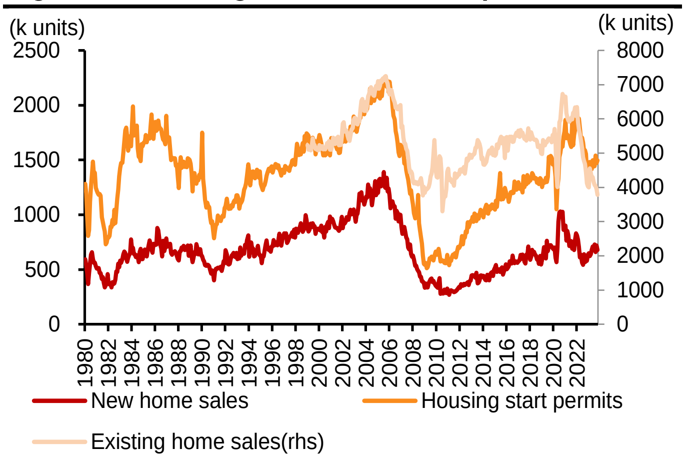
Source: Bloomberg, Wind, CMBIGM estimates

Figure 19: Housing affordability and demand



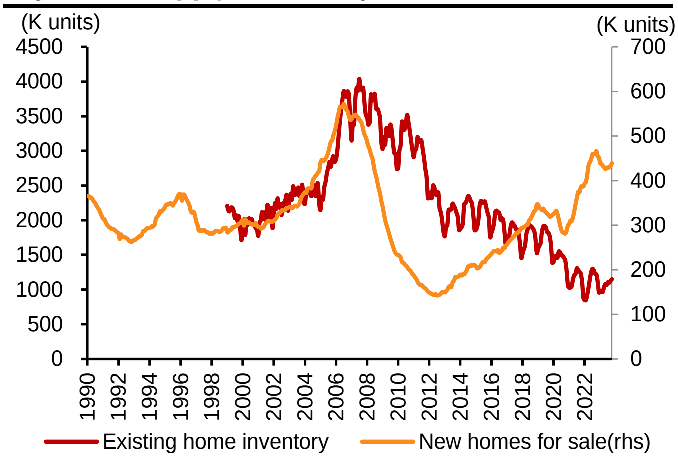
Source: Bloomberg, Wind, CMBIGM estimates

Figure 20: Housing sales & new start permits



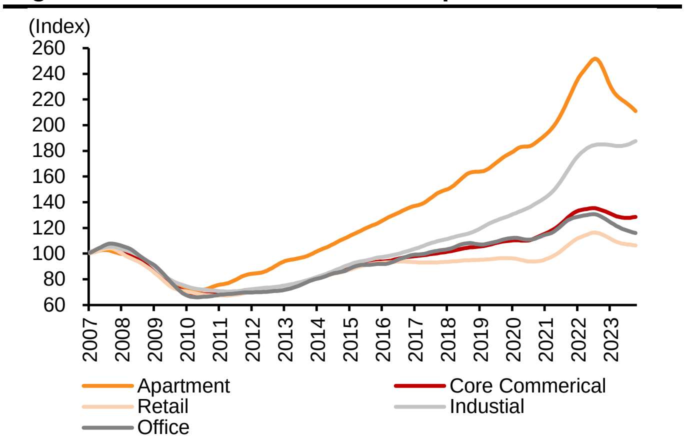
Source: Bloomberg, Wind, CMBIGM estimates

Figure 21: Supply of existing and new homes



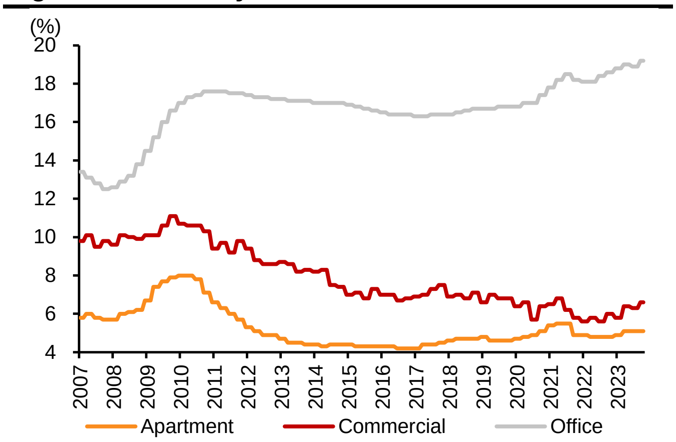
Source: Bloomberg, Wind, CMBIGM estimates

Figure 22: Commercial real estate price index



Source: Bloomberg, Wind, CMBIGM estimates

Figure 23: Vacancy rates of commercial real estate



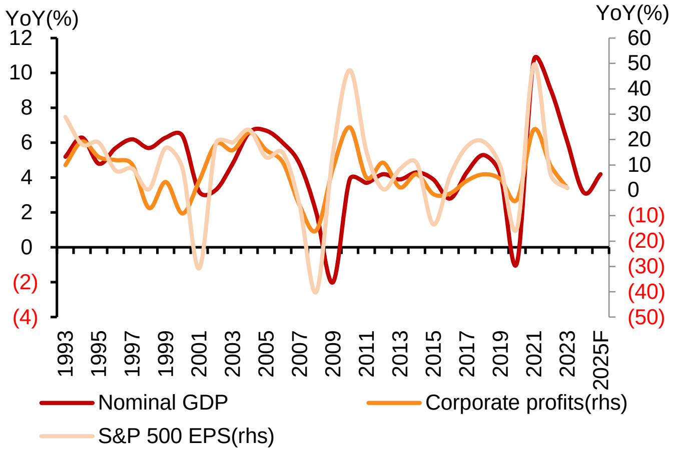
Source: Bloomberg, Wind, CMBIGM estimates

Business Investment and Inventory Cycle

Business investment maintained rapid growth in 2023, with manufacturing construction investment being a highlight. Non-residential fixed investment at constant price rose 4.3% YoY in 9M23, compared to 5.3% in 2022, 2.2% in 2020-2022 and 4.7% in 2013-2019. Despite the aggressive interest rate hikes, business investment maintained strong growth, contributing 0.6ppt to the annualized QoQ GDP growth in the first three quarters. Breaking down items, construction investment and intellectual property investment respectively grew by 11.2% and 5%, while equipment investment slightly declined by 0.1% in 9M23. Manufacturing construction investment, intellectual property and transportation equipment respectively contributed 66.2%, 28.2% and 22.8% to the business investment growth, whereas IT equipment, mining construction and industrial equipment all dragged down the investment growth. The robust growth in manufacturing construction investment was primarily driven by the computer and electronic and electrical equipment industries, with likely benefits from the Inflation Reduction Act and the CHIPS Act. The former provides US$369bn subsidy for electric vehicles, key minerals, clean energy and power generation while the latter provides US$252.7bn subsidy for investment in semiconductors, artificial intelligence and related sectors. As the PPI continued to decline, businesses continued to maintain low inventory levels. Inventory change detracted 0.3ppt from the annualized QoQ GDP growth in the first three quarters.

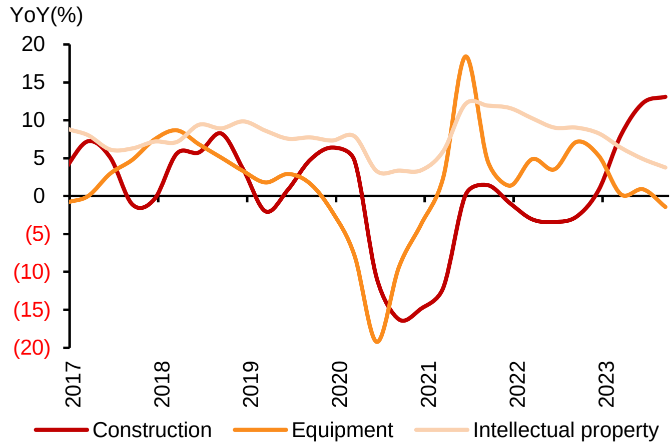
Business investment may moderate in 2024, due to continuous credit tightening, high-cost pressure, demand softening and stimulus effect fading. Business credit conditions continued to tighten, with the YoY growth of outstanding commercial and industrial loans sharply down from 12.7% at end-2022 to -0.3% at end-10M23. The QoQ growth slightly improved from July, but remained below 2% in annualized terms. In the past decade with low interest rates, businesses typically opted for fixed-rate borrowing, and the proportion of floating-rate bonds in bond issuance dropped from nearly 30% before the financial crisis to about 15% over the past ten years. Net interest expenses of large enterprises have remained low thanks to the rise in returns on abundant cash assets after the aggressive interest rate hikes. As low-interest debt continues to mature, however, refinancing costs may gradually rise in future. High labor costs remain a concern as corporate profits dropped 0.8% in 1H23, potentially dragging down investment activity. Consumer demand may gradually cool down in the next few quarters, adding downside pressure on business investment. In addition, the policy stimulus effect on business investment may decline in 2024. The Republicans are making efforts to limit further expansion of the Biden administration's spending and corporate subsidies, and some investors are starting to worry about possible overcapacity in new energy and semiconductor industries in the medium term. The de-stocking cycle may end in 2024, but businesses may have low willingness to increase inventory if the demand prospect weakens. Business inventory investment may only see a modest increase.

Figure 24: Nominal GDP and profit growth



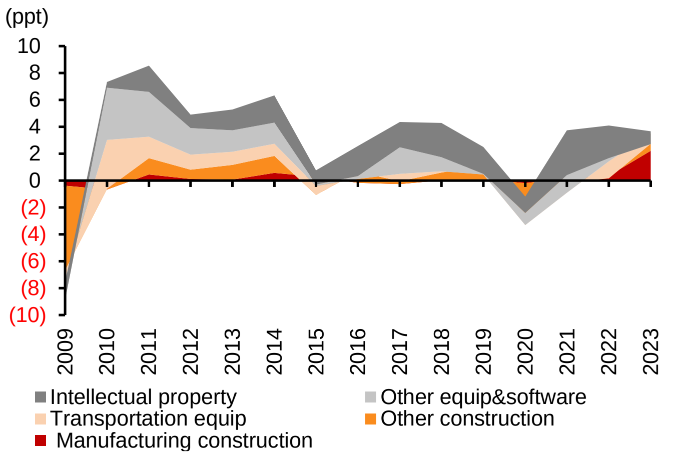
Source: Bloomberg, Wind, CMBIGM estimates

Figure 25: Real growth of corporate investment



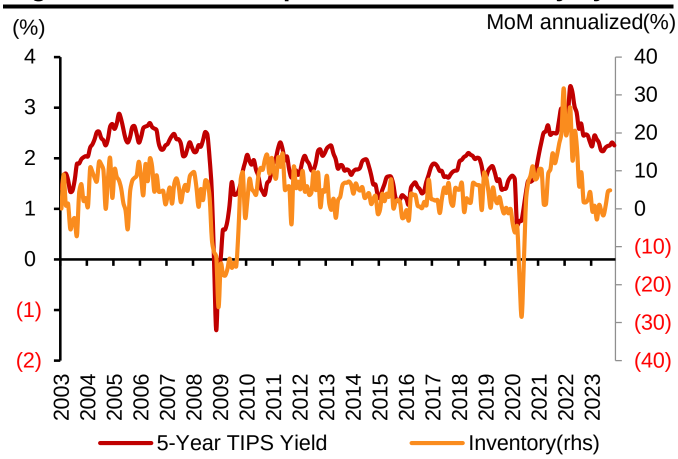
Source: Bloomberg, Wind, CMBIGM estimates

Figure 26: Contribution to investment growth



Source: Bloomberg, Wind, CMBIGM estimates

Figure 27: Inflation expectations & inventory cycle



Source: Bloomberg, Wind, CMBIGM estimates

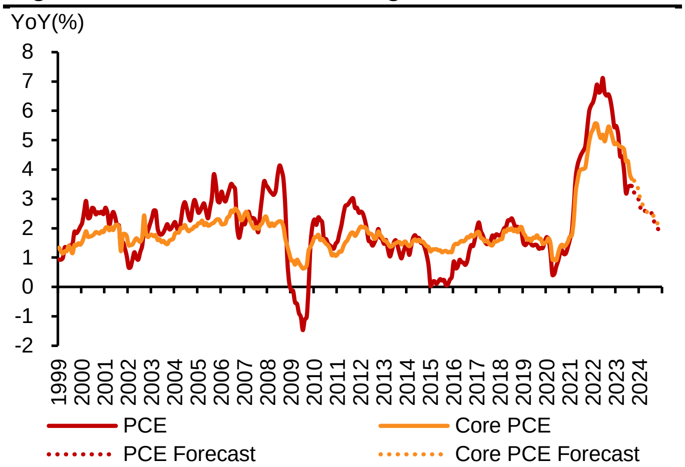
The Disinflation Goes On

Inflation receded in 2023. Energy inflation experienced the largest decline, non-energy goods and non-rent services decreased noticeably, yet rent inflation only marginally reduced. The CPI and core CPI growth respective decreased from 6.4% and 5.7% in December 2022 to 3.2% and 4% in October 2023. Specifically, the growth of energy and food prices dropped from 7.1% and 10.5% to -4.5% and 3.3%; other goods and services excluding rent decreased from 2.2% and 7.5% to 0% and 3%; and rent inflation only declined from 7.6% to 6.8%. The disinflation trend slowed in 2H23 due to resilient economy, rebounding commodity prices and the base effect. The annualized MoM growth of core CPI and food price respectively reached 2.4% and 2.8% in the past three months, while the growth of other goods declined from 4.4% to -2.4% thanks to demand softening and supply chain restoration in durables. However, the price of non-rent services picked up 5.6% in annualized MoM terms after rising 0.4% in 2Q23, as rebounds in energy price pushed up transportation service price, and strikes in the healthcare sector along with recalculations of health insurance price increased medical care inflation.

The disinflation trend should persist into 2024 with the most significant contribution from the rent component. In the CPI, rent is derived from surveys of tenants and homeowners, reflecting the prices of existing rental agreements or equivalent rents. Because adjustments to existing rental prices have a lag, and the Department of Labor samples rents of the same residential units only once every six months, CPI rent changes lag behind market rents by 12 months. The MoM growth of Zillow's Market Rent Index peaked around September 2021, and its YoY growth rate peaked around March 2022, with a significant decline in 2H22. The most recent two months have seen the YoY growth rate drop to around 3%. Therefore, the CPI rent inflation still has much room to decrease in the future. Services inflation excluding energy is closely related to labor cost increases. As the labor market weakens and wage growth decelerates, services inflation excluding energy will likely fall further.

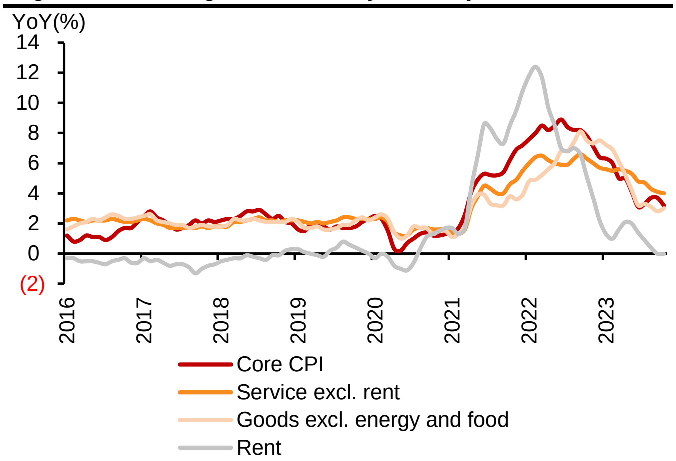
Commodity inflation may fluctuate at low levels in 2024. Bulk commodities may decline slightly while industrial product prices may bottom out. Macro factors that could boost commodity prices in 2024 include moderate easing of global monetary policies; modest improvement in demand from China and the Eurozone; and disruptions to bulk commodity supplies due to weather and geopolitical factors. Macro factors that could dampen commodity prices include possibly still-tight credit conditions and slowing demand in the US; further restoration of global commodity supply amid potential easing of the Russo-Ukrainian war and phased improvement in Sino-US relations.

Figure 28: PCE and core PCE growth



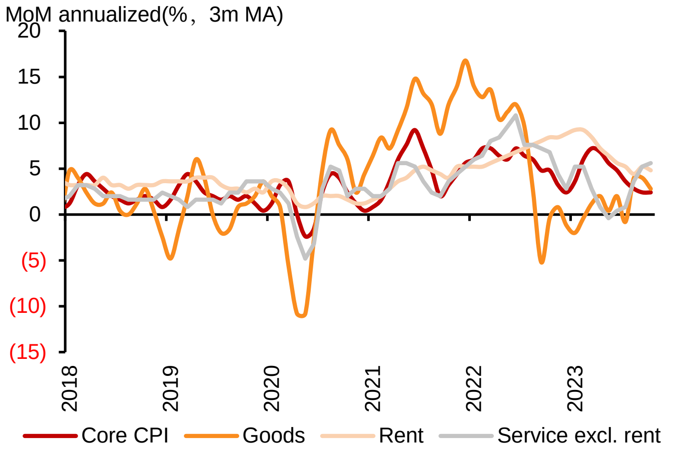
Source: Bloomberg, Wind, CMBIGM estimates

Figure 29: YoY growth of major components



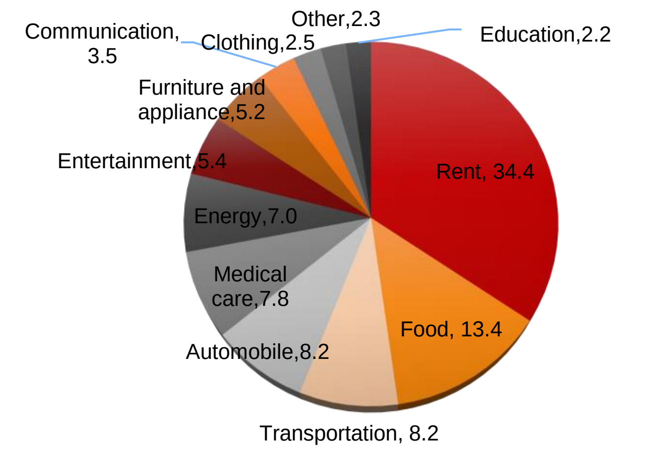
Source: Bloomberg, Wind, CMBIGM estimates

Figure 30: MoM Growth of major CPI components



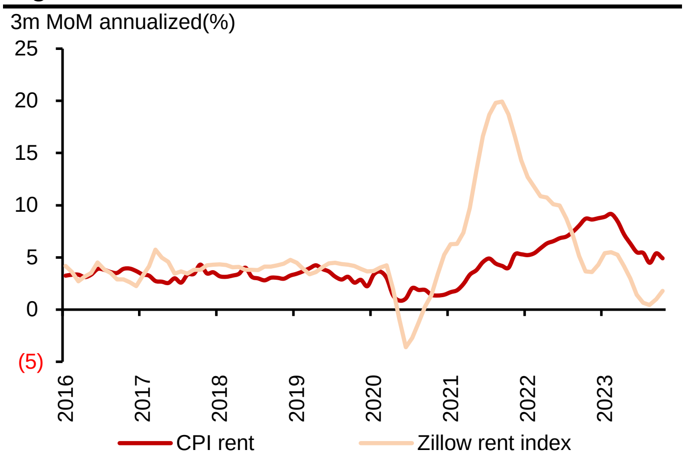
Source: Bloomberg, Wind, CMBIGM estimates

Figure 31: CPI component weights



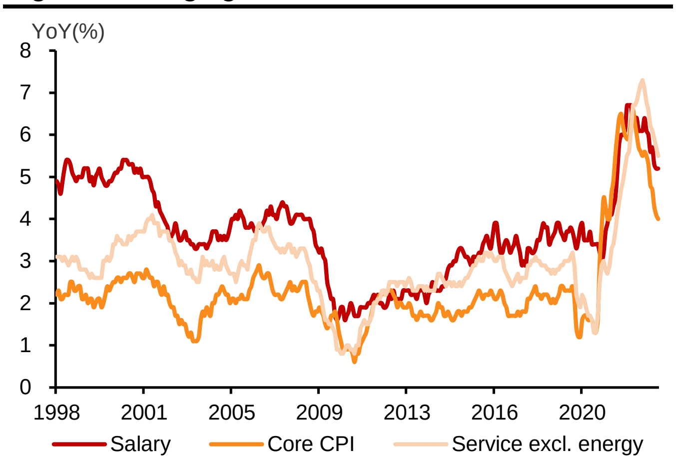
Source: Bloomberg, Wind, CMBIGM estimates

Figure 32: Growth rate of rent



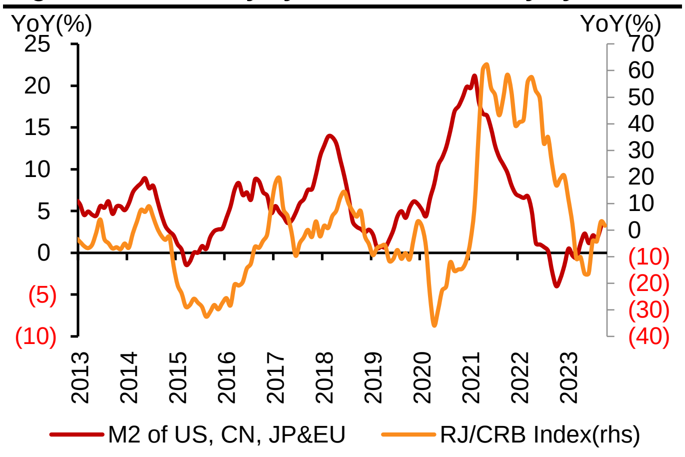
Source: Bloomberg, Wind, CMBIGM estimates

Figure 33: Wage growth and core inflation



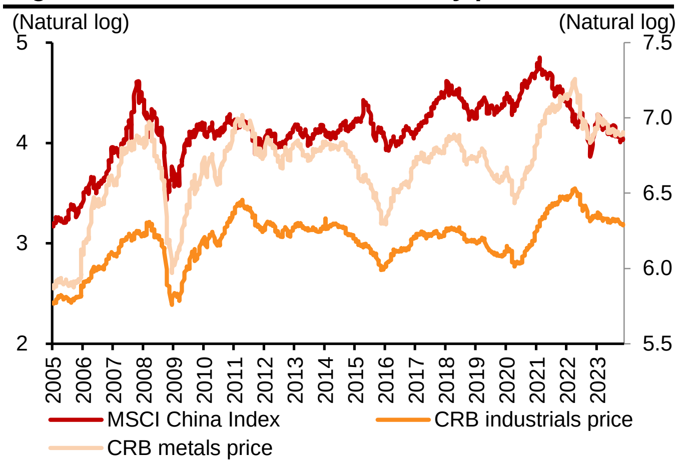
Source: Bloomberg, Wind, CMBIGM estimates

Figure 34: Monetary cycle and commodity cycle



Source: Bloomberg, Wind, CMBIGM estimates

Figure 35: MSCI China & commodity price



Source: Bloomberg, Wind, CMBIGM estimates

Macroeconomic Policy

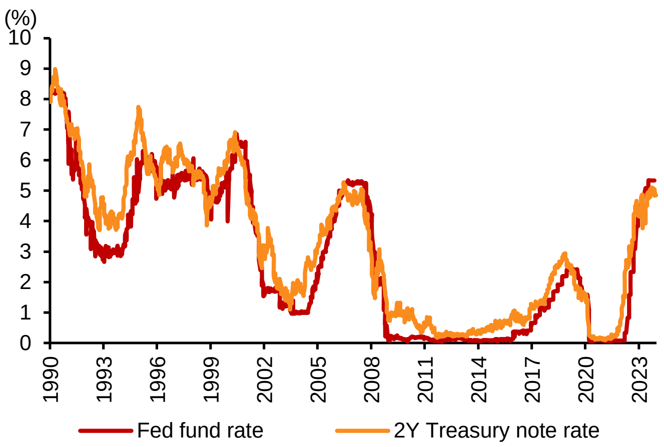
Fiscal expansion may slow in 2024. The federal deficit ratio is expected to decline from 6.1% in 2023 to 5.8% in 2024. Government spending growth may slow from 3.4% in 2023 to 1.3% in 2024 due to the halting of large emergency allocations and relief expenditures during the pandemic, the expiration of some tax credits and a June 2023 debt ceiling agreement to reduce spending by US$234bn over the next two fiscal years. Accompanying sharp interest rate hikes, the federal government's debt service burden has significantly increased. Interest expenditure reached nearly 15% of revenue in 2023 and may be above 20% in the coming years. The sustainability of federal government budget and debt has attracted heightened attention with both parties to engage in intense debates over the fiscal budget before the election. While the Biden administration desires further fiscal expansion to extend the economic boom, the Republicans are determined to impose restrictions. The Brookings Institution expects a decline of fiscal expansion may drag down the 2024 GDP growth by 0.6ppt. However, significant cuts in federal spending are challenging. Two-thirds of the expenditures are mandatory welfare spending on social security, healthcare and social relief. There is strong political resistance to cutting these outlays.

The Fed's rate-hiking cycle has peaked. As inflation receded, credit conditions tightened, financial pressure rose and employment softened, the Fed has regained confidence in controlling inflation and started to pay attention to potential risks after aggressive tightening. Most coincidental indicators such as employment, consumption and service activity have pointed to a resilient economy, but some leading indicators like the yield curve, manufacturing PMI, credit condition and consumer confidence have sent warning signals for economic downside risks. The ceasing of a policy rate hike in October-November indicates the Fed became reluctant to risk financial turmoil for over tightening, opting instead to patiently await the further release of high interest rate effects.

The Fed will likely commence a rate-cutting cycle in 2024. As inflation falls markedly, real interest rates would reach high levels, potentially continuing to pressure the banking system and financial markets, with conditions for rate cuts gradually materializing. The Fed may start to cut rates around May or June, with a total reduction of about 1.5 percentage points throughout the year. As real interest rates continue to rise with tightening credit conditions, households' financial condition would worsen, putting downward pressure on consumption and housing sales. Businesses will be more cautious about capex expansion and inventory increase. Fixed rates on long-term loans are pressuring small and medium banks with turbulence risk still there. Due to the strong balance sheet of the real sector and a resilient banking system, the possibility of a banking crisis should be low.

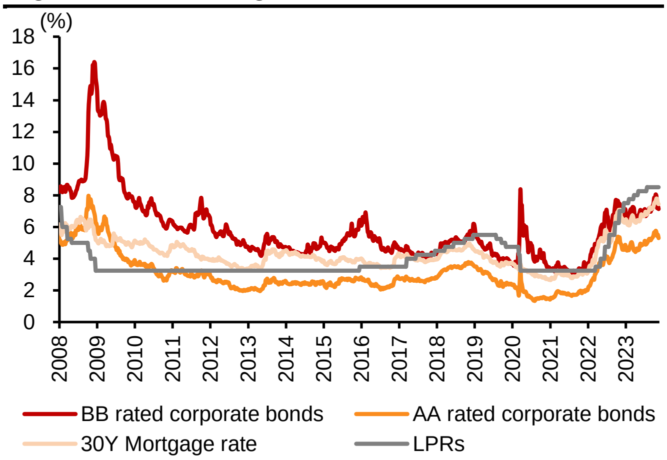
The US dollar index may undergo a cyclical decline. First, the growth differentials between the US and Europe may moderately narrow. The US economic growth, inflation and interest rates are likely to fall significantly with GDP growth potentially decreasing from 2.3% in 2023 to 0.8% in 2024, while the Eurozone's economy has already significantly slowed down in 2023 as its GDP growth may rise slightly from 0.6% in 2023 to 0.8% in 2024. Secondly, the Russo-Ukrainian War may move towards de-escalation, reducing pressure on the euro. The conflict continues to intensify the drain on both sides, and the Israeli-Palestinian conflict may further divert US attention and resources, with anti-war sentiment growing within Europe and America. Lastly, Sino-US relations may see a phased improvement, which would be positive for the euro. China seeks to improve Sino-US relations to restore market confidence and rejuvenate its economy. The US government, aiming to extend the current business expansion cycle and alleviate pressures on businesses and SMEs, is focused more on targeting China's high-tech sectors while reopening communication and cooperation in other areas. The Eurozone's dependency on the Chinese supply chain and market is higher than that of the US, so a phased improvement in Sino-US relations would benefit the euro.

Figure 36: Policy rate and 2Y T-bond yield



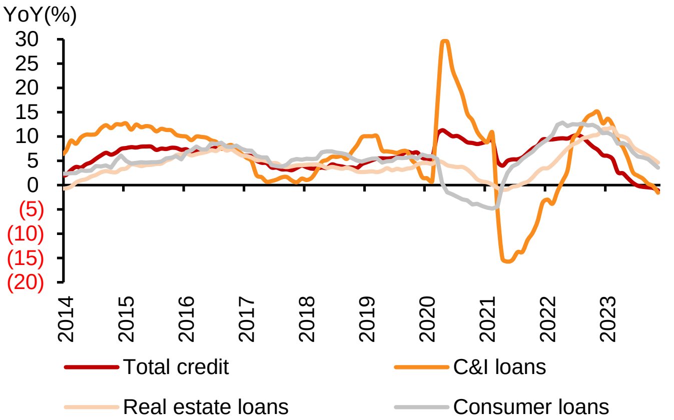
Source: Bloomberg, Wind, CMBIGM estimates

Figure 37: Financing cost



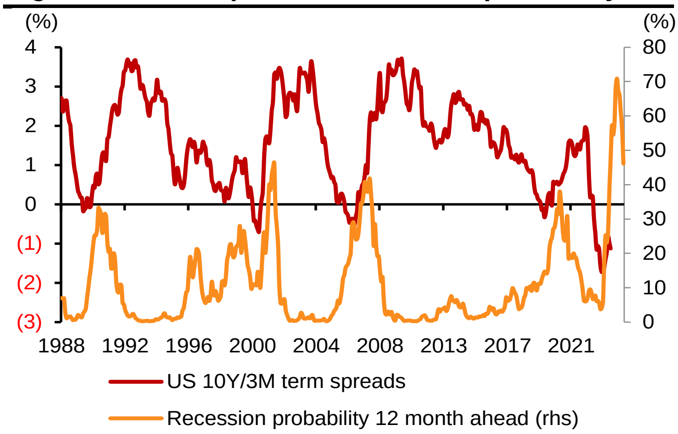
Source: Bloomberg, Wind, CMBIGM estimates

Figure 38: Credit growth



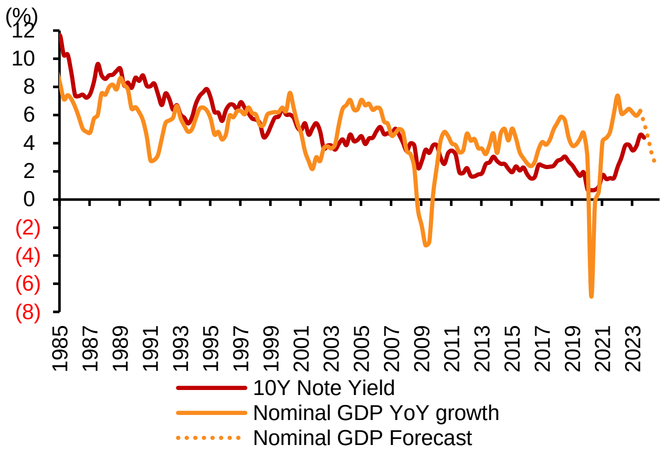
Source: Bloomberg, Wind, CMBIGM estimates

Figure 39: Term spreads & recession probability



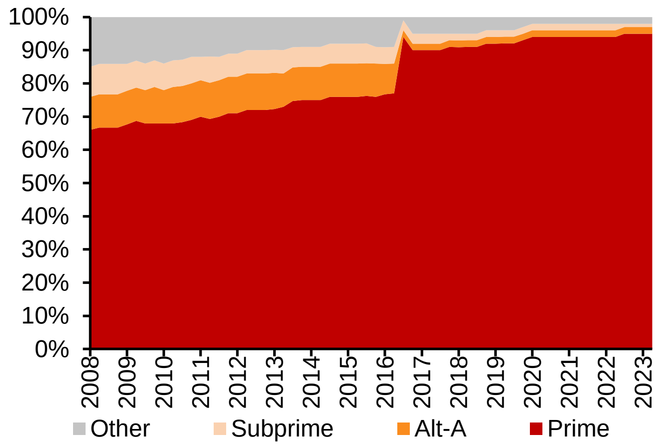
Source: Bloomberg, Wind, CMBIGM estimates

Figure 40: 10Y T-bond yield & nominal GDP growth



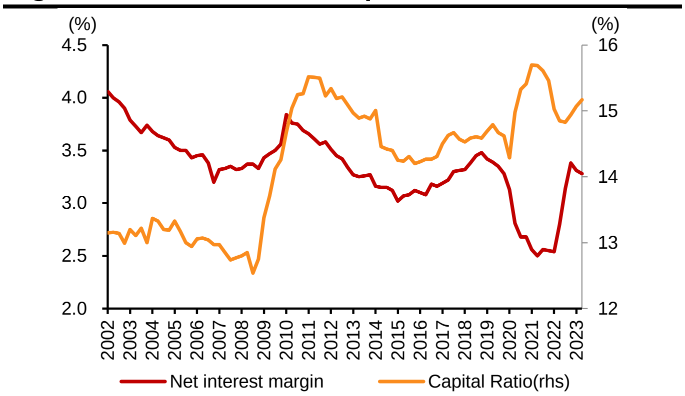
Source: Bloomberg, Wind, CMBIGM estimates

Figure 41: Existing mortgage structure by quality



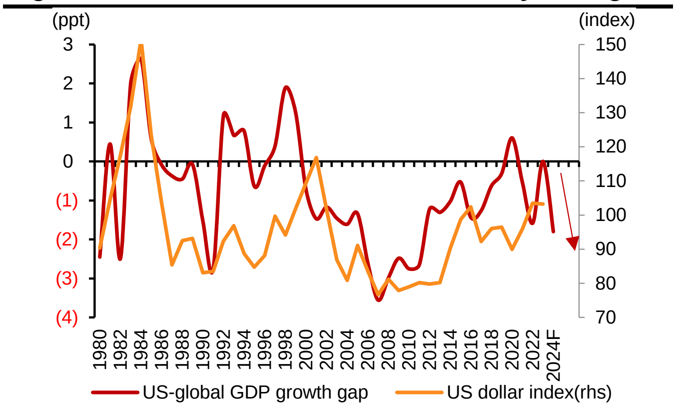
Source: Bloomberg, Wind, CMBIGM estimates

Figure 42: Banks' NIMs & capital ratio



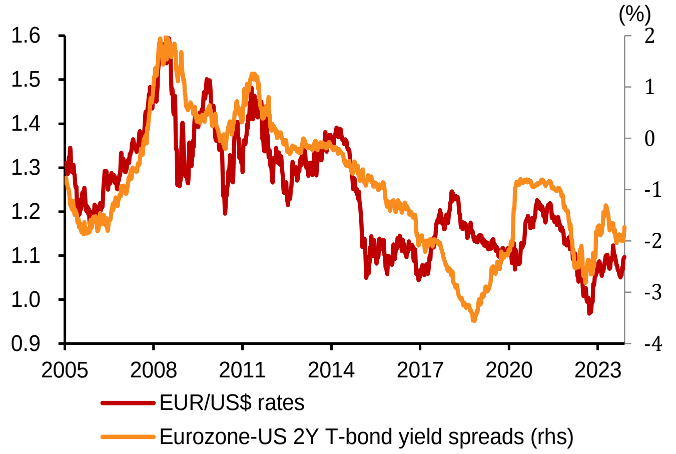
Source: Bloomberg, Wind, CMBIGM estimates

Figure 43: US Dollar Index & US economy strength



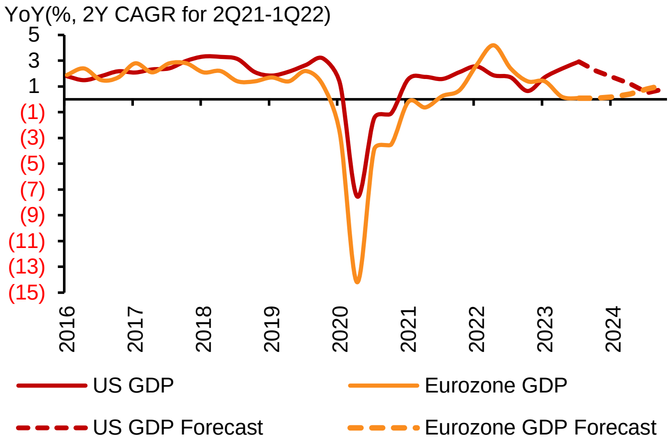
Source: Bloomberg, Wind, CMBIGM estimates

Figure 44: Euro/US dollar rates & interest spreads



Source: Bloomberg, Wind, CMBIGM estimates

Figure 45: US-Eurozone growth differentials



Source: Bloomberg, Wind, CMBIGM estimates

2024 China Economic Outlook

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Path to moderate improvement

The economic recovery in 2023 is full of twists and turns. The property slump, deflation and expectations of Japanization have severely dampened confidence in the private sector. Local fiscal dilemmas and implicit debt risks have hindered the effectiveness of fiscal policy while the US Fed's aggressive rate hikes constrained the room for PBOC's interest rate policy. In 2024, policymakers may maintain the 5% GDP growth target, increase fiscal easing and further relax monetary policy with focus on stabilizing real estate, mitigating risks and restoring confidence. China's economy will improve moderately with a modest uptick in consumption, a mild improvement in real estate, an upswing in fixed investment and foreign trade and gradual easing of deflation. China's nominal GDP growth will once again surpass that of the US, which may narrow difference of the US-Sino interest rate and support a moderate rebound of RMB.

- **Moderate economic improvement:** The nominal GDP growth rate is expected to rise from 4.5% in 2023 to 5.8% in 2024; while the real GDP growth rate will drop from 5.3% in 2023 to 4.8% in 2024, yet higher than the CAGR of 4.1% in 2022-2023 (benefited from low base effect in 2023). China will increase policy easing, accelerate opening up, optimize business environment and strive to improve international relations and entrepreneur confidence.

- **Gradual easing of deflation:** GDP deflator, CPI, core CPI and PPI growth rates may rise from -0.8%, 0.4%, 0.7% and -3% respectively in 2023 to 1%, 1.4%, 1.6% and 0.3% in 2024, due to capacity reduction in live hog, continued recovery in service and the end of industrial destocking cycle. But reflation pressure should be low as China's growth remains below its potential level with low possibility of demand overheating and high risk of overcapacity.

- **Slow recovery in consumption:** Retail sales growth is expected to drop from 7.6% in 2023 to 5.3% in 2024, yet higher than the CAGR of 4.2% in 2022-2023. Retail sales of medicine, food, beverage and cosmetics would maintain rapid growth, while those of cultural and office goods, telecom equipment, home appliance and furniture may noticeably rebound. However, auto, clothing, sports and entertainment goods and jewelry retail sales may slow down. Consumption of services such as transportation, accommodation, tourism, sports & entertainment will continue to improve.

- **Slowdown in contraction in real estate sector:** Gross floor area for commodity buildings and development investment may respectively drop 5% and 7% in 2024 after declining 8% and 9% in 2023. Incremental investment in village renovation and affordable housing construction in cities may narrow the property investment decline by 3ppts. New housing demand is likely to decline further in the medium term. Without taking the demolition factor into account, we expect urban residential demand to drop from 1.03 bn s.q. in 2023 to 700 mn s.q. in 2030 due to expected declines in young population, new migrants to cities & towns and incremental demand for housing upgrade.

- **Rebound in investment growth**: Fixed asset investment growth may rise from 2.8% in 2023 to 4.2% in 2024. Manufacturing investment growth is expected to rise from 6.2% in 2023 to 6.5% in 2024, bolstered by recovery in consumer goods & exports and supply-side technological innovation, industrial transformation and import substitution. Infrastructure investment growth may drop from 8.2% in 2023 to 7.8% in 2024. Despite the more expansionary fiscal policy, the cabinet may strictly control the expansion of hidden debts of local government.

- **Pickup in imports and exports:** We expect China's exports and imports of goods to pick up 3.6% and 3.3% respectively in 2024 after dropping 4.3% and 4.9% in 2023. The slowdown in the US economy should mainly come from the service sector, while the European economy may see mild improvement. The destocking cycle in global commodity should come to an end with possible rebound in industrial prices. The growth rates of service exports and imports are expected to rise from -12% and 15.5% in 2023 to 15% and 20% in 2024. China will further open up its service sector and accelerate service trade restoration as cross-border flows should continue to recover.

- **More expansionary fiscal policies:** China's actual broad fiscal deficit, including general deficit, local governments' special bond financing, special refinancing bond quota and carryover funds from the previous year, may exceed 8% of GDP in 2024. General fiscal revenue growth may slow from 6.7% in 2023 to 4.8% in 2024, while general fiscal expenditure growth would rise from 5.6% to 6.4%. The supply of quasi-policy loans from state-owned banks will continue to expand. In the medium term, aging population and slowing urbanization may continue to expand the fiscal revenue-expenditure gap and the proportion of fiscal spending on social security and medical health.

- **Continuous easing of monetary policy:** There may be two RRR cuts in 2024, with the 1-year and 5-year LPRs probably lowered by 10bps and 20bps respectively. Monetary policy will vigorously support fiscal expansion and quasi-policy credit supply. Social financing amount and new RMB loans are expected to grow by 11% and 14% respectively, with a slight pickup in the growth rate of outstanding RMB loans. Due to the base effect and decreasing willingness to save, M2 growth may slow down. USD/CNY exchange rate is expected to fall from 7.1 in end-2023 to 6.95 in end-2024. As the US economic growth and inflation decline while China's growth and inflation rebound, the US-Sino interest rate spreads and nominal GDP growth differentials should narrow.

Figure 1: China's economic forecast

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
GDP																	
Real GDP (YoY %)	9.4	10.6	9.6	7.9	7.8	7.4	7.0	6.8	6.9	6.7	6.0	2.2	8.4	3.0	5.3	4.8	4.5
Nominal GDP (US$ trn)	5.1	6.1	7.6	8.5	9.6	10.4	11.0	11.2	12.3	13.9	14.3	14.7	17.8	18.0	18.0	19.0	20.1
Per capita GDP (US$)	3823	4541	5597	6280	7057	7586	7923	8065	8797	9880	10124	10404	12615	12720	12749	13495	14281
Inflation (YoY %)																	
GDP deflator	(0.2)	6.9	8.0	2.3	2.1	1.1	0.0	1.5	4.3	3.5	1.2	0.5	4.6	2.2	(0.8)	1.0	1.7
CPI	(0.7)	3.3	5.4	2.6	2.6	2.0	1.4	2.0	1.6	2.1	2.9	2.5	0.9	2.0	0.4	1.4	1.7
PPI	(5.4)	5.5	6.0	(1.7)	(1.9)	(1.9)	(5.2)	(1.4)	6.3	3.5	(0.3)	(1.8)	8.1	4.1	(3.0)	0.3	1.8
GDP by industry (YoY %)																	
Agriculture	4.0	4.3	4.2	4.5	3.8	4.1	3.9	3.3	4.0	3.5	3.1	3.1	7.1	4.1	3.9	3.9	3.7
Industry & construction	10.3	12.7	10.7	8.4	8.0	7.2	5.9	6.0	5.9	5.8	4.9	2.5	8.7	3.8	4.7	4.4	4.3
- VAIO	11.0	15.7	13.9	10.0	9.7	8.3	6.1	6.0	6.6	6.2	5.7	2.8	9.6	3.6	4.5	4.3	4.2
Service	9.6	9.7	9.5	8.0	8.3	8.3	8.8	8.1	8.3	8.0	7.2	1.9	8.5	2.3	6.0	5.2	4.8
Contribution to GDP Growth (ppt)																	
Consumption	5.4	5.0	6.3	4.4	3.9	4.2	4.9	4.5	3.9	4.3	3.5	(0.2)	5.3	1.0	4.3	3.3	2.7
Investment	8.0	6.7	3.9	3.3	4.1	3.3	1.6	3.1	2.7	2.9	1.7	1.8	1.1	1.5	1.6	1.7	1.6
Net exports	(4.0)	(1.1)	(0.6)	0.2	(0.2)	(0.1)	0.5	(0.8)	0.3	(0.5)	0.8	0.6	1.7	0.5	(0.6)	(0.2)	0.2
Demand indicators (YoY %)																	
FAI	30.4	24.5	23.8	20.6	19.6	15.7	10.0	8.1	7.2	5.9	5.4	2.9	4.9	5.1	2.8	4.2	4.5
- Manufacturing	26.6	26.9	31.8	22.0	18.5	13.5	8.1	4.2	4.8	9.5	3.1	(2.2)	13.5	9.1	6.2	6.5	6.1
- Property development	16.1	33.2	27.9	16.2	19.8	10.5	1.0	6.9	7.0	9.5	9.9	7.0	4.4	(10.0)	(9.0)	(7.0)	(2.5)
- Infrastructure	42.2	18.5	6.5	13.7	21.2	20.3	17.3	15.7	14.9	1.8	3.3	3.4	0.2	11.5	8.2	7.8	6.1
Retail sales	15.9	18.8	18.5	14.5	13.1	12.0	10.7	10.4	10.2	9.0	8.0	(3.9)	12.5	(0.2)	7.6	5.3	4.9
Exports of goods	(16.0)	31.3	20.3	7.9	7.8	6.0	(2.9)	(7.7)	7.9	9.9	0.5	3.6	29.6	5.6	(4.3)	3.6	3.2
Imports of goods	(11.2)	38.8	24.9	4.3	7.2	0.5	(14.3)	(5.5)	16.1	15.8	(2.7)	(0.6)	30.1	0.7	(4.9)	3.3	3.0
Monetary conditions																	
M2 (YoY %)	27.7	19.7	13.6	13.8	13.6	12.2	13.3	11.3	8.1	8.1	8.7	10.1	9.0	11.8	10.0	8.5	8.0
M1 (YoY %)	32.4	21.2	7.9	6.5	9.3	3.2	15.2	21.4	11.8	1.5	4.4	8.6	3.5	3.7	2.0	3.1	3.5
New RMB loans (RMB trn)	9.6	8.0	7.5	8.2	8.9	9.8	11.7	12.7	13.5	16.2	16.8	19.6	20.0	21.3	23.4	26.9	29.0
Total social financing (RMB trn)	13.9	14.0	12.8	15.8	17.3	16.5	15.4	17.8	26.2	22.5	25.6	34.9	31.4	32.0	36.2	40.2	43.6
RRR for large banks (%)	15.5	18.5	21.0	20.0	20.0	20.0	17.5	17.0	17.0	14.5	13.0	12.5	11.5	11.0	10.3	9.8	9.5
10Y T-bond rates (%)	3.73	3.90	0.00	3.58	4.56	3.62	2.83	3.02	3.88	3.24	3.14	3.14	2.77	2.84	2.75	2.78	2.70
1Y LPR (%)					5.73	5.51	4.30	4.30	4.30	4.30	4.30	4.30	4.30	3.65	3.45	3.35	3.35
5Y LPR (%)											4.80	4.65	4.65	4.30	4.20	4.00	4.00
Public finance																	
Fiscal revenue (YoY %)	11.7	21.3	25.0	12.9	10.2	8.6	5.8	4.5	7.4	6.2	3.8	(3.9)	10.7	0.6	6.7	4.8	5.1
Fiscal expenditure (YoY %)	21.9	17.8	21.6	15.3	11.3	8.3	13.2	6.3	7.6	8.7	8.1	2.9	0.3	6.1	5.6	6.4	4.7
General deficit ratio (%)	2.7	2.5	1.8	1.5	2.0	2.1	2.4	2.9	2.9	2.6	2.8	3.7	3.1	2.8	3.9	3.6	3.4
Special fund revenue (YoY %)				(9.3)	39.2	3.5	(21.8)	11.9	34.8	22.6	12.0	10.6	4.8	(20.6)	(15.0)	(5.0)	0.5
Special fund expenditure (YoY %)				(9.7)	37.9	1.8	(17.7)	11.7	32.7	32.1	13.4	28.8	(3.7)	(2.5)	(15.0)	(5.0)	0.5
LG special bond quota / GDP (%)								0.5	1.0	1.5	2.2	3.7	3.2	3.0	3.0	3.3	3.3
BOP & Exchange rates																	
Trade surplus of goods / GDP (%)	4.8	4.0	3.0	3.6	3.7	4.2	5.3	4.4	3.9	2.7	2.8	3.5	3.2	3.7	3.4	3.2	3.3
Trade surplus of service / GDP (%)	(0.5)	(0.4)	(0.6)	(0.9)	(1.3)	(2.0)	(2.0)	(2.1)	(2.1)	(2.1)	(1.8)	(1.0)	(0.6)	(0.5)	(1.2)	(1.3)	(1.4)
Current account balance / GDP (%)	4.8	3.9	1.8	2.5	1.5	2.3	2.7	1.7	1.5	0.2	0.7	1.7	1.8	2.2	1.5	1.4	1.3
Financial account balance /GDP (%)	3.8	4.6	3.4	(0.4)	3.6	(0.5)	(4.0)	(3.7)	0.9	1.2	0.1	(0.4)	0.2	(1.2)	(1.0)	(0.7)	(0.9)
Error & omission / GDP (%)	(0.8)	(0.9)	(0.2)	(1.0)	(0.7)	(0.6)	(1.8)	(1.9)	(1.7)	(1.3)	(0.9)	(1.1)	(0.9)	(0.5)	(0.2)	(0.5)	(0.6)
Forex reserve (US$ trn)	2.40	2.85	3.18	3.31	3.82	3.84	3.33	3.01	3.14	3.07	3.11	3.22	3.25	3.13	3.11	3.14	3.10
US$/RMB spot rate (year-end)	6.83	6.59	6.30	6.23	6.05	6.20	6.49	6.95	6.51	6.87	6.97	6.54	6.37	6.95	7.10	6.95	7.17

Source: Bloomberg, Wind, CMBIGM estimates

Moderate improvement in economy

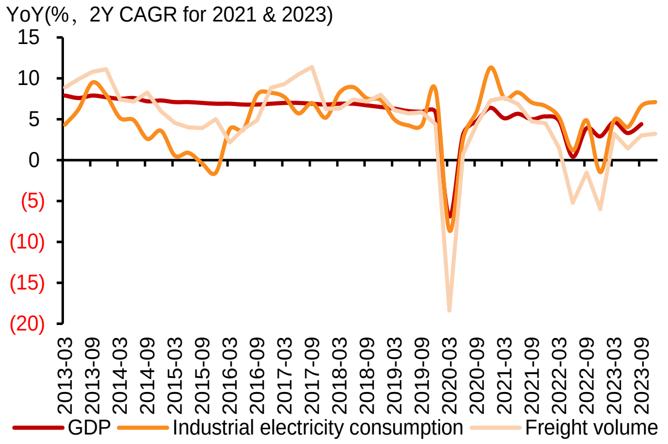
China's economic recovery in 2023 is full of twists and turns. 1Q23 was in a period of exuberance after economic reopening. With a surge in investor risk appetite, pent-up consumer demand and escalated production and inventory, the QoQ GDP growth jumped to 9.5%. But 2Q23 saw deterioration in sentiment, pent-up demand exhaustion, de-stocking and price wars as the QoQ GDP growth plummeted to 2%. 3Q23 witnessed a stabilization in economic growth at low levels thanks to more proactive fiscal, monetary and property policies. The QoQ GDP growth rebounded to 5.3%. 4Q23 experienced a slight rebound as the Yicai high-frequency economic activity index rose from 0.83 in 3Q23 to 0.91 in early November.

China's economic recovery is tepid in 2023 with sectoral disparities. Real GDP growth may reach 5.3% in 2023 with the 2Y CAGR at 4.1%, lower than 5.3% in 2020-2021. Consumption growth rebounded thanks to recovery and base effect as retail sales growth rose from -0.2% in 2022 to 7.6% in 2023. Fixed asset investment growth is expected to decline from 5.1% in 2022 to 2.8% in 2023 due to continuous property slump and a slowdown in infrastructure and manufacturing investment. China's exports and imports of goods may respectively drop 4.3% and 4.9% in 2023 after rising 5.6% and 0.7% in 2022 due to a global shift from goods consumption back to services and a decline in industrial prices. Service exports is expected to drop 12% in 2023 after rising 8.1% in 2022 with a contraction in exports of transportation services and intellectual property fees. But service imports may jump 15.5% in 2023 after rising 8.9% in 2022 thanks to a surge in outbound tourism, overseas education and imports of cultural & entertainment services.

The recovery pace in 2023 was uneven across different sectors. Automotive, transportation services, catering & lodging, entertainment and information technology services strongly recovered, while real estate, building materials, capital goods and consumer electronics were weak. Based on power consumption by sector, electrical machinery and equipment (including some new energy devices), railway transport, air transport, automobile manufacturing, education, culture and entertainment, accommodation and catering, leasing and business services, wholesale and retail, internet, pharmaceuticals, public services and aerospace equipment demonstrated strong operational activities, while instruments & meters, housing construction, communication equipment, non-ferrous metals, civil engineering construction and computer manufacturing showed weaker operational activities.

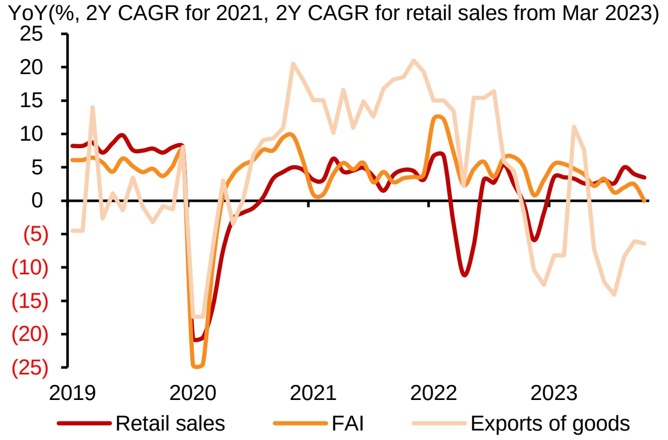
China's economy will show moderate improvement in 2024. The GDP growth is projected to reach 4.8%, up from the CAGR of 4.1% in 2022-2023. Growth in retail sales, fixed asset investment, goods exports and service exports are projected to be at 5.3%, 4.2%, 3.6% and 15%, respectively. There are four supportive factors. Firstly, China may maintain a 5% GDP growth target for 2024 with more expansionary fiscal policies. Achieving the same 5% growth target should become more challenging as the low-base effect wanes in most sectors, indicating a need for stronger macro policies. Actual broad fiscal deficit, including general deficit, special bond financing and carryover funds from the previous year may exceed 8% of GDP in 2024. Secondly, China may further loosen monetary policy with additional cuts in RRR, LPRs and deposit rates to stimulate credit supply expansion. The PBOC would urge banks to roll over local government hidden debts. Thirdly, China may continue to loosen property policies. The authorities may encourage property loan supply, relax housing purchase restrictions and lower down-payment ratios & mortgage. Lastly, China will further open up, optimize business environment and exhibit a pro-business stance to improve international relations and entrepreneurial confidence.

Figure 2: GDP, electricity consumption, and freight volume growth



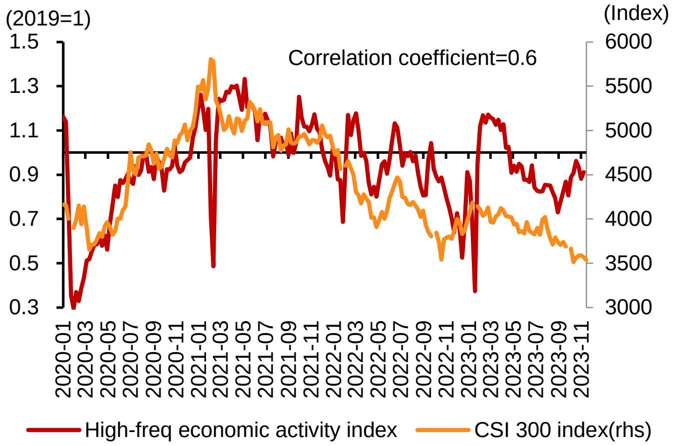
Source: Bloomberg, Wind, CMBIGM estimates

Figure 3: Total retail sales, FAI, and exports growth



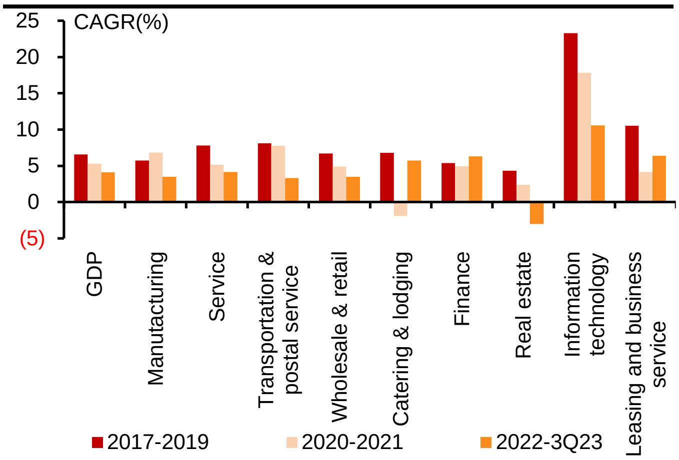
Source: Bloomberg, Wind, CMBIGM estimates

Figure 4: High-frequency Economic Activity Index and CSI 300 Index



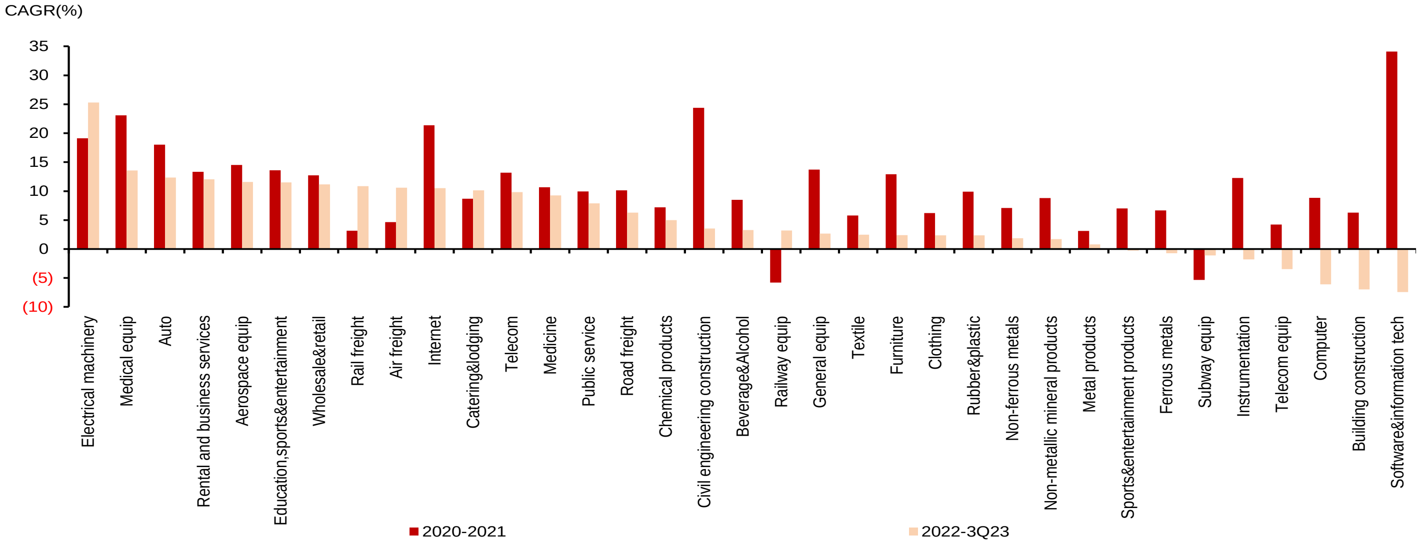
Source: Bloomberg, Wind, CMBIGM estimates

Figure 5: Major industries GDP growth



Source: Bloomberg, Wind, CMBIGM estimates

Figure 6: Electricity consumption growth by industry



Source: Bloomberg, Wind, CMBIGM estimates

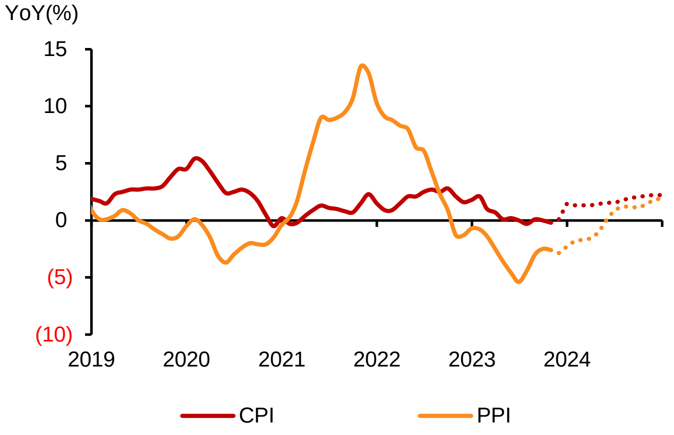
Alleviation of deflation

China experienced apparent deflation in 2023 due to subdued demand, overcapacity and falling commodity prices. The GDP deflator decreased 0.8% in 9M23 and CPI growth dropped from 2% in 2022 to 0.4% in 10M23. PPI fell 3.1% in 10M23 after rising 4.1% in 2022. The GDP deflator, CPI and PPI growth rates for 2023 are expected to be -0.8%, 0.4% and -3%, respectively. Breaking down CPI by categories, prices of pork, energy and durable goods declined sharply, while traditional Chinese medicine and tourism services saw significant price increases. Pork prices have fallen for three consecutive years due to weak demand and overcapacity in live hogs. Energy prices also dropped sharply especially in 1H23. Prices for home appliance, vehicles and communication equipment declined, reflecting weak consumer demand and increased supply competition. For PPI, most commodities saw sharp declines while prices of durables & capital goods weakened significantly, indicating soft demand and overcapacity pressure. The ongoing weakness in global manufacturing, domestic consumer demand and the US Fed's aggressive tightening all contributed to the industrial deflation.

The three-year pandemic severely hurt service businesses and caused a temporary regression in urbanization, which exacerbated economic slowdown and deflation pressure. Some rural migrant workers went back to their hometowns in rural areas and shifted from net consumers to net producers in the agriculture sector, leading to consumption downgrade, housing demand shrinkage and deflation pressure in agricultural products, durables and housing rents. In 2022, service employment and urban employment respectively fell 3.6% and 1.8%, marking the first decline since 1978. Meanwhile, agricultural employment rose 3.5%, which is unusual as the last time with agricultural employment growth was during the deflation period in 1998-2001 caused by the Asian financial crisis and the US recession. Housing rents in CPI started to fall MoM from April 2022 and remained weak with slight improvement in 2023, reflecting the slow recovery of youth employment.

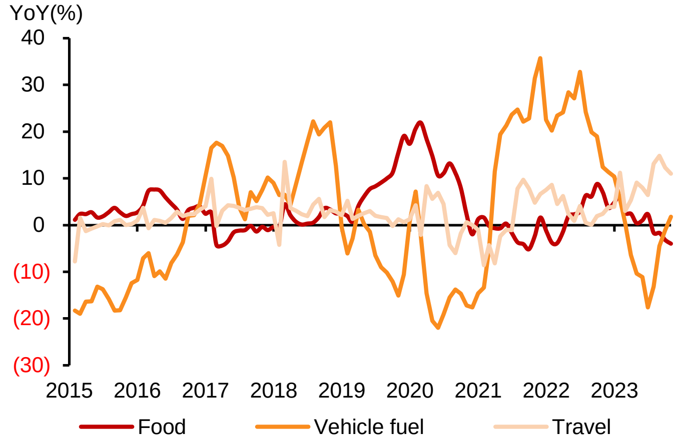
China's deflation will gradually ease in 2024 due to capacity reduction in live hog, continuous recovery in service consumption and the end of global industrial destocking cycle. GDP deflator, CPI and PPI growth rates are expected to increase from -0.8%, 0.4% and -3% in 2023 to 1%, 1.4% and 0.3% in 2024 respectively. At present, the pig-to-grain ratio is close to a historical low and the operation loss will push the sector to reduce overcapacity. Live hog price may bottom out and rebound in 2024. Urban service may continue to recover and rural migrant workers gradually return to cities and towns as employment and consumption will improve moderately. Food and core CPI growth rates are expected to rebound from 0.4% and 0.7% in 2023 to 1.4% and 1.5% in 2024 respectively. With the end of the global manufacturing de-stocking cycle, industrial product prices are likely to stop falling and slightly increase, and commodity prices may fluctuate slightly. In the medium term, China faces less reflation pressure as economic growth remains below potential. Some sectors may continue to face deflation pressure with soft demand and fierce supply competition.

Figure 7: Forecasted CPI and PPI growth



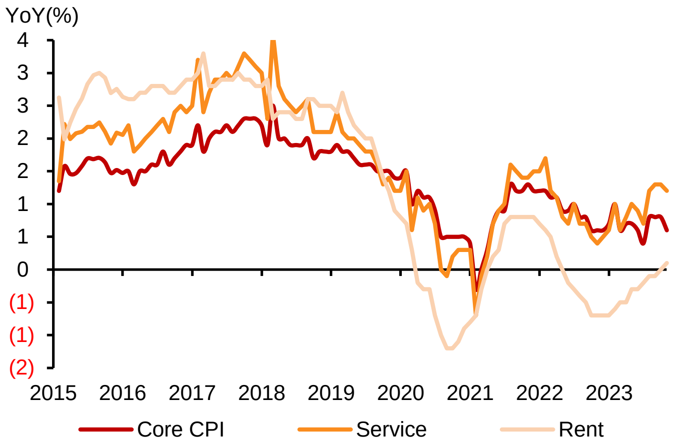
Source: Bloomberg, Wind, CMBIGM estimates

Figure 8: Food, energy, and tourism price growth



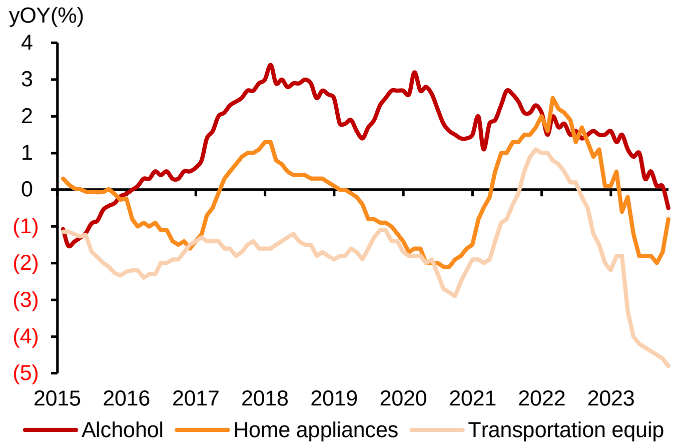
Source: Bloomberg, Wind, CMBIGM estimates

Figure 9: Core CPI, services, and rent growth



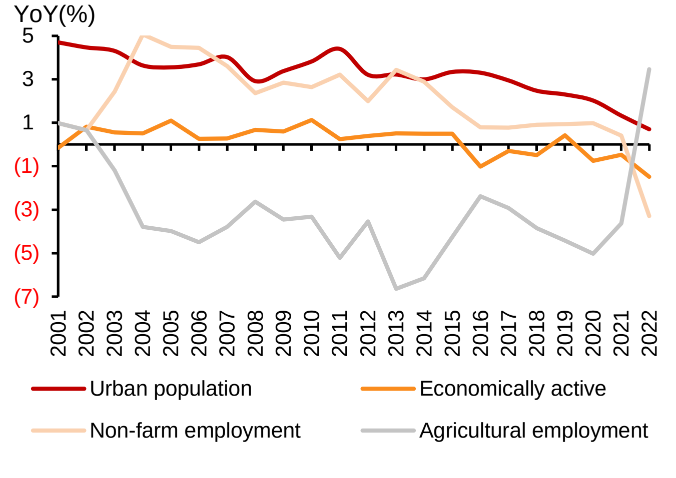
Source: Bloomberg, Wind, CMBIGM estimates

Figure 10: Alcohol, household appliances, and transportation equipment price growth



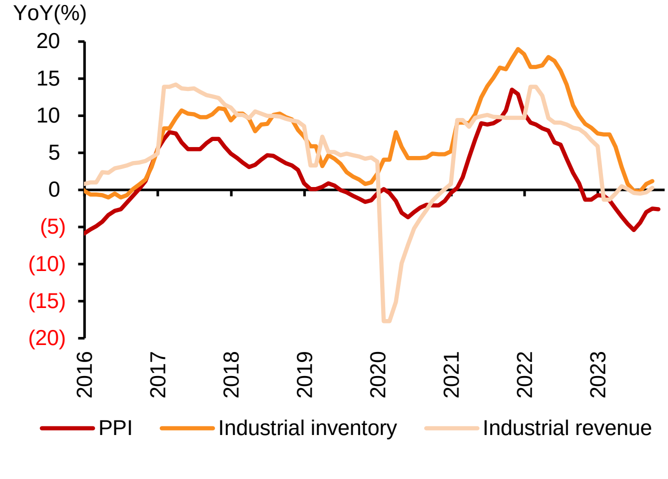
Source: Bloomberg, Wind, CMBIGM estimates

Figure 11: Urban population and employment growth



Source: Bloomberg, Wind, CMBIGM estimates

Figure 12: PPI, industrial inventory and revenue growth



Source: Bloomberg, Wind, CMBIGM estimates

Slow recovery in consumption

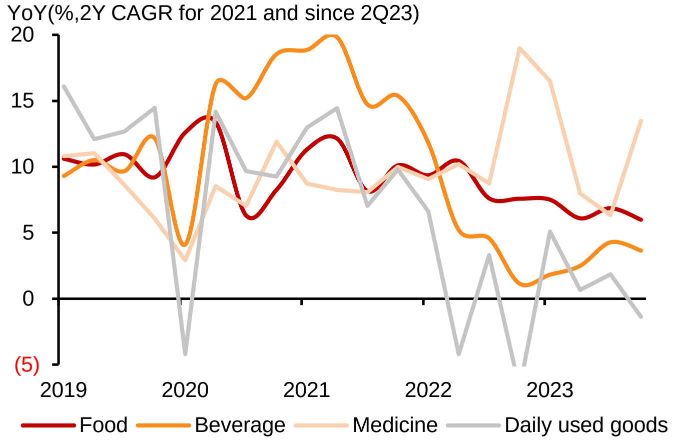
Household consumption growth rebounded in 2023 due to low base and reopening of economy, yet the overall recovery remained weak. In 10M23, retail sales grew 6.9% with the 2Y CAGR at 3.7%, much lower than the 8% growth in 2019. Staples grew stably as food and medicine retail sales respectively rose 5.2% and 8.7% in 10M23. Travel, accommodation, catering and recreational services recovered as retail sales in petroleum products, clothing, catering service, books & magazines and sports equipment rose 6.4%, 10.2%, 18.5%, 6.3% and 9.9%. Automobile retail sales grew 5.3%, beating expectations. However, retail sales in communication equipment and home appliance were tepid. The weakest recovery was seen in housing-related items, with furniture mildly growing 2.9% and construction & decoration materials dropping 7.5%.

Three factors constrained household consumption in 2023. Firstly, household income and confidence declined as private businesses cut costs and slowed capex amid weak confidence. Private businesses accounted for 80% of urban employment. The YoY growth of fixed investment by private enterprises declined from 7% in 2021 to 0.9% in 2022 and -0.5% in 10M23. Consumers' expectations about employment and income weakened and individual income tax fell 0.5% in 10M23, reflecting subdued household income. Consumer confidence and credit growth recovered slightly but remained low, while savings rates stayed high compared to pre-pandemic levels. The surveyed unemployment rate has dropped to pre-pandemic levels, but this indicator may not capture the whole labor market picture due to stringent criteria for recognizing unemployment. China has weak social safety nets and strong hardworking & family collectivism culture as it is common for the unemployed to engage in paid gig work. But unemployment rate for the youth remained high as they could depend on their parents' high savings for living. Secondly, property market continued to slump, hitting household consumption through wealth effect, confidence channel and complementary spending effect. A sluggish stock market also hurt consumer confidence. Thirdly, deflation expectations also hurt consumption by increasing real-term interest rates and debt burden and postponing capex or durable spending plans.

Household consumption is expected to improve slowly in 2024. Retail sales are forecasted to grow 5.3%, higher than the CAGR of 3.6% in 2022-2023. Medicine, food & beverage may maintain rapid growth. Cultural and office goods, communication equipment, cosmetics, home appliance and furniture are expected to improve. Sports and recreational goods and clothing may see slight improvement. Construction and decoration materials may see less declines, while automobile may slow down.

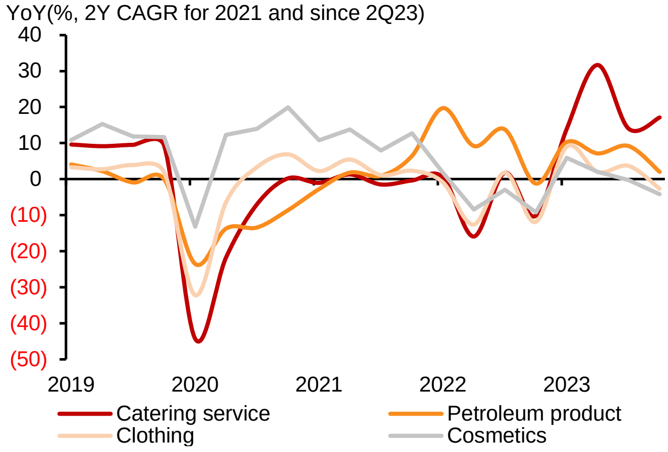
Four major factors will support a gradual improvement in household consumption in 2024. Firstly, service sector may continue to recover, which will improve employment condition, household income and consumer confidence. Secondly, China will adopt more expansionary fiscal policies and resolve local government hidden debt risks. Financial condition of local governments and local SOEs should improve, which will benefit employment and capex in broad government sector, local SOEs and private enterprises with to-G business. Thirdly, real estate market may narrow its shrinkage with possible stabilization in core cities, thanks to continuous policy easing and gradual release of upgrading demand. Second-hand housing market has already seen some improvement, which should boost consumer confidence and related durable consumption. Lastly, consumer prices may mildly rebound, which will eliminate deflation expectations and boost durable consumption.

Figure 13: Growth of retail sales in food, beverage, medicine, and daily necessities



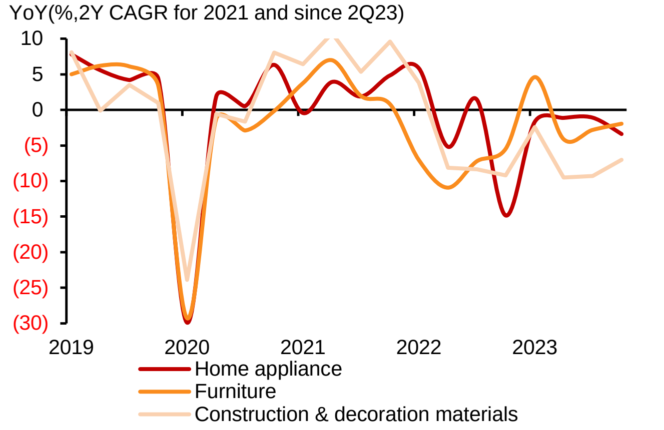
Source: Bloomberg, Wind, CMBIGM estimates

Figure 14: Growth of retail sales in catering, petroleum products, clothing, and cosmetics



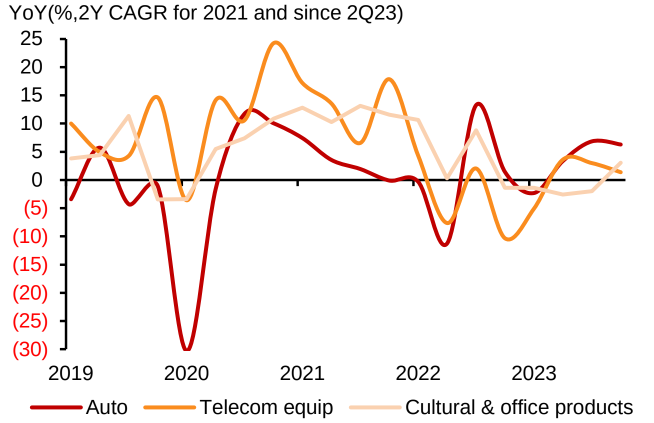
Source: Bloomberg, Wind, CMBIGM estimates

Figure 15: Growth of retail sales in home appliance, furniture, and construction materials



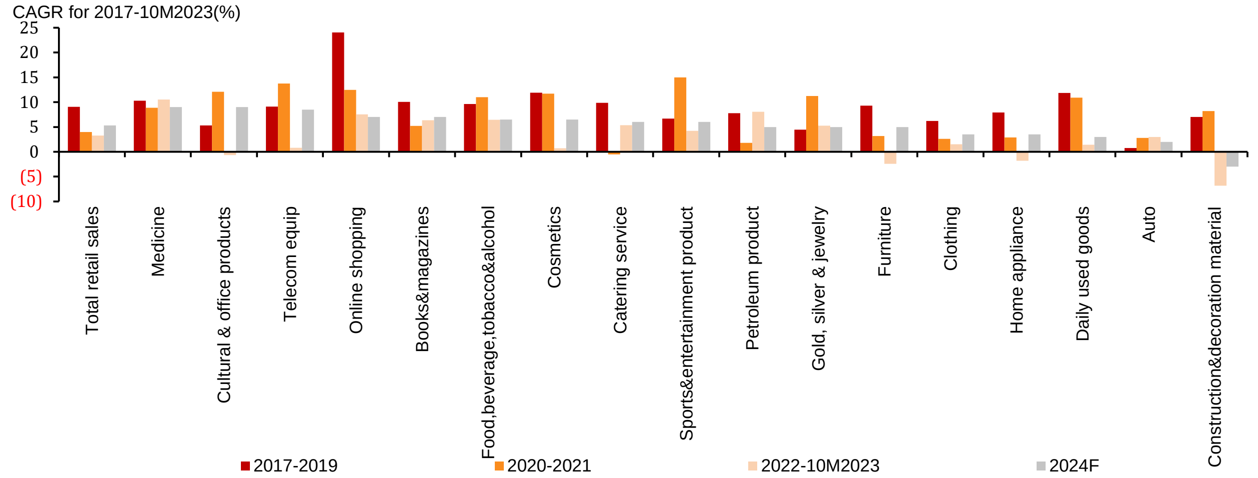
Source: Bloomberg, Wind, CMBIGM estimates

Figure 16: Growth of retail sales in automobiles, communication equipment, and office supplies



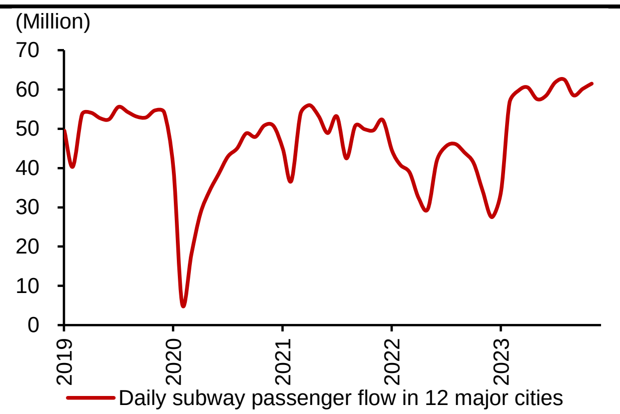
Source: Bloomberg, Wind, CMBIGM estimates

Figure 17: Retail sales growth by industry



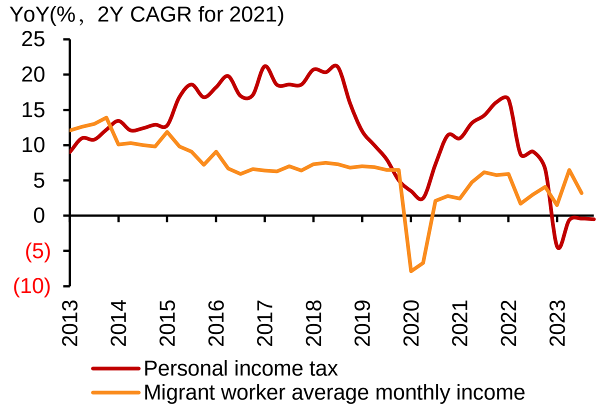
Source: Bloomberg, Wind, CMBIGM estimates

Figure 18: Subway passenger flow in 12 major cities



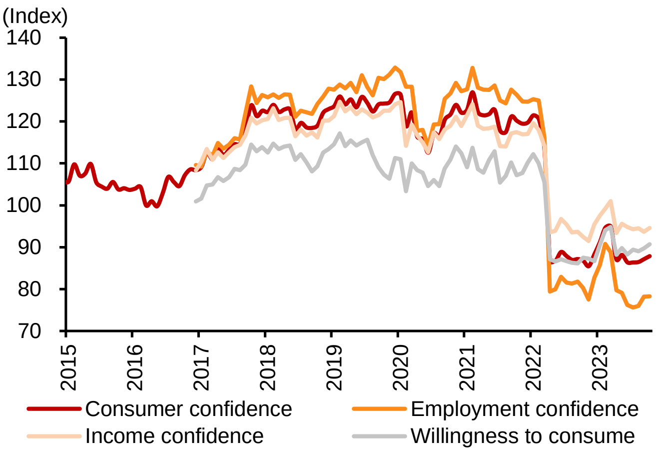
Source: Bloomberg, Wind, CMBIGM estimates

Figure 19: Personal income tax and migrant worker monthly income growth



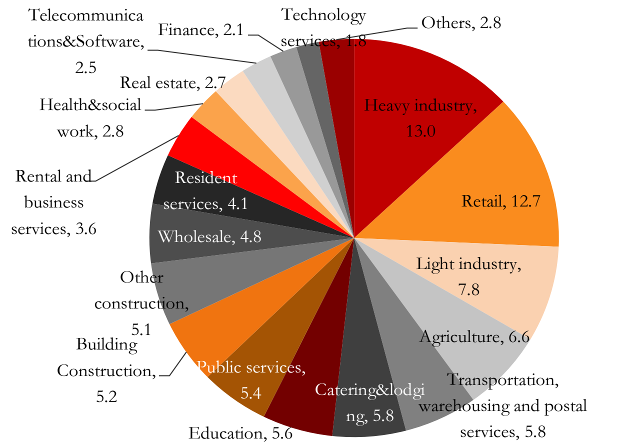
Source: Bloomberg, Wind, CMBIGM estimates

Figure 20: Consumer confidence and willingness to consume



Source: Bloomberg, Wind, CMBIGM estimates

Figure 21: Distribution of employment by industry based on the 2020 census



Source: Bloomberg, Wind, CMBIGM estimates

Smaller contraction in property sector

The property market continued to slump with less magnitude in 2023. New housing starts shrank more significantly than new housing sales. Existing housing sales outperformed new housing sales. Higher-tier cities fared better than lower-tier cities. Gross floor area (GFA) sold for commodity buildings dropped 7.8% in 10M23 after shrinking 24.3% in 2022. Due to poor sales expectations, tight cash flows and strict supervision over pre-sale projects, land purchases and new starts significantly declined. GFA started for commodity buildings and land area sold cumulatively dropped 60% and 70% from 2021 to 10M23, respectively. The ratio of GFA started to GFA sold dropped from 100.3% in 2014-2019 to 72.6% in 10M23. Property development investment fell 10% in 2022 and 9.3% in 10M23. The authority considered completion of pre-sale projects as the priority, supporting a remarkable 19% YoY increase in GFA completed in 10M23. Second-hand housing market outperformed new housing market as the sales in 11 cities (Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan, and Foshan) increased 30.2%, with the recovery rate relative to 2019 at 97.8% in 10M23. GFA sold for off-plan buildings fell 12.7%, while GFA sold for ready-to-move-in homes grew 15.6% in 10M23.

There are three reasons for the continuous slump of property market in 2023. Firstly, households' desire to purchase homes remained low, due to weak employment condition, insolvency risk of developers and housing price correction. Households' expectations about employment and income stayed low. Potential homebuyers were concerned about insolvency risks of developers in the pre-sale projects and they were also reluctant to buy in a falling market. Secondly, banks and investors lacked confidence on housing sales outlook in future as they remained cautious to provide financing to property projects. Lastly, developers' cash flows remained tight as insolvency risks continued to exist.

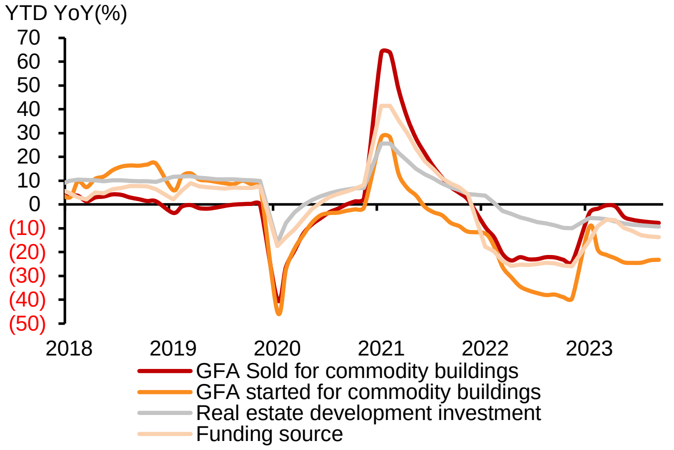
The property market may continue to show narrowed decline in 2024. GFA sold, GFA started and property development investment are expected to drop 5%, 10% and 7% in 2024 after decreasing 7.8%, 23.2% and 9% in 2023. The PBOC may further loosen credit supply to property sector with additional cut in 5Y LPRs. Core cities may continue to abolish purchase restrictions and lower down-payment ratio & mortgage rates for second-home buyers. Upgrading demand for housing may gradually release thanks to continuous policy easing and gradual economic improvement. Developers' cash flows and confidence should improve more slowly as new starts may continue to underperform new sales and property development investment may remain weak. The village renovation and affordable housing construction in cities may provide some contribution by narrowing property development investment decline by 3ppts in 2024.

In the medium to long term, urban housing demand depends on incremental population and room of upgrading in cities and towns. In the short term, housing demand is influenced by business and policy cycles. We estimate the annual urban housing demand since 2013 according to incremental urban population and per capita housing area each year. According to our estimation, 2017 might have been a turning point for housing market as the incremental urban population peaked. Before 2017, GFA sold for housing was below the estimated housing demand as the two variables continued to rise. After 2017, however, the estimated housing demand continued to decline and GFA sold for housing started to exceed the estimated housing demand. The gap further expanded in 2018-2021 as the estimated housing demand dropped sharply while GFA sold for housing remained high amid policy stimulus. The overdrawn demand in 2017-2020 should have amplified the effect of policy tightening after 2021 with a severe slump in housing market in 2022-2023.

Urban housing demand may continue to decline in the medium term. Firstly, the number of population aged 25-40 is estimated to cumulatively drop 12% between 2023 and 2030. Secondly, urbanization may slow noticeably. Incremental urban population dropped from 20 mn in 2019 to 6.5 mn in 2022, and may rebound to 8.5 mn in 2023-2024 before gradually decreasing in 2025-2030. Lastly, upgrading demand for housing may slow down. According to the Ministry of Housing and Urban-Rural Development, urban households' per capita housing floor area reached 38.6 sq. m in 2020, which should have already met basic living needs. We project the annual average growth of per capita housing floor area may decrease from 2.5% in 2010-2020 to 1.6% in 2020-2030 with the per capita floor area expected to reach 45.1 square meters in 2030.

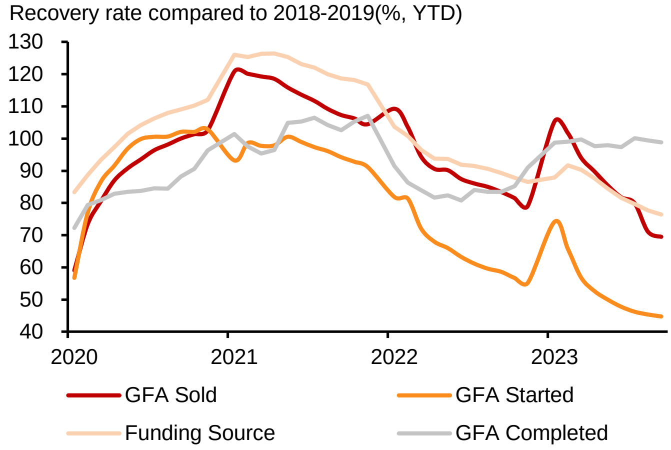
Our medium-term forecast for urban housing demand is as follows: under the baseline scenario, if urban population proportion ratio increases annually by 0.53ppt from 65.9% in 2023 to 69.2% in 2030 with incremental urban population down from 8.5 mn in 2024 to 5 mn in 2030, then GFA of housing demand is expected to decrease annually by 6.3% from 1.03 bn sq in 2023 to 700 mn sq in 2030. Under the optimistic scenario, if the urban population proportion ratio increases annually by 0.58ppt to 69.7% in 2030 with incremental urban population down 8.5 mn in 2024 to 7.8 mn in 2030, then GFA of housing demand may drop annually by 3.7% from 1.03 bn sq. m in 2023 to 830 mn sq.m in 2030. Under the pessimistic scenario, if the urban population proportion ratio increases annually by 0.45ppt to 68.4% in 2030 with incremental urban population down from 8.5 mn in 2024 to 3.4 mn in 2030, then GFA of housing demand would drop annually by 7.4% from 1.03 bn sq.m in 2023 to 630 mn sq.m in 2030. We do not take other factors into account like demolitions and urban-rural area reclassifications. The estimated absolute values may have some deviations, but these factors should have limited impacts on the estimated annual growth rates. We believe the era of large-scale urban demolitions and expansion comes to an end.

Figure 22: Real estate sales, new construction, and investment growth



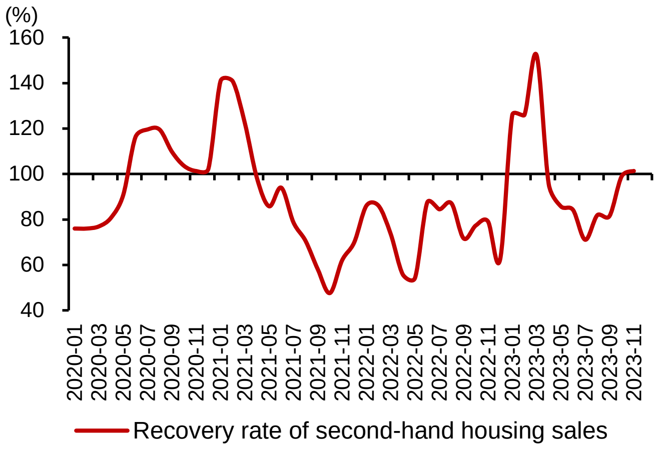
Source: Bloomberg, Wind, CMBIGM estimates

Figure 23: Recovery rates of real estate indicators compared to 2018-2019



Source: Bloomberg, Wind, CMBIGM estimates

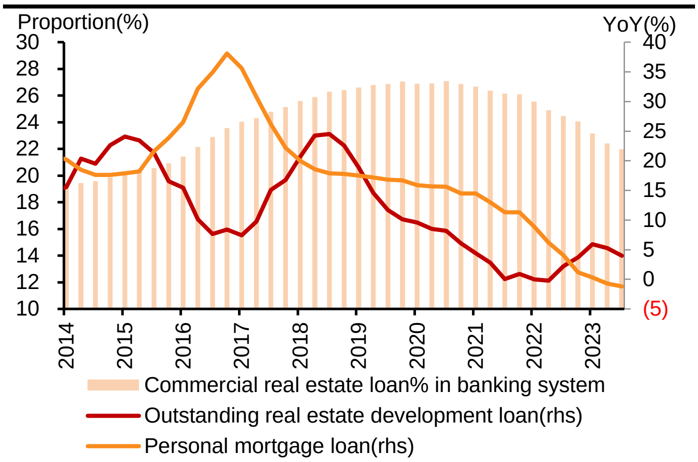
Figure 24: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities



Source: Bloomberg, Wind, CMBIGM estimates

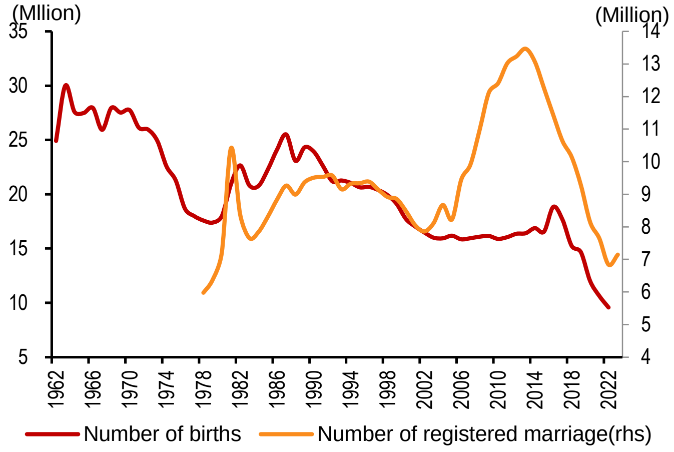
Note: 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Fosha

Figure 25: Proportion and growth rate of real estate loans



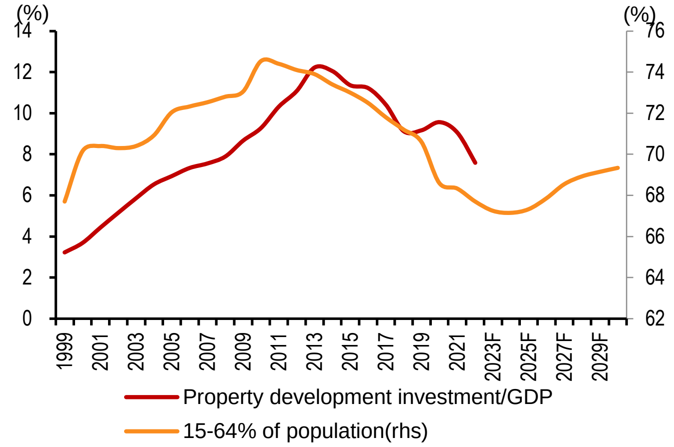
Source: Bloomberg, Wind, CMBIGM estimates

Figure 26: Birth numbers and marriage pairs



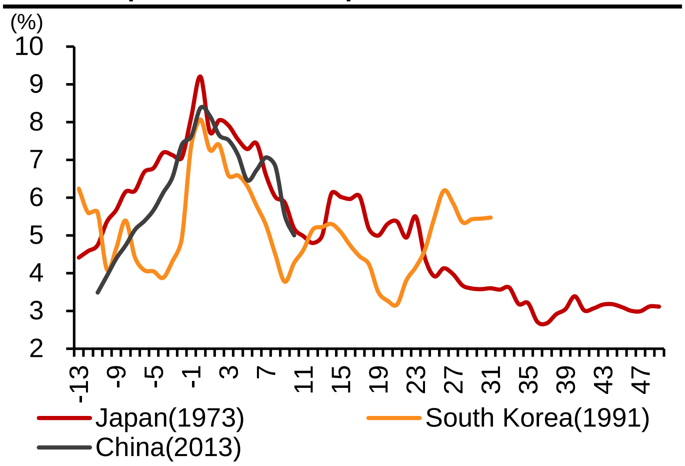
Source: Bloomberg, Wind, CMBIGM estimates

Figure 27: Proportion of real estate development investment/GDP and percentage of aged 15-64



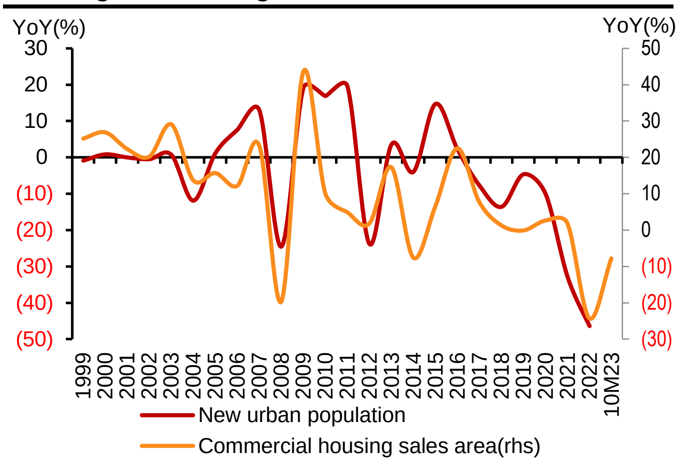
Source: Bloomberg, Wind, CMBIGM estimates

Figure 28: Residential investment/GDP ratio before and after peak in China, Japan, and South Korea



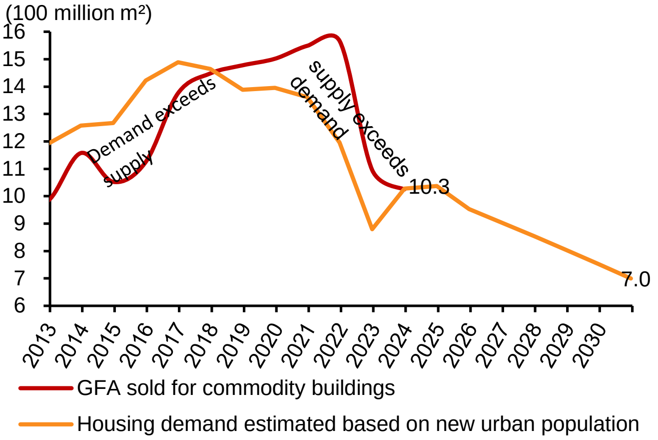
Source: Bloomberg, Wind, CMBIGM estimates

Figure 29: New urban population and commercial housing sales area growth



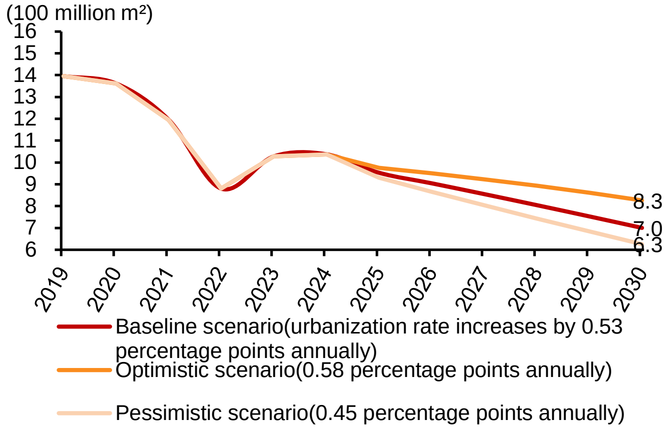
Source: Bloomberg, Wind, CMBIGM estimates

Figure 30: Residential sales area and estimated housing demand based on new urban population



Source: Bloomberg, Wind, CMBIGM estimates

Figure 31: Forecast of China's housing demand



Source: Bloomberg, Wind, CMBIGM estimates

Fixed investment growth picks up

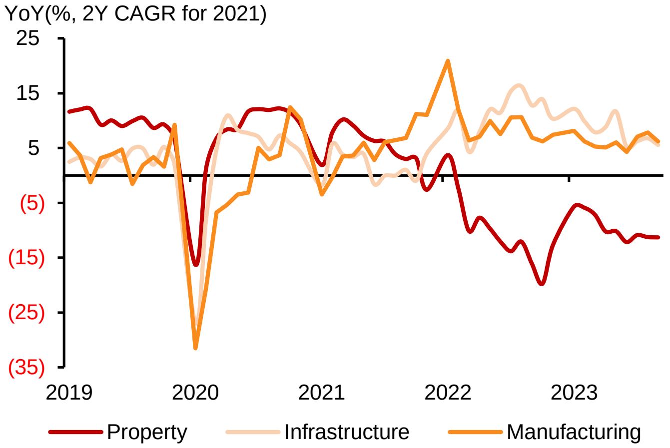
FAI growth significantly decelerated in 2023 with a slump in property development investment and a slowdown in both infrastructure and manufacturing investment. FAI growth declined from 5.1% in 2022 to 2.9% in 10M23. Infrastructure and manufacturing investment growth rates respectively decreased from 11.5% and 9.1% in 2022 to 8.3% and 6.2% in 10M23. Since 2Q23, monthly YoY growth of fixed investment dropped to below 2.5%, with a deterioration in property development investment and local infrastructure investment. Local infrastructure investment slowed sharply as FAI growth in road transportation, water conservancy, environmental protection and public facility management, education and health & social work decelerated from 8.5%, 7.8%, 6.2% and 18.5% in 1Q23 to 0%, -0.8%, 1.6%, and -1.3% in 10M23. However, infrastructure investment led by central SOEs maintained rapid growth thanks to ample credit supply. FAI growth in power generation & supply and railway transportation respectively picked up 29.4% and 24.8% in 10M23 after rising 26% and 17.6% in 1Q23.

The sharp deterioration in local infrastructure investment in 2023 was mainly due to a slump in both land market and LGFV financing. Local government land income is expected to drop 40% from RMB8.7tn in 2021 to RMB5.2tn in 2023. Due to high dependence on local government land income, LGFVs faced tougher financing condition in 2022-2023. Net issuance of LGFV bonds fell from RMB1.9tn in 2021 to RMB0.9tn in 2022 and RMB0.7tn in 11M23. In the 12 provinces with high hidden debt risk (Tianjin, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Guangxi, Chongqing, Guizhou, Yunnan, Gansu, Qinghai, Ningxia), net LGFV bond financing was negative in both 2022 and 11M23. The cabinet allowed provincial governments to issue special refinancing bonds to replace their hidden debts but strictly controlled new hidden debts and infrastructure projects in those provinces. Infrastructure investment in Tianjin and Guangxi respectively dropped 12.6% and 8.7% in 10M23 after rising 10.1% and 16.7% in the same period in 2022. The 12 provinces shared nearly a quarter in the national infrastructure investment. Every 10% drop of infrastructure investment in the 12 provinces is expected to lower China's infrastructure investment growth by nearly 2.5ppts.

The slowdown in manufacturing investment can be attributed to base effect and overcapacity pressure. Manufacturing investment surged by 9.1% in 2022 as domestic manufacturers expanded capacity after benefiting from overseas aggressive policy stimulus and supply chain disruptions in 2020-2021. The explosive growth in new industries such as EVs and photovoltaic & wind power also fueled aggressive investment in upstream and downstream segments. However, 2023 saw a noticeable slowdown of manufacturing investment as exports of goods dropped, domestic demand recovery was weak and overcapacity pressure increased. Most manufacturing industries faced declining demand, inventory pressure and tougher competition. The ex-factory prices and profits in many industries saw a decline. Only a few industries like new energy electrical equipment, auto, instrument and chemical product maintained strong growth in fixed investments.

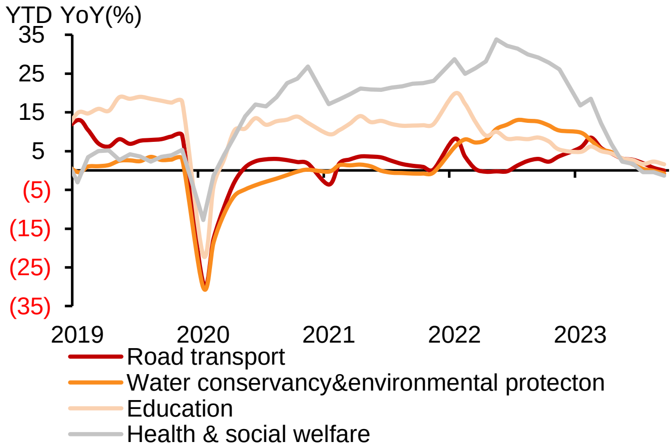
FAI growth is expected to rebound from 2.8% in 2023 to 4.2% in 2024. Property development investment would narrow its declines from 9% in 2023 to 7% in 2024. Infrastructure investment may see softening growth from 8.2% growth in 2023 to 7.8% growth in 2024. Despite more expansionary fiscal policies, the cabinet will continue to strictly control LGFVs' new debt financing. Infrastructure investments led by central SOEs are expected to maintain rapid growth, while those led by local SOEs may remain weak. Manufacturing investment growth may accelerate from 6.2% in 2023 to 6.5% in 2024 thanks to the recovery in exports of goods, improvement in household consumption and end of industrial de-stocking and deflation.

Figure 32: Investment growth in property, infrastructure, and manufacturing



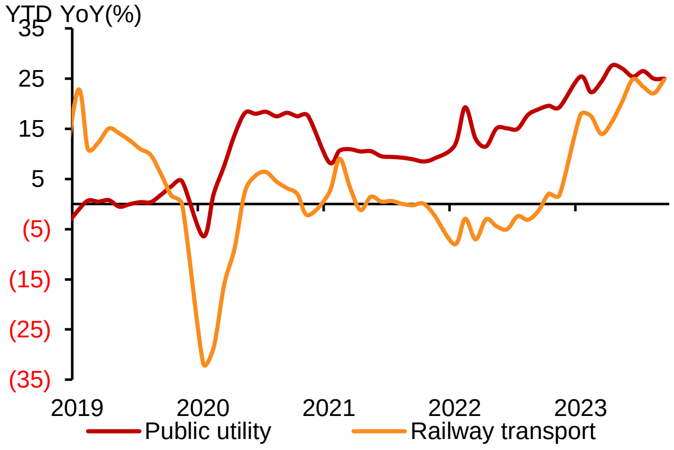
Source: Bloomberg, Wind, CMBIGM estimates

Figure 33: Infrastructure investment growth led by local government SOEs



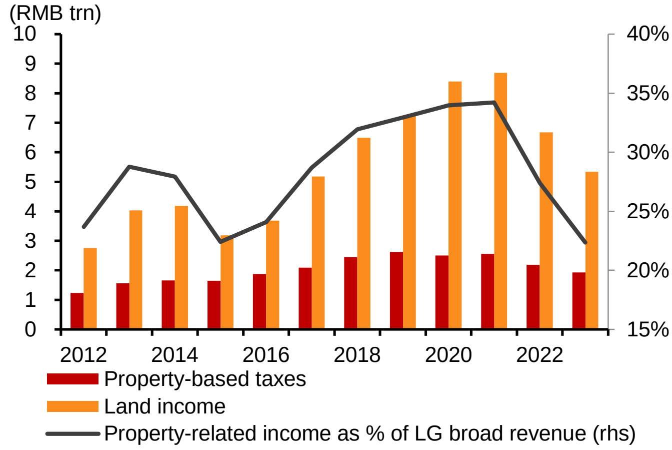
Source: Bloomberg, Wind, CMBIGM estimates

Figure 34: Infrastructure investment growth led by central government SOEs



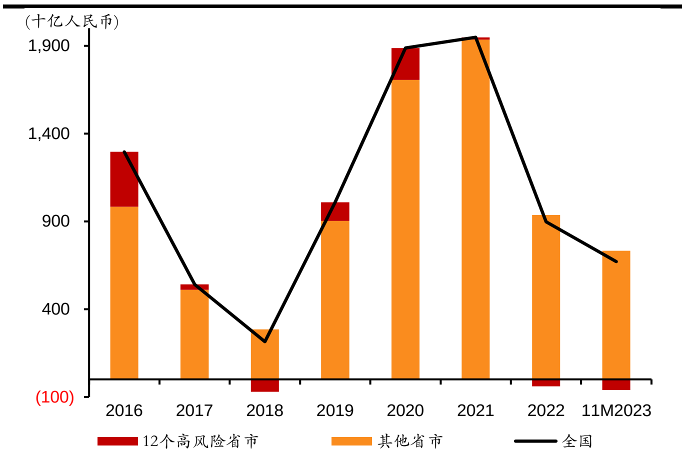
Source: Bloomberg, Wind, CMBIGM estimates

Figure 35: Local government real estate-related income



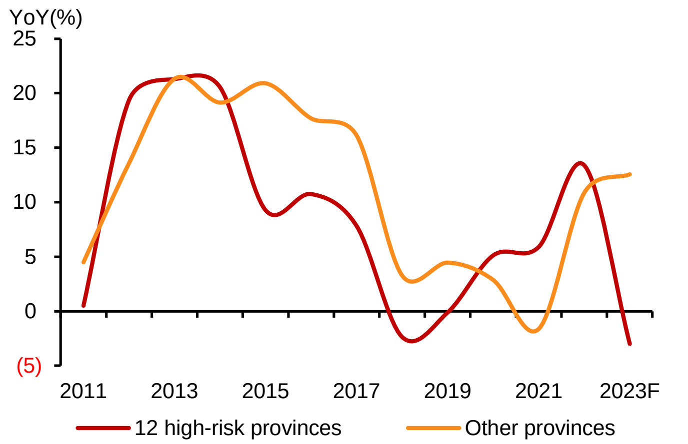
Source: Bloomberg, Wind, CMBIGM estimates

Figure 36: Net financing of LGFV bonds



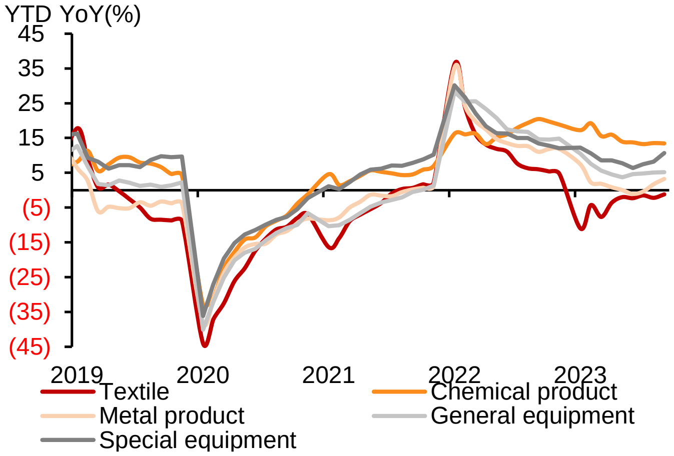
Source: Bloomberg, Wind, CMBIGM estimates

Figure 37: Infrastructure investment growth in different types of provinces



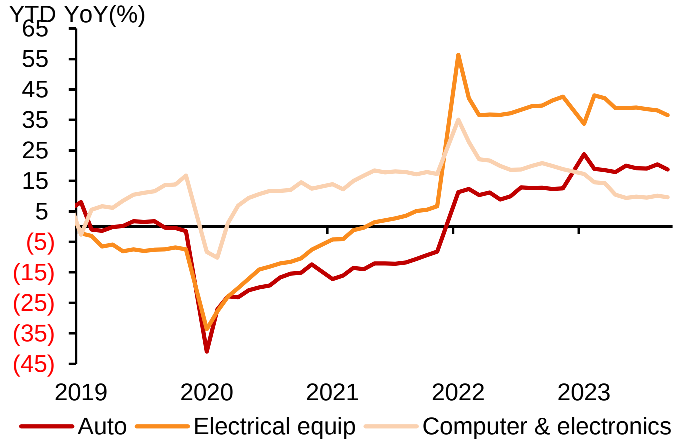
Source: Bloomberg, Wind, CMBIGM estimates

Figure 38: Investment growth in textiles, chemicals, and machinery equipment



Source: Bloomberg, Wind, CMBIGM estimates

Figure 39: Investment growth in automobiles, electrical equipment, and consumer electronics



Source: Bloomberg, Wind, CMBIGM estimates

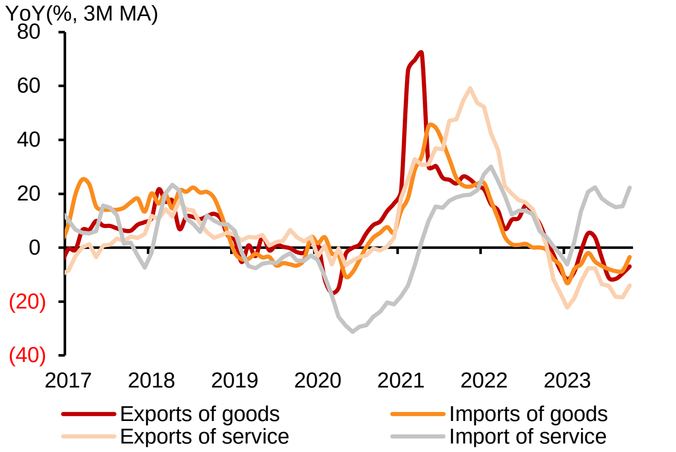
Import and export trade recover

China's foreign trade of goods deteriorated in 2023. Exports and imports of goods respectively dropped 5.6% and 6.5% in 10M23. Breaking down exports by destination, the largest declines were to North America and Europe, followed by Asia, with relatively better performance in exports to emerging markets. In terms of imports, the decline widened from the US, Japan, South Korea and ASEAN, while it narrowed from the EU, and imports from Australia shifted from a decrease to an increase. Analyzing export commodities, apparel, bags, toys, furniture, lighting, decorative materials and steel products significantly declined due to softening overseas demand, de-stocking and price decline. However, exports of home appliances rebounded, particularly for strong to emerging markets. Overseas demand for electronics and semiconductors remained weak as exports of computers, mobile phones and integrated circuits further declined. But automobiles and new energy equipment & components continued to see explosive growth. Looking at imports, the volume of bulk commodities remained strong, but import prices fell sharply. Soybeans, copper ore, crude oil, and natural gas all showed significant volume increases over 2022, but with varying degrees of price declines. Following the economic reopening, domestic demand for transportation and healthcare rebounded quickly, leading to a significant increase of imports in airplanes and pharmaceuticals. However, import volume of capital goods dropped as property development investment, local infrastructure investment and business capex remained weak.

China's service trade was mixed in 2023. Service exports dropped 15.2%, while service imports increased 15.3% in 10M23. For service exports, a significant decline was observed in processing and transportation services due to the contraction of goods trade. Financial service exports also declined probably due to reduced capital inflow into China. Increased technological trade barriers from the US and Europe led to a contraction in the export of intellectual property fees for the first time in years. However, exports of travel services, insurance and pension services rebounded thanks to the reopening of economy. In terms of service imports, while there was a significant decrease in processing services, insurance and pension services and intellectual property usage fees, the reopening of outbound travel led to a surge in imports of travel, personal cultural and recreational services.

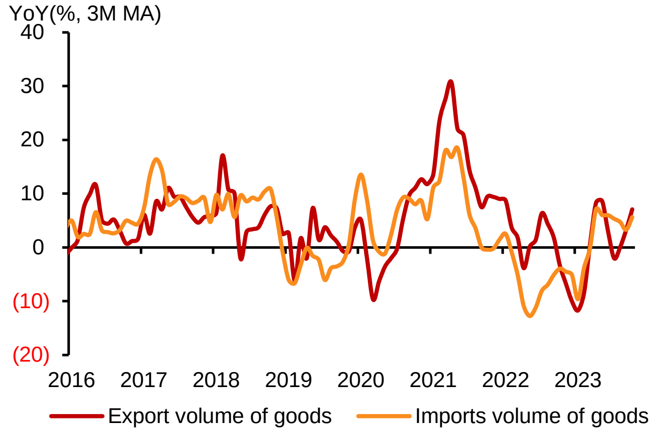
We expect a significant rebound in China's export and import trade in 2024. The growth rates for goods exports and imports are projected to recover from -4.3% and -4.9% in 2023 to 3.6% and 3.3% in 2024, respectively. Similarly, the growth rates for service exports and imports are anticipated to rise from -12% and 15.5% in 2023 to 15% and 20% in 2024. Global trade activity is expected to rebound from a low base, with the IMF forecasting an increase in global goods trade volume and price growth rates from -0.3% and -2.5% in 2023 to 3.2% and 1.5% in 2024. The WTO predicts global goods trade volume growth to increase from 0.8% in 2023 to 3.3% in 2024. With moderate improvement in China's economy and prices, goods import growth is expected to rebound from a low base. The further recovery of cross-border personnel exchanges and a phased improvement in Sino-US relations may continue to boost China's service trade.

Figure 40: Import and export of goods and services



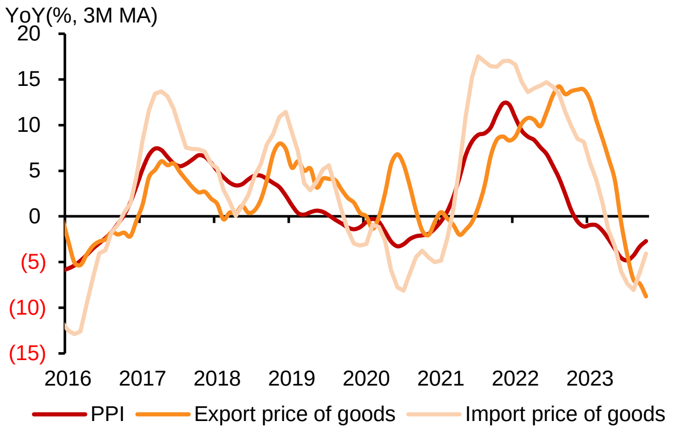
Source: Bloomberg, Wind, CMBIGM estimates

Figure 41: Volume of goods imports and exports



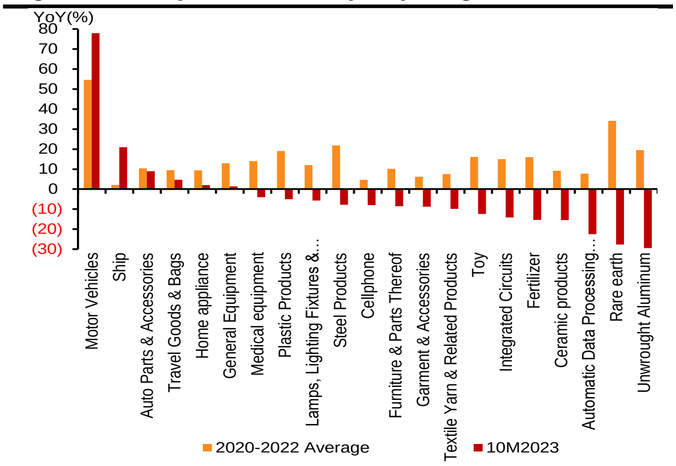
Source: Bloomberg, Wind, CMBIGM estimates

Figure 42: PPI and import and export price of goods



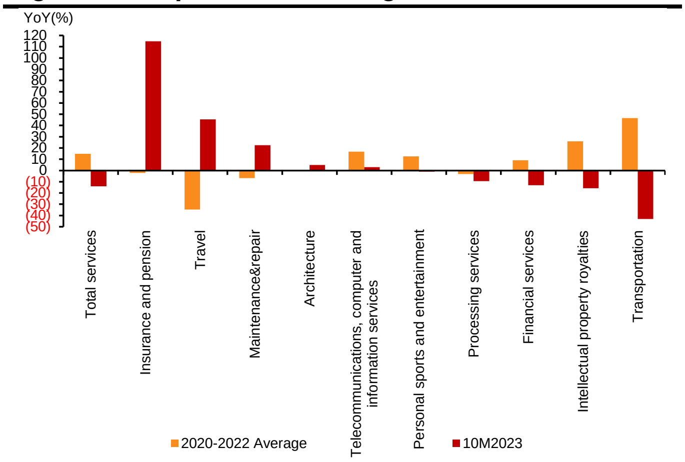
Source: Bloomberg, Wind, CMBIGM estimates

Figure 43: Major commodity export growth



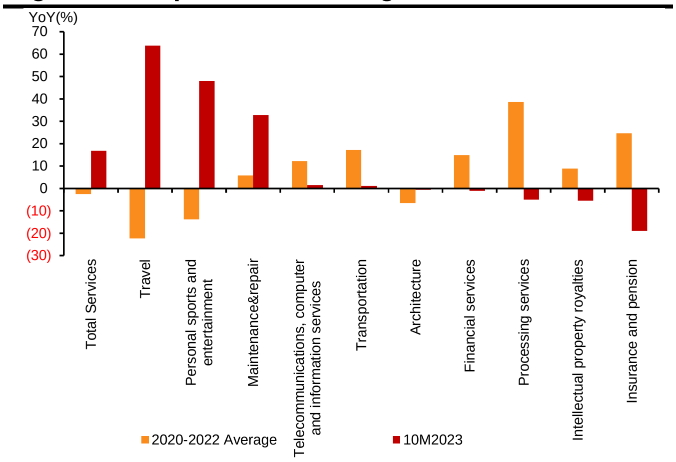
Source: Bloomberg, Wind, CMBIGM estimates

Figure 44: Exports of service growth



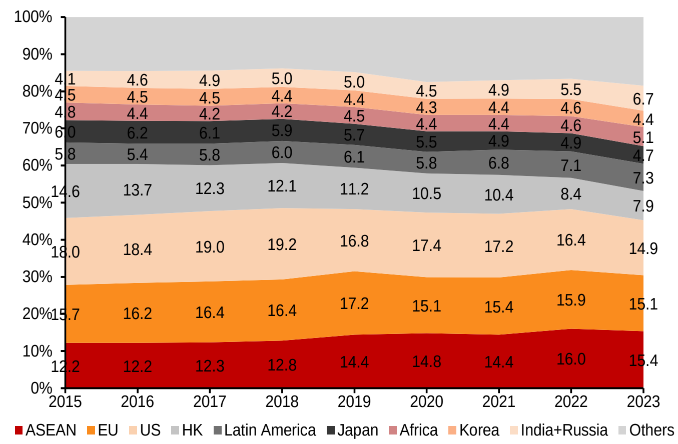
Source: Bloomberg, Wind, CMBIGM estimates

Figure 45: Imports of service growth



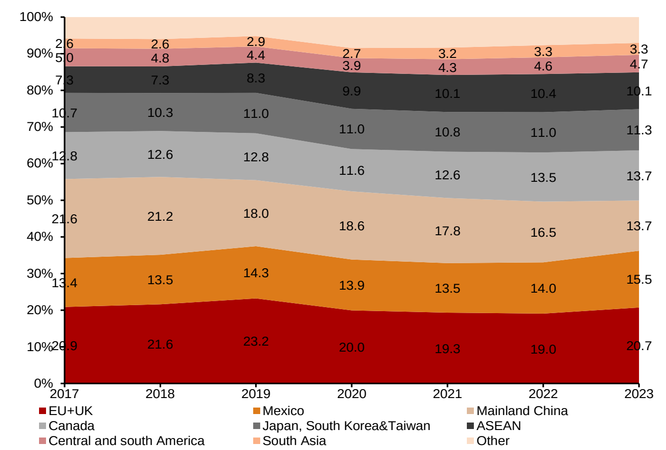
Source: Bloomberg, Wind, CMBIGM estimates

Figure 46: Changes in structure of China's goods export destination



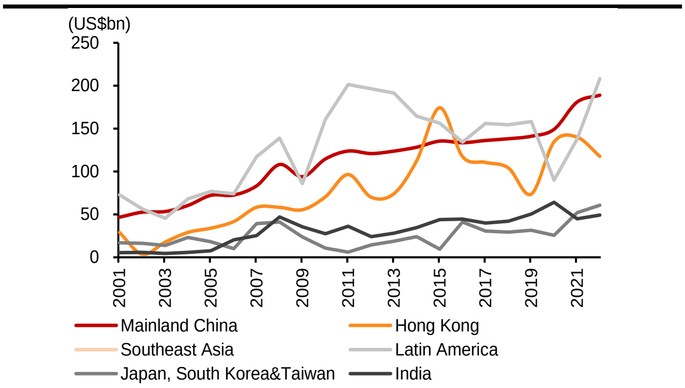
Source: Bloomberg, Wind, CMBIGM estimates

Figure 47: Changes in structure of US goods import sources



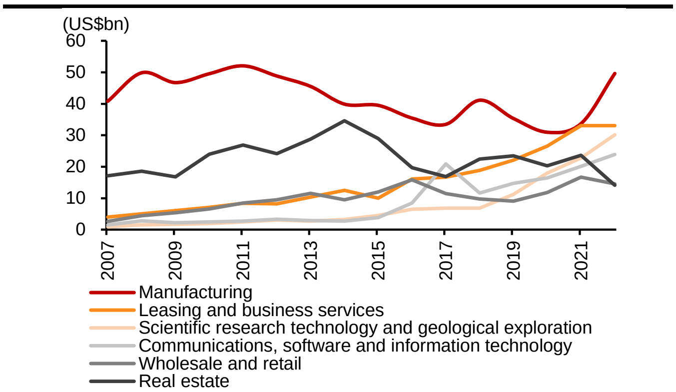
Source: Bloomberg, Wind, CMBIGM estimates

Figure 48: FDI flow sizes in major economies



Source: Bloomberg, Wind, CMBIGM estimates

Figure 49: FDI flow attracted by major industries in China



Source: Bloomberg, Wind, CMBIGM estimates

More expansionary fiscal policies

Fiscal policy was weaker than expected in 7M23 and became stronger after the July Politburo meeting. In 7M23, general fiscal revenue grew 11.5%, far exceeding the planned growth of 6.7% for 2023; but general fiscal expenditure only rose 3.3%, much lower than the planned growth of 5.6% for this year. The completion rate of general fiscal deficit was only 31.7%, with net government bond financing down 25% YoY. From August, fiscal policy became stronger as the growth rates of general fiscal expenditure and net government financing respectively rose to 4.6% and 21.5% and the general deficit completion rate climbed to 72.8% in 10M23. However, land market continued to slump with pressure on government special fund revenue and expenditure. Government special fund income further dropped 16% in 10M23 after decreasing 14.3% in 7M23. Thanks to more issuance of local government special bonds, government special fund expenditure narrowed its declines from 23.3% in 7M23 to 15.1% in 10M23.

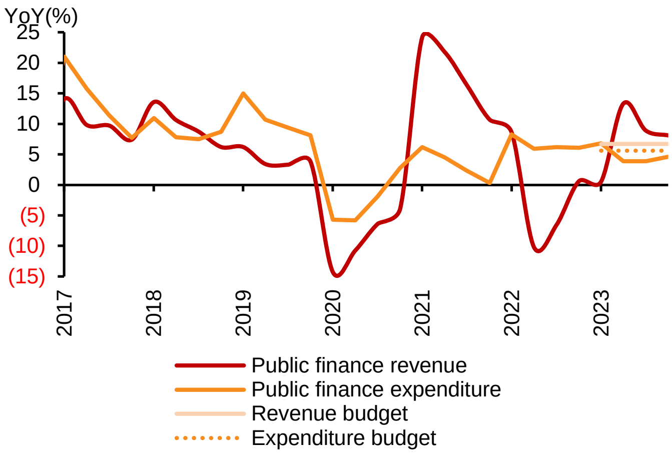
Local governments' fiscal difficulty and hidden debt risk hindered the effectiveness of fiscal policy in 2023. Property-related income and hidden debt financing dropped sharply from last year, causing a squeeze effect on local fiscal system. With the cash flow pressure and hidden debt risk, local governments were very cautious on spending. The growth of local general fiscal expenditure and local government special fund expenditure respectively dropped from 6.4% and -4.7% in 2022 to 2.9% and -21.8% in 7M23. The July Politburo meeting led to stronger fiscal policy from August. The cabinet required local governments to complete the issuance of special bonds planned for this year by end-3Q23 and accelerate fiscal spending. The policymakers actively sought to resolve local government hidden debt risk by allowing provincial governments to issue special refinance bonds for debt swap and guiding state-owned banks to roll over the hidden debts. The cabinet also urgently increased its general deficit by RMB1tn and transferred it to local governments. The Ministry of Finance also planned to allow local governments to use at most 60% of their new special bond quotas for 2024 in advance. Thanks to the above supportive policies, the growth of general fiscal expenditure rose from 3.3% in 7M23 to 11.9% in October.

China's proactive fiscal policy is expected to be more expansionary in 2024. The Central Economic Working Conference in December is likely to maintain a GDP growth target of 5% for 2024. Due to the diminishing effect of the low base and the slow recovery of private sector, achieving this target will be more challenging, necessitating a greater role for fiscal policy. Broad fiscal deficit may exceed 8% of GDP in 2024. General fiscal deficit (including special T-bonds), local government special bond financing (including special refinancing bond for debt swap) and carryover funds from the previous year are expected to respectively reach 3.7%, 3.7% and 0.7% of GDP in 2024. After evaluating the effectiveness of the local government debt swap (using local government special refinancing bonds to replace hidden debt), there may be new quotas for the program. General fiscal expenditure growth is expected to rise from 5.6% in 2023 to 6.4% in 2024, while general fiscal revenue growth may decrease from 6.7% in 2023 to 4.8% in 2024. Policymakers will guide state-owned commercial banks and policy banks to further expand quasi-policy credit supply.

Fiscal expenditure in 2024 will focus on employment stability, basic livelihoods, grassroots operations, food and energy security, supply chain resilience, tech innovation and industrial upgrade. According to our estimation based on the detailed data in 2022, expenditures on public services such as education, social security and employment, healthcare, agriculture, forestry, water affairs and urban-rural community affairs collectively accounted for nearly 45% of public fiscal expenditure. Expenditures on public sector operations, including administrative departments, public institutions and public safety, accounted for nearly one-third. Expenditures on science & technology, energy conservation & environmental protection, energy resources and industrial development made up about 10%. The challenging fiscal condition of local governments in 2022-2023 have markedly affected social welfare, public sector operations and industrial policies. With higher broad deficit, local governments' cash flow may improve in 2024, with an increase in basic livelihood expenditures, improvements in public sector employment and expenditures and potentially stronger tax reductions for the private sector.

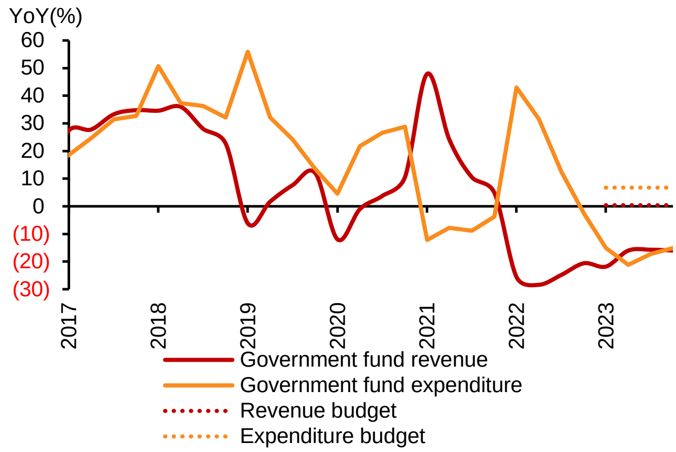
In medium to long term, the aging population and slowing urbanization will profoundly impact the fiscal system. The downward trend in housing demand will continue to pressure local governments' property-related revenue. Meanwhile, the deficit in social security system and healthcare expenditure will continue to increase rapidly. China's three northeastern provinces, including Heilongjiang, Liaoning and Jilin, are ahead in population aging. In 2022, the ratio of contributors to retirees in urban basic pension insurance dropped to 1.3-1.4 times. The deficit in urban basic pension insurance exceeded RMB170bn, equivalent to 3.7 times of the general fiscal revenue of the three provinces. Social security & employment expenditure accounted for over 25% of total fiscal expenditure in these provinces, which is far higher than the national level of 14%. These provinces are highly dependent on transfer payments from the central government.

Figure 50: Public fiscal revenue and expenditure growth



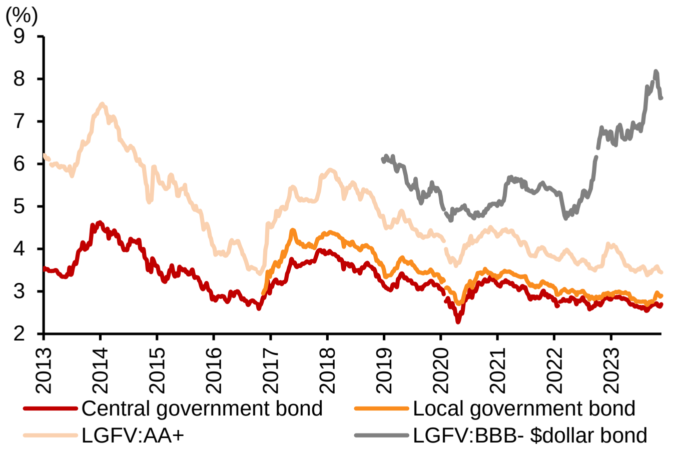
Source: Bloomberg, Wind, CMBIGM estimates

Figure 51: Government fund income and expenditure growth



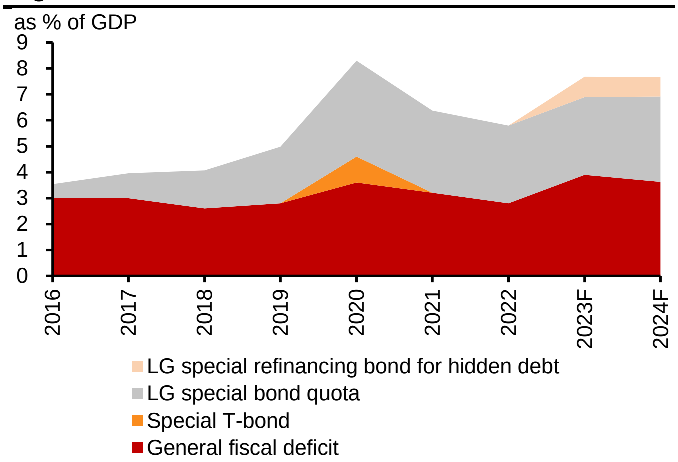
Source: Bloomberg, Wind, CMBIGM estimates

Figure 52: Government and LGFV bond yields



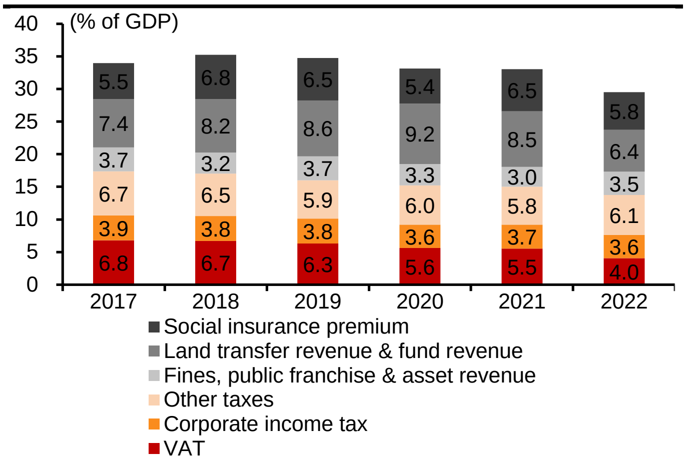
Source: Bloomberg, Wind, CMBIGM estimates

Figure 53: Fiscal deficit rate



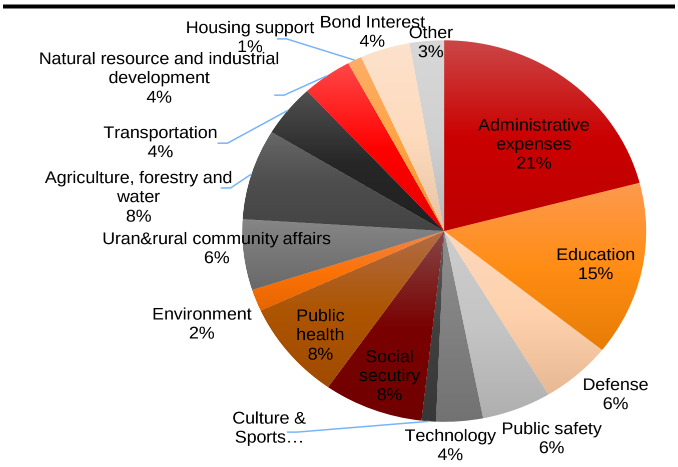
Source: Bloomberg, Wind, CMBIGM estimates

Figure 54: Proportion of broad government revenue to GDP



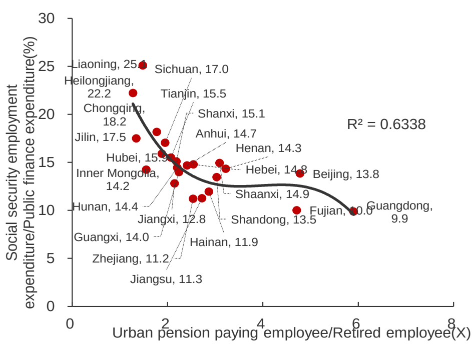
Source: Bloomberg, Wind, CMBIGM estimates

Figure 55: Structure of public fiscal expenditure (%)



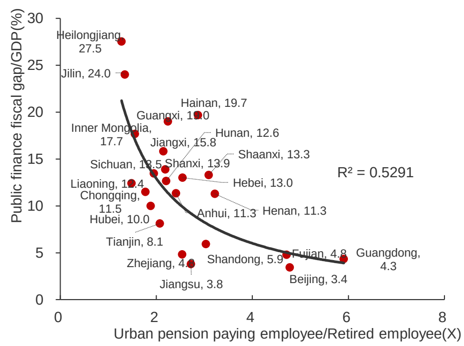
Source: Bloomberg, Wind, CMBIGM estimates

Figure 56: Ratio social security contributing workers to retired workers and social security expense to public finance expenditure



Source: Bloomberg, Wind, CMBIGM estimates

Figure 57: Ratio of social security contributing workers to retired workers and fiscal revenue-expenditure gap to GDP



Source: Bloomberg, Wind, CMBIGM estimates

Continuous monetary policy easing

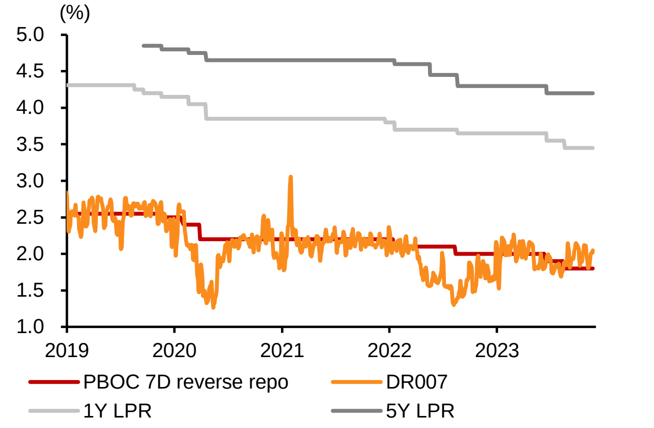
Monetary policy easing has been below market expectations in 2023. In 11M23, the PBOC cut RRR twice increasing liquidity supply by RMB1tn. The central bank lowered 1Y and 5Y LPRs by 20bps and 10bps respectively. The PBOC also decreased down-payment ratio and the minimum interest rates for mortgage loans, moderately lowered existing mortgage loan rates, loosened the criteria for first-home recognition and guided banks to increase credit supply to property sector. However, the actual effects were mixed. Banks' average 7D repo rates, 3M Shibor and 6M NCD rates respectively rose from 1.76%, 2.08% and 2.15% in 2022 to 1.95%, 2.29% and 2.38% in 11M23. The average rates of 7-year government bonds and AA corporate bonds slightly declined from 2.76% and 4.25% in 2022 to 2.72% and 4.08% in 11M23. The average interest rates for corporate loans and mortgage loans respectively decreased from 3.97% and 4.26% in 4Q22 to 3.95% and 4.11% in 2Q23. Total social financing and new RMB loans to the real sector increased by 8.6% and 9.1% respectively in 10M23. However, the growth of outstanding social financing and RMB loans decreased from 9.6% and 11.1% in end-2022 to 9.3% and 10.9% in end-10M23. Notably, the growth of property development loans slightly increased from 3.7% in end-2022 to 4% in end-3Q23, but the growth of mortgage loans dropped from 1.2% to -1.2%.

Four major factors have restricted the space and actual effects of monetary policy easing in 2023. Firstly, the US Fed's aggressive interest rate hikes and the Russia-Ukraine war strengthened the US dollar and caused RMB depreciation pressure. Fear of floating and capital outflows have constrained the room for China's interest rate policy. Secondly, weak credit demand, intense competition for deposits and deteriorating asset quality squeezed banks' NIMs while the PBOC worried interest rate cuts may add pressure on the banking system. Banks' average NIM fell from 1.91% in 4Q22 to 1.73% in 3Q23, below the warning line of 1.8%. Thirdly, property market continued to slump and private sector confidence remained low, which suppressed credit demand. Lastly, deflation may have offset the effects of nominal rate cuts. With GDP deflator as the inflation indicator, real-term rates of 10Y T-bonds and banking loans rose from 0.92% and 2.54% in 3Q22 to 3.66% and 5.15% in 2Q23.

China may further loosen its monetary policy in 2024. The PBOC may cut RRR twice by 0.5ppt. 1Y and 5Y LPRs may further decline by 10bps and 20bps, respectively. Deposit rates may also drop by 20bps to protect banks' NIMs. Credit growth may mildly rebound. The growth rates of outstanding social financing and RMB loans are expected to rise from 9.5% and 10.8% in end-2023 to 10% and 11.3% in end-2024.

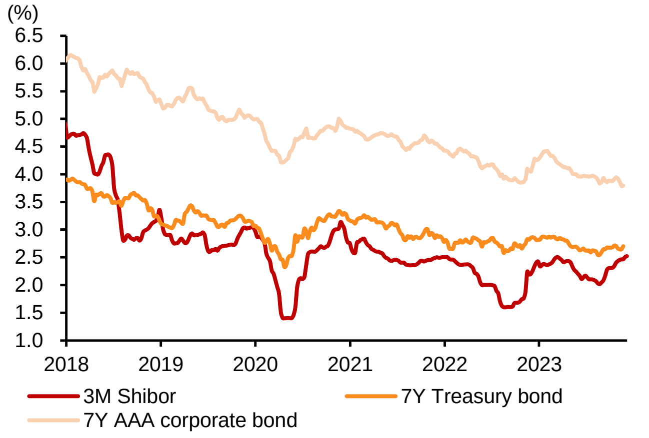
The four major constraints will improve in 2024, increasing the room and actual effects of monetary policy easing. Firstly, the US dollar may weaken as the Fed may cut its policy rate by 150bps and the Russia-Ukraine war may close to an end. China's economy may moderately improve with an alleviation of deflation. The USD/CNY rates is projected to decrease from 7.1 in end-2023 to 6.95 in end-2024. Secondly, RMB deposit rates are likely to be reduced in tandem with LPRs to offset the impact of rate cuts on banks' NIMs. Thirdly, fiscal policy is expected to become more expansionary with higher public spending, while private sector confidence may recover slowly, which could improve credit demand. Lastly, deflation will gradually ease with the GDP deflator change moving from negative to positive, and the real-term interest rates should decline by over 1.5ppts.

Figure 58: Central Bank Policy Rates



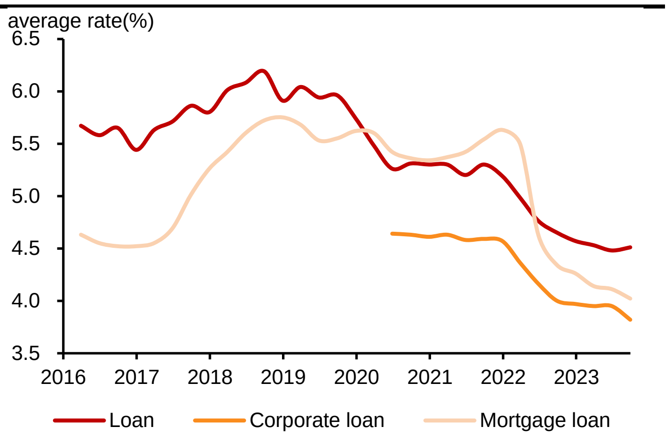
Source: Bloomberg, Wind, CMBIGM estimates

Figure 59: Money market and bond market rates



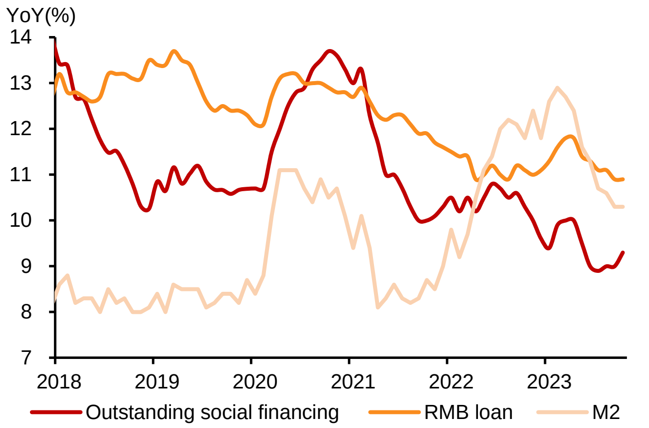
Source: Bloomberg, Wind, CMBIGM estimates

Figure 60: Weighted average rates of bank loans



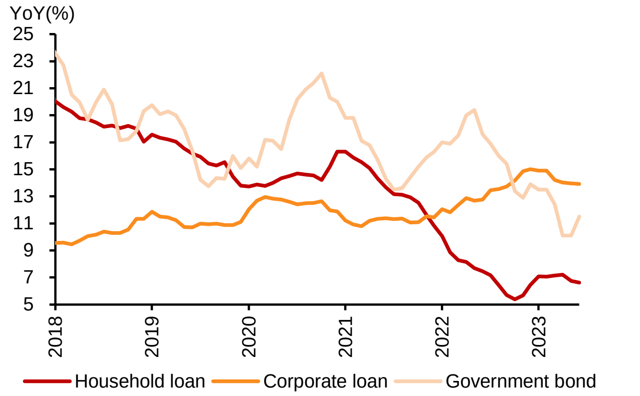
Source: Bloomberg, Wind, CMBIGM estimates

Figure 61: Outstanding social financing and credit growth



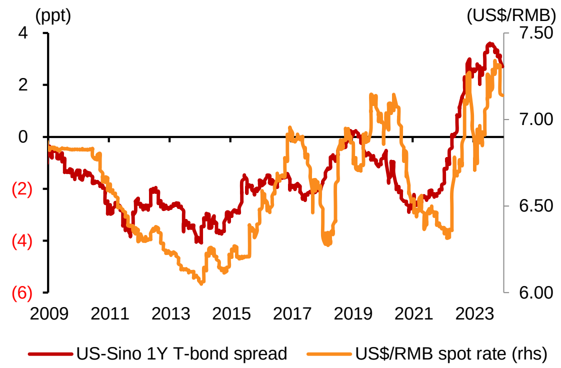
Source: Bloomberg, Wind, CMBIGM estimates

Figure 62: Credit growth to the real sector



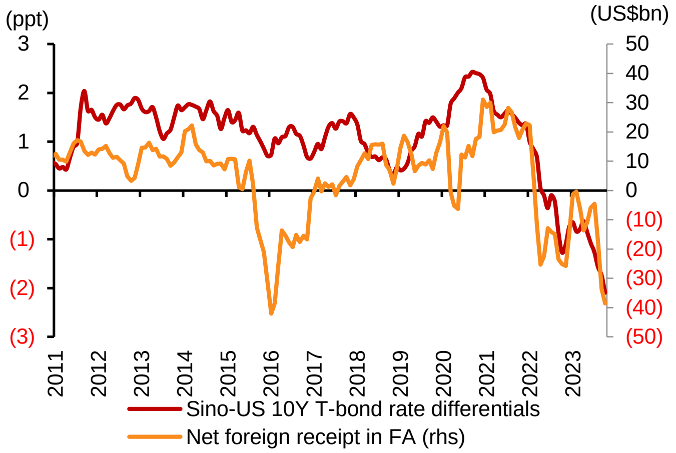
Source: Bloomberg, Wind, CMBIGM estimates

Figure 63: US-Sino spread & US$/RMB rate



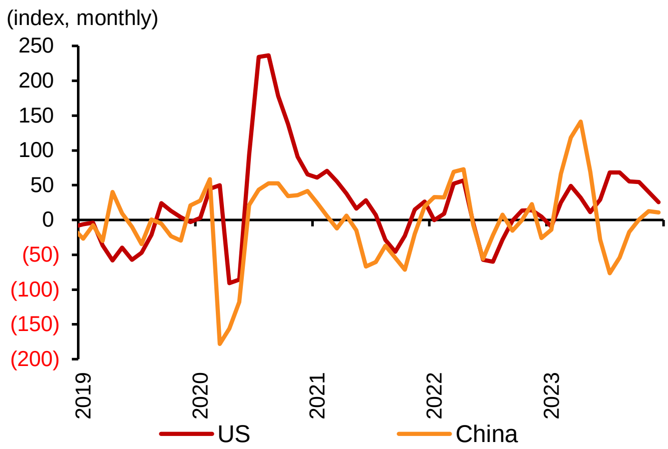
Source: Bloomberg, Wind, CMBIGM estimates

Figure 64: US-Sino spread & China financial account capital flows



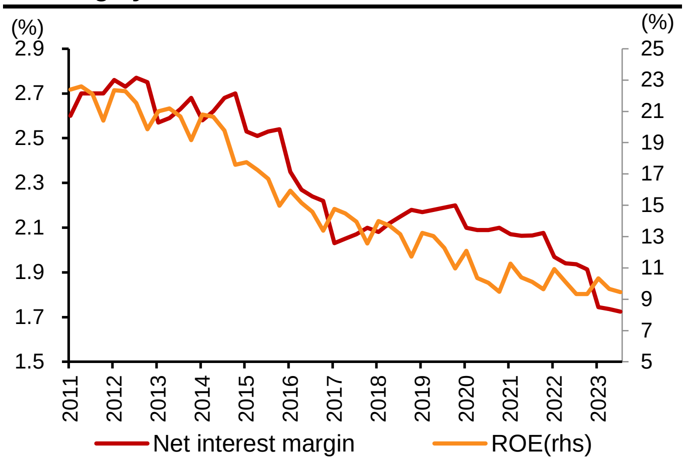
Source: Bloomberg, Wind, CMBIGM estimates

Figure 65: China& US Economic Surprise Indices



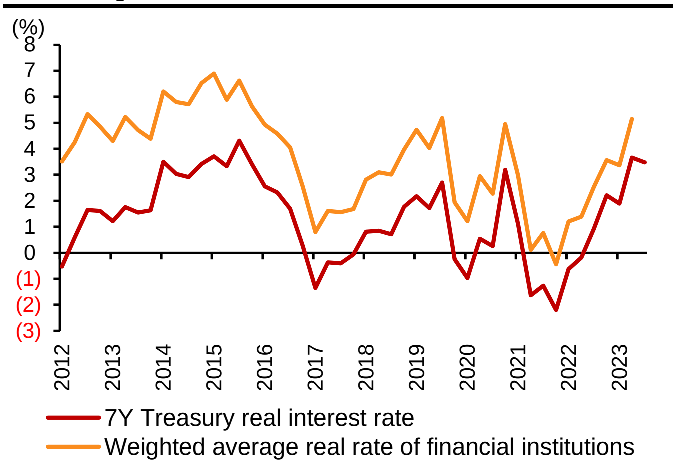
Source: Bloomberg, Wind, CMBIGM estimates

Figure 66: Net interest margin and ROE of Chinese banking system



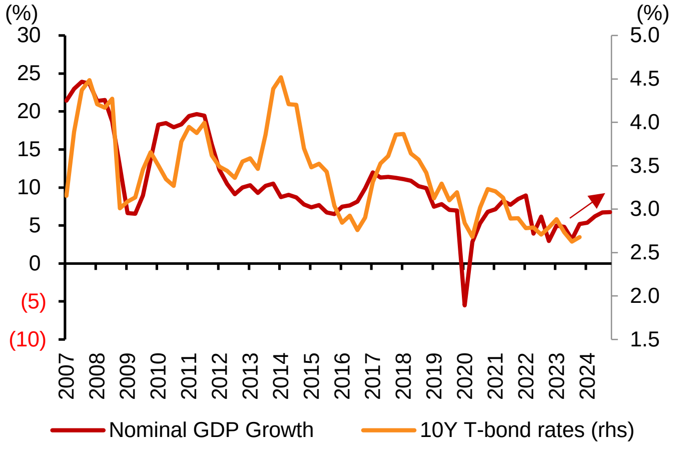
Source: Bloomberg, Wind, CMBIGM estimates

Figure 67: Real interest rate levels adjusted for GDP deflator growth rate



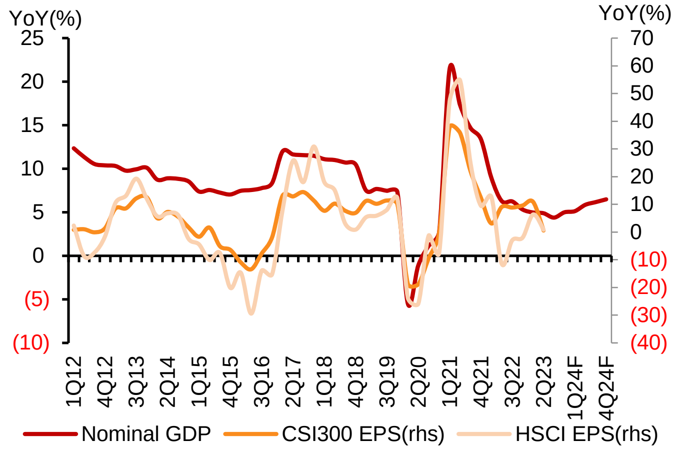
Source: Bloomberg, Wind, CMBIGM estimates

Figure 68: China's nominal GDP growth rate and 10-year government bond yields



Source: Bloomberg, Wind, CMBIGM estimates

Figure 69: China's nominal GDP and stock market EPS growth



Source: Bloomberg, Wind, CMBIGM estimates

Sector Outlook

- China Internet & Software – OUTPERFORM
- China Semiconductor – OUTPERFORM
- China Technology – OUTPERFORM
- China Healthcare – OUTPERFORM
- China Consumer Staples – MARKET-PERFORM
- China Consumer Discretionary – MARKET-PERFORM
- China Automobiles – OUTPERFORM
- China Insurance – OUTPERFORM
- China Property – OUTPERFORM
- China Construction Machinery/HDT – OUTPERFORM
- China Entertainment – OUTPERFORM
- China Energy: Power Operators – OUTPERFORM
- China Energy: City Gas Operators – OUTPERFORM

China Internet & Software

OUTPERFORM

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Enhancing core business competitive edge and shareholder return in a holistic view

Driving quality growth and enhancing core competitive edges

In 2023, stock prices of two types of internet and software companies outperformed the overall industry: 1) companies that can deliver better-than-market expected revenue and earnings growth on a constant basis, and proved that they can still drive for sustainable and solid revenue and earnings growth; 2) companies whose core businesses have established a competitive moat, and which have proved their willingness to enhance shareholder return. Overseas expansion and the ramp-up of revenue generation from generative AI business are likely to be two key drivers for incremental industry revenue growth in 2024, while companies with a differentiated competitive edge and strong technological capabilities likely have the ability to further enhance shareholder return. Regarding stock recommendation, we reiterate our BUY rating on Alibaba, Tencent, Pinduoduo, and Baidu in the internet industry, and suggest accumulating Kingdee in the software industry.

Robust business model as the key competitive edge

We expect companies with robust business models to deliver sustainable earnings growth on their strong operating leverage, which will improve the company ROE and shareholder return, such as Tencent, Alibaba and Baidu. 1) Tencent's core competitive edges remain solid, and we expect the strong growth of higher-margin businesses (Video Account & Mini Games) to drive FY24 non-IFRS net income to increase by 18% YoY; the company repurchased shares worth a total amount of RMB32.2bn in 9M23, equivalent to 1.1% of its market cap. 2) Alibaba's revenue growth is likely to reaccelerate with the improving macro environment in 2024, and the narrowing loss of non-core businesses could support the group's margin improvement, based on our forecast. Underpinned by the rising margin, Alibaba's initiatives to enhance shareholder return will support its re-rating in our view.

Business with the ability to sustain high growth may continue to enjoy valuation premium

As the GMV and revenue growth in domestic e-commerce market slows, e-commerce companies are leveraging domestic supply chain advantage to expand in overseas markets, which helps unlock long-term growth potential. Currently, the US, Southeast Asia, and Europe are major markets for overseas expansion. With a gradually improving global infrastructure system, e-commerce platforms could tap into more markets worldwide. Pinduoduo's Temu business and Alibaba's International Digital Commerce Group both recorded strong revenue growth in 2023. Looking into 2024 and beyond, the strong revenue growth brought by overseas expansion for e-commerce business could sustain, in our view, which is on track to support long-term revenue and earnings growth.

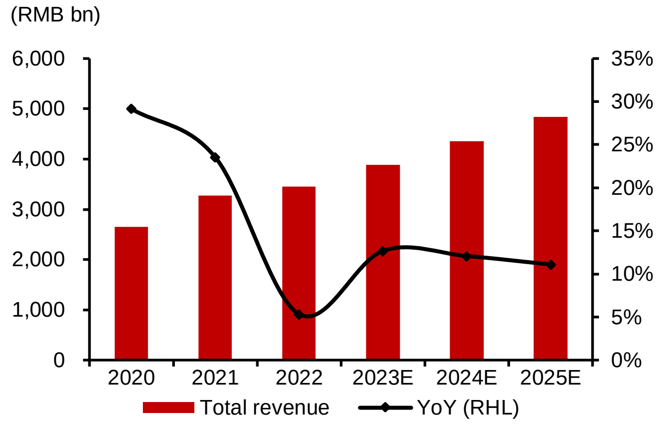
Quality growth remains as the key theme

For 2024, Internet companies will continue to focus on the quality development strategy, optimizing user traffic operation and reducing margin-destructive competition. Based on

Bloomberg consensus and our estimate, we estimate adjusted net income of the internet sector to grow by 15% YoY in 2024, with adjusted NPM up by 0.4ppt YoY to 14.4%. We prefer leading internet companies like Alibaba, Tencent, Baidu, and Pinduoduo, which could leverage diversified monetization methods to improve monetization on its abundant consumer/business user traffic. The middle-tier platforms may face more competitive pressures and need to offer differentiated products/services to maintain their market share.

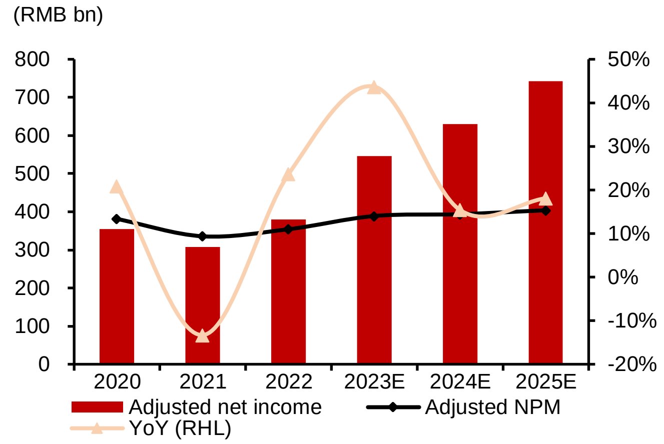
Focus Charts

Figure 1: China Internet: total revenue



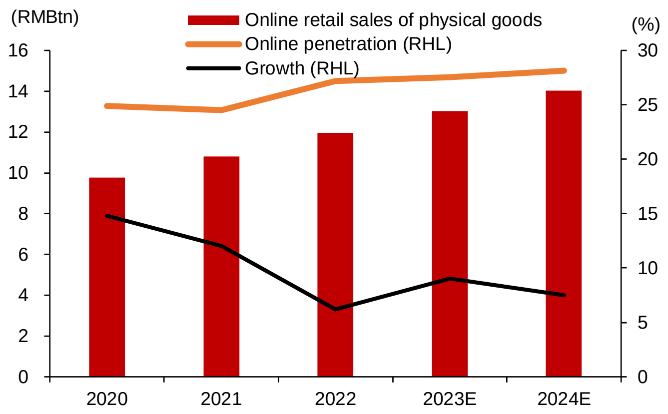
Source: Company data, Bloomberg, CMBIGM estimates

Figure 2: China Internet: adjusted net income



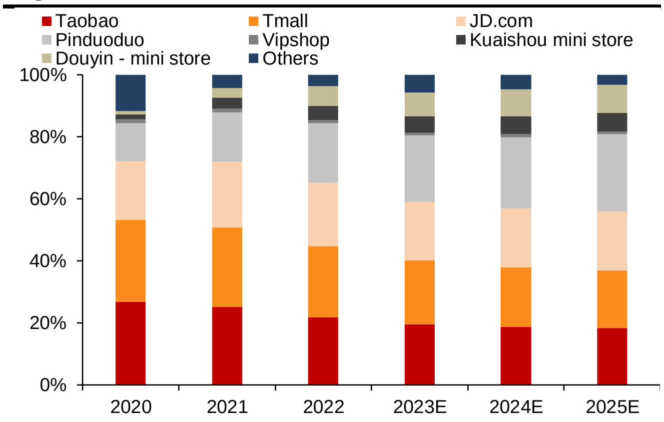
Source: Company data, Bloomberg, CMBIGM estimates

Figure 3: China: online retail sales of physical goods



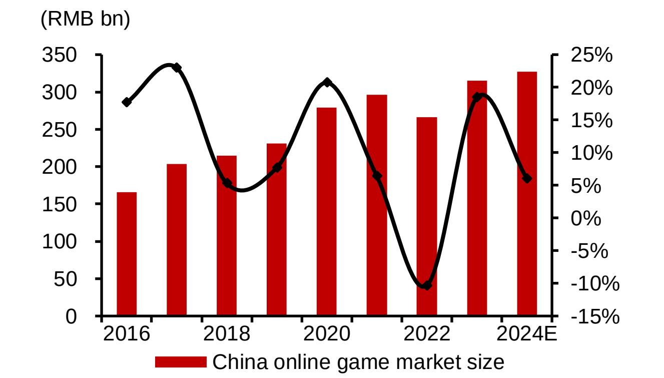
Source: Company data, CMBIGM estimates

Figure 4: China: e-commerce market share



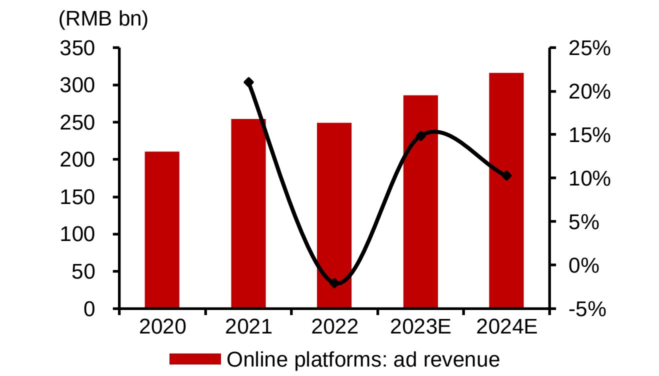
Source: Company data, CMBIGM estimates

Figure 5: China: online gaming market



Source: CNG, GPC, CMBIGM estimates

Figure 6: China online platforms: ad revenue



Source: Company data, Bloomberg, CMBIGM estimates

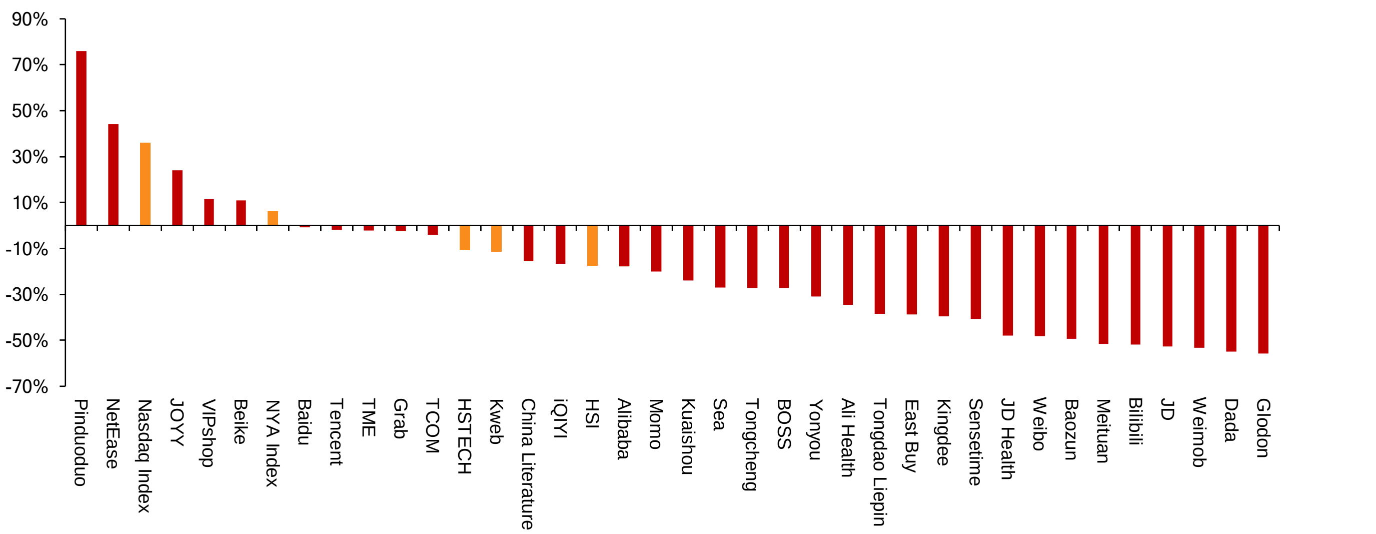
Enhancing core business competitive edges and shareholder return in a holistic view

In 2023, stock prices of two types of internet and software companies outperformed the overall industry: 1) companies that can deliver better-than-market expected revenue and earnings growth on a constant basis, and proved that they can still drive for sustainable revenue and earnings growth (ie. Pinduoduo, NetEase); 2) companies whose core businesses have established a competitive moat, and which have proved their willingness to enhance shareholder return (ie. VIPShop). Also, companies whose business fundamentals were hurt by pandemic outbreaks, but which are on track for a solid recovery in the post-pandemic era have also delivered relatively better-than-industry benchmark performance in 2023 (ie. TCOM, Beike).

In terms of fundamentals and shareholder return, against the backdrop of mild economy recovery and consumption recovery, we expect three key themes for 2024: 1) sustaining high quality growth for existing businesses; 2) exploring new revenue growth opportunities in an efficient way; and 3) remaining determined to improve the level of shareholder return. The enhancement of shareholder return, in our view, can be achieved through: 1) elevating investment in new business that can drive long-term revenue and earnings growth — currently, overseas expansion of e-commerce business and incremental monetization opportunities brought by the ramp-up of generative AI business are two important directions; 2) enhancing user experience for the core user base, and driving for profitability improvement through technology advancement and operating efficiency improvement, thereby enhancing shareholder return. For software companies, the structural recovery in fundamentals likely still takes time, and may lag behind the recovery of corporate earnings. Overall revenue growth is likely to recover along with economy recovery, and driving for improvement in profitability via operating efficiency improvement should remain a key theme in 2024, in our view.

In terms of valuation, we expect the marginal easing of US dollar liquidity pressure may promote a valuation rerating of the Hong Kong stock market.

Figure 7: YTD stock price performance



Source: Wind, CMBIGM

Note: Time span of stock price performance calculation: 31 December 2022 – 6 December 2023

Theme I: companies with overseas expansion potential poised to continue outperforming others in 2024

As the GMV and revenue growth in domestic e-commerce market slows, e-commerce companies are leveraging domestic supply chain advantage to expand in overseas markets, which helps unlock long-term growth potential. Currently, the US, Southeast Asia, and Europe are major markets for overseas expansion. With a gradually improving global infrastructure ecosystem, e-commerce platforms could tap into more markets worldwide. Pinduoduo's Temu business and Alibaba's International Digital Commerce Group both recorded strong revenue growth in 2023. Looking into 2024 and beyond, the strong revenue growth brought by overseas expansion for e-commerce business could sustain, in our view, which is on track to support long-term revenue and earnings growth.

Theme II: favour companies riding on the tailwind of generative AI

We expect Baidu, Alibaba and Tencent to benefit from the development of generative AI, given their: 1) advanced digital infrastructure and ample inventories of GPUs; 2) strong synergies between their MaaS solutions and their IaaS/PaaS/SaaS business; and 3) more powerful self-developed large models versus domestic peers. Strong AI capabilities and vast use cases will help companies improve user experience and enhance their own business efficiency. Besides, large models could optimize ad solutions and improve advertising ROI. We expect the positive impact of large models to gradually reflect on the companies' financials in FY24.

Theme III: favour companies with solid business models and capabilities to enhance shareholder return

We prefer Alibaba, Tencent and Vipshop for their solid competitive edges, capability to improve operating efficiency, and strong cash flow generation, which should support their growing dividends and share repurchases to enhance shareholder return. 1) Tencent's core competitive edges remain solid, and we expect the strong growth of higher-margin businesses (Video Account & Mini Games) to drive FY24 non-IFRS net income to increase by 18% YoY; the company repurchased shares worth a total amount of RMB32.2bn in 9M23, equivalent to 1.1% of its market cap. 2) Alibaba's revenue growth is likely to reaccelerate with the improving macro environment in 2024, and the narrowing loss of non-core businesses could support the group's margin improvement, based on our forecast. Underpinned by the rising margin, Alibaba's initiatives to enhance shareholder return will support its re-rating in our view.

Figure 8: Internet: shareholder return & company fundamentals

	Cash reserve		Shareholder return		Valuation & Fundamentals		
Company	9/30 Cash (US$mn)	Cash/mkt cap	FY23E Dividend Yield	Remaining buyback quota as % of mkt cap	FY23 PE	FY23E Adj. NPM	23-25E Earnings CAGR
Alibaba	33,945	18.4%	1.2%	7.9%	8.0	17.3%	11.6%
Tencent	20,401	5.3%	0.7%	NA	17.9	25.4%	21.9%
Baidu	4,862	12.2%	0.0%	12.5%	10.7	19.9%	14.0%
NetEase	2,105	3.1%	1.3%	6.4%	17.2	30.4%	17.0%
JD	16,152	38.2%	0.7%	4.0%	9.1	3.1%	14.5%
Beike	2,206	11.5%	0.2%	6.6%	14.1	12.8%	58.2%
Kuaishou	1,570	5.1%	0.0%	1.2%	25.6	7.7%	NA
TME	1,724	12.2%	0.0%	2.8%	16.7	21.7%	14.4%
Vipshop	2,624	31.7%	0.0%	6.7%	6.8	8.0%	12.8%
BiliBili	1,064	22.8%	0.0%	9.5%	NA	-15.6%	NA

Source: Company data, Bloomberg, CMBIGM

Theme IV: companies with attractive valuation likely to benefit more when liquidity pressure sees a marginal easing trend

After experiencing recent market volatilities, internet companies on average are trading at 16.1x 2024E PE (vs forward one-year trading range over the past three years: 14.6-32.9x, average: 22.7x). Looking into 2024, the marginal easing of USD liquidity is likely to drive a rerating of the Hong Kong stock market, while the TMT sector could see higher upside potential, in our view, with small- and mid-cap stocks outperforming relatively larger-cap stocks. Looking ahead, we think a structural rerating may still depend on the recovery of the overall macro environment and consumption sentiment, but the strategic move to enhance user experience for the core user base, to improve operating efficiency, and to leverage technological capabilities to seek further expansion opportunities in an efficient way, could lead to an improvement in operating margin. For stocks that currently have a relatively low valuation and face cash flow pressure, they may have financing needs to drive future development.

2024 outlook for key subsectors

E-commerce: enhance core user stickiness, and drive for overseas expansion

The e-commerce sector saw a mild recovery trend in 2023, with total retail sales/online retail sales of physical goods seeing respective GMV growth of 6.9/8.4% YoY in 10M23. Consumers increasingly prefer value-for-money products, and price is becoming an increasingly important metric for consumers when considering shopping on which specific platform. E-commerce platforms are improving supply chain efficiency, enhancing value-for-money product supply, and enhancing content ecosystems and consumer services to improve user stickiness for the core user base, and drive quality growth. At the same time, leveraging the increasingly sticky consumer base and enhancing merchants' ROI, e-commerce platforms in turn have the opportunity to increase their monetization rate and achieve better revenue growth.

Looking into 2024, we expect a mild consumption recovery trend driven by the implementation of stimulus policy, while we expect driving quality growth to remain a key theme for e-commerce platforms. For domestic business, e-commerce platforms will aim at enhancing quality product supply at a decent price, driving engagement improvement of the core user base to grow GMV. Aided by strong interactive features, live streaming e-commerce could maintain higher-than-overall industry average GMV growth in 2024, in our view. However, as an increasing number of brands are focusing more on ROI, the competition brought about by live streaming e-commerce platforms against traditional horizontal e-commerce platforms is likely to see a further marginal easing trend in 2024.

We estimate 7.3% YoY GMV growth for online retail sales of physical goods on the back of a 5.3% YoY growth forecast for total retail sales in 2024E. At the same time, leveraging strong domestic supply chain capability, overseas expansion remains vital to drive long-term revenue and earnings growth. Maintain BUY on Pinduoduo, Alibaba, and JD.

Gaming: competition further intensifies; expand into new genres to capture opportunities

Looking ahead to 2024, we expect China's gaming market revenue to grow by 6% YoY, with Tencent/NetEase's games revenue up by 5/10% YoY respectively. The competition in the domestic gaming market continues to intensify. The gaming companies need to develop/publish the best-in-class games in specific genres to compete for user traffic and time spend. For the overseas market, we expect the performance of China's gaming companies to be muted in FY24. Most Tencent/NetEase's 3A games are still in the early development phase and target to be launched after FY25.

For leading gaming companies like Tencent/NetEase/miHoYo, it is vital for them to expand into new game genres to boost revenue growth, in our view. As a result, we highlight several games in Tencent/NetEase's pipeline, which may support their genre expansion in FY24/25E: 1) *Dream Stars* by Tencent to expand market share in the party game genre; 2) *Where Winds Meet* by NetEase to tap into the open-world RPG game genre; and 3) *Honor of Kings: World* by Tencent and *Naraka: Bladepoint Mobile* by NetEase, which are still pending license approval.

Online advertising: expect mild recovery; mid-to-short video platforms continue to outperform

For 2024, we expect China online ad market to continue its mild recovery trend and estimate online ad revenue of major platforms to grow by 10% YoY. We expect e-commerce-related ads will drive Tencent/Kuaishou/Bilibili's advertising business to outperform in FY24, as they improve their e-commerce ecosystem and advertising infrastructure. We forecast Tencent/Kuaishou/Bilibili ad revenue to increase by 11/18/18% YoY in FY24. From a long-term perspective and with reference to Kuaishou's e-commerce ad monetization, we estimate the live streaming e-commerce ads will bring RMB15.8/1.5bn incremental ad revenue to Tencent/Bilibili, which account for 15/23% of Tencent/BiliBili FY23 ad revenue.

Online music: focus on core music business; positive on the long-term growth potential

As online music platforms strengthened risk control and compliance measures for the social entertainment business in 2023, core music business has become a key revenue and earnings driver for these platforms. Underpinned by the enhanced protection of music IP and an increased proportion of paid music content, we are positive on the sustainable growth of online music paid subscribers. We forecast the average paid subscribers of TME/Cloud Music to grow by 12/10% YoY to RMB113/48mn in FY24, with the paying ratio reaching 19.0/22.5%. We also see ample improvement potential for online music ARPPU. Average monthly ARPPU of TME/Cloud Music was only RMB8.6/6.6 in FY22, versus the standard membership of RMB18 per month.

Cloud: driving quality growth remains a key theme, eyeing on incremental revenue growth brought by generative AI

In 2023, macro headwinds weighed on cloud industry revenue growth. Meanwhile, leading internet companies have been proactively adjusting their business development strategy for cloud business, focusing more on driving quality cloud services revenue growth. Alibaba Cloud and Baidu Cloud have demonstrated stable profitability, which is likely to further improve with business scale expansion. Business adjustment for both Tencent Cloud and Baidu Cloud is approaching the end. Combined with the positive impact from generative AI-related revenue, which is gradually ramping up, we expect both Baidu Cloud and Tencent Cloud to deliver double-digit revenue growth in 4Q23-2024. For Alibaba Cloud, with the reshuffle of the management team, the company is increasingly focused on driving quality growth, which will likely weigh on near-term revenue growth recovery, but aid long-term healthy growth.

Looking into 2024, we expect overall cloud industry revenue growth to recover along with the recovery of the macro environment and enterprises' digitalization budget, while incremental revenue generation from generative AI is likely to bring upside potential to cloud business revenue for both Alibaba Cloud and Baidu Cloud, from a low-single-digit level of revenue contribution in 3Q23 to a higher level. We are expecting an operating margin expansion for both Alibaba Cloud, Tencent Cloud and Baidu Cloud in 2024, driven by the strategy to drive quality growth, and enlarging economies of scale.

Generative AI & SaaS: eyes on monetization opportunities and operating efficiency improvement

The monetization of large models will support both To-B and To-C revenue growth in our view. On the consumer front, current monetization explorations by tech companies mainly focus on: 1) monetization of new AI products—Baidu's ERNIE Bot and Alibaba's Qwen were launched as individual apps; and 2) incremental revenue from enhancing existing product features—Baidu leverage its large model to empower its To-C products, and Alibaba integrates DingTalk with the large model to launch several new functions. This shall bring incremental revenue via raising subscription prices. On the business front, we expect MaaS solution providers to focus on lowering service costs and improving service quality to expand their market share, which shall lead to investment in infrastructure and end-to-end capability optimization.

For China's SaaS sector, we expect structural recovery of the sector to still take time, due to the macro uncertainty and enterprises' stringent budget. However, the improvement in US market liquidity may support the re-rating of the sector. Looking ahead in the mid-to-long term, we remain positive on the investment theme of software localization. We believe the recovery of the macro environment should support enterprise IT spending and the sector valuation recovery.

OTA: consumption segmentation trend to sustain, eyeing on outbound travel recovery

In 1H23, with the strong release of pent-up demand, stock performance of OTA companies was better than the industry average. However, volatilities of stock prices appeared after market expectation for a strong recovery was fully reflected. Looking into 2023, domestic travel is likely to experience the high base effect, and major industry GMV growth drivers will likely come from outbound travel, in our view. The strong growth of pure international travel business is likely to bring incremental revenue. The consumer segmentation trend may sustain, and OTA companies that have a consumer base shifting towards high-end customers will likely benefit more.

Key recommendations

Tencent (700 HK, BUY, TP: HK$465.0)

Tencent's core competitive edges remain solid. Supported by the strong operating leverage of its consumer internet business, Tencent is able to deliver sustainable earnings growth amid macro uncertainty and intensifying competition. Looking into 2024, we expect: 1) higher-margin businesses like Video Account and Mini Games will bring incremental monetization opportunities and support overall GPM expansion; 2) the company will expand into new game genres such as causal games and content-driven games to driver steady growth of games business; 3) AI will empower Tencent's business lines, elevate ad ROI, improve games business efficiency and generate incremental revenue for cloud business; and 4) the company continues share repurchases to enhance shareholder return. We forecast FY24/25 non-IFRS net income to grow by 18/9% YoY. The company's current valuation of 16x FY24E non-IFRS PE (or 12x FY24E PE excluding strategic investments) offers attractive value. Our SOTP-derived target price is HK$465.0. Maintain BUY.

Alibaba (BABA US, BUY, TP: US$148.3)

Although Alibaba domestic business's GMV and revenue growth are still weighed down by the competitive pressure and relatively low consumption sentiment, leveraging the "user first" strategy, Alibaba is on track to keep its long-term revenue and earnings growth to be in line with industry trends. Although the decision not to proceed with a full spin-off for Cloud Intelligence Group (CIG) has disappointed the market in the near term, this should benefit long-term business development for both CIG and Alibaba. Moreover, management guided for a holistic approach to enhance shareholder return. Looking into 2024, we expect the recovery of macro conditions to drive a recovery for Alibaba's revenue growth, while the loss reduction of non-core assets will likely continue to drive an improvement in margins. Leveraging improving profitability, Alibaba is able to increase shareholder return, which shall drive a valuation rerating, in our view. The current valuation of 7.6x FY24E non-GAAP PE is not demanding, in our view. Maintain SOTP-based target price of US$148.3 and BUY rating.

Figure 9: Internet & software: peer valuation

Company	Ticker	Rating	TP (LC)	Closing (LC)	Upside	Mkt Cap (US$ mn)	P/E (x) FY24E	P/E (x) FY25E	P/S (x) FY24E	P/S (x) FY25E
HK/China Internet										
Tencent	700 HK	BUY	465.0	316.8	47%	379,520	15.3	13.6	4.0	3.6
Pinduoduo	PDD US	BUY	142.6	142.8	0%	189,762	19.4	15.0	4.1	3.3
Alibaba Group	BABA US	BUY	155.0	73.0	112%	185,746	7.3	6.5	1.3	1.2
Meituan	3690 HK	BUY	161.5	86.5	87%	67,381	15.9	10.7	1.5	1.2
NetEase	NTES US	BUY	132.5	104.2	27%	67,191	16.5	15.1	4.1	3.7
JD.com	JD US	BUY	57.5	26.6	116%	41,786	8.4	7.3	0.3	0.2
Baidu	BIDU US	BUY	195.6	113.7	72%	39,749	10.7	9.8	1.9	1.8
Kuaishou	1024 HK	BUY	97.0	55.0	77%	29,985	15.4	10.3	1.6	1.5
Trip.com	TCOM US	BUY	45.8	33.7	36%	21,775	14.2	12.1	3.0	2.7
Beike	BEKE US	BUY	24.7	15.6	58%	19,411	14.3	14.9	1.6	1.4
JD Health	6618 HK	NR	NA	36.7	NA	14,971	26.5	20.8	1.7	1.4
TME	TME US	BUY	8.9	8.3	7%	14,226	15.2	13.8	3.6	3.3
VIPShop	VIPS US	NR	NA	15.3	NA	8,283	6.5	6.1	0.5	0.5
Ali Health	241 HK	NR	NA	4.3	NA	7,531	40.5	40.5	1.5	1.5
Boss Zhipin	BZ US	NR	NA	14.1	NA	6,280	20.4	16.2	6.1	4.9
SenseTime	20 HK	BUY	2.3	1.4	69%	5,695	NA	NA	7.4	5.8
Bilibili	BILI US	BUY	24.0	11.5	108%	4,788	NA	47.4	1.3	1.2
Kingsoft	3888 HK	NR	NA	24.7	NA	4,271	24.5	19.3	3.0	2.5
TCEL	780 HK	BUY	25.1	13.9	81%	3,964	12.7	10.5	2.0	1.7
China Lit	772 HK	NR	NA	26.2	NA	3,352	14.3	12.7	2.9	2.6
PA Healthcare	1833 HK	BUY	23.8	17.0	40%	2,476	NA	NA	3.0	2.6
Cloud Village	9899 HK	BUY	99.5	88.0	13%	2,343	20.0	14.1	1.9	1.7
Weibo	WB US	BUY	23.5	9.6	144%	2,334	4.5	4.0	1.3	1.2
Dada	DADA US	NR	NA	3.3	NA	865	14.9	8.1	0.5	0.4
						Average	***16.1***	***15.0***	***2.5***	***2.2***
Global										
Microsoft Corp	MSFT US	NR	NA	369.1	NA	2,743,545	32.7	28.5	11.3	9.9
Alphabet Inc	GOOGL US	NR	NA	129.3	NA	1,626,323	18.2	15.4	5.7	5.1
Amazon	AMZN US	NR	NA	144.8	NA	1,496,781	31.7	25.4	2.4	2.1
NVIDIA Corp	NVDA US	NR	NA	455.1	NA	1,124,097	37.0	22.2	19.0	12.2
Meta	META US	NR	NA	320.0	NA	822,407	17.7	15.8	5.4	4.9
Tesla Inc	TSLA US	NR	NA	235.6	NA	748,890	NA	43.8	6.3	5.2
Adobe Inc	ADBE US	NR	NA	604.6	NA	275,256	33.6	29.5	12.6	11.3
Salesforce Inc	CRM US	NR	NA	250.7	NA	242,639	30.6	26.2	7.0	6.3
Netflix Inc	NFLX US	NR	NA	453.9	NA	198,663	28.5	23.1	5.2	4.7
Intuit Inc	INTU US	NR	NA	570.5	NA	159,695	34.8	30.0	10.0	8.8
ServiceNow	NOW US	NR	NA	687.6	NA	140,962	NA	44.7	13.0	10.8
Shopify Inc	SHOP US	NR	NA	72.5	NA	93,079	NA	NA	11.2	9.3
Palo Alto	PANW US	NR	NA	286.6	NA	90,368	NA	44.4	11.0	9.4
Workday	WDAY US	NR	NA	269.2	NA	70,805	46.9	40.9	9.8	8.4
Snowflake	SNOW US	NR	NA	188.3	NA	62,007	NA	NA	22.2	17.1
						Average	**32.0**	**29.7**	**9.7**	**8.0**

Source: Company data, Bloomberg, CMBIGM

China Semiconductor

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Three Key Investment Areas to Focus on in 2024

In 2024, we anticipate the spotlight of the market to be AI-related topics and the advancement of China's semiconductor domestic substitution, in tandem with the gradual recovery of broader market demand. We suggest investors explore investment opportunities in the following key areas.

Artificial intelligence (AI): Rising capital expenditure benefiting entire AI value chain

2023 marks the beginning of an investment cycle in AI infrastructure. The debut of OpenAI's ChatGPT has attracted significant capital and talent to the AI sector, leading to increased market interest in AI-related players. In 2024, leading cloud service providers (CSP) are expected to continue to boost their AI infrastructure investments, aiming to secure their current market leading positions in the AI tech race and to capture a larger market share. Bloomberg projects a 15% YoY increase in total capital expenditure by major global CSPs, including Amazon, Microsoft, Google, and Meta, for 2024. Additionally, investments backed by governments globally are also poised to play a formidable role in the overall AI competition.

With the deployment of AI applications, edge computing is set to emerge as a significant trend in the future AI development. We expect the adoption rates of AI-enabled smartphones and PCs, among other products, will surge in 2024, benefiting sectors related to edge computing. **We maintain a positive outlook on AI growth as well as true beneficiaries within the AI supply chain. We recommend Innolight (300308 CH, BUY).**

Semiconductor domestic substitution: Global complications forcing supply chain localization

Prompted by events like the comeback of Huawei's high-end smartphones (e.g., the Mate 60 series) and the escalation of the US' export ban on tech products to China, China's semiconductor supply chain localization advanced at a faster pace in 2H23, presenting a prominent investment area to all investors. The current global dynamics indicate that a shift towards supply chain localization will likely become a persistent trend. We believe with more and stricter US tech policies rolling out in the future, more Chinese tech players will be encouraged to opt for domestic strategies. Our outlook on the future of China's semiconductor sector remains optimistic as Chinese tech companies pursue semiconductor self-reliance. **We recommend Willsemi (603501 CH, BUY) and Maxscend (300782 CH, BUY).**

Anticipate recovery in semiconductor industry: Healthier inventory levels and potential demand resurgence

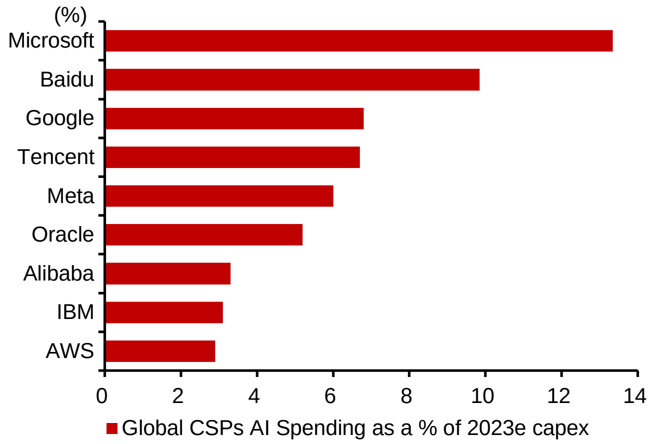
While the consumer electronics sector experienced a seasonal boost in 3Q23, which possibly extended to the end of 2023, a broader and overall demand recovery has yet to come. Currently, the inventory situation of several tech companies has improved to healthier levels. As the macro environment in 2024 is expected to show more clarity or even experience some tailwinds, demand within the semi sector may also see a gradual rebound. **We recommend Wingtech (600745 CH, BUY) and Shengyi Tech (600183 CH, BUY).**

Telecom sector remains a defensive play

Major Chinese telecom companies continue to appeal to investors who favor a cautious investment strategy for their financial stability, consistent cash flow, attractive dividend payouts, and resilience against macro uncertainties. Additionally, the advent of satellite communication as a key feature in smartphones is poised to enhance the telecom sector further. We recommend **ZTE (000063 CH/763 HK, BUY).**

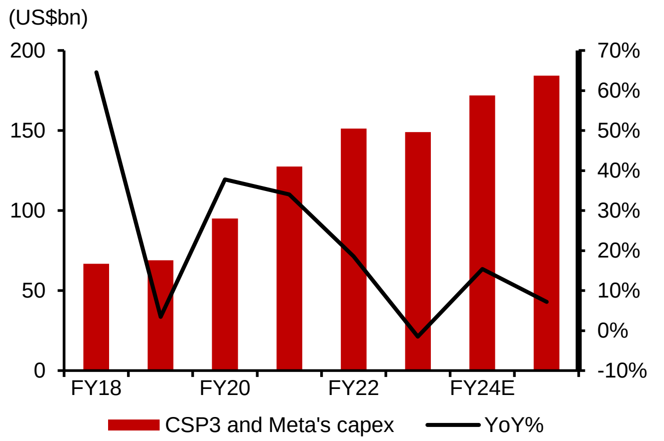
Focus Charts

Figure 1: Global CSPs' AI spending



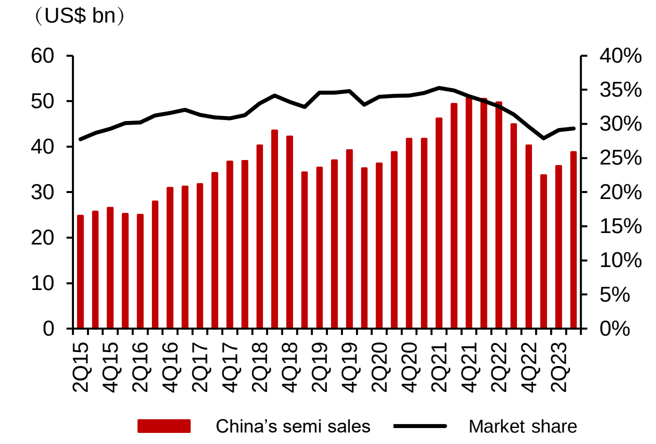
Source: Company data, Bloomberg, CMBIGM

Figure 2: Overseas CSPs' capex outlook



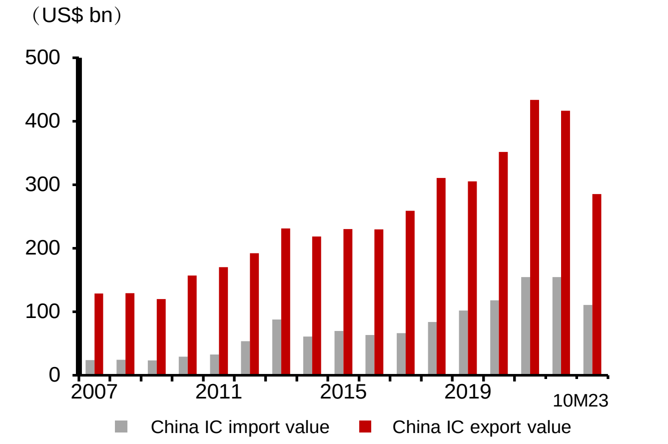
Source: Company data, Bloomberg, CMBIGM

Figure 3: China's semiconductor industry quarterly sales and market share



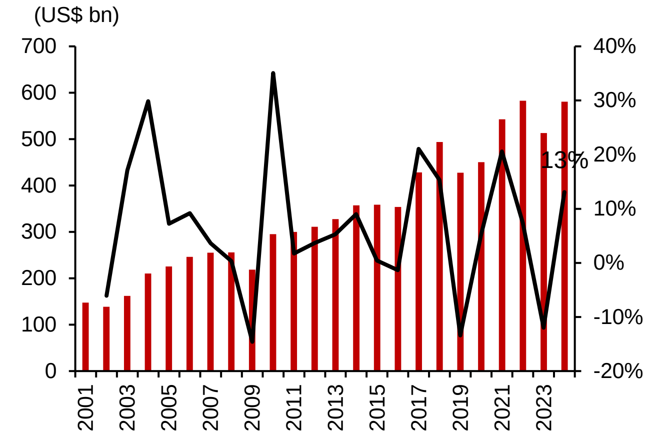
Source: Company data, Wind, CMBIGM

Figure 4: China's IC export value far exceeds the import value



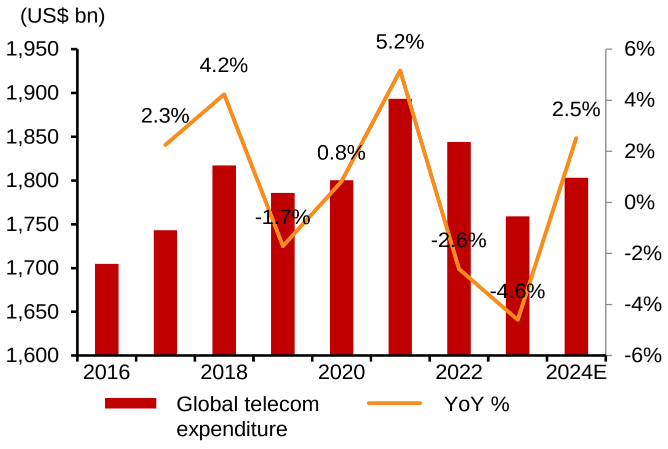
Source: Wind, GAC, CMBIGM

Figure 5: Global semi sales to grow by 13.1% in 2024



Source: WSTS, CMBIGM

Figure 6: Global telecom industry expenditure



Source: Bloomberg, CMBIGM

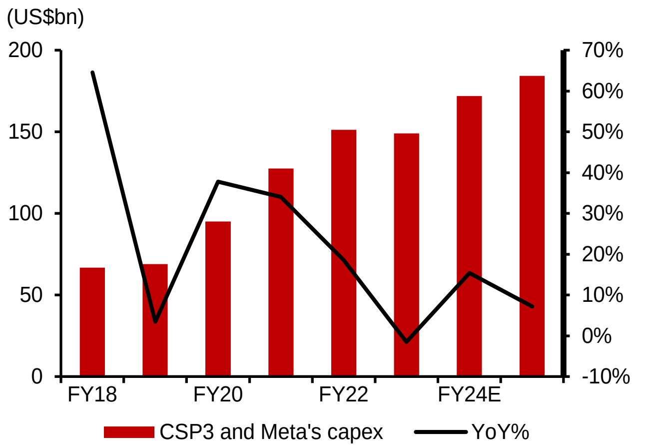
AI: Consistent growth in capital expenditure continues to fuel value chain development

Major CSPs are set to ramp up their capital expenditure to secure current leading positions

In 2023, the AI value chain rode on the ChatGPT wave, which propelled multiple global tech giants to invest in and develop their own AI models, marking the onset of a new AI investment cycle. Tech giants such as Amazon, Microsoft, Google, and Meta (together as CSP3 & Meta) reported a significant increase in their capital expenditure in 3Q23, the total of which exceeded US$37bn, recording the fourth highest quarterly expenditure in history. Such momentum has fueled investors' confidence in the prospects of further AI capital spending in the upcoming quarters.

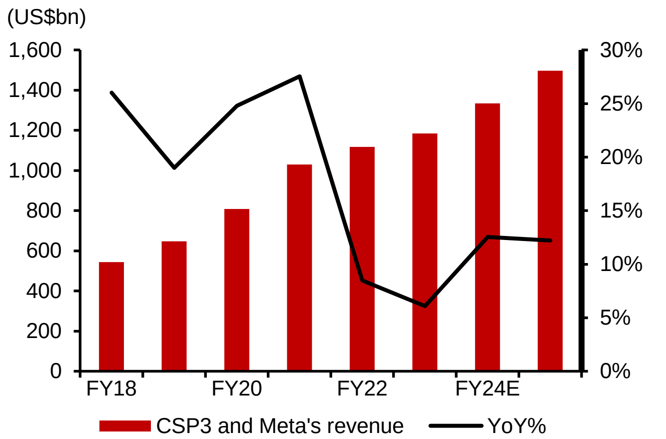
Looking forward to 2024, we anticipate that CSP3 & Meta will continue to make hefty investments in AI-related fields to solidify their market leadership as well as to gain more global share. According to Bloomberg forecast in 3Q23, CSP3 & Meta are expected to spend as much as US$172bn on capital expenditure in 2024, up 15% YoY from 2023. This projection represents a 6% rise from the previous estimate in Aug 2023 (US$163bn). Between 2020 and 2022, CSP3 & Meta altogether saw capital expenditure growth of 38%, 34%, and 19%, reaching unprecedented levels already. **We believe the latest and optimistic forecast by Bloomberg indicates a highly positive market outlook on tech giants' capital expenditure in AI infrastructure in the coming year.**

Figure 7: CSP3 & Meta's capital expenditure expected to reach US$172bn (+15% YoY) in 2024



Source: Company data, Bloomberg, CMBIGM

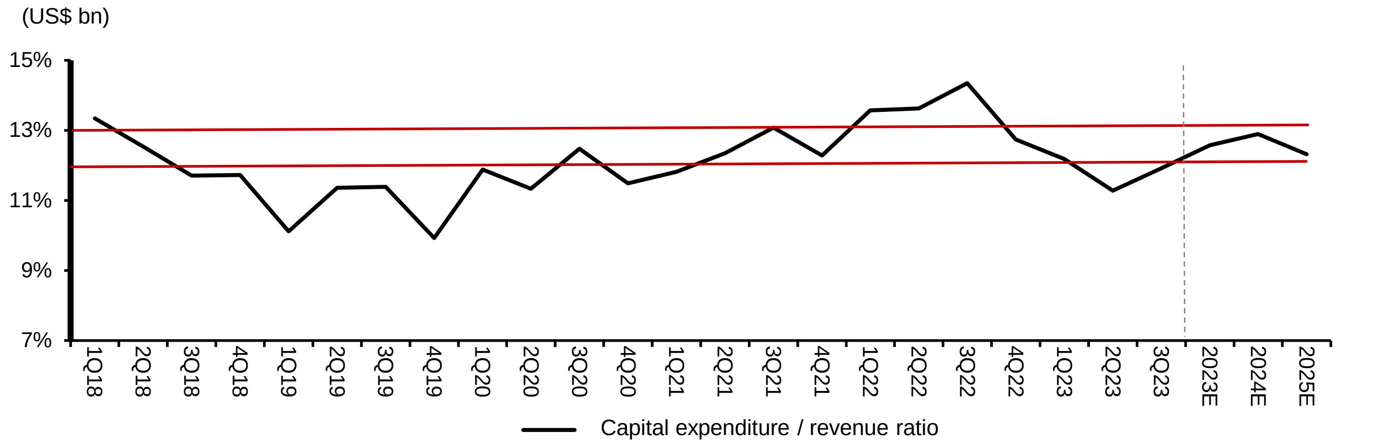
Figure 8: CSP3 & Meta's revenue and growth



Source: Company data, Bloomberg, CMBIGM

We view the intensified capital expenditure by leading CSPs as in line with the evolving trends in the AI sector. Bloomberg predicts revenue from CSPs will grow by 13%/12% YoY in 2024/25, respectively. Consequently, the ratio between capital expenditure to revenue is anticipated to decrease, stabilizing within a 12%-13% bracket. This level mirrors the ratios observed in 2020/21, alleviating investors' concerns regarding the potentially excessive capital spending.

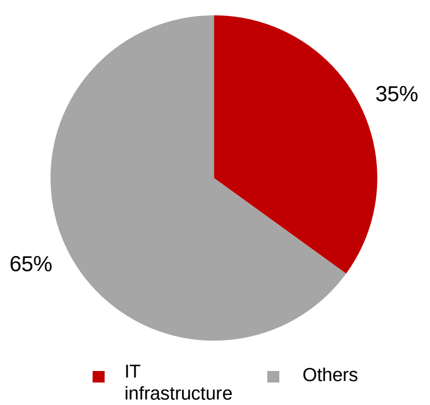
Figure 9: CSP3 & Meta capital expenditure to revenue ratio is expected to maintain ~12-13%) in 2024



Source: Company data, Bloomberg, CMBIGM

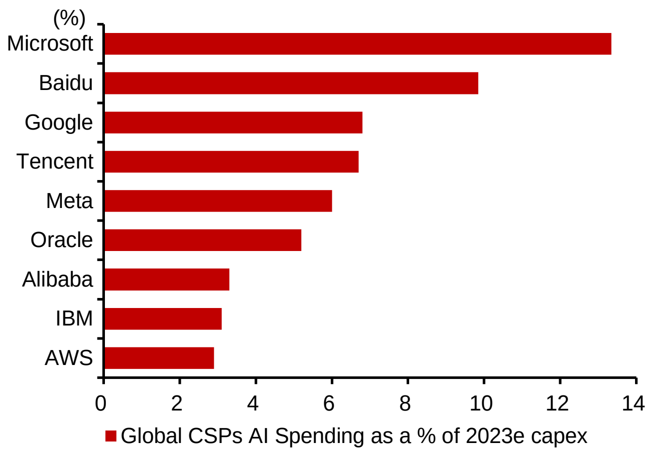
Per Counterpoint, the global capital expenditure of CSPs on IT infrastructure in 2023 accounts for about 1/3 of their total capital expenditure. **We believe a major portion of this spending will be directed towards AI developments in order to gain more market share as well as maintaining a leading edge in the fast-growing AI industry.**

Figure 10: IT infrastructure spending accounts for ~35% of CSPs' capital expenditure in 2023



Source: Company data, Counterpoint, CMBIGM

Figure 11: Global CSPs' AI-related spending as a % of revenue in 2023



Source: Company data, Counterpoint, CMBIGM

Government-backed funds to also boost the ongoing AI momentum

While CSPs currently serve as the primary driver for AI industry growth, we believe that government-backed investments globally will also emerge as a significant force. For example, the UK plans to invest 300mn pounds to increase its AI supercomputing capabilities by more than 30x; Germany aims to double its public investment in AI research in the next two years to EUR1bn. Nvidia, in its recent earnings, stated that national-level investments in computing power will become a crucial economic strategy for countries. The market for AI infrastructure development driven by government-backed funds in the future could reach a scale of several billion dollars, based on our estimates.

Figure 12: Government-backed funding in AI industry

Country	AI Investment
UK	On 2 Nov 2023, the UK gov't announced to increase spending in AI research to 300 million pounds (approx. US$366mn), aiming to enhance the UK's supercomputing capabilities by more than 30x. HPE will use the next-generation HPE Cray EX supercomputer and over 5,000 of the most advanced NVIDIA GH200 chips to build and deliver the new AI system (Isambard-AI). The advanced design will enable Isambard-AI to achieve computational speeds of 200tn calculations per second.
Germany	Germany is seeking to accelerate AI advancement both nationally and across Europe, as revealed in the latest AI action plan unveiled by the Federal Ministry of Education and Research on 7 Nov. The strategy is designed to propel the EU to a level of competitiveness comparable to the current leaders in the field, the US and China.
Saudi Arabia & UAE	Saudi Arabia and the UAE plan to purchase thousands of high-performance Nvidia chips
India	Nvidia will partner with Indian Gov't and other local tech companies, such as Infosys, Reliance and Tata, to deliver AI computing infrastructure and platforms for developing AI solutions.
France	French private cloud provider Scaleway is building a regional AI cloud based on NVIDIA H100, InfiniBand, and NVIDIA AI Enterprise software.

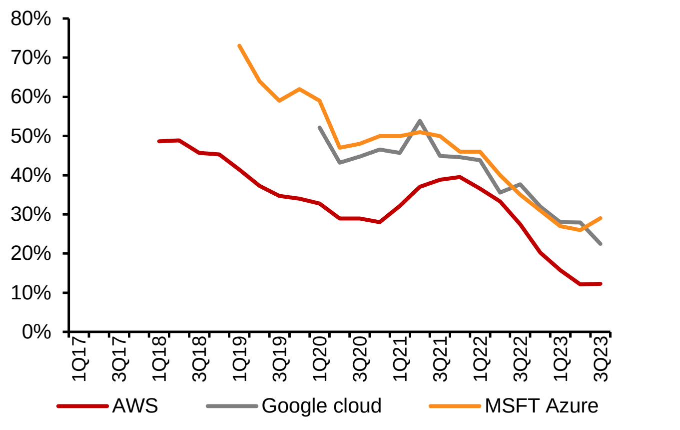
Source: Company data, Reuters, BBC, Financial Times, CMBIGM

AI monetization strategies and cost optimization remain a key focus for investors

Notably, the share prices of the CSPs after their 3Q23 earnings showed divergence, underscoring investors' concerns about the development of cloud-based AI applications. Moreover, the high operational costs associated with AI are critical to the future profitability of these CSPs, placing a spotlight on the importance of cost optimization.

In particular, Microsoft's share price saw an uptick, as the company was favored by the market for its accelerated revenue growth in Azure during 3Q23. On the other hand, Google's share price came under pressure due to its cloud business revenue not meeting expectations and experiencing a slowdown in growth. Although Amazon's AWS recorded the lowest growth rate at just 12%, the company indicated that revenues from several significant clients would be reflected in 4Q23, leading to a swift recovery in its share price.

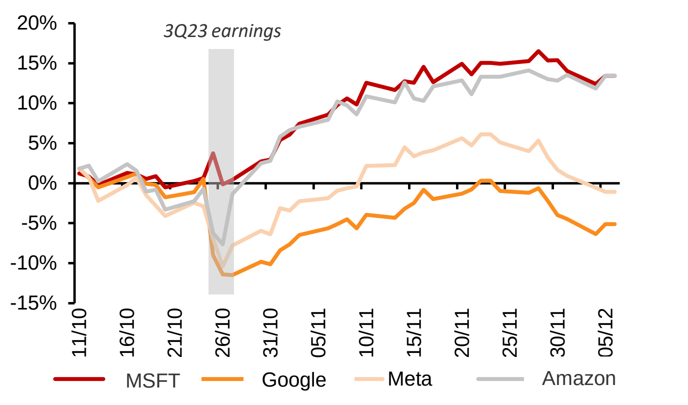
Figure 13: CSP3's expected cloud sector growth in 2024



Source: Company data, CMBIGM

Figure 14: CSP3 & Meta's share prices showed divergence after 3Q23 earnings

(Share price % since 11 Oct)



Source: Company data, Bloomberg, CMBIGM

In our August report, we highlighted that the continuation of the AI sector growth and the ongoing increase in CSPs' capital expenditures hinge upon the successful deployment and monetization of AI applications. Recently, the industry has witnessed a number of encouraging catalysts, suggesting a strong likelihood of sustained momentum in the AI industry. **We maintain that the generation of sustainable cash flows and profits is**

crucial for AI sector's long-term expansion, in order to foster a cycle of investment that leads to monetization, followed by profit generation and subsequent reinvestment.

Recent catalysts in the sector feature the following:

1. OpenAI's annual recurring revenue surpassing US$1.3bn. (link)
2. Tech giants like Microsoft (link), Amazon (link), Alphabet (link), Meta (link), and Adobe (link) rolling out new products and services featuring generative AI that charge a fee.
3. OpenAI's first developer conference featuring several groundbreaking efforts in introducing new models with higher word limit in addition to better cost structure.
4. The introduction of the AI wearable device, AI Pin, priced at US$699 with a monthly subscription fee of US$24, exemplifying a successful monetization strategy via AI hardware.
5. Apple plans to substantially boost its AI investments, potentially up to US$1bn annually, to stay competitive with rivals like Google, Microsoft, and Amazon. (link)

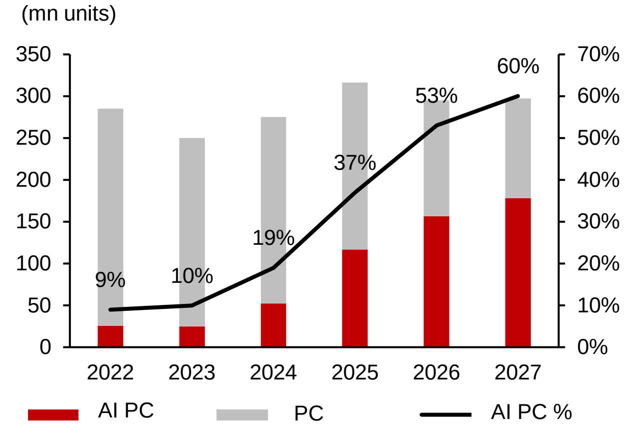
AI edge computing poised to be a significant trend

AI edge computing is poised to be a significant trend in future developments. Although the current market is predominantly focused on cloud-based AI, edge computing is emerging as an equally important trend. For 2024, we expect a swift rise in the adoption of AI-powered smartphones and PCs. Notably, Chinese smartphone manufacturers such as Huawei and Xiaomi are spearheading the “cloud + edge” strategy in AI phones. This strategy aims to run large language models (LLM) directly on smartphones, thereby extending AI apps to end-user devices. A prime example includes Huawei's voice assistant Celia and the Honor Magic6 phone, which is equipped with an LLM on the Snapdragon 8 Gen 3 mobile platform.

Beyond AI smartphones, AI PCs are also set to integrate edge AI capabilities. These AI PCs are envisioned to become a fusion of terminal, edge computing, and cloud technologies. For instance, Lenovo's inaugural AI PC product can locally operate miniaturized AI models, facilitating advanced features like intelligent photo editing and video editing.

We believe that the incorporation of AI edge computing features into end-user devices is an emerging trend driven by three factors: 1) enhancing personalized user experiences, 2) optimizing system operations, and 3) ensuring data and privacy security. This trend marks a significant innovation and breakthrough for device manufacturers in a market that is still awaiting a rebound in consumer electronics demand amid heated competition.

Figure 15: AI PC penetration exp. to grow swiftly (by sales)



Source: Company data, Canalys, CMBIGM

Figure 16: AI PC processors

	Processor	Release date	Node	Power
Apple	M1	4Q20	TSMC N5	11 TOPS
Apple	M2	4Q21	TSMC N5P	15.8 TOPS
Apple	M3	4Q23	TSMC N3	>30 TOPS
Qualcomm	8cx Gen4	1H24	TSMC N4	>40 TOPS
Qualcomm	8cx Gen3	4Q21	TSMC N5	29 TOPS
AMD	Ryzen 7040	2Q23	TSMC N4	10 TOPS
Intel	Meteor Lake	4Q23	Intel 4	>30 TOPS
AMD	Ryzen 8050	2H24	TSMC N4	~40 TOPS

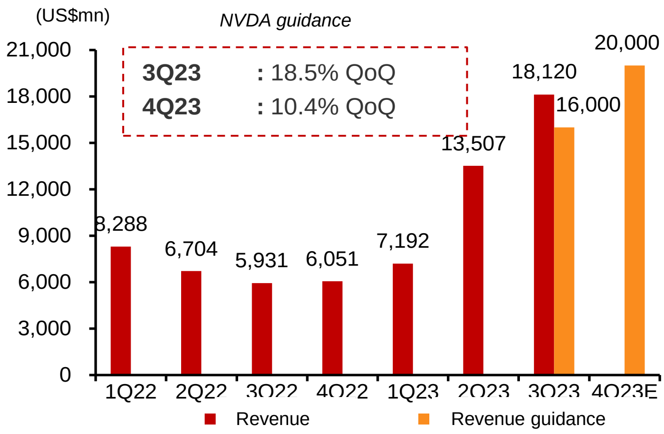
Source: Company data, Canalys, CMBIGM

At the same time, chip manufacturers such as Qualcomm and MediaTek are also starting to develop specialized chips for edge AI devices. In the figure above, we have listed AI PC chips that have been released or are about to be released by various chip manufacturers/hardware manufacturers. For example, Qualcomm recently introduced its new-generation chip “Snapdragon 7 Gen 3” which integrates AI functions. Another platform, 'Snapdragon X Elite', developed for the PC market, integrates its self-developed Oryon CPU and Hexagon NPU.

Investing in AI supply chain

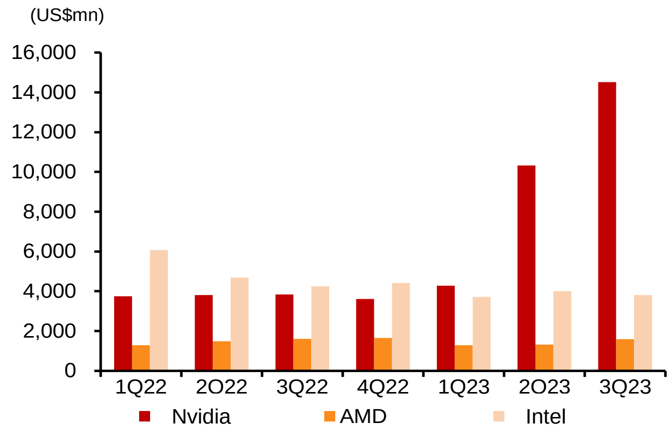
In the near term, we expect the demand for AI GPUs to remain strong, with clear order projections extending into 2024. The AI accelerator market is poised for continued growth. Key player Nvidia is likely to keep the lion’s share in the market, but it will also encounter increasing competition. AMD is set to gain a larger market share with the roll-out of its MI300 series. In addition, Microsoft's recent foray into in-house designed chips for cloud computing, following Amazon and Google's lead, signals that major CSPs are striving to enhance their own efficiency and performance. This development could position these cloud giants as potential long-term challengers in the AI GPU manufacturing arena. (link)

Figure 17: Nvidia revenue and company guidance



Source: Company data, Bloomberg, CMBIGM

Figure 18: Nvidia, AMD, and Intel datacenter revenue



Source: Company data, Bloomberg, CMBIGM

In the short-to-medium term, we anticipate that the burgeoning demand for AI chips and associated hardware will consistently outpace supply, thereby boosting the revenues within the AI supply chain. Furthermore, we've observed notable disparities in share performance among players in the industry. As outlined in our earlier report (link), it is apparent that only true beneficiaries in the AI value chain are positioned to benefit significantly from the sector's expansion and experience increasing sales. For example, in their 3Q23 earnings, Innolight (300308 CH, BUY) and TFC (300394 CH, NR) recorded impressive YoY growth in revenue and net profit of 14.9%/89.5% and 73.6%/95.0%, respectively. We particularly highlight Innolight as a key beneficiary within the domestic AI value chain. Given the sustained strong demand from major CSPs for the company's optical transceivers, we see Innolight as our top pick with TP at RMB109.3.

Figure 19: AI sector comps table

Company	Code	Mkt Cap US$(mn)	Price (LC)	P/E (x) FY24E	P/E (x) FY25E	ROE (%) FY24E	ROE (%) FY25E	EPS (US$) FY24E	EPS (US$) FY25E
Overseas AI beneficiaries									
MICROSOFT	MSFT US	2,743,545	374.51	32.7	28.4	33.5	31.6	11.29	12.98
ALPHABET	GOOGL US	1,626,323	131.86	18.2	15.4	26.4	25.1	7.11	8.40
META	META US	822,407	324.82	17.7	15.8	25.8	23.7	18.04	20.19
AMAZON	AMZN US	1,496,781	147.03	31.7	25.4	17.1	17.6	4.56	5.71
NVIDIA	NVDA US	1,124,097	467.65	37.0	22.2	84.4	75.4	12.30	20.46
AMD	AMD US	191,550	121.39	31.2	23.7	7.9	10.8	3.80	5.01
BROADCOM	AVGO US	433,736	930.00	19.8	18.0	72.5	58.6	46.76	51.35
SUPER MICRO	SMCI US	14,877	269.63	15.1	13.5	40.3	20.3	17.61	19.79
MARVELL	MRVL US	44,963	52.80	34.4	25.7	7.9	7.1	1.51	2.02
FABRINET	FN US	6,067	165.00	20.1	17.6	19.1	19.2	8.31	9.48
MICRON	MU US	81,573	75.93	-	13.9	(3.6)	13.1	-1.23	5.35
ARISTA	ANET US	66,918	216.64	29.7	26.8	27.2	24.5	7.23	8.03
SK HYNIX	000660 KS	69,755	132600.00	15.9	8.1	10.1	17.1	6.13	12.07
			Avg	***25.3***	***19.6***	***28.4***	***26.5***	***11.0***	***13.9***
			Median	***24.9***	***18.0***	***25.8***	***20.3***	***7.2***	***9.5***
Domestic AI beneficiaries									
INNOLIGHT	300308 CH	11,321	100.00	20.6	16.6	23.4	22.5	0.69	0.85
EOPTOLINK	300502 CH	4,777	49.83	27.3	19.9	19.2	21.0	0.25	0.34
ACCELINK	002281 CH	3,294	30.07	30.7	26.1	10.3	10.8	0.14	0.16
SUZHOU TFC	300394 CH	4,551	76.68	33.7	25.6	25.3	26.7	0.34	0.45
			Avg	***28.1***	***22.1***	***19.5***	***20.3***	***0.4***	***0.5***
			Median	***29.0***	***22.8***	***21.3***	***21.8***	***0.3***	***0.4***

Source: Bloomberg (updated as of 5 Dec), CMBIGM

Semiconductor domestic substitution: Global complications forcing supply chain localization

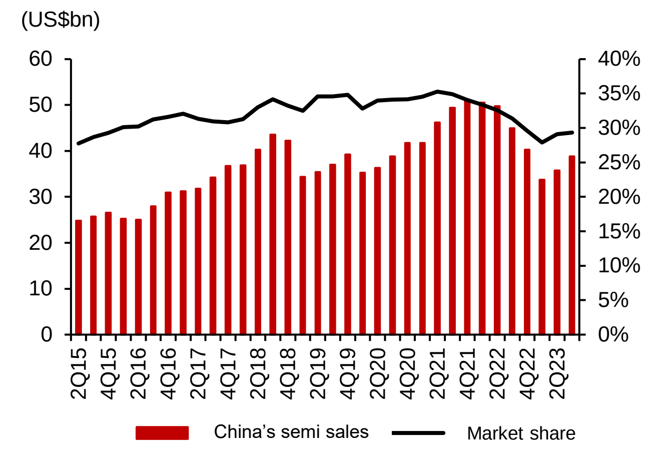
Triggered by events like the comeback of Huawei smartphones and the heightened US export ban on AI chips, China's domestic substitution has risen as a key investment theme in 2H23, attracting substantial interest from participants in the relevant supply chain.

Based on current global dynamics and our own industry research, it is evident that localizing the semiconductor supply chain is evolving into a long-term trend. For one thing, the escalation of US export bans has propelled Chinese manufacturers to adopt local alternatives. For another, recent tech breakthroughs by various domestic semiconductor companies are spurring hardware manufacturers towards proactive localization efforts.

From 2020 to 2022, China's semiconductor sales stood at US$152bn, US$188bn, and US$186bn, with YoY growth of 4.2%, 23.8%, and -1.5%, respectively. China's share of sales accounted for 33.8%, 34.7%, and 31.8% during the same period, which saw a slight dip in 2022 but has been recovering over the past two quarters, climbing from 27.9% in 1Q23 to 29.3% in 3Q23.

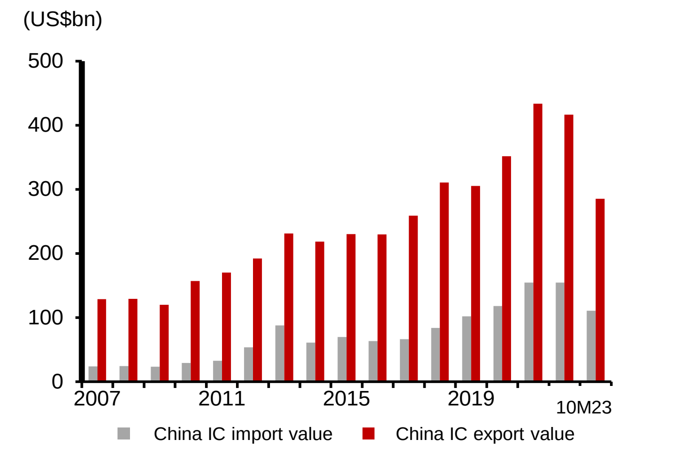
China is a crucial player in the global semiconductor market, and yet the journey towards full domestic self-sufficiency remains a long way to go. China is vigorously supporting domestic substitution and autonomy in tech sectors. Nonetheless, China's import value of ICs still significantly surpasses its exports. In 2022, China's imports of ICs amounted to US$416.2bn, far exceeding the export value of US$154.7bn.

Figure 20: China quarterly semi sales and market share



Source: Company data, Wind, CMBIGM

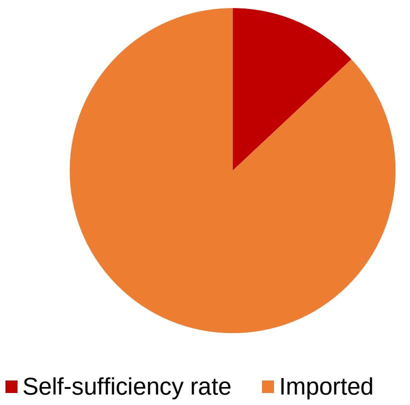
Figure 21: China's IC export value far exceeded the import value



Source: Wind, GAC, CMBIGM

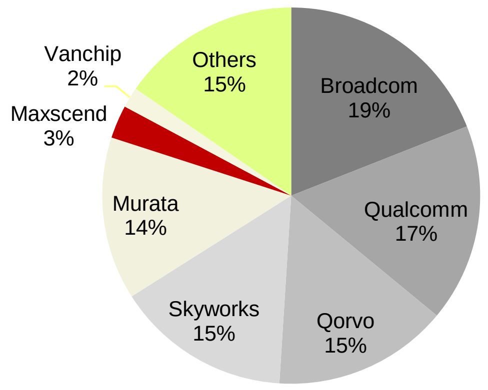
Considering the semiconductor self-sufficiency rate, we still see sufficient room for expansion in the field of domestic semiconductor substitution. For example, China's analog IC had a self-sufficiency rate of merely 13% in 2022 per Frost & Sullivan. This low rate highlights the immense market potential awaiting Chinese analog IC design firms. Furthermore, under the national policy promoting self-reliance in the tech sector, the market demand for Chinese manufactured chips is experiencing a swift uptick.

Figure 22: China's analog IC self-sufficiency rate was 13% in 2022



Source:Frost & Sullivan, CMBIGM forecast

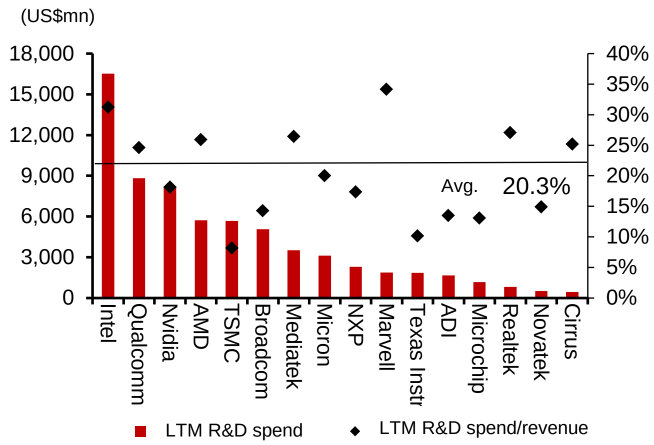
Figure 23: Radio Frequency (RF) market outlook in 2022 by sales



Source: Company data, Bloomberg, Yole, CMBIGM forecast

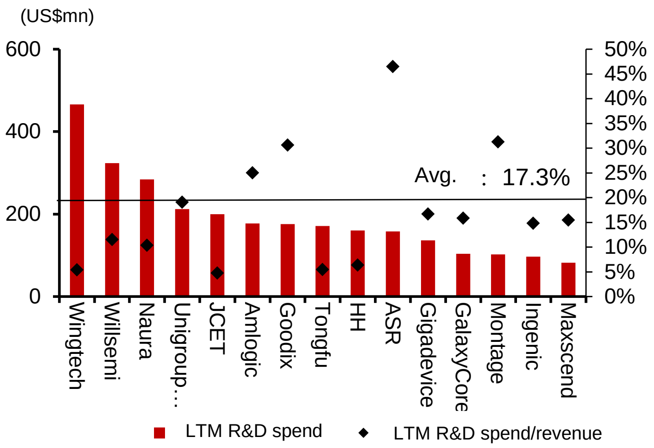
In the following graph, we've compared the R&D spending of several global tech giants with that of Chinese counterparts. The leading tech companies in China, when considering both the absolute amounts and their R&D spending as a percentage of revenue (avg. 17.3% in 2020), notably lagging behind the respective global tech giants, which averaged 20.3% in 2020. This discrepancy is linked to the scale of Chinese tech companies and the ongoing developmental phase of the industry. Looking ahead, we see a pressing need for Chinese tech companies to bolster their R&D spending, to enhance their technological barriers and competitive edge in product offerings.

Figure 24: Overseas tech companies' R&D/revenue ratio



Source: Company data, Bloomberg, CMBIGM

Figure 25: China's tech companies' R&D/revenue ratio



Source: Company data, Bloomberg, CMBIGM

While our R&D spending ratio may still lag behind that of global counterparts, recent years have seen China's leading tech companies make significant strides and breakthroughs in various specialized markets. **Take Maxscend (300782 CH, BUY) as an example: in 1H23, the company delivered over 160mn units of DiFEM, L-DiFEM, and GPS modules, among others, integrated with its proprietary filters.** This achievement signifies stable mass production of products incorporating in-house filters and a gradual increase in client uptake. Duplexers and quadplexers have also begun mass production with several clients. Another notable example is Willsemi's (600745 CH, BUY) OV50H, which features Omnivision's first H/V QPD autofocus tech, enhancing image quality for wide and ultra-wide rear cameras in high-end smartphones. This tech advancement not only showcases the company's superior R&D capabilities, but has also garnered recognition from its suppliers.

In addition, in response to US tech bans, China is rapidly progressing towards self-reliance in its semiconductor industry, achieving substantial milestones, particularly in the memory storage sector where trends towards domestic substitution are accelerating. According to Digitimes, ChangXin Memory Technologies launched its LPDDR5 series on 28 Nov, with its 12GB LPDDR5 chips already verified by mainstream Chinese handset manufacturers like Xiaomi. Simultaneously, Yangtze Memory's NAND products have made their way into Xiaomi's supply chain, with Xiaomi 14 series phones featuring Yangtze Memory's advanced 232-layer NAND flash memory chips.

We are optimistic about the long-term trajectory of China's semiconductor industry, which is aligned with the nation's industrial growth, global dynamics, and the shift in market demands. In the context of semiconductor domestic substitution, we are particularly confident in the potential of leading companies within niche segments and in areas where domestic semiconductor penetration remains low. **Our top picks are Willsemi (603501 CH, BUY) and Maxscend (300782 CH, BUY).**

Figure 26: Semi sector comps table

		Mkt Cap	Price	P/E (x)		ROE (%)		EPS (US$)	
Company	Code	US$(mn)	(LC)	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Semi localization									
Semi: foundry and equipment									
SMIC-A	688981 CH	30,357	54.15	62.0	43.9	4.5	5.5	0.12	0.17
SMIC-H	981 HK	30,357	21.25	25.8	17.5	3.6	4.9	0.10	0.15
HUA HONG SEMI	1347 HK	5,359	17.36	20.2	11.4	3.5	5.4	0.11	0.19
NAURA TECH	002371 CH	16,609	232.84	25.1	19.6	17.7	18.8	1.25	1.60
ADVANCED MICRO	688012 CH	14,146	169.02	55.1	42.0	10.1	11.8	0.42	0.55
PIOTECH	688072 CH	6,764	257.86	60.8	40.9	15.6	17.7	0.60	0.89
			Avg	***41.5***	***29.2***	***9.2***	***10.7***	***0.4***	***0.6***
			Median	***40.5***	***30.3***	***7.3***	***8.7***	***0.3***	***0.4***
Semi: chip design									
WILLSEMI	603501 CH	17,887	109.50	40.3	27.6	13.6	16.7	0.37	0.53
MAXSCEND	300782 CH	9,857	138.05	41.2	30.5	15.6	17.5	0.45	0.61
GIGADEVICE	603986 CH	8,402	95.15	43.2	28.7	8.5	11.4	0.29	0.44
SG MICRO	300661 CH	5,656	90.49	70.7	46.7	13.2	17.5	0.17	0.26
GALAXYCORE	688728 CH	7,342	20.64	195.9	94.7	2.7	6.2	0.01	0.03
			Avg	***47.2***	***32.8***	***11.6***	***14.3***	***0.3***	***0.4***
			Median	***41.2***	***30.3***	***13.2***	***16.7***	***0.3***	***0.4***
Semi: power semi									
STARPOWER	603290 CH	4,221	185.13	25.2	19.7	16.7	18.5	0.98	1.26
ZHUZHOU CRRC	688187 CH	6,089	37.69	14.8	13.0	8.5	8.9	0.34	0.39
CHINA RESOURCE	688396 CH	8,515	47.35	30.7	24.8	8.6	9.9	0.21	0.26
HANGZHOU SILAN	600460 CH	5,429	24.34	36.2	26.5	11.1	13.5	0.09	0.12
WINGTECH	600745 CH	7,688	48.42	14.5	11.7	9.2	10.2	0.43	0.53
			Avg	***24.3***	***19.1***	***10.8***	***12.2***	***0.4***	***0.5***
			Median	***25.2***	***19.7***	***9.2***	***10.2***	***0.3***	***0.4***
Semi: packaging									
JCET GROUP	600584 CH	7,366	30.54	18.8	15.0	10.0	11.4	0.22	0.28
TONGFU MICROEL	002156 CH	4,636	22.46	36.9	24.9	5.6	8.1	0.08	0.12
TIANSHUI HUATI	002185 CH	3,887	8.94	39.8	26.8	3.9	5.8	0.03	0.05
			Avg	***31.8***	***22.2***	***6.5***	***8.4***	***0.1***	***0.1***
			Median	***36.9***	***24.9***	***5.6***	***8.1***	***0.1***	***0.1***
Semi: EDA									
EMPYREAN TECHN-A	301269 CH	7,624	99.29	156.1	109.9	6.8	8.7	0.09	0.13
SEMITRONIX COR-A	301095 CH	2,170	81.39	52.3	32.9	8.7	12.1	0.21	0.33
PRIMARIUS TECH-A	688206 CH	1,345	23.10	203.3	124.5	2.2	2.9	0.02	0.03
			Avg	***96.1***	***62.9***	***6.0***	***8.0***	***0.1***	***0.2***
			Median	***52.3***	***32.9***	***6.5***	***8.4***	***0.1***	***0.1***

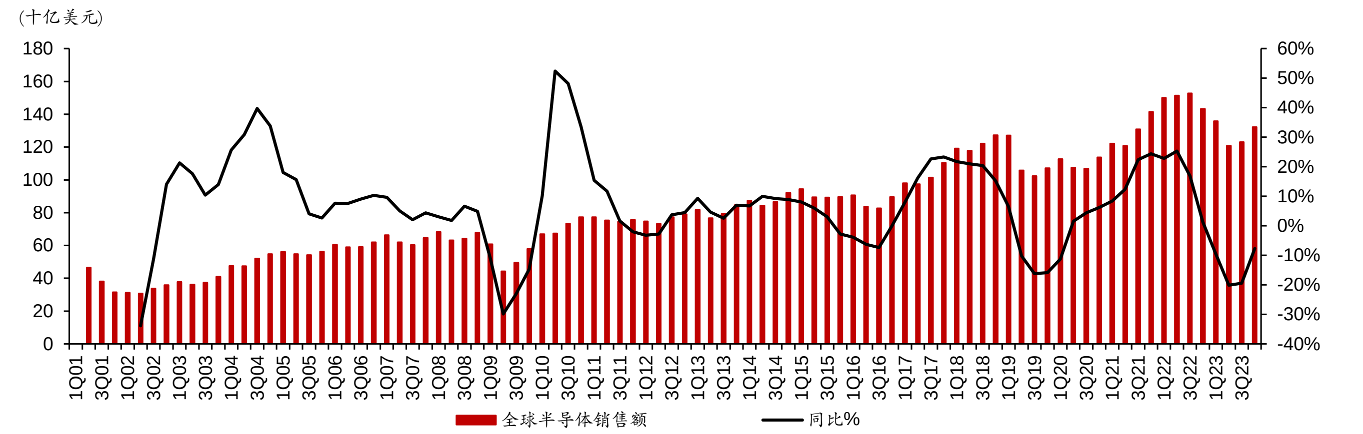
Source: Bloomberg (updated as of 5 Dec), CMBIGM

Anticipate recovery in semiconductor industry: Healthier inventory levels and potential demand resurgence

From 2020 to 2022, global semiconductor sales amounted to US$450bn, US$543bn, and US$583bn, with growth of 5.2%, 20.6%, and 7.4% YoY, respectively. In the first three quarters in 2023, global sales dropped to US$121bn, US$123bn, and US$132bn, with YoY growth dropping to 20.2%, 19.5%, and 7.7%, respectively. Sequentially, QoQ growth showed some signs of recovery at -11.0%, 1.8% and 7.4%, respectively.

The semiconductor industry's recent improvement can be attributed to several factors. **1) Seasonal demand:** Typically, towards the end of the year it is normal to see heightened demand in consumer electronics, driving manufacturers to replenish and restock inventories. Per Counterpoint, TSMC's 3Q23 revenue indicated positive QoQ growth for the first time since 3Q22. This upswing is linked to the rebound in PC and smartphone markets, with expectations of continued growth into 4Q23. **2) Inventory levels:** After two years of destocking cycle, inventories have now stabilized at healthier levels. **3) Market dynamics:** The launch of Huawei's smartphones in 2H23, coupled with increased demand for handset upgrades, has spurred growth in consumer electronics.

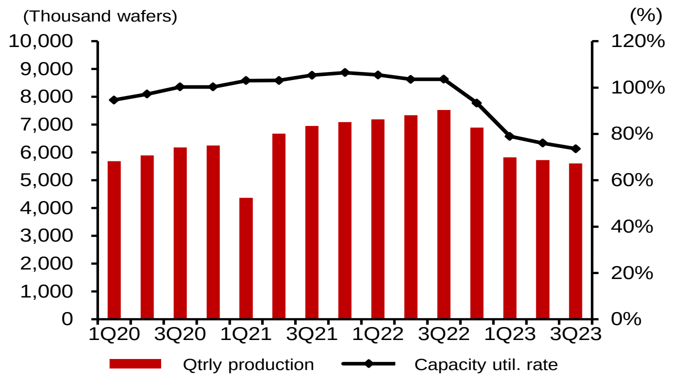
Figure 27: Global semi sales back to growth trajectory in recent quarters



Source: Company data, Wind, CMBIGM

WSTS forecasts a 9.4% YoY decline in global semiconductor industry market size in 2023. Looking forward to 2024, with gradual improvements in the macro landscape and healthier inventory levels, our outlook for demand recovery in the semiconductor industry remains optimistic, particularly in 2H23. WSTS and IDC project a substantial increase in global semiconductor market size for 2024, with YoY growth estimates of 13.1% and 20.2%.

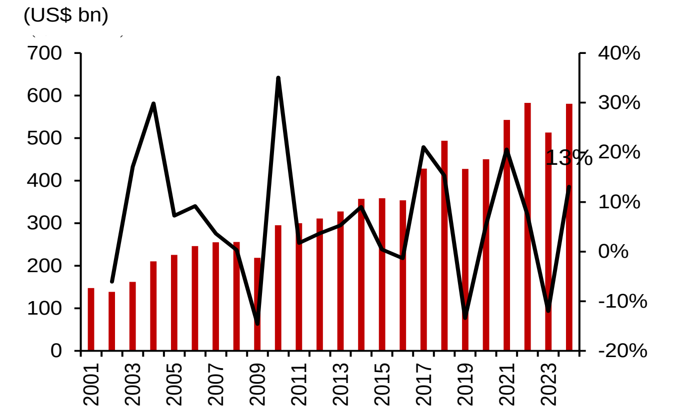
Figure 28: 4 major foundries* capacity utilization rate



Source: WSTS, CMBIGM

Note: *TSMC, UMC, SMIC and Huahong Semi

Figure 29: Global semi sales to grow by 13% in 2024



Source: WSTS, CMBIGM

Key beneficiaries include Wingtech (600745 CH, BUY) and Shengyi Technology (600183 CH, BUY).

Wingtech delivered impressive 3Q23 results, with an 11.9% increase in revenue and an 11.4% increase in net profit. The company's ODM business experienced significant 24.3% YoY revenue growth, reflecting an ongoing enhancement in profitability. Despite a recent decision to cease production of optical module products for a certain client, which constituted less than 5% of Wingtech's total revenue, the company's overall outlook remains intact. With a forecasted rebound in global consumer electronics demand in 2024, Wingtech is positioned for further growth, in our view.

Shengyi Tech, a leader in the copper clad laminate (CCL) industry, also reported better-than-expected 3Q23 results. Its revenue and net profit rose by 3.8% and 31.6% YoY, respectively, with a continued expansion in both gross and net profit margins. The company saw growing restocking signals from downstream clients and maintained a high utilization rate. Given the positive correlation between semiconductor market sales and the printed circuit board (PCB) market, we estimate a potential resurgence in semi demand could directly benefit the company.

Figure 30: PCB/CCL sector comps table

		Mkt Cap	Price	P/E (x)		ROE (%)		EPS (US$)	
Company	Code	US$(mn)	(LC)	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
PCB/CCL sector									
SCC	002916 CH	5,051	72.73	20.6	17.1	11.7	12.9	0.48	0.58
SHENGYI TECH	600183 CH	5,441	17.18	21.2	16.9	12.4	14.3	0.11	0.14
SUZHOU DONGSHAN	002384 CH	4,243	18.55	10.3	8.3	14.2	15.3	0.24	0.30
AVARY	002938 CH	6,778	21.54	9.6	8.5	14.5	14.8	0.30	0.34
WUS PRINTED	002463 CH	5,381	21.02	19.4	15.8	17.5	18.2	0.15	0.18
SHENZHEN KINWO	603228 CH	2,570	22.57	12.4	11.0	14.1	15.0	0.24	0.27
			Avg	***15.6***	***12.9***	***14.1***	***15.1***	***0.3***	***0.3***
			Median	***15.9***	***13.4***	***14.1***	***14.9***	***0.2***	***0.3***

Source: Bloomberg (updated as of 5 Dec), CMBIGM

Telecom sector remains a defensive play

The telecom sector is seen as a defensive play amid investors for its operational stability, steady cash flow, high dividend yields, and inherent resilience against macro uncertainties. In 2023, a 2.0% YoY increase in telcos spending is expected by us [by whom?], with growth focusing on more dynamic areas like computing power, industrial digitization, and cloud sector. We have observed a slowdown in 5G investments by China's key telcos, which may potentially extend into 2024, but this may be offset by rising investments in computing and cloud sectors. (link)

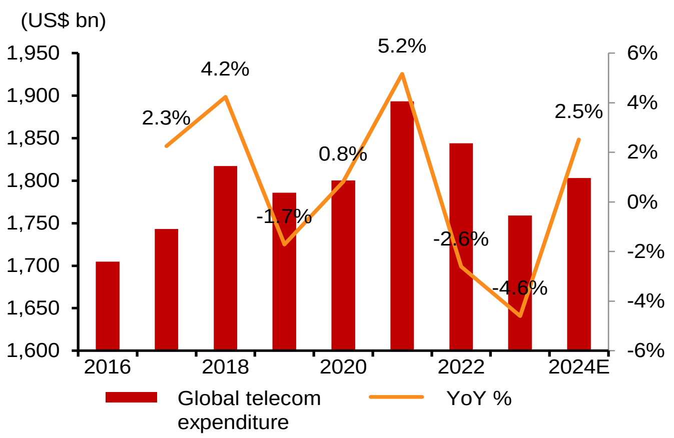
■ Telecom equipment players

China's major telcos have slowed down their 5G investments in 2023, which we think may further decelerate in 2024. However, investment in computing and cloud sectors might offset this decline. Satellite communication, emerging as a key smartphone feature, will benefit the sector too. **Potential beneficiaries include ZTE (000063 CH/763 HK, BUY, TP: RMB36.9/HK$27.4)**.

■ Tower infrastructure players

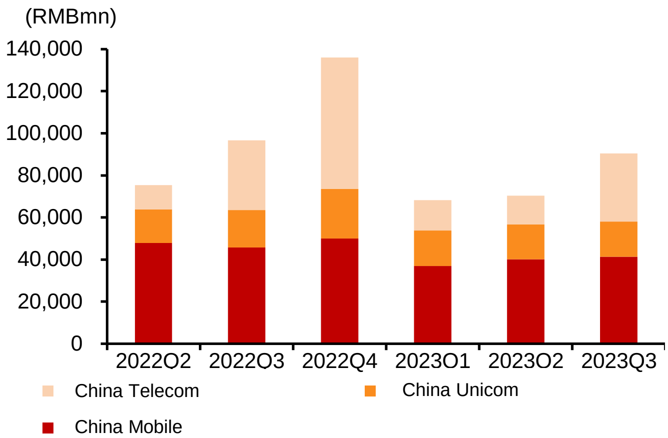
China Tower (788 HK, HOLD, TP: HK$0.89) may further see pressure due to the new Pricing Agreements with the major telcos. Looking forward, we expect the company's revenue to increase by single digits given telcos' further cost optimization as well as macro headwinds.

Figure 31: Global telecom expenditure



Source: Bloomberg, CMBIGM

Figure 32: 3 major domestic telcos' expenditure



Source: Company data, Bloomberg, CMBIGM

Figure 33: Telecom sector comps table

Company	Code	Mkt Cap US$(mn)	Price (LC)	P/E (x) FY24E	P/E (x) FY25E	ROE (%) FY24E	ROE (%) FY25E	EPS (US$) FY24E	EPS (US$) FY25E
Telecom sector									
ZTE-H	763 HK	15,718	16.96	6.6	6.0	15.9	15.7	0.32	0.35
CHINA TOWER	788 HK	18,237	0.82	11.4	9.3	5.5	6.3	0.01	0.01
CHINA MOBILE	941 HK	174,817	62.35	8.4	7.9	10.5	10.8	0.95	1.01
CHINA UNICOM	762 HK	18,984	5.00	6.7	5.9	5.9	6.2	0.09	0.11
CHINA TELECOM	728 HK	62,430	3.64	8.6	7.8	7.5	8.1	0.05	0.06
			Avg	***8.3***	***7.4***	***9.1***	***9.4***	***0.3***	***0.3***
			Median	***8.4***	***7.8***	***7.5***	***8.1***	***0.1***	***0.1***

Source: Bloomberg (updated as of 5 Dec), CMBIGM

China Technology

OUTPERFORM

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Positioned for revival and AI-driven cycle in 2024

Global technology set to benefit from demand recovery and AI cycle

In 2023, global macro weakness, geopolitical conflicts and inventory destocking led to a challenging environemnt for global technology supply chains. With the booming trend of ChatGPT applications, we expect the supply chain for AI cloud and Edge AI will continue to benefit from robust demand with rising content growth. Heading into 2024, we see encouraging signs of smartphone/PC recovery driven by inventory restocking, new product launches, and empowerment of edge AI. For servers, the destocking process in traditional servers is close to the end, and we expect AI servers to see accelerated demand recovery. Overall, we are positive on multiple growth drivers in 2024, and recommend investors to focus on investment themes such as CE demand recovery, AR/VR/MR, and cloud/edge innovation.

Smart devices: Huawei comback, localization and spec innovation

Following the success of Huawei Mate 60 series, we expect Huawei's comeback to drive supply chain recovery and spec upgrades in optics, storage, cooling, satellite and foldable display. On the back of accelerated localization, we believe domestic supply chain is set to capture growth opportunities in spec ugprades and shipment growth, and we are positive on names such as BYDE, Sunny Optical, Luxshare, Cowell, and FIT Hon Teng.

AI supply chain: computing demand to boost AI server demand; edge AI to accelerate PC/mobile/MR innovation

With the development of big data and cloud computing, and acceleration in AI use cases, we believe demand for high computing power will continue to drive demand for AI servers. For edge AI, with more product launches of AI PCs/smartphones in 2024, we expect the innovation of AI use cases to accelerate the PC replacement cycle and rising penetration of AI phones. In addition, new AI+MR products are set to drive product/component innovation. We suggest paying attention to names including Lenovo, Xiaomi and Transsion.

Automotive electronics: electrification and intelligence to drive growth opportunities; positive on domain controller makers

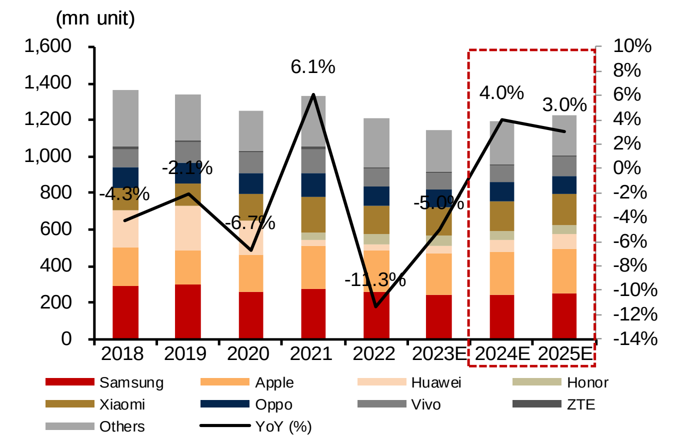
China's NEV market continued to see robust growth momentum in 2023, and NEV exports could serve as a new industry growth driver. In view of the trend of automotive intelligence, automotive electronics players will benefit from intelligent vehicle upgrades for product differentiation in a highly competitive NEV market. Intelligent vehicle domain controllers and related supply chains will likely become major beneficiaries in the wave of automotive intelligence trend. In particular, demand for ADAS cameras should continue to rise thanks to rising penetration of ADAS and autonomous driving. We suggest investors pay attention to names including Intron Tech, BOE Varitronix, Desay SV, Joyson Electronics and Jingwei Hirain.

2024 outlook: Positive on demand recovery and AI-driven product innovations and breakthroughs

Global smartphone shipments stablisied, AI innovations to boost replacement

Global smartphone shipmentw started to bottom out in 3Q23, and we believe edge AI innovations are set to drive the next replacement cycle in 2024. In 3Q23, global smartphone shipments stablised at 3.03bn units, down 0.1% YoY. We expect 4Q23 smartphone shipments to reach 3.2bn units, up 7.3% YoY, and 2023 shipments to reach 1.16bn, down 5% YoY, After two years of shipment decline, we forecast global smartphone shipments to resume positive growth of 4.0% YoY in 2024, and AI applications will likely become the new growth driver triggering the next replacement cycle.

Figure 1: Global smartphone shipment forecast



Source: IDC, CMBIGM estimates

Figure 2: Global smartphone market share

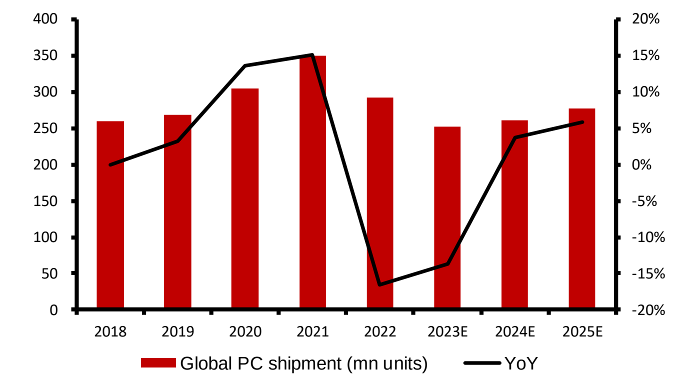
(mn units)	2020	2021	2022	2023E	2024E	2025E
Samsung	257	272	262	241	244	252
Apple	203	236	226	227	235	242
Xiaomi	148	191	153	155	160	165
Huawei	189	38	31	45	65	80
Honor	-	40	57	58	50	53
Oppo	111	134	106	95	102	105
Vivo	112	132	99	88	95	100
Others	262	317	271	237	240	231
Total	**1,281**	**1,360**	**1,206**	**1,145**	**1,191**	**1,227**
YoY	*-6.7%*	*6.1%*	*-11.3%*	*-5.0%*	*4.0%*	*3.0%*

Source: IDC, CMBIGM estimates

PC market returns to positive growth, all eyes on AI PC in 2024

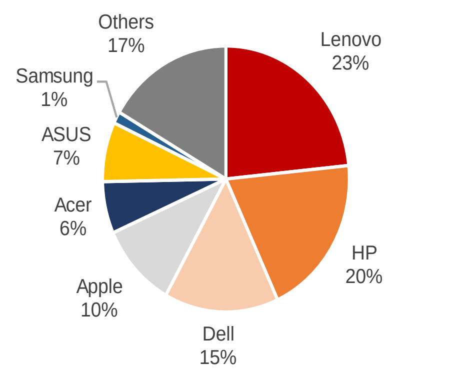
After logging strong growth in 2020/21, the global PC market entered an inventory destocking downcycle in 2022-23. With shipment stablisation in 2Q/3Q23, we expect 3.7% YoY growth in 2024 (vs. a 13.7% YoY decline in 2023), backed by healthy channel inventory and multiple AI PC product launches in 2024. We believe AI PC innovations will enhance user experience and boost further industry recovery..

Figure 3: Global PC shipment forecast



Source: IDC, CMBIGM estimates

Figure 4: Global PC market share (3Q23)

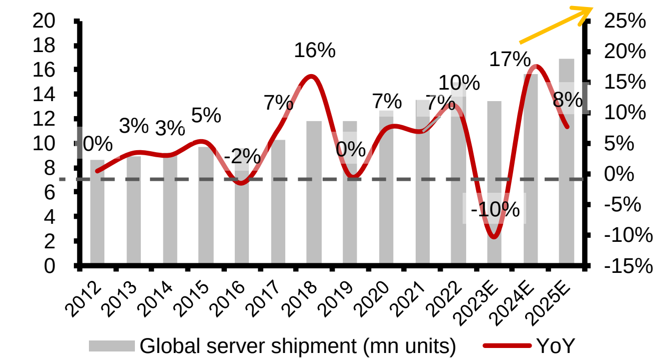


Source: IDC, CMBIGM

Traditional server destocking is close to the end; AI servers to maintain strong momentum

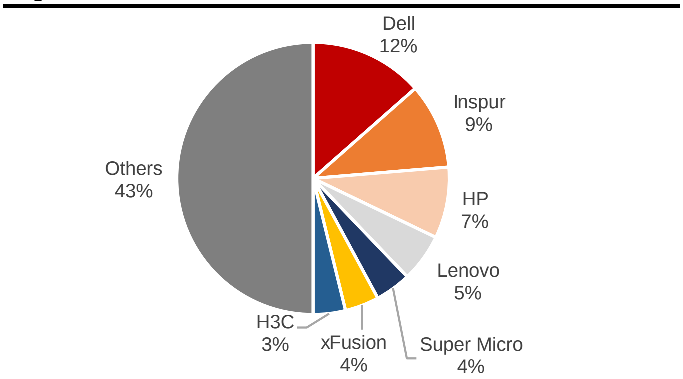
Due to macro headwinds and inventory destocking in the server industry, along with the impact of AI servers Capex squeezing out that of general servers, overall server shipments in the first three quarters of 2023 were trending down. Looking ahead, the demand for general servers is expected to show a mild recovery trend. IDC forecasts global server shipments will recover with 16.9% YoY growth in 2024, folllowig a decline of 10.3% YoY in 2023. The rebound in general server shipments, together with the strong incremental growth of AI servers, should lead to a medium- to long-term upward trend in server market shipments, in our view.

Figure 5: Global server shipment forecast



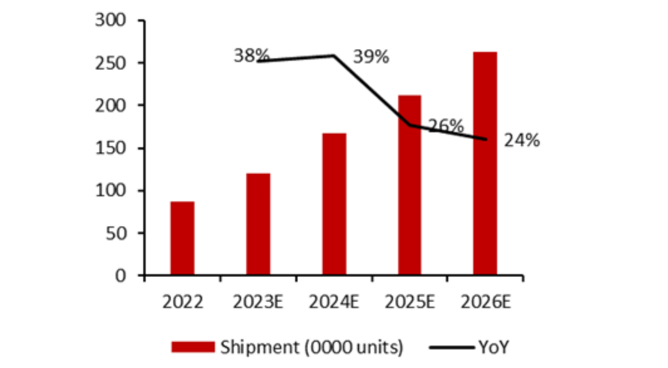
Source: IDC, CMBIGM estimates

Figure 6: Global server market share



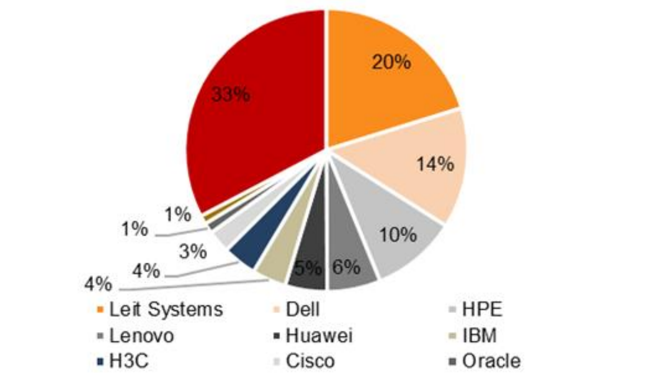
Source: IDC, CMBIGM estimates

Figure 7: Global AI server shipment forecast



Source: TrendForce, CMBIGM estimates

Figure 8: Global AI server market share (2022)

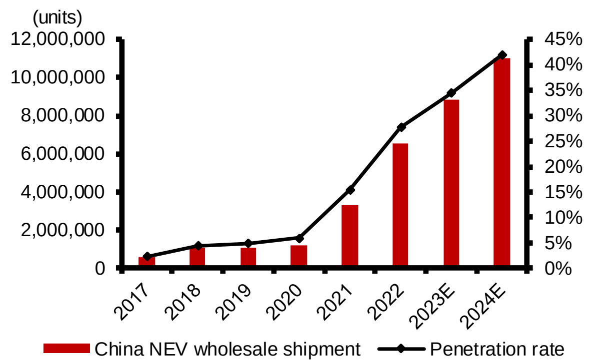


Source: IDC, CMBIGM

Auto electrification and intelligence trends continue; NEV exports gaining momentum

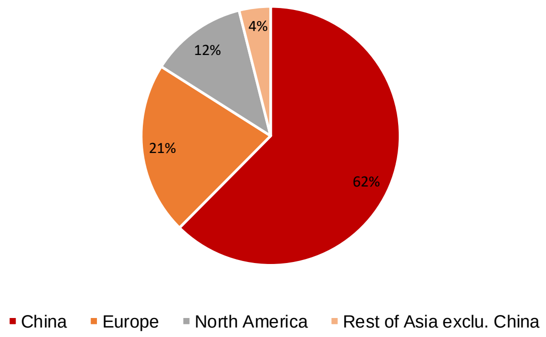
Global NEV sales continue to maintain high-speed growth, driven by ongoing waves of electrification and intelligence in the automotive industry. NEV exports have become a new growth driver for automotive OEMs, and intelligent vehicle technology upgrades have served as a key product differentiator among industrial competitors. According to data from the China Association of Automobile Manufacturers (CAAM), in the first 10 months of 2023, China's NEV wholesale/retail shipments reached 7.35mn/7.28mn units, up 33.9%/37.8% YoY. According to CMBIGM auto team, China's NEV wholesale shipment volume is expected to rise to 11.0mn units in 2024, delivering 24% YoY growth, including 1.8mn for export sales. According to the China Passenger Car Association (CPCA), in the first 10 months of 2023, China's NEV shipments accounted for 62% of the global NEV market. Ongoing waves of automotive electrification and intelligence are expected to maintain strong momentum, with China NEV export growth to accelerate, in our view.

Figure 9: Global NEV wholesale shipments and penetration rate



Source: CAAM, CMBIGM estimates

Figure 10: China NEV shipments accounted for 62% of global NEV shipments in 10M23

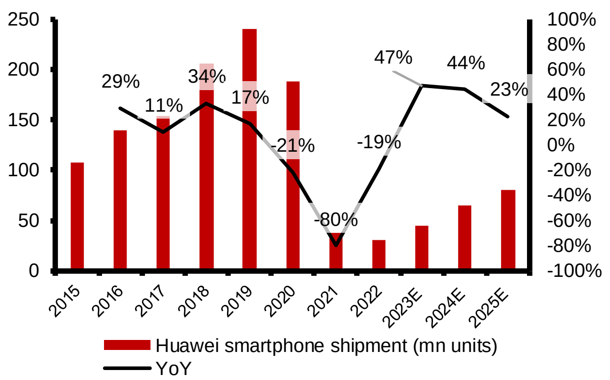


Source: CPCA, CMBIGM

Smart devices: Huawei comback, localization and spec innovation

Driven by launches of iPhone 15 and Huawei Mate 60 in 3Q23, the global smartphone market in 3Q23 embraced early signs of recovery, with an 8% YoY decline and a 2% MoM increase. In Oct 2023, China smartphone sales increased by 11% YoY thanks to Huawei and Xiaomi's impressive sales growth, among which, Huawei Mate 60 series boosted overall sales by 83% YoY, based on Counterpoint. Huawei raised its target of full-year shipments to 40mn units vs prior 30mn, and Mate 60 series achieved innovation in optics, storage, cooling, satellite communication and foldable screens, benefiting related supply chain players.

Figure 11: Huawei smartphone shipments 2015-23E



Source: IDC, Bloomberg, CMBIGM estimates

Figure 12: 2024 Huawei smartphone release timeline

Expected Launch Date	Huawei Models	Shipment forecast (units)
Early 2024	Nova series	15mn
Mar 2024	P70 series	15mn
Sep 2024	Mate70 series	10mn
2024	Changxiang series	13mn
2024	Other series	12mn

Source: CMBIGM

Next optics upgrade cycle driven by Huawei's high-end comeback

1) Huawei Mate 60: 64MP rear-cam, OIS and 4K video recording; 16MP ultra-wide angle camera for wider field of view shooting; 8MP telephoto camera for 3x optical zoom/OIS;

2MP macro camera for close range shooting; 32MP front-cam for beauty algorithms and wide-angle shooting. **2) Huawei Mate 60 Pro:** Main-cam of 50M Sony IMX766 ultra spotlight RYYB lens, paired with 12MP ultra-wide angle and 48MP periscope telephoto. In 1H24, P70 series will be launched with a focus on telephoto periscopes and hybrid lenses. We believe Huawei's return to the high-end segment will drive the optics upgrade cycle. Main beneficiaries: 1) **Optical lens:** Lianchuang, Ofilm, Costar Group, W-Olf Photoelectric, Doti Micro, and Gyz Electronic; **2) Periscope/main camera**: Howell, Sony and Smartsens; **3) Camera module:** OFilm, Luxvisions, Largan and Sunny Optical.

Adoption of domestic components in Huawei smartphones to bring growth opportunities for local supply chain

In addition to optics, upgrades to the Huawei Mate 60 series also include network speed, screen refresh, battery capacity, memory, and satellite messaging compared to its predecessor. Among them, the Huawei Mate 60 has improved network speed thanks to its self-developed Kirin chip supporting 5G networks; the series support 120Hz adaptive refresh, making the screen smoother and more energy-efficient; the series have built-in 4750mAh battery, an increase of 290mAh compared to the previous generation, with an extended battery life; the series support bidirectional Beidou satellite messages and larger memory. According to Fomalhaut Technology Solutions, the total cost of Huawei Mate 60 Pro components is 422 dollars, of which SoC, storage, camera module, battery and screen are the highest-cost components, while Chinese manufacturing accounts for 47%, which is 18ppts higher than the model released three years ago. Among them, the proportion of domestic screens and CMOSs has significantly increased. The main supplier of OLED displays with the highest ASP is BOE, while the main supplier of CMOS is Howell. According to Jibang Consulting, the localized manufacturing rate for Huawei Mate 60 series components reached as high as 90%, and only a small number of components were foreign-made, such as DRAM from SK Hynix. We expect that given geopolitical pressures, the domestic component replacements will accelerate, thereby promoting the competitiveness of Huawei's mobile phone series products and ushering in growth opportunities for the domestic component supply chain.

We suggest paying attention to beneficiaries including: **1) connector and structural components:** BYDE, Luxshare Precision, Everwin Precision, Huafeng Technology and Lingyi iTech**; 2) screen:** BOE, TCL Technology, Tianma Microelectronics and Visionox Technology; **3) battery:** Desay Battery Technology and Sunwoda Electronics; **4) acoustic:** AAC Technologies and Goertek; **5) RF:** Maxscend Microelectronics, Vanchip Technology and Sai Microelectronics**; 6) CMOS:** Will Semiconductor and Galaxycore; **7) satellite communication:** Hwa Create and Haige Communications; **8) EMS:** Shenzhen Kaifa Technology.

Figure 13: Huawei Mate 60/Mate 60 Pro official component BOM in RMB

	Mate 60 (12GB+512 GB）	Mate 60 Pro (12GB+512 GB)
Display	Brand new: 1799	Brand new: 1999
Battery	219	249
Motherboard	2999	3499
Back case	899	1099
Telephoto lens	255	845
Wide-angle lens	265	265
Rear main camera lens	598	698

Front lens	270	270
Adapter	168	199
Data cable	59	59
Cardholder	12	12
ToF deep sense lens	-	244

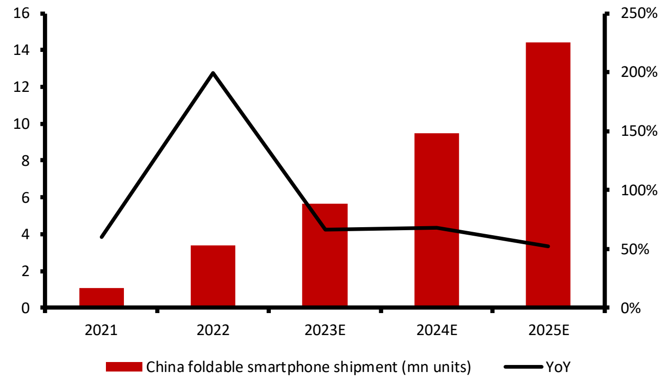
Source: Jicai, CMBIGM

Foldable smartphones to become mainstream in 2024

Foldable smartphones delivered rapid growth in 2023 despite weakness in the smartphone market. According to IDC, in 3Q23, China's foldable smartphone shipments reached 1.96mn units, up 90.4% YoY, vs the 6.3% YoY decline for total smartphones. Starting from July 2023, multiple foldable models have been launched, such as Huawei Mate X5, Xiaomi MIX Fold 3, Honor Magic V2, and OPPO Find N3, and received positive consumer feedback.

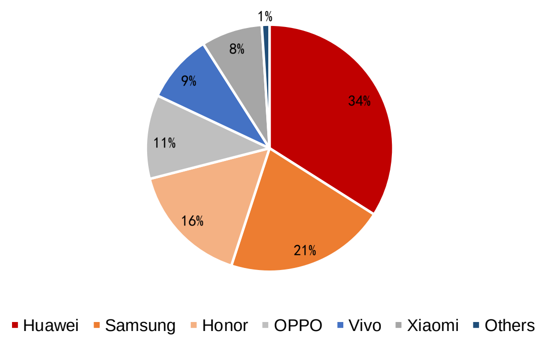
In China, Huawei was ranked No.1 in the foldable smartphone market with a market share of 34% in 3Q23, followed by Samsung with 21%, based on Counterpoint. Honor showed impressive share gains to 16% in 3Q23, securing the third position. OPPO was ranked the fourth, which gained share by 6ppts YoY to 11%, while Vivo ranked fifth with 9% share.

Figure 14: China foldable phone shipment forecast



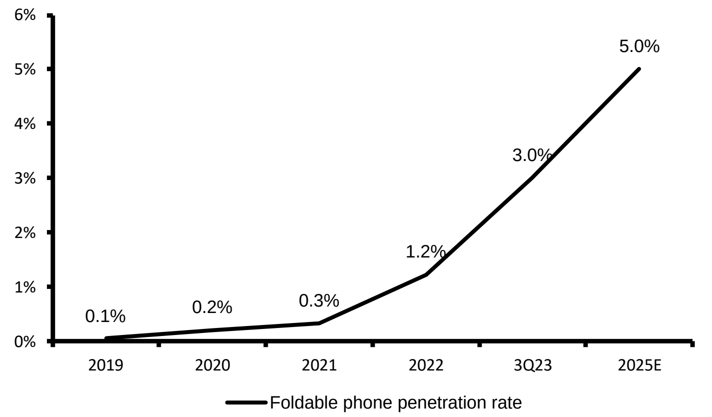
Source: Counterpoint, CMBIGM estimates

Figure 15: China foldable phone market share (3Q23)



Source: Counterpoint, CMBIGM estimates

Figure 16: China foldable phone penetration rate



Source: Counterpoint, CMBIGM estimates

Figure 17: HONOR Magic V2 gained No.1 place by China foldable phone market share in 3Q23

Source: Counterpoint, CMBIGM estimates

We believe that foldable smartphones have become a niche growth segment in China's smartphone market, and technology improvements will continue in terms of image quality, battery life and fold screen display. In terms of costs, hinges and screens are the highest incremental cost factors. As OLED screen price decreases and hinge technology matures, we are optimistic about further penetration of foldable smartphones. We believe the related supply-chain names will benefit, such as AAC Tech (2018 HK), which supplies hinge products for the Honor Magic V2 series, hinge product suppliers for Android foldable screens such as Gian (300709 CH) and NBTM (600114 CH), as well as liquid metal hinge structural component supplier EONTEC (300328 CH).

AI supply chain: Computing demand to boost AI server demand; edge AI to accelerate PC/mobile/MR innovation

AI server as artificial intelligence data server can be used to support local applications as well as providing complex AI models and services for cloud and local servers. Strong growth of big data and cloud computing has stimulated demand for AI intelligent servers. In AI computing power, with the development of technologies including big data and cloud computing, and the acceleration in use cases, we believe that demand for high computing power will drive the growth of AI servers. In terms of edge AI, with the anticipated launch of AI PC products, we expect the innovation in end-user large-scale model applications to promote a new replacement cycle. Given performance improvement in AI phones, we expect the penetration will continue to climb. In addition, new AI+MR products are set to promote product/component innovation in 2024.

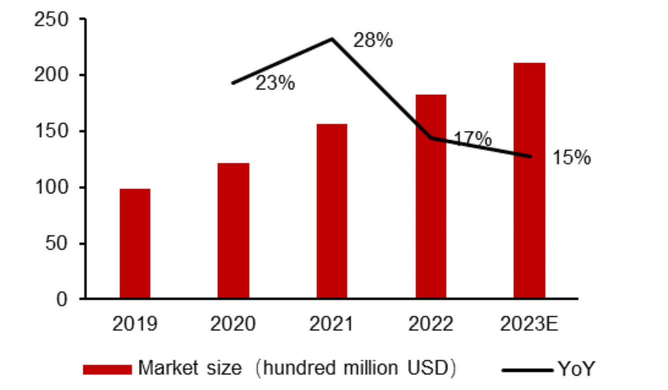
AI computing: Indsutry application accelerating, high computing power demand driving AI server growth

At present, the server market is mainly dominated by CPU servers. As the amount of data increases, the improvement of algorithms, computing, and storage capabilities will raise requirements for server data processing capabilities, making various manufacturers rely on GPU servers to solve the problem of slow CPU server computing speed. With accelerating AI application and growing demand for computing power, natural language processing and AI model development continue. IDC forecasts that AI servers will be widely used, and the global AI server market is expected to grow by 15.3% YoY in 2023.

With the efforts of ChatBOT generative AI, CSPs such as Microsoft, Google, and AWS have increased investment in AI and AI servers. TrendForce forecasts AI server shipments (equipped with GPUs, FPGAs, ASICs, etc.) will exceed 1.2mn units in 2023, up 37.7% YoY, accounting for 9% of total server shipments, and then the volume will grow 38.7% YoY in 2024. After 2024, more AI application developers will invest in the development of professional AI model software services, driving the growth of mid-range to low-end GPU and edge AI servers.

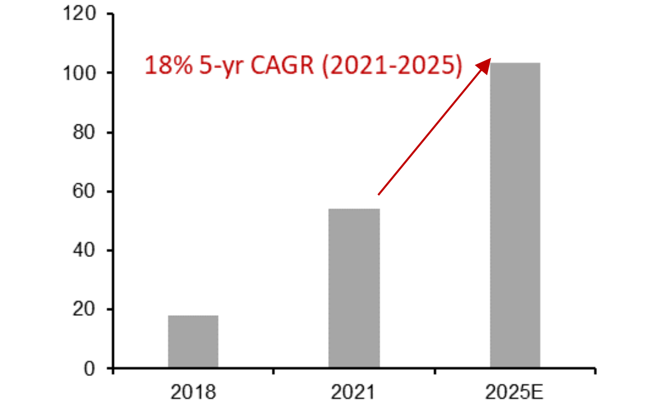
Driven by the application of AI in new fields and the policy of "computing from the east to the west", cloud computing and supercomputing centers are developing rapidly in China, and AI servers as computing power infrastructure are expected to grow rapidly. According to Guanzhihainei Information, China's AI server market will grow at an 18% CAGR in 2021-25.

Figure 18: 2019-2023E global AI server market size



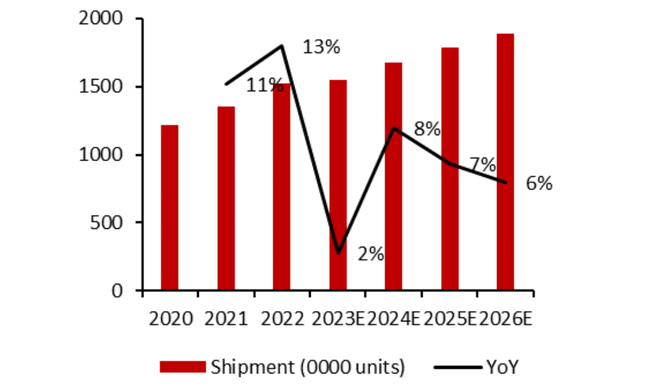
Source: IDC, Guanzhihainei Consulting, CMBIGM

Figure 19: 2018-2025E China AI server market size



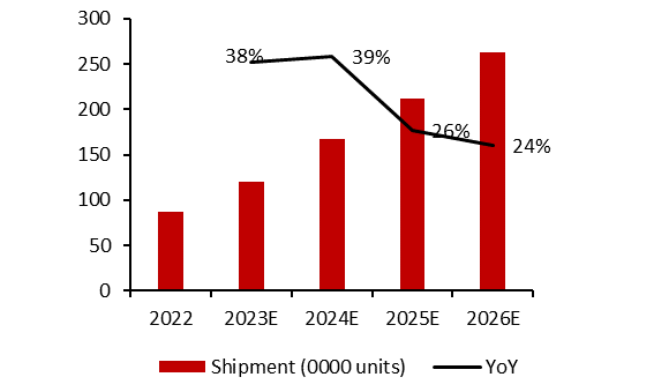
Source: IDC, Guanzhihainei Consulting, CMBIGM

Figure 20: 2020-2026E global server shipments



Source: Trendforce, Guanyantianxia, CMBIGM estimates

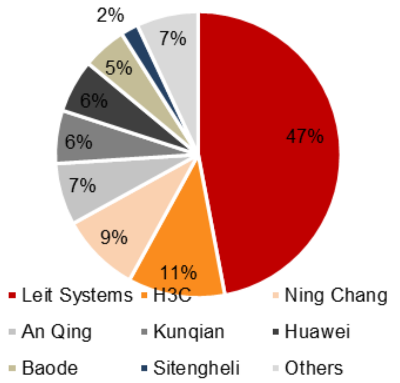
Figure 21: 2022-2026E global AI server shipments



Source: Trendforce, Guanyantianxia, CMBIGM estimates

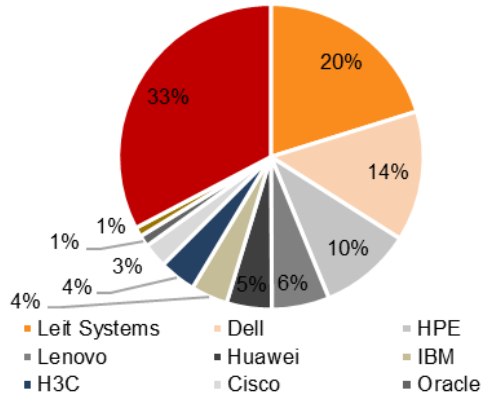
Microsoft, Google, Meta and AWS, global four largest cloud providers, accounted for a high proportion of AI server purchases, while Chinese enterprises such as ByteDance, Tencent, Alibaba and Baidu account for a relatively low proportion. Driven by AIGC, cloud computing, supercomputing, and HPC, higher requirements for computing speed, storage capacity, and specialization will drive growth for the high-end server market, in our view. Beneficiaries of AI server names include Dawning Information, Unisplendour, ZTE, Foxconn Industrial Internet, Leit Systems, China Greatwall, Digital China, Talkweb and Grg Banking Equipment.

Figure 22: China AI server market share in 2022



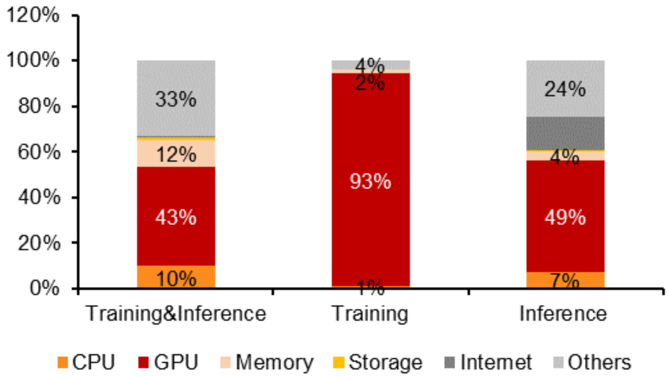
Source: Guanzhihainei Consulting, CMBIGM

Figure 23: Global AI server market share



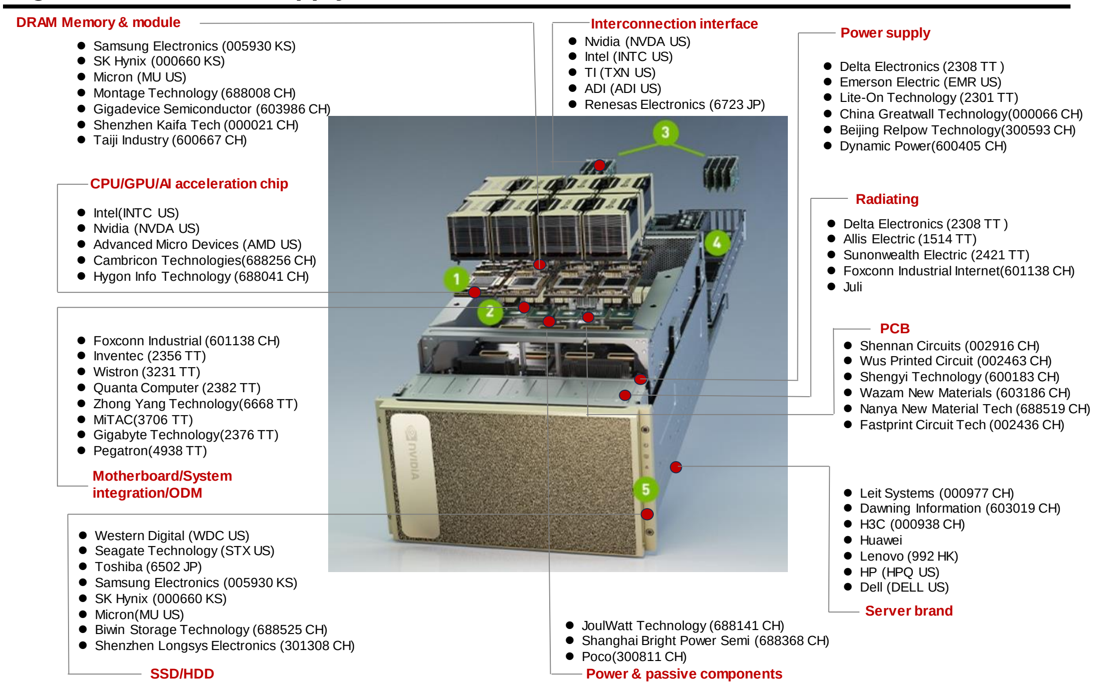
Source: IDC, CMBIGM

Figure 24: AI server BOM structure by type



Source: Nvidia, Dell and HP official websites, CMBIGM

Figure 25: AI server supply chain



Source: Nvidia, CMBIGM

Edge AI: AI PCs, AI smartphones to drive product innovations

Driven by innovations in AI large language model applications and the surge in demand for cloud-based model training, the related supply chain has become a key investment theme in 2023. For 2024, we think the market focus is going to shift towards the deployment of AI applications on the edge side and the increasing demand for edge inference.

Edge AI represents the next stage in AI development, working in synergy with cloud-based AI but featuring characteristics such as low cost, low latency, high reliability, and enhanced privacy. Edge AI enables the deployment of AI models even in senarios where internet connection is not available. With the compression of large models and the gradual optimization of algorithms, the efficiency of edge computing, storage, and communication continues to improve. We expect more product launches aiming at running AI models and utilize AI applications at the edge side.

Figure 26: Hybrid AI is the next phase of the AI deployment

Source: Nvidia, CMBIGM estimates

In 2H23, both global and dometic companies such as Intel, Qualcomm, MediaTek, Google, Lenovo and Xiaomi, have released their new products focusing on processor upgrades with edge AI computing capabilities and hardware edge AI application innovations. As the demand for edge AI functionalities gradually unfolds, traditional data center and cloud-based computing have moved to a combination of cloud and edge terminals, such as PCs and smartphones. Hybrid AI refers to the combination of the computation resource between edges and the cloud, allocating AI computing workloads based on model size and task complexity to achieve the optimal cost, latency, and reliability performance.

In certain scenarios, computation will be primarily executed on the edge side, with tasks being offloaded to the cloud when necessary. This approach is to ahieve the best cost-effective way of fulfilling the user’s computing requirement even in the case of computing resource conjestion or the senario with no internet connectivity. Low-cost edge AI can reach a wider base of potential users that will boost the penetration of AI applications.

AI PC product launches to accelerate in 2024, edge AI to lead new replacement cycle

AI PCs are able to localize the deployment of AI models, with the capability of collecting user information and behaviour habits. AI PCs can provide cross-application personalized search results and facilitate human-machine interation. We believe that the deployment of large AI models on PCs offers advantages in terms of low cost, high reliability, and enhanced privacy. PCs can collect user behavior information in daily user scenarios; with the empowerment of edge AI resources, they can offer user personalized solutions across applications in a cost-effective way, improving user efficiency and productivity.

In terms of processor architectural innovations, leading manufacturers are making progress on new architectural designs to meet the computing requirements of AI PCs. The most common designs have been the hybrid AI architecture, modular separation, and the inclusion of NPUs in the processor architecture. For example, Qualcomm adopts a hybrid AI architecture that supports different workload distribution methods. It can perform distributed processing based on model size and query complexity. On the other hand, Intel employs a modular separation design in Meteor Lake, introducing ultra-low-power efficiency cores on top of a 3D high-performance hybrid architecture that includes high performance and efficiency cores, resulting in a significant reduction in power consumption.

Figure 27: AI PC processor manufacturers and increasing adoption of Arm architecture

Manufacturer	Processor	Release date	Process	Architecture	System	Release date with new processor
Qualcomm	Snapdragon X Elite-Oryon	October 2023	4nm	Arm	Windows	1H24
Intel	Meteor Lake Core Ultra	September 2023	7nm	x86	Windows	1H24
Apple	M3	October 2023	3nm	Arm	Mac OS	November 2023
AMD	Phoenix	Expected 2025	4nm	x86/Arm	Windows	TBD
MediaTek. Nvidia	Kompanio	Expected 2025	6nm	Arm	Windows	TBD

Source: Company data, CMBIGM

For processor product upgrades, PC chip makers have released chips tailored for AI PCs. For instance, Intel has launched Meteor Lake Core Ultra, and Qualcomm has introduced Snapdragon X Elite. Downstream OEMs and PC brand manufacturers are actively promoting their AI PC products. We believe that 2024 will be the milestone year for AI PCs. Initial postiive consumer feedback is expected to further accelerate the upgrade of both hardware designs and software ecosystems. We suggest paying attention to PC and related names, including Lenovo (992 HK), Chunqiu Electronic (603890 CH), Huaqin Tech (603296 CH), Bromake (301387 CH) and Laibao High Tech (002106 CH).

Figure 28: Attention to multiple new AI PC product launches in 2024

PC brands and manufacturers	AI PC industrial outlook and product pipeline
Acer	AI PCs will be a gradual process rather than a sudden occurrence; this transformation will take place in both commercial and consumer markets.
ASUS	Predict that the penetration rate of AI PCs would reach single digits in 2024 and double digits in 2025.
Quanta	AI PC will be the next industrial growth driver, with Microsoft set to launch the latest Windows featuring AI functions the next summer.
Lenovo	Will launch the first AI PC product in 2H24.
HP	Will launch AI PC products in 2024.
DELL	Announce to work with Nvidia to launch AI PC products.

Source: Company data, CMBIGM estimates

AI smartphones: Improved user experience set to boost penetration

The deployment of AI applications on smartphones has become a new innovation opportunity for smartphone brands. With smartphone processor manufacturers releasing chips with edge-side large model computing power, major smartphone brands have announced edge AI product layouts this year. We expect 2024 will be a crucial year for penetration of AI smartphones. Initial consumer feedbacks are likely to accelerate ecosystem innovations.

Qualcomm and MediaTek have released their next-generation processor chips with the capability of deploying generative AI on the edge. The "CPU+GPU+NPU" architecture design for smartphone processors will potentially become the mainstream. Qualcomm has introduced its flagship chip Snapdragon 8 Gen 3, which is capable of running a 10bn-parameter model on the edge side with a 98% improvement in NPU performance. MediaTek has launched the new SoC, Dimensity 9300, which supports running an edge large model up to 33bn parameters. Google's Tensor G3 chip features a "CPU+GPU+TPU" architecture design, showing significant improvements in the number of machine learning models it is capable of running compared to the previous generation, enabling faster processing of complex AI tasks.

Figure 29: AI smartphone SoC product line

		Qualcomm Snapdragon 8 Gen 3	MediaTek Dimensity 9300	Apple A 17 Pro	Google Tensor G3
Launch date		2023/10/25	2023/11/6	2023/9/13	2023/10/4
Primary launch model		Xiaomi 14 Series	Vivo X100 Series	iPhone 15 Series	Google Pixel 8 Series
Process		TSMC 4nm	TSMC 4nm	TSMC 3nm	Samsung 4nm
CPU	**Frequency**	3.3GHz	3.25GHz/2.0GHz	3.77GHz	3.0GHz
	Core no.	8	8	6	9
	Core type	1*3.3GHz X4 core 3*3.15GHz A720 core 2*2.96GHz A720 core 2*2.27GHz A530 core	4*Cortex-X4 core 4*Cortex-A720 core	2*high performance core 4*energy efficient core	1 *3.0GHz Cortex-X3 core 4*2.45GHz Cortex-A715 core 4* 2.15GHz Cortex-A510 core
GPU		Qualcomm Adreno 750 @ 770 MHz	Arm Immortalis-G720 MC12	A 17 Pro GPU @ 1398 MHz	10 core Mali-G710
Ray tracking		Y	Y	Y	Y
Memory		4.8GHz LPDDR5X	LPDDR5T	3200MHz LPDDR5	LPDDR5X
		24 GB 77Gbit/s	UFS 4.0	8GB 51.2Gbit/s	12GB, UFS3.1
Connectivity		Wi-Fi 7; Bluetooth 5.4	Wi-Fi 7	Wi-Fi 6E; Bluetooth 5.3	WiFi 7
AI chip/NPU		Qualcomm Hexgon NPU	MediaTek APU 790	16 core Apple NPU	Google TPU

Source: Company data, CMBIGM estimates

Major smartphone brands have recently launched flagship AI smartphones equipped with AI processors and edge AI features. We expect most secondary flagship models will be equipped with edge AI capabilities in 2024, which will boost AI smartphone penetration meaningfully. By running large models locally, AI phones can enhance personal data privacy and introduce features like AI Doodle, AI Search and AI Portrait.

Figure 30: Smartphone brands focus on edge-side AI large model and software system developments

Brand	Model	Parameters	AI assistant	System	Features
Huawei	PanGu	10bn/38bn/ 71bn/100bn	Xiao yi	Harmony OS 4	Merge cloud and edge, advantage in hardware ecosystem
Xiaomi	MiLM-6B	1.3bn/6bn	Xiao Ai	PengPai OS	edge side computing performance comparable to the cloud side, advantage in human/vehicle/home smart ecosystem
Vivo	vivo LM	1bn/7bn/ 70bn/ 130bn/ 175bn	Lan xin xiao V	Origin OS 4	Co-operate with MediaTek on AI application innovation
OPPO	AndesGPT-7B	10bn to 100bn	Breeno	Color OS	Light-weight AI model on the edge side, co-operate with MediaTek on edge-side AI application innovation
Honor	-	7bn	NA	NA	NA

Source: Company data, CMBIGM estimates

We believe smartphone supply chains are set to work closely with leading SoC suppliers in developing edge-side AI applications. We expect edge AI smartphone applications to unlock AI value on smartphones, and enhance consumer experience with new selling points. We are positive on smartphone brands with strong R&D capability and first-mover advantages in smartphone edge AI large model, operating systems and smart hardware ecosystem. We suggest keeping an eye on Xiaomi and Transsion.

AI + MR: Multiple MR product launches in 2024, boosting software ecosystem and applications innovation

Apple's Vision Pro product is set to be released in the US in January 2024, followed by later launches in Canada, the UK and other regions. Apple will bring ~2mn applications on the iOS platform for Vision Pro. Apple's software application ecosystem will be a key attraction to MR end-users. In addition to the official shipment of Apple's MR products, Samsung is expected to release its first XR device in collaboration with Google in 2024. We believe that successive launches of AR/VR/XR products by tech giants will drive product upgrades, ecosystem development, cost reduction and breakthroughs in consumer acceptance.

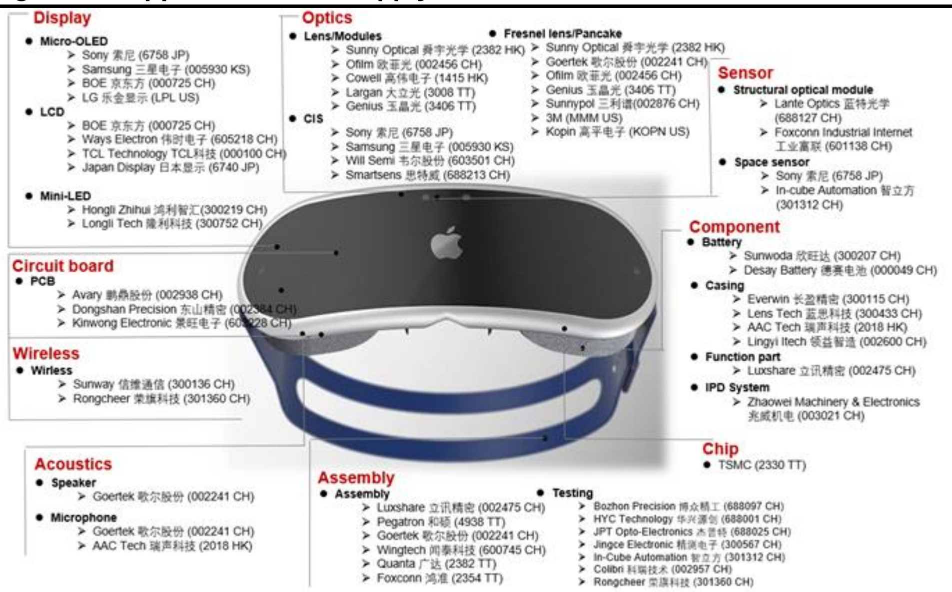
Figure 31: Apple Vision Pro BOM cost list

Category	Component	Supplier	No.	ASP (USD)	Total (USD)
SoC	SoC	Apple M2 Series	1	100	**100**
ISP	ISP	Apple	1	60	**60**
Memory	ROM	Samsung, Kioxia	1	20	**20**
	RAM	SK Hynix, Samsung	1	30	**30**
Inner Display	Micro-OLED	Sony	2	300	**600**
Outer Display	AMOLED/OLED	LG	1	30	**30**
Optics	Pancake Lens	Genius, Young Optics	2	30	**60**
	Module	GIS	1	50	**50**
Interaction Sensors	6DoF tracking	Lens: Largan; Module Cowell	4	5	**20**
	VST RGB camera	Lens: Largan; Module Cowell	2	8	**16**
	Eye-tracking	Sony	2	12	**24**
	Face-tracking	Sony	2	12	**24**
	Body-tracking	Lens: Largan; Module: Cowell	2	5	**10**
	Gesture-tracking	Lens: Largan; Module: Foxconn	1	10	**10**
	ToF	Lens: Genius; Module: LG	1	10	**10**
	IMU	TDK	1	3	**3**
	Haptics		2	2	**4**
Structural components	Outer shield, frame	Everwin, Lingyi Itech	1	120	**120**
Acoustics	MIC	Merry	3	3	**9**
	SPK	Goertek	4	2	**8**
PCB+FPC	PCB+FPC	Avary, Dongshan Precision	1	55	**55**
Headset battery	Battery		1	3	**3**
External battery	Battery	Desay, Sunwoda	1	15	**15**
OEM/ODM	Assembly	Luxshare, Pegatron	1	130	**130**
Others	WiFi, PMIC, Thermal dissipation, waterproof		1	100	**100**
Total BOM					**1511**

Source: Company data, CMBIGM

According to our checks, Apple plans to launch an affordable version of Vision Pro, with BOM cost half of its first model. Price range is expected to be US$1,500-2,500. Product sampling is expected to begin in 2Q24 with releases slated for 2H25. We are optimistic about the official shipment of Apple's Vision Pro next year and the introduction of the affordable version, which we think should boost its AR/VR ecosystem and product penetration. Beneficiaries include Luxshare, Goertek, Zhaowei, Cowell, and Everwin.

Figure 32: Apple Vision Pro supply chain

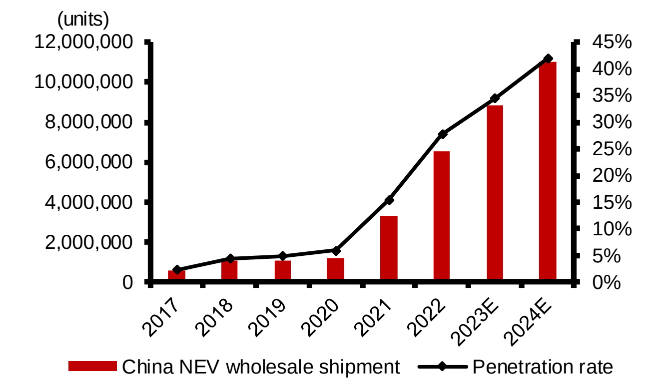


Source: Company data, CMBIGM

Automotive electrification and intelligence trends persisting, NEV exports gaining momentum

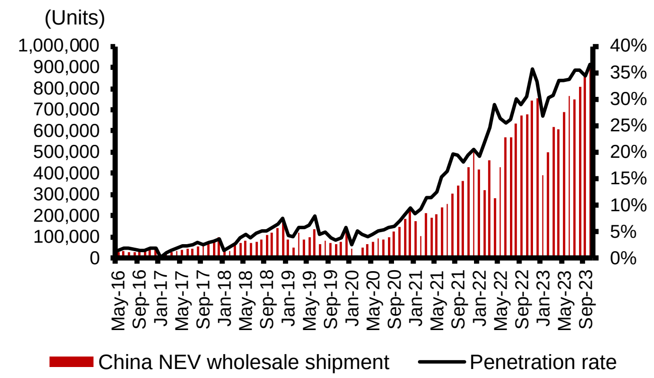
Global NEV sales continue to maintain high growth, driven by ongoing waves of auto electrification and intelligence. NEV exports have become a new growth driver for automotive OEMs, and intelligent technology upgrades now serve as a key product differentiator. According to CMBIGM auto team, China's NEV wholesale shipment volume is expected to rise to 11mn units in 2024, delivering a 24% YoY rise, including 1.8mn for export sales. Ongoing waves of automotive electrification and intelligence are expected to maintain their momentum, with China NEV export growth to accelerate.

Figure 33: Global NEV wholesale shipments and penetration rate



Source: CAAM, CMBIGM estimates

Figure 34: China NEV monthly wholesale shipment data and penetration rate

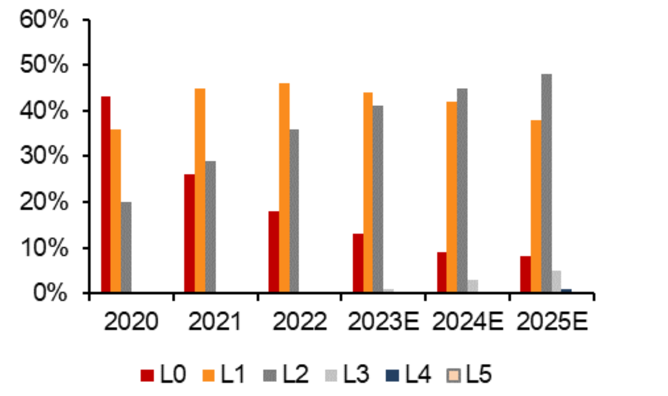


Source: CAAM, CMBIGM

Rising ADAS trend to drive automotive camera lens demand

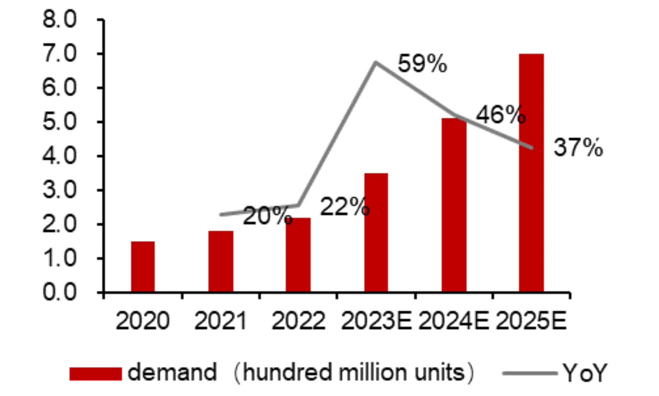
The automotive camera was initially used to assist with reverse and driving recording, with a resolution requirement of only a few hundred thousand pixels; however, as the penetration rate of autonomous driving increases, auto cameras require more complex functions and are applied in different scenarios. The ADAS system enables vehicles to have automation and intelligence functions, and sensors act as channels for vehicles to perceive the surrounding environment through visual, auditory, and tactile senses. With the development of computing and chip technology, vehicles are able to process a large amount of sensing information and begin to recognize the surrounding environment, make autonomous judgments, and achieve functions such as automatic braking and steering. With the development of the automotive electrification trend, the penetration rate of ADAS continues to increase, and the demand for ADAS cameras is expected to accelerate. We suggest focusing on companies including Sunny Optical, Lianchuang Electronic Technology, Ofilm and Yutong Optical Technology.

Figure 35: 2020-2025E global ADAS penetration



Source: Chaodianzhiku, CMBIGM estimates

Figure 36: 2020-2025E global ADAS camera demand

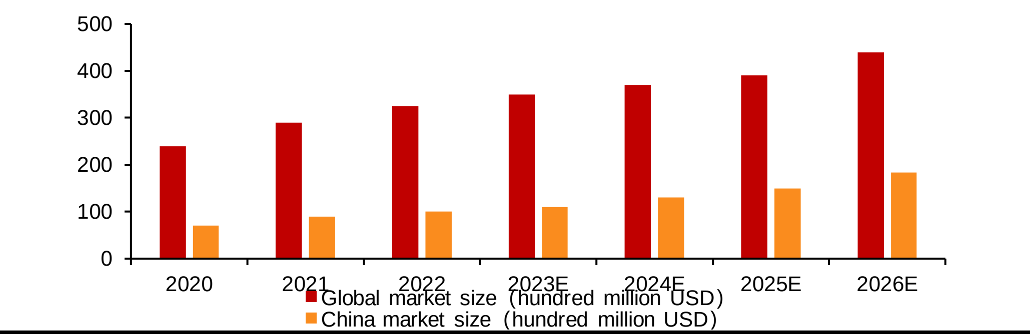


Source: Chaodianzhiku, CMBIGM estimates

Intelligent cockpit to drive auto display upgrades, focus on AR-HUD, CMS and display technology upgrade trend

With the continued development of intelligent vehicles towards intelligence and networking, the intelligent cockpit integrates various systems such as LCD instrument panel, information entertainment system, HUD, and electronic rearview mirror to achieve multimodal human-machine interaction. Automotive displays have evolved from a single central control screen to various products such as LCD instrument panel, rear entertainment, touch, HUD, and electronic rearview mirrors. We remain positive on the increasing penetration rate of automotive head-up display AR HUD, the popularization of CMS electronic rearview mirrors, and the upgrading of display technology to OLED, Mini LED, and Micro LED, under the multi-screen and large screen automotive display upgrade trend.

Figure 37: 2020-2026E global/China intelligent cockpit market size

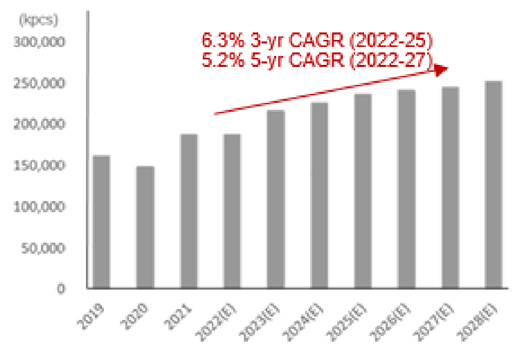


Source: Huaon, CMBIGM estimates

Upgrading display technology to OLED, Mini LED, and Micro LED: Although LCD is currently the mainstream in the auto display market, in the long run, OLED has advantages such as low power consumption, lightweight, high refresh rate, and flexibility, which can significantly increase the added value of automobiles. According to Omdia, as the demand for large-sized and high-definition displays increases, the application of OLED panels in cars will become increasingly widespread, while the market share of auto LCD panels could gradually decline. The market size of in-car OLEDs is expected to expand from US$480mn in 2023 to US$2.18bn in 2027; the shipment volume of OLED panels for vehicles is expected to increase from 1.48mn units in 2023 to 4mn in 2025, and will exceed 9mn in 2027. It is expected that by 2027, the market share of in-car OLED display panels will increase to 17.2%. In addition, Mini LED miniaturizes the LED beads in the backlight layer of LCD screens to achieve better brightness, and improves the black and white contrast problem of LCDs by dimming LED chips in zones. Micro LED integrates all the advantages of LCDs and OLEDs, with significant advantages such as high image quality, low energy consumption, and long lifespan. However, the manufacturing process of Micro LEDs is complex and the production cost is high.

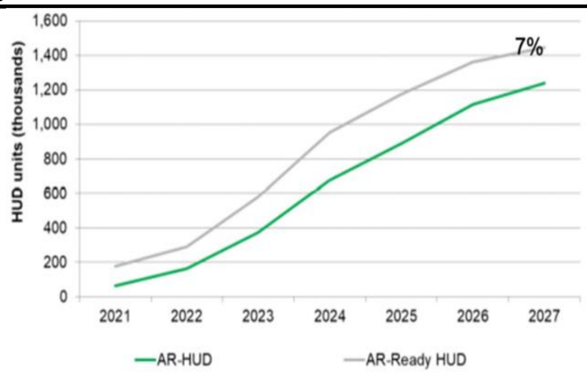
Major panel manufacturers are actively laying out their automotive display roadmaps based on their own technology and production capacity. We believe that leading manufacturers are poised to maintain their high market share. Among them, BOE Varitronix, a leading global player in auto displays, is expected to benefit from the rapid development of intelligent cabins and the trend of large, multi-screen, and intelligent auto displays; moreover, its continued efforts in new products such as HUDs and CMSs are expected to drive future growth. Other beneficiaries include Tianma Microelectronics, Truly, Visionox and TCL Technology.

Figure 38: Global auto display market size growth



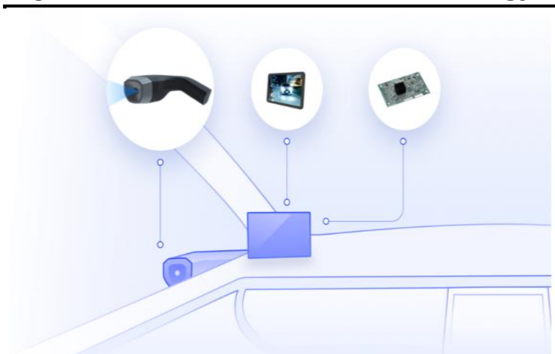
Source: Omdia, CMBIGM estimates

Figure 39: Global AR HUD demand forecast



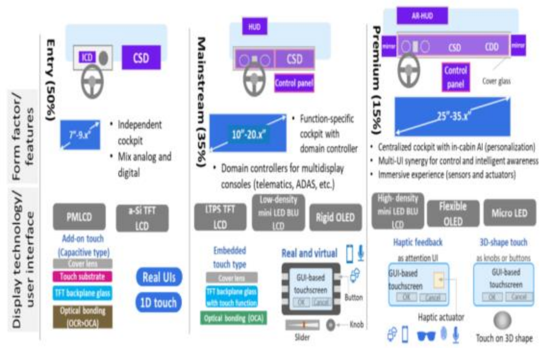
Source: IHS Markit, CMBIGM estimates

Figure 40: Thunder Software Technology's CMS



Source: Smart Auto Club, CMBIGM estimates

Figure 41: Smart cockpit display trend (2021-2026E)



Source: Omdia, CMBIGM estimates

Valuation

Figure 42: Peers' valuation

Company	Ticker	Rating	Mkt. Cap (US$ mn)	Price (LC)	P/E (x) FY23E	P/E (x) FY24E	P/B (x) FY23E	P/B (x) FY24E	ROE (%) FY23E	ROE (%) FY24E	Performance YTD (%)
Brand											
Xiaomi	1810 HK	BUY	51,321	15.98	19.4	18.1	2.2	2.0	11.5	11.1	46.1
Apple	AAPL US	NR	3,081,156	198.11	32.6	30.0	52.8	41.9	169.4	149.4	52.5
Samsung	005930 KS	NR	337,883	73,300	46.0	16.0	1.4	1.3	3.0	8.2	32.5
LG	066570 KS	NR	12,282	97,200	10.6	7.0	0.8	0.7	7.8	10.8	12.4
			Average		**27.2**	**17.8**	**14.3**	**11.5**	**47.9**	**44.9**	**35.9**
ODM/EMS											
BYDE	285 HK	BUY	9,800	33.95	17.3	13.8	2.4	2.1	13.6	15.1	35.3
Luxshare	002475 CH	BUY	31,893	31.73	20.5	16.2	2.2	2.0	10.9	12.3	(0.1)
Hon Hai	2317 TT	NR	45,043	101.50	10.6	9.4	0.9	0.9	8.9	9.4	1.6
			Average		**16.1**	**13.1**	**1.8**	**1.6**	**11.2**	**12.3**	**12.3**
Optics											
Sunny Optical	2382 HK	HOLD	10,158	72.25	47.7	27.1	3.1	2.9	6.4	10.6	(22.1)
Q Tech	1478 HK	BUY	689	4.54	16.3	8.5	1.0	0.9	5.9	10.3	7.8
Cowell	1415 HK	NR	2,417	22.15	35.0	21.8	5.6	4.5	15.4	22.3	104.0
Largan	3008 TT	NR	11,408	2,670	19.4	18.9	2.2	2.0	11.5	11.2	30.9
Genius	3406 TT	NR	1,545	428.00	17.2	15.9	2.3	2.1	13.7	13.8	27.6
O-Film	002456 CH	NR	3,977	8.68	-	42.8	9.8	9.1	(7.3)	9.7	84.3
LG Innotek	011070 KS	NR	4,514	247,000	9.8	7.1	1.2	1.1	13.0	15.9	(2.2)
			Average		**24.2**	**20.3**	**3.6**	**3.2**	**8.4**	**13.4**	**22.8**
Acoustics/Haptics											
AAC Tech	2018 HK	HOLD	3,669	23.90	42.0	24.1	1.1	1.1	2.7	4.6	34.0
Goertek	002241 CH	BUY	8,947	18.60	43.3	24.2	2.0	1.9	4.6	7.8	10.5
Luxshare	002475 CH	BUY	31,893	31.73	20.5	16.2	2.2	2.0	10.9	12.3	(0.1)
Merry	2439 TT	NR	811	115.50	18.9	17.9	1.9	1.8	10.0	10.3	44.9
Nidec	6594 JP	NR	23,468	5,588	40.2	17.7	2.4	2.1	7.0	12.7	(18.3)
			Average		**30.8**	**19.2**	**2.0**	**1.8**	**7.0**	**9.5**	**13.2**
Connector											
FIT Hon Teng	6088 HK	BUY	1,074	1.15	7.6	6.2	0.4	0.4	5.2	6.3	(43.9)
Luxshare	002475 CH	BUY	31,893	31.73	20.5	16.2	2.2	2.0	10.9	12.3	(0.1)
TE	TEL US	NR	44,547	143.34	21.4	19.3	4.0	3.6	19.1	19.3	24.9
Amphenol	APH US	NR	59,119	98.81	33.3	30.5	7.2	6.4	24.4	23.6	29.8
			Average		**20.7**	**18.0**	**3.4**	**3.1**	**14.9**	**15.4**	**2.7**
Casing											
BYDE	285 HK	BUY	9,800	33.95	17.3	13.8	2.4	2.1	13.6	15.1	35.3
Tongda	698 HK	BUY	151	0.12	6.7	4.2	0.2	0.1	2.3	3.5	(6.2)
TK Group	2283 HK	BUY	154	1.44	5.1	3.8	0.7	0.6	13.3	16.3	(8.9)
Everwin	300115 CH	NR	2,082	12.30	58.6	21.0	2.5	2.3	2.9	9.6	19.1
Lens Tech	300433 CH	NR	8,886	12.68	20.3	15.4	1.4	1.3	6.8	8.5	20.4
Catcher	2474 TT	NR	4,029	185.00	11.3	17.1	0.8	0.8	6.8	4.3	9.5
Jabil	JBL US	NR	17,454	136.42	16.0	14.9	6.4	8.2	43.5	43.7	100.0
			Average		**19.3**	**12.9**	**2.0**	**2.2**	**12.7**	**14.4**	**19.8**
Hinge											
AAC Tech	2018 HK	HOLD	3,669	23.90	42.0	24.1	1.1	1.1	2.7	4.6	34.0
KH Vatec	060720 KS	NR	261	14,270	7.9	8.3	1.3	1.1	16.3	14.1	2.7
Foseltek	6805 TT	NR	778	354.50	36.1	19.5	5.6	4.5	16.1	26.0	75.1
Jarlytec	3548 TT	NR	371	193.00	23.4	15.0	-	-	-	-	218.5
NBTM	600114 CH	NR	1,162	13.40	41.1	25.4	3.1	2.9	7.7	11.7	57.6
			Average		**30.1**	**18.5**	**2.8**	**2.4**	**10.7**	**14.1**	**58.5**

Source: Bloomberg, CMBIGM

Figure 43. Peers' valuation

Company	Ticker	Rating	Mkt. Cap (US$ mn)	Price (LC)	P/E (x) FY23E	P/E (x) FY24E	P/B (x) FY23E	P/B (x) FY24E	ROE (%) FY23E	ROE (%) FY24E	Performance YTD (%)
PC/Server											
Lenovo	992 HK	NR	16,100	10.22	9.5	14.9	2.5	2.5	30.6	17.3	59.8
Dell	DELL US	NR	51,541	72.43	9.7	10.9	-	-	(179.3)	(156.9)	80.1
HP	HPQ US	NR	30,567	30.93	9.4	9.0	-	-	(139.1)	(429.4)	15.1
ASUSTeK	2357 TT	NR	9,653	406.00	18.7	13.1	1.3	1.3	7.1	9.6	51.2
Inspur	000977 CH	NR	7,209	34.82	27.5	20.7	2.7	2.5	9.6	11.6	61.8
Dawning	603019 CH	NR	8,054	39.13	28.8	22.8	3.0	2.7	10.5	12.0	76.7
Super Micro	SMCI US	NR	16,443	294.40	26.0	16.9	8.0	5.3	36.3	40.3	258.6
			Average		**15.8**	**14.3**	**3.4**	**2.8**	**(51.2)**	**(106.5)**	**75.8**
PC/Server ODM											
FII	601138 CH	NR	41,292	14.78	12.3	10.2	2.0	1.8	16.8	17.7	61.0
Quanta	2382 TT	NR	25,039	202.50	19.8	15.9	4.3	3.8	21.9	25.0	180.1
Wistron	3231 TT	NR	8,503	91.60	21.9	14.1	2.5	2.2	11.5	16.3	211.6
Wiwynn	6669 TT	NR	9,739	1,740.00	26.4	17.9	7.3	5.9	28.6	36.0	118.3
GigaByte	2376 TT	NR	5,169	254.00	30.3	18.5	4.4	3.9	14.1	21.1	138.5
			Average		**22.1**	**15.3**	**4.1**	**3.5**	**18.6**	**23.2**	**141.9**
Substrate											
Unimicron	3037 TT	NR	8,885	182.00	24.3	16.4	3.1	2.7	13.0	18.1	51.7
Ibiden	4062 JP	NR	7,539	7,599.00	22.1	28.4	2.6	2.3	12.2	8.7	58.8
NYPCB	8046 TT	NR	5,223	252.50	27.6	20.9	3.3	3.1	11.8	16.0	11.2
			Average		**24.7**	**21.9**	**3.0**	**2.7**	**12.3**	**14.2**	**40.6**
PCB											
WUS Printed	002463 CH	NR	5,781	21.54	28.2	20.8	4.3	3.6	15.3	17.5	81.0
Victory Giant	300476 CH	NR	2,301	18.97	18.0	13.8	2.1	1.7	11.7	13.4	46.6
Gold Circuit	2368 TT	NR	3,393	215.50	28.9	16.5	6.6	5.0	24.1	32.9	148.3
SCC	002916 CH	NR	5,042	69.90	24.7	20.4	2.7	2.5	10.8	11.7	(3.1)
			Average		**25.0**	**17.9**	**3.9**	**3.2**	**15.5**	**18.9**	**68.2**
Transceiver											
Innolight	300308 CH	NR	12,425	110.05	45.1	22.5	6.4	5.0	14.7	23.4	307.1
TFC Optical	300394 CH	NR	5,378	96.85	61.5	39.4	12.4	10.0	20.3	25.3	282.1
Eoptolink	300502 CH	NR	5,092	51.00	50.9	28.9	6.7	5.5	12.3	19.0	200.6
Lumentum	LITE US	NR	3,341	49.86	11.0	34.4	2.2	2.6	18.0	5.9	(4.4)
			Average		**42.1**	**31.3**	**6.9**	**5.8**	**16.3**	**18.4**	**196.3**
Power Supply											
Delta	2308 TT	NR	26,026	313.00	24.1	20.5	4.2	3.8	16.6	18.2	9.2
Lite-on	2301 TT	NR	8,491	112.00	16.8	14.6	3.0	2.8	18.4	20.4	75.5
			Average		**20.5**	**17.6**	**3.6**	**3.3**	**17.5**	**19.3**	**42.4**
Thermal											
FII	601138 CH	NR	41,292	14.78	12.3	10.2	2.0	1.8	16.8	17.7	61.0
AVC	3017 TT	NR	3,657	298.00	21.8	17.3	5.6	4.7	28.5	30.5	169.7
Sunowealth	2412 TT	NR	29,427	118.50	24.5	23.8	2.5	2.4	9.9	10.3	4.9
			Average		**19.6**	**17.1**	**3.4**	**3.0**	**18.4**	**19.5**	**78.5**

Source: Bloomberg, CMBIGM

Figure 44. Peers' valuation

Company	Ticker	Rating	Mkt. Cap (US$ mn)	Price (LC)	P/E (x) FY23E	P/E (x) FY24E	P/B (x) FY23E	P/B (x) FY24E	ROE (%) FY23E	ROE (%) FY24E	Performance YTD (%)
Auto Electronics											
Luxshare	002475 CH	BUY	31,893	31.73	20.5	16.2	2.2	2.0	10.9	12.3	(0.1)
Sunny Optical	2382 HK	HOLD	10,158	72.20	47.6	27.1	3.1	2.9	6.4	10.6	(22.1)
BYDE	285 HK	BUY	9,800	33.95	17.3	13.8	2.4	2.1	13.6	15.1	35.3
BOE Varitronix	710 HK	NR	678	6.69	10.2	7.2	1.2	1.1	12.2	15.4	(54.9)
Intron Tech	1760 HK	NR	358	2.57	5.3	4.1	1.0	0.8	20.3	20.3	(37.0)
Desay SV	002920 CH	NR	10,066	128.96	47.9	34.4	9.3	7.6	20.3	23.2	22.4
Joyson	600699 CH	NR	3,606	18.20	25.0	18.3	1.9	1.7	7.8	9.6	29.5
Jingwei Hirain	688326 CH	NR	2,100	124.44	212.0	59.5	2.8	2.7	0.1	5.0	(16.7)
Foryou	002906 CH	NR	2,579	34.98	38.1	27.5	3.4	3.1	9.4	11.5	5.3
O-Film	002456 CH	NR	3,977	8.68	-	42.8	9.8	9.1	(7.3)	9.7	84.3
LianChuang	002036 CH	NR	1,563	10.40	-	31.1	2.9	3.0	(3.6)	6.3	(15.9)
			Average		**47.1**	**25.6**	**3.6**	**3.3**	**8.2**	**12.6**	**2.7**

Source: Bloomberg, CMBIGM

China Healthcare

OUTPERFORM

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A year of rebound

Healthcare sector to rebound in 2024E

The sector has experienced over two years of correction since July 2021. During July 2021 and November 2023, the MSCI China Healthcare Index recorded a cumulative 59% decline. We expect the sector to rebound in 2024 thanks to the following reasons. 1) The regulatory policy environment turned more constructive which will encourage the innovation in drugs and medical devices. 2) The medical demand will gradually recover during the ongoing anti-corruption activities. 3) Overseas markets will drive the growth thanks to the ease of US-China tensions. 4) The sector valuation will re-rate from a very low level.

The GLP-1 market has huge market potential

The global GLP-1 market in 9M23 is approximately US$25.7bn (+59% YoY). Wall Street analysts predict that the global GLP-1 market could reach US$100bn by 2030. The current rapid growth of the global GLP-1 market is mainly driven by the demand for the use of GLP-1 products for weight loss. As of Aug 2023, MAT sales in the global weight loss drug market reached approximately US$7.7bn, with a growth rate of 134%. There are approximately 764mn obese people worldwide, of whom only about 10% seek help and only 2% receive treatment. In China, we predict that the GLP-1 market size will be approximately RMB9.6bn in 2023 and reach RMB101.4bn in 2030 (CGAR 40%), in which obesity indication is expected to contribute to approximately 80% in 2030.

Great potential in label expansion of GLP-1 drugs. In addition to diabetes and obesity, GLP-1 drugs have shown potential for cardiovascular risk, non-alcoholic steatohepatitis (NASH), diabetic nephropathy, Alzheimer's disease, peripheral arterial disease and other diseases. For NASH, in cross-trial comparisons to Madrigal's resmetirom (THR-β agonist), semaglutide achieved better NASH remission (59% vs 30%) and fibrosis score improvement (43% vs 26%). GLP-1/GCG dual receptor agonists, such as mazdutide, efinopegdutide and pemvidutide, show better liver fat content reduction than the single-target semaglutide.

Competition in China's GLP-1 market is fierce, while product strength determines market share. There are currently no approved long-acting GLP-1 drug for obesity treatment in China. Semaglutide and tirzepatide submitted BLAs for obesity in China in Jun and Aug 2023 respectively. Innovent/Eli Lilly’s mazdutide is about to submit BLA for obesity (6mg dose) at end-2023 or early-2024. In addition, Eli Lilly's retatrutide and orforglipron, Novo Nordisk's CagriSema, Sciwind/Kawin's ecnoglutide, CSPC's GX-G6, etc. are in Ph3 trials in China for obesity. The competition in China's GLP-1 market will be fierce in the future. Novo Nordisk, Eli Lilly and Innovent will leverage their first-mover and product advantages to occupy China’s major GLP-1 market, in our view. The GLP-1 market will also face competition from semaglutide biosimilars/generics in the next few years. However, we believe the most important factor in determining the market share of GLP-1 products is still product strength, namely efficacy, safety, medication convenience, etc.

GLP-1 brings a new growth driver to the global CXO industry. Due to the severe supply shortage of GLP-1 peptide drugs in the world, pharmaceutical companies have invested heavily to expand production capacity. In Nov 2023, Novo Nordisk announced to invest DKK42bn (~US$6bn) to expand its plants in Denmark. Meanwhile, in Nov 2023, Eli Lilly announced plans to construct a new US$2.5bn high-tech manufacturing site in Germany which will further expand the company's global parenteral (injectable) product and device manufacturing network and support an increased demand for Lilly's diabetes and obesity drugs. Eli Lilly also announced in early 2023 to invest US$450mn to expand its North Carolina facilities. As construction of production capacity takes time, pharmaceutical companies are actively seeking external capacity to meet the surging demand. As a result, multiple Chinese and foreign CDMO companies have signed major peptide supply contracts. WuXi AppTec has secured commercial manufacturing orders for a globally-marketed dual-target GLP-1 drug. EU-based Bachem has announced three major peptide contracts since September 2022, involving a total value of more than CHF1.5bn.

Innovative drugs to enjoy favorable regulatory environment

Medical insurance policies continue to favor innovative drugs. The latest price reduction rules for innovative drug NRDL renewals turned moderate. For example, the price cut standard will be reduced by half for the drugs that have been negotiated in NRDL for 4+ years. The National Healthcare Security Administration (NHSA) has stressed many times that negotiations with enterprises are by no means arbitrary bargaining of "the lower the price, the better". The authorities have always been supporting medical innovations. We believe innovative drugs will enjoy a more favorable payment environment in China.

New globalization milestones of China's innovative drugs. Recently, Junshi Biologics' toripalimab, Hutchmed's fruquintinib and Yifan Pharma's efbemalenograstim alfa all received approvals from the US FDA, representing landmark milestones for the globalization of Chinese biopharma companies. Additionally, we expect BeiGene's tislelizumab to be approved by the US FDA for 2L ESCC at end-2023/1H2024, and the BLA of Hengrui's camrelizumab for 1L HCC will also receive FDA decision by May 31, 2024. Meanwhile, BeiGene's zanubrutinib has recorded US$880mn global sales in 9M23, +126% YoY. We expect the drug to realize around US$1.27bn in FY23. Legend's BCMA CAR-T Carvykti has achieved US$340mn sales in 9M23, of which the sales in 3Q23 was US$152mn, representing a 30% QoQ growth. Due to the upcoming "patent cliff" and the future price decline of major drugs caused by the US IRA, MNCs are eager to fill their pipelines with high-quality assets. We believe overseas licensing will remain an important path for the internationalization of China's innovative drugs, while we think MNCs will have stricter control over asset risks, and China's innovative drugs will face higher thresholds for licensing out.

CXO sector approaching an inflection point

The overall revenue growth of the global CXO industry has slowed down significantly in 1H23, due to the largely-decreased global demand for COVID drug R&D in the post-pandemic era as well as the high base impact in 2022. However, the non-COVID revenue growth has maintained a rapid growth rate, indicating a stable global demand for pharmaceutical R&D. For example, WuXi Biologics' non-COVID revenue increased by 60% YoY in 1H23.

China's CXO industry has been deeply integrated into the global pharmaceutical R&D value chain, thus the global pharmaceutical financing has material impacts on China's CXO industry. According to Pharmacube, the global financing of innovative drugs has largely stabilized in 2023 after a sharp decline in 2022 (-47% YoY). The trend of China's innovative drug financing is similar to that of the world. Looking forward to 2024, as the US Fed is likely to cut interest rates, while global innovative drug financing is expected to rebound. Although it takes time from financing rebound to the earnings recovery of CXOs, we anticipate that the global CXO industry may see demand rise in 2024.

Bomming demand in medical devices

Deregulation of the large-scale medical equipment configuration will drive the growth of large-scale medical equipment procurement. In 2023, the National Health Commission (NHC) removed purchase limit of CT and MRI for public hospitals. The PET/MR, Tomo and LINAC were moved from Class A regulation to Class B regulation, implying loosening in purchase limits. Moreover, the NHC will issue more large-scale medical equipment configuration permits for the “14th Five-Year Plan” period (2021-2025). For example, the new configuration permit for PET/CT is 860 units, an increase of 483 units compared with the “13th Five-Year Plan” period of 377 units. The configuration permits of abdominal minimally invasive surgery robot and PET/MR during the “14th Five-Year Plan” period are 559 (vs. 154 units during “13th Five-Year Plan” period) and 141 units (vs. 28 units during “13th Five-Year Plan” period), respectively. Government stressed the need to promote high-quality development of public hospitals and strengthen the medical service capabilities of county hospitals. Thus, the deregulation of the large medical equipment configuration may lead to growth in China’s medical equipment market, in our view. We expect companies with highly competitive technologies and groundbreaking products such as United Imaging and Medbot to benefit.

Medical device companies have great potential for overseas expansion. The export volume of medical devices has accelerated since 2016 and amounted to US$18bn in 2020. The average proportion of overseas revenue of China’s medical device companies in 2022 was 28%, which was much lower than that of MNCs such as Medtronic, Danaher, GE Healthcare, Stryker. We believe that China’s medical device companies with cost-effective products and growing international competitiveness will continue to gain overseas market share.

VBP rules turned transparent and reasonable. In 2023, the national and provincial VBPs followed the previous bidding rules of national spinal VBP, which has set the cap prices. This enabled any product with a certain price discount to win the tender and has increased the visibility of VBP results.

Valuation

Figure 1: China healthcare valuation comps

Company	Ticker	Rating	Mkt Cap (US$mn)	Price (LC)	TP (LC)	Upside/ Downside	P/E(x) FY23E	FY24E	P/B(x) FY23E	FY24E	ROE(%) FY23E	FY24E
Medical service												
Jinxin Fertility	1951 HK	BUY	1,341	3.84	7.35	91.4%	22.5	17.5	1.0	1.0	4.5	5.5
Aier Eye Hospital	300015 CH	N/A	22,105	16.95	N/A	N/A	45.1	35.5	7.7	6.6	18.2	19.7
Hygeia Healthcare	6078 HK	N/A	3,956	48.80	N/A	N/A	37.8	28.1	4.8	4.1	13.5	15.2
Gushengtang Hold	2273 HK	BUY	1,552	50.35	70.77	40.6%	41.5	31.1	5.6	4.7	13.4	15.1
EC Healthcare	2138 HK	BUY	344	2.26	N/A	N/A	12.9	11.4	1.4	1.4	11.3	12.3
C-Mer Eye Care	3309 HK	N/A	590	3.63	N/A	N/A	60.5	40.3	N/A	N/A	4.0	6.0
			Average				36.7	27.3	4.1	3.6	10.8	12.3
Biotech												
Innovent	1801 HK	BUY	9,401	45.30	57.35	26.6%	N/A	N/A	6.3	6.7	(11.0)	(6.6)
Hutchmed	13 HK	BUY	3,394	30.35	36.77	21.2%	N/A	N/A	5.4	5.7	(1.1)	(7.1)
Innocare	9969 HK	BUY	1,693	6.70	9.07	35.4%	N/A	N/A	1.6	1.7	(10.6)	(9.9)
Beigene	BGNE US	BUY	20,130	184.72	295.67	60.1%	N/A	N/A	13.2	9.8	(21.2)	(24.3)
Shanghai Junsh	1877 HK	N/A	5,185	21.65	N/A	N/A	N/A	N/A	2.5	2.8	(20.5)	(18.6)
Zai Lab	ZLAB US	N/A	2,804	28.37	N/A	N/A	N/A	N/A	2.9	4.1	(39.9)	(52.4)
Remegen	9995 HK	BUY	4,423	44.00	57.65	31.0%	N/A	N/A	5.6	6.3	(27.6)	(23.1)
Akeso	9926 HK	BUY	5,167	47.85	51.23	7.1%	19.8	N/A	8.4	7.9	48.5	(8.4)
			Average				19.8	N/A	5.8	5.6	(10.4)	(18.8)
CXO												
Wuxi Apptec	603259 CH	BUY	34,627	83.13	116.01	39.6%	24.2	20.2	4.5	3.8	19.1	19.4
Wuxi Biologics	2269 HK	BUY	25,155	46.05	69.39	50.7%	34.0	26.3	4.4	3.7	13.1	14.6
Tigermed	300347 CH	BUY	7,207	62.30	80.31	28.9%	23.7	20.7	2.5	2.2	11.1	11.1
Pharmaron	300759 CH	N/A	7,443	32.26	N/A	N/A	33.2	26.2	4.6	4.1	14.4	15.8
Asymchem	002821 CH	N/A	7,132	141.33	N/A	N/A	20.7	24.3	2.9	2.6	14.5	11.3
			Average				27.1	23.5	3.8	3.3	14.4	14.4
Medical device												
AK Medical	1789 HK	BUY	969	6.73	8.44	25.4%	27.2	20.4	2.8	2.5	10.4	12.3
Kindly Medical	1501 HK	BUY	618	28.15	33.3	18.3%	25.8	19.0	N/A	N/A	10.5	13.2
Microport	853 HK	N/A	2,990	12.70	N/A	N/A	N/A	N/A	2.9	3.8	(31.1)	(29.6)
MedBot	2252 HK	N/A	2,504	20.35	N/A	N/A	N/A	N/A	41.5	26.5	(84.2)	(165.8)
Weigao Group	1066 HK	N/A	4,319	7.44	N/A	N/A	12.4	10.7	1.3	1.2	11.5	12.0
Mindray	300760 CH	BUY	47,676	281.27	383.43	36.3%	29.3	24.4	8.7	6.9	31.0	30.2
			Average				23.7	18.6	11.5	8.2	(8.7)	(21.3)
Pharma												
CSPC Pharm	1093 HK	BUY	10,513	6.88	8.16	18.6%	12.2	11.1	2.2	1.9	10,513	6.88
Simcere Pharm	2096 HK	BUY	2,486	7.36	8.15	10.7%	10.7	14.1	1.9	1.7	2,486	7.36
Jiangsu Hengrui	600276 CH	N/A	41,736	46.80	N/A	N/A	64.6	53.2	7.2	6.4	41,736	46.80
Sino Biopharm	1177 HK	N/A	9,051	3.75	N/A	N/A	22.4	19.6	2.0	1.8	9,051	3.75
Hansoh	3692 HK	N/A	11,182	14.68	N/A	N/A	29.1	26.4	3.2	2.9	11,182	14.68
			Average				27.8	24.9	3.3	2.9		
Medical aesthetic												
IMEIK	300896 CH	N/A	9,528	315.00	N/A	N/A	35.9	26.0	9.6	7.5	9,528	315.00
Giant Biogene	2367 HK	BUY	4,535	35.50	48.87	37.7%	23.9	18.4	8.0	5.6	4,535	35.50
Angelalign	6699 HK	N/A	1,337	61.60	N/A	N/A	96.2	46.7	2.5	2.4	1,337	61.60
			Average				52.0	30.4	6.7	5.2		

Source: Bloomberg, CMBIGM estimates, as of 27 Nov 2023.

China Consumer Staples | MARKET-PERFORM

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Asymmetric recovery continues

Themes into a chaotic 2024; pecking order revised

2024 looks no more than an extension of 2023, and we continue to expect consumption to asymmetrically recover. Our economist forecasts total social retail sales to grow at 7.6% YoY, and this likely comes with a higher wallet share by services spending, when retail pursuits, such as ingredient (skincare/beverage), value (alcohol/dairy/IMF/packaged food), and contents (cosmetics/duty-free/luxury/jewelry), remain diverged. A broad-base trade-down could gravitate further, when volume growth falters and space expansion mutes. Otherwise, we still see premiumization to selectively take place partiularly in travel retail abroad by the Chinese cluster. Cost efficiency is under the limelight, and subsequently ascends to the predominant source of earnings growth for the year.

Premiumization is still selectively happening

Commanding price hikes for staple names will go through an even more bumpy path. Mix upgrade, in our view, will become the only driver to organic price inflation that will be executed by differentiators such as Moutai/CR Beer/Tsingtao/Yili/Nongfu/Proya/Giant Biogene (covered by our healthcare team). Among these, baijiu names flourish with less visible price ceilings, breweries struggle to lap on a high base, and cosmetics see content migration. Fine retailers (Prada/Samsonite/CTG Duty Free), in our view, will embrace a more normalised outook, albeit a high-quality one relative to other cohorts, which will be fuelled predominantly by price when volume growth is likely muted in 1H. Duty-free could come as an exception, when high-end leisure spending continuously diverts to overseas.

Cost efficiency is under the limelight

Easing input costs are tailwinds to GPM expansion for early 2024. Dairies and breweries are sensitive to the trend per our sensitivity analysis. Operationally, administrative cost cut is a mainstream initiative, and marketing spend ramp-up is a swing factor to the masterplan.

Dragon-year impact on fertility rates is on a flimsy footing

Anecdotal evidence we collected refuted the correlation between higher fertility rates to the China Zodiac Year of the Dragon. We project the number of new births to grow steadily by 8.2mn/8.0mn/7.5mn for 2023/24/25E. Considering also the time a baby boom takes to translate into profits, speculation on an imminent IMF recovery is on a flimsy footing.

Our revised pecking order; stock-for-action

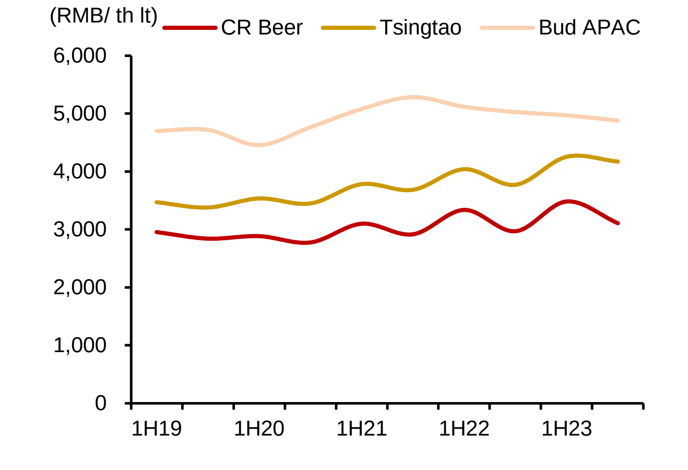
We caveat that languishing pricing power could lure another wave of valuation de-rating (or already happening), and this will likely be snowballed by the subsequent reset of expectations that were stalely based on inefficacious corporate guidance. We prefer 1) fine retailers with regional exposure that benefit from the unwavering spending power of Chinese outbound tourists, 2) F&B names with up-sloping price curve, and 3) an overall healthy cash inflow with a shareholder-friendly dividend policy. **Moutai** is our top pick (price hike/dividend), followed by **Samsonite** (price hike/regional exposure), and **Yili** (stabilizing 4Q23 expectation).

Premiumization is still selectively happening

Beer – premiumization could decelerate

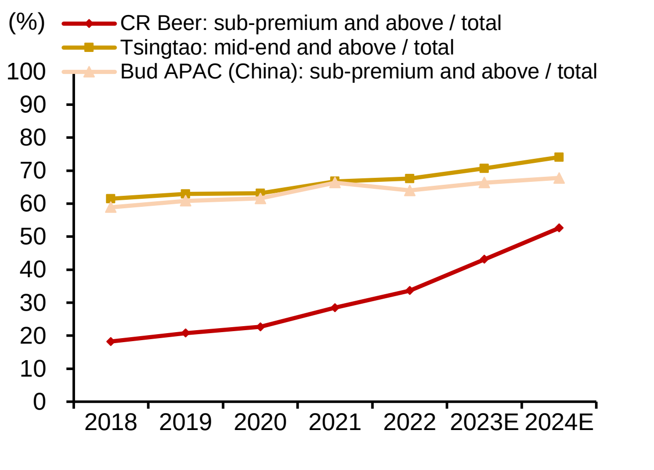
Beer premiumization is set to continue in 2024, in our view, but this will be mainly driven by mix upgrade, when LFL price hike is becoming more difficult to execute against the backdrop of consumption trade-down. Compared to 2022 when major breweries we covered (CR Beer, Tsingtao and Bud APAC) were able to universally levy LFL price increases, they only managed to selectively execute the same strategy in their stronghold regions and/or on their best-selling SKUs in 2023. In 2024, if consumption trade-down gravitate further, any LFL inflation will more likely result in market share loss, and this will make breweries inclined to achieve price growth through mix optimization. To the worst, we might also see beer trade-down from super-premium/premium to premium/sub-premium cohorts, considering the affordability trade-off from mass-market Baijiu to premium beers that took place in 2023. We think this would the last to happen if the macro environment deteriorates further, which we still consider it a tail risk for now.

Figure 1: ASP trend for major local breweries



Source: Company data, CMBIGM

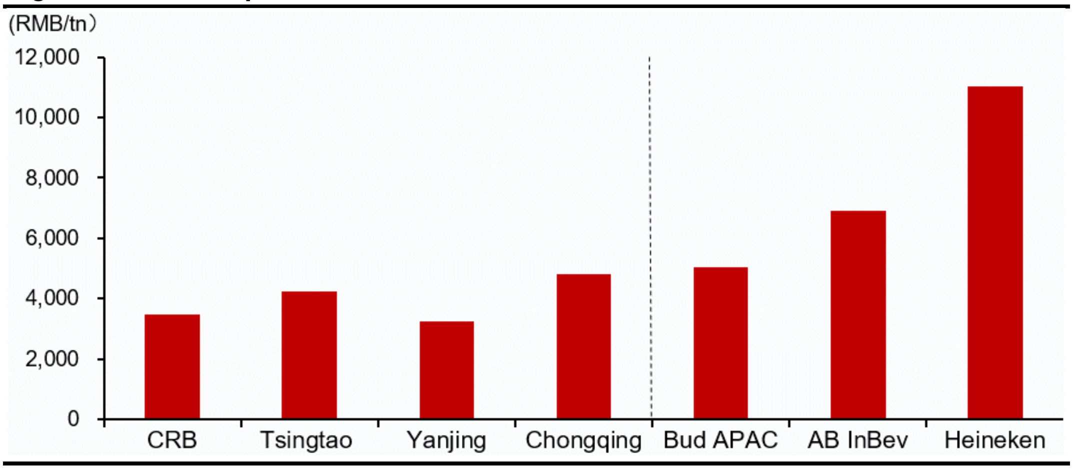
Figure 2: Sub-premium+ revenue contribution



Source: Company data, CMBIGM estimates

Numerically, we anticipate that breweries will book 3-4% ASP growth in 2024, coupled with 0-2% volume growth. Longer term, we consider the headwinds above transient, and a temporary hiccup shall not deter the multi-year premiumization story. There remains ample growth potential for China premium beer consumption, when premium beer penetration now rests at 30%+, while in other markets, such as the US, Europe and Japan, this stands at 80-90%.

Figure 3: ASP comparison of domestic and overseas breweries

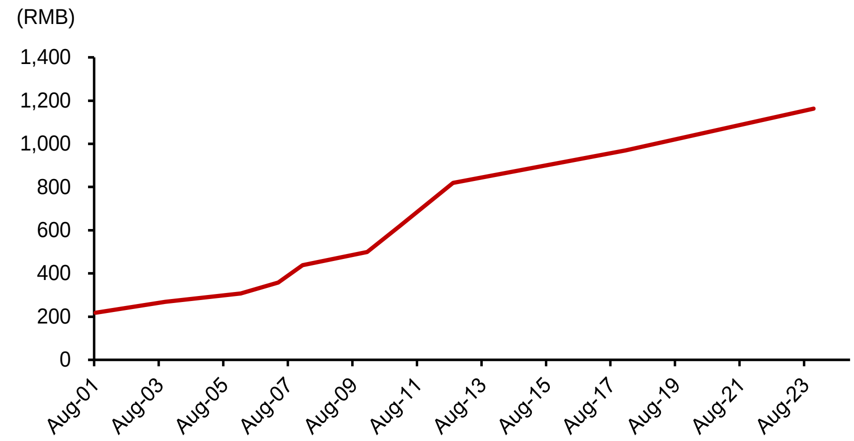


Source: Company data, CMBIGM

Baijiu – Moutai's price hike a blockbuster

For the baijiu industry, Moutai's recent price hike is a blockbuster with multiple merits, in our view. For one thing, it represents a supportive stance from policy-maker to foster a more balanced profit distribution along the value chain. For another, it breaks the price ceiling faced by mid-end brands and pave the way for brand upgrade among tiers. That said, before any price initiatives take place, we believe mid-end brands would have to eliminate excess channel inventory in order to ensure an effective pass-through.

Figure 4: Historical ex-factory price of Feitian Moutai 53% abv, 500ml



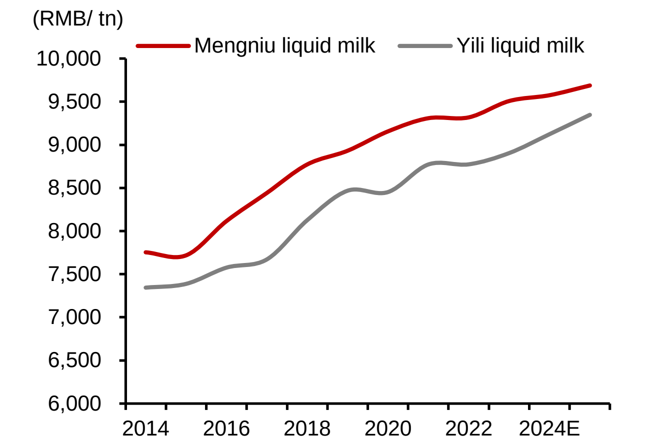
Source: CMBIGM

After Kweichow Moutai increased the factory price of its "Feitian Moutai" by 20% on November 1, 2023, expectation has been building up on whether other brands will follow suit. In the high-end market, both Wuliangye and Luzhou Laojiao responded by saying they are adopting a cautious stance regarding price adjustments for their flagship products ("Wuliangye 8th Generation" and "Guojiao 1573"). In early November, Wuliangye denied price adjustment intention and stated that its further strategy is to develop low-alcohol drinks to cater to young consumers. However, at the end of November, a major Wuliangye distributor revealed that "Wuliangye 8th generation" will see a price increase of RMB100-200 per bottle, representing a 10-20% increase. On November 1, Luzhou Laojiao raised ex-factory prices for three of its mid-class products. The price of the "60th Edition Tequ" was hiked by around RMB20 per bottle, indicating a 4-5% increase. At the end of November, Laojiao announced that the expected phenomenon of "inverted retail price" remained controllable and there were no plans to adjust prices for "Guojiao 1573." Furthermore, at the end of November, Yanghe raised the ex-factory price of its flagship product "Sujiu Toupai" by 3%.

Dairy – back to the basics

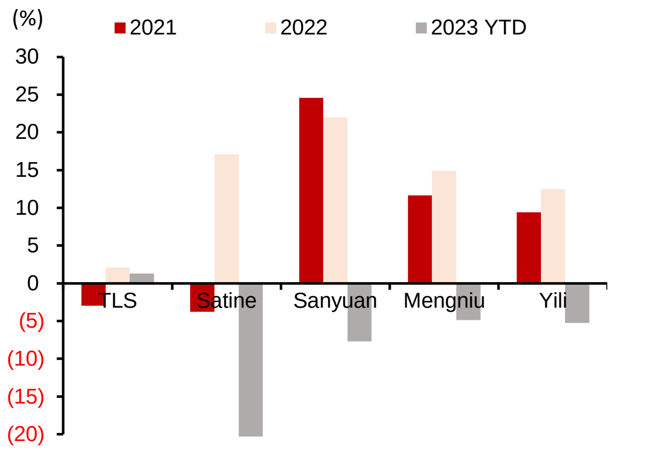
Our channel check suggested channel inventory continues to build up, and retail promotion has further intensified. We think the destocking cycle for dairy products, such as yogurt, cheese, or any low-temp variants, has not completed and would further pressurize channel sell-in in 2024E. Relative to smaller players, the duopoly between Mengniu and Yili could help mitigate part of the loss from malignant competition, and is yet unable to revive these bellwethers from product mix scale-down back to the staple-like basic white milk, for which premiumization, albeit decelerating, remains a viable strategy to enhance penetration. According to the online sales data we tracked, the online ASPs of Milk Deluxe and Satine brands in 2020 were RMB96 and RMB108 per unit, representing a premium of 52% and 71% compared to mainstream white milk brands, respectively. From the beginning of 2023 until now, the premium ratio has narrowed to 24% and 19%. In terms of other business segments, the UHT yogurt sales growth experienced pressures due to overprice compared to soft drinks and lactobacillus beverages. Cheese, a category also falling into a relatively higher price range, needs time to unveil its potential in both the 2C and 2B markets.

Figure 5: Liquid milk ASP of Mengniu and Yili



Source: Company data, CMBIGM

Figure 6: Liquid milk ASP change on Taobao & Tmall

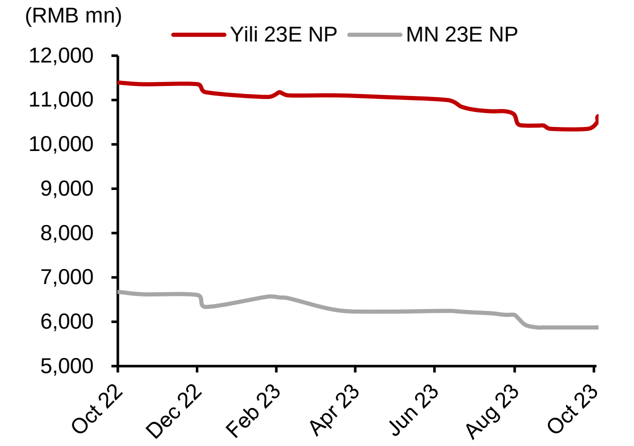


Source: Moojing, CMBIGM

IMF could remain in the doldrums when the Zodiac year of the Dragon seems not to be that effective in stimulating fertility wishes (to be discussed further in the next section). Longer term, a more stringent requirement with the new national standard in place should foster a healthier environment for established players when tail brands gradually exit the market.

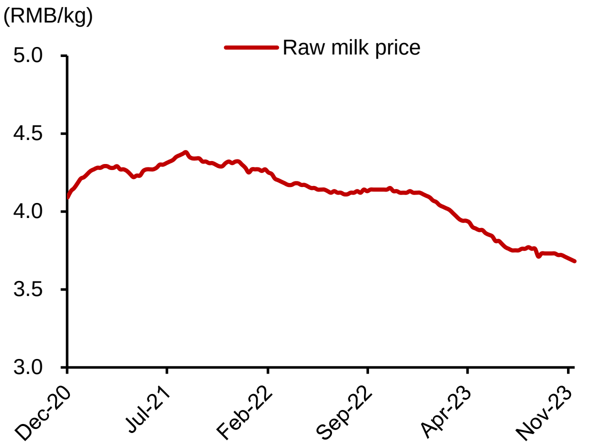
We take a rather gloomy view on the dairy segment. That said, in the near term, we prefer Yili to Mengniu on a more stabilized earnings expectation for 4Q23E, when quarterly results has prompted consensus to frequently refresh their projections. On the positive side, should the duopoly be able to achieve growth for 2024E, we assert that the major drivers behind the scene will be 1) ongoing mix upgrade in basic white milk with more punchy new launches to the market (Yili's Satine and AMX have been doing well in 2H23), 2) an easing raw milk price that enables cost savings.

Figure 7: Consensus changes for Mengniu and Yili



Source: Bloomberg, CMBIGM

Figure 8: Raw milk price trend

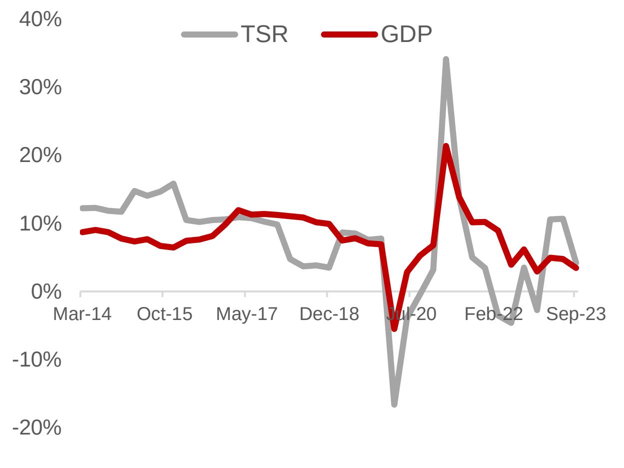


Source: Wind, CMBIGM

Cosmetics – A new normal with ongoing content migration

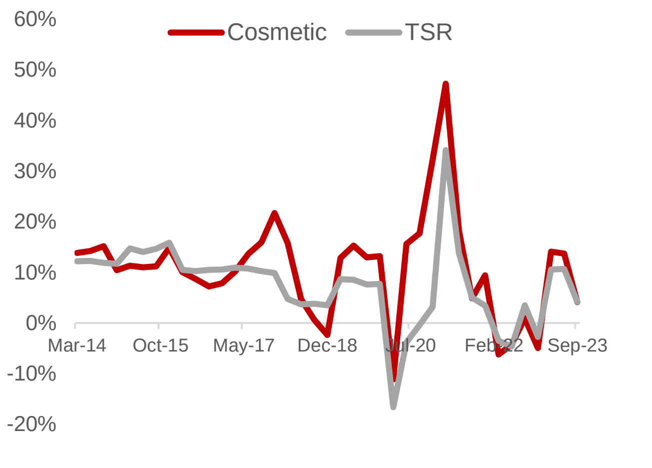
Cosmetics may no longer take share within a more rationalised consumer wallet. Low penetration and channel migration to e-commerce platforms enabled cosmetics sales to grow at a 60%+ CAGR between 2019 and 2021, consistently tracking above the 40%+ in total social retail sales (TSR). The expansion cycle was staged: it began with the steady growth between 2016 and 2018, followed by a persistent beat between 2019 and mid-22, and plateaued again until now. The driving forces behind the scene are two-fold, such as the dissipating low-hanging fruit of live-streaming, and languishing spending power in the post-pandemic era. In our view, these trends are here to stay, and when consumers are becoming more value-cautious and ingredient-savvy, and when they are incrementally re-prioritizing their wallet share, higher price tags have made skincare (relative to colour make-up) more vulnerable to trade-down (though selective and transient). We caveat that a lower 2023 could just be the start, or essentially the inflection point, of the renewed cycle with cosmetic sales growth re-converging to that of TSR.

Figure 9: China GDP and TSR growth trends



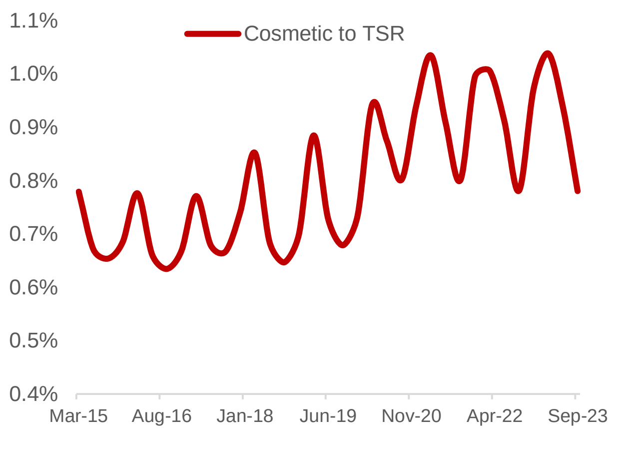
Source: Wind, CMBIGM

Figure 10: TSR and cosmetics sales growth trends



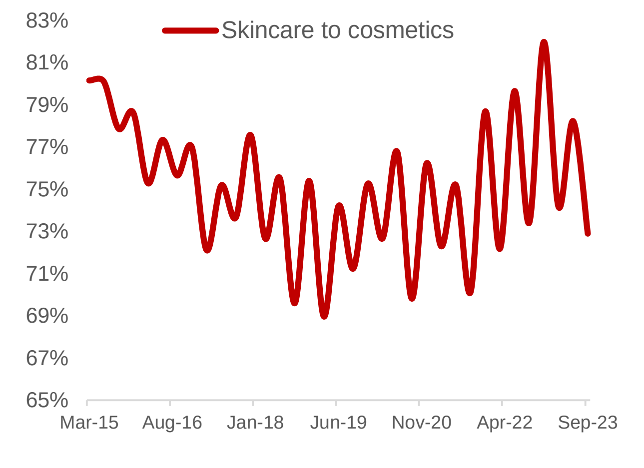
Source: Wind, CMBIGM

Figure 11: Cosmetics sales to TSR



Source: Wind, CMBIGM

Figure 12: Skincare spending to total cosmetics



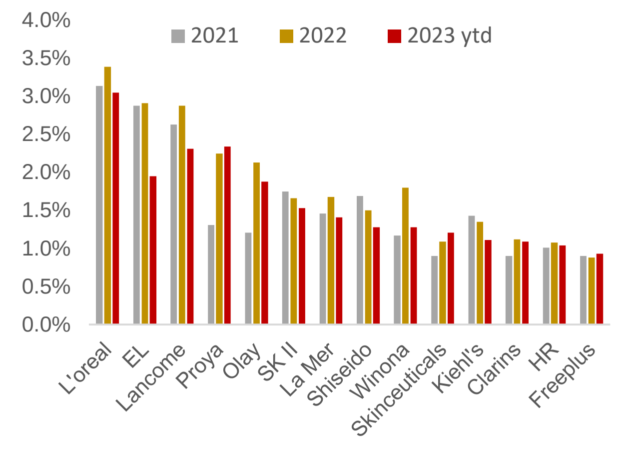
Source: Wind, CMBIGM

- **Close-quarters combat among brands across the "4P"**

1. **Consumer trade-up may not be as eye-catching.** Premiumization and polarization is selectively happening within the cosmetics sector. We argued that domestic brands were collectively catching up and taking market share from foreign brands. But now, we notice the situation is slightly twisted, with demand polarization becoming more obvious. Year-to-date data may not be conclusive, but indeed alarming enough to raise the eyebrows – the top 15 brands, mainly high-end/prestige brands we surveyed on Tmall/Taobao have been losing market share (likely to long-tail brands) compared to the last two years. This comes in with an exception for Proya, Skinceuticals and Freeplus. The latter two position themselves as niche functional skincare brands and ride on the popularity of HA and canarium album extract essences, Nicotinamide and aminoamides face washes**.**

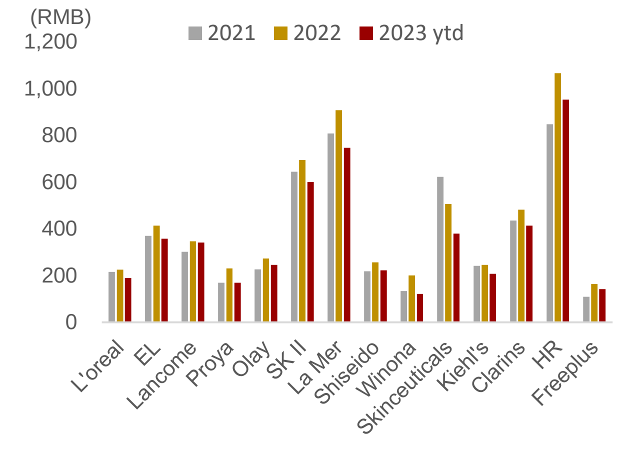
2. **Competition heated up in all of the "4P".** The fatigue among consumers' online cosmetics buying over the 3-year lockdown has lured brands into price cuts in an attempt to snap up/maintain their competitiveness. Of note, between 2021 and 9M23, online cosmetics prices were 5.3% lower than offline. Estee Lauder again is the major loser as the company looks likely to have over-shipped since the beginning of this year upon a softer-than-expected recovery. Beyond price cuts, brands are also increasing their marketing spend to re-establish their brand equity. Witnessing this, we argue that competition has fully heated up across the "4P", from previously Place (e-commerce migration) to currently Price (deeper discounts), Promotion (higher ad spend) and Product (ingredient heterogeneity).

Figure 13: Market share trends on Tmall/Taobao



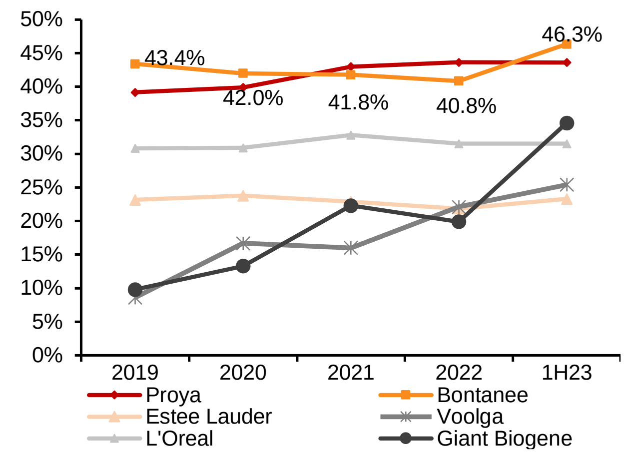
Source: Moojing, CMBIGM estimates

Figure 14: ASP trends on Tmall/Taobao



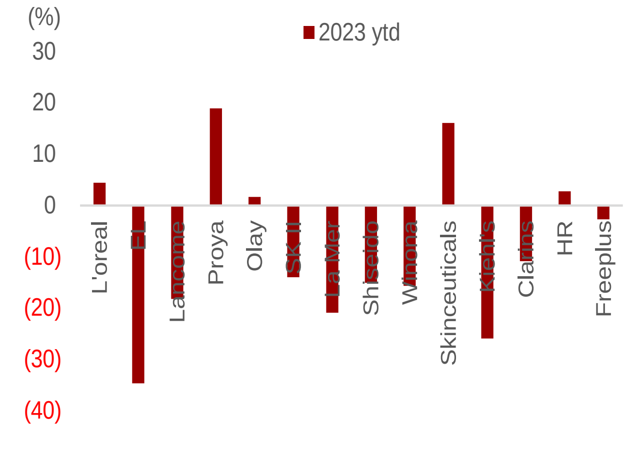
Source: Moojing, CMBIGM estimates

Figure 15: Brands increase advertising spending



Source: Company data, CMBIGM estimates

Figure 16: Brands' GMV growth on Tmall/Taobao

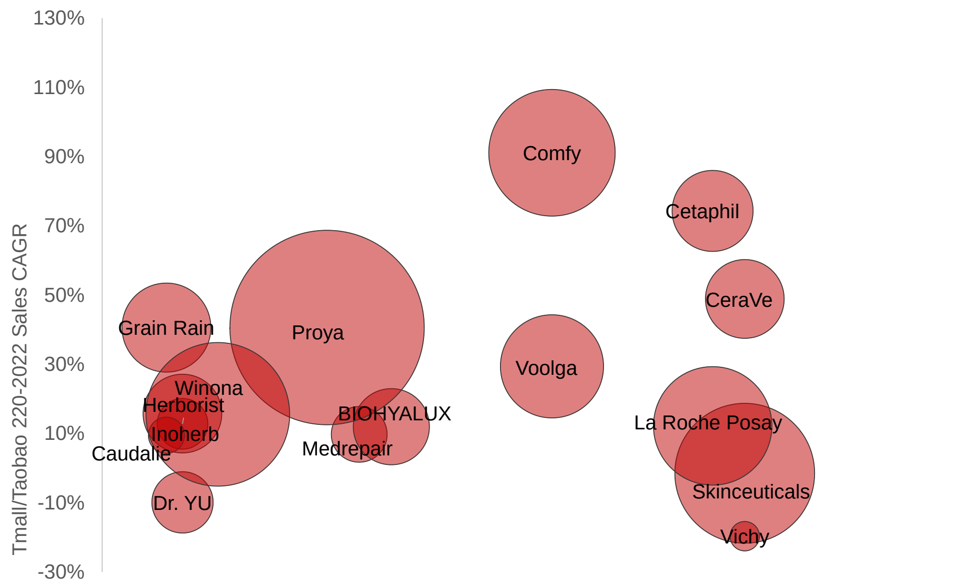


Source: Moojing, CMBIGM

■ **The shift from herbal-/HA-based to collagen-based skincare**

1. **Collagen-based skincare commensurate better with "medical beauty".** Surveys by Frost & Sullivan have unveiled that a growing demand for rapid skin barrier repair among consumers who have undertaken non-surgical medical aesthetics procedures, with the latter likely to deliver 54% stack growth between 2020 and 2025E. Recombinant collagen is seen as the best active ingredient, among animal-derived collagen and hydraulic acid, to relieve post-procedure adverse reaction such as redness, itch, scaling and dryness. Our data collected from Moojing substantiate the trend, with plant-based brands (such as Caudalie, Herborist, Inoherb)/hydraulic acid-based brands (such as Voolga) grew at a 9-16%/29% CAGR between 2020 and October 2023, underperforming Comfy (Giant Biogene) that saw a 91% CAGR.

Figure 17: GMV growth vs market size among brands on Taobao/Tmall



Source: Moojing, CMBIGM

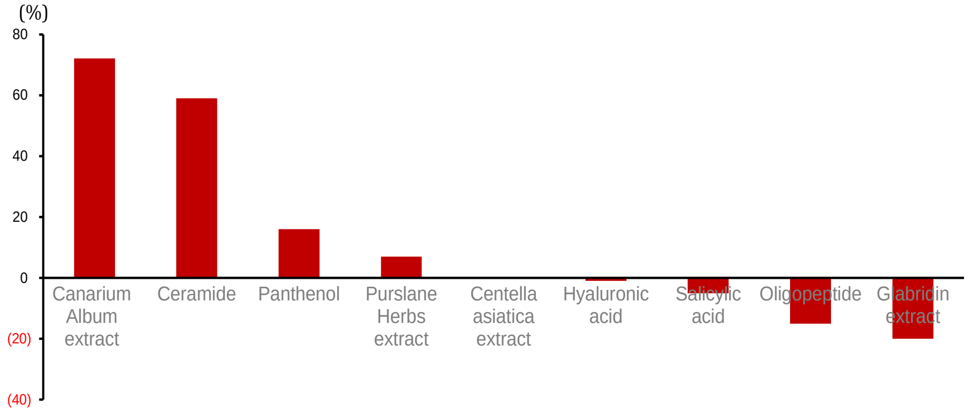
2. **Consumers are becoming more ingredient-savvy.** Statistics from BEBD show that user time spend on active viewing of skincare products' ingredients increased by 177% YoY in 2021, and that on actively researching for the functionalities of specific ingredients increased by 111% YoY. Meanwhile, consumers with skin concerns have undergone a significant shift in their pursuits from stabilizing skin conditions towards repair and rejuvenation efficacy. Search frequency for herbal ingredients among various online surveys in 2022 have shown a significant downtrend vs that in 2020. About half of the searches associated with skincare were related to anti-oxidation and anti-aging.

Figure 18: Significant reshuffle of active ingredients searched for skincare SKUs

	2020	2022
Top 1	Centella asiatica extract (积雪草)	Nicotinamide (烟酰胺)
Top 2	Selaginella tamariscina extract (复活草)	Hyaluronic acid (透明质酸钠)
Top 3	Laminaria extract (海藻)	Tocopherol (生育酚)
Top 4	Chamomile extract (洋甘菊)	Centella asiatica extract (积雪草提取物)
Top 5	Aloe extract (芦荟)	Glabridin extract (光果甘草根提取物)

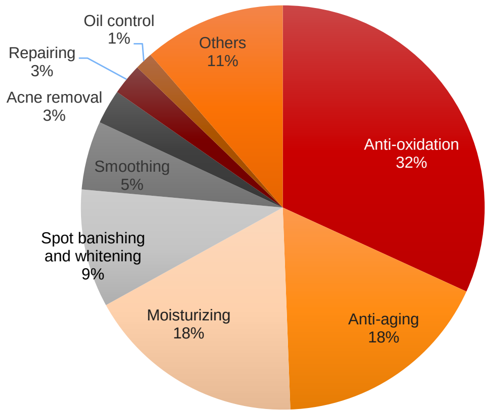
Source: Beautydata, BEBD, CMBIGM

Figure 19: Online search frequency changes on active ingredients 2022



Source: BEBD, CMBIGM

Figure 20: Half of skincare searches are associated with anti-oxidation/aging



Source: BEBD, CMBIGM

3. **Foreign brands are joining the party.** Meanwhile, the participation of foreign brands, notably with more proven technology and hence product quality, has speeded up the shift. Comparing the price range and active ingredient of the four SKUs below, La Roche Posay looks to be the most value-for-money brand and has every reason to sell better than its peers. A more proactive use of social media also helps foreign brands to establish more localised touch points for customer acquisition.

Figure 21: Foreign brands offer equally high value-for-money SKUs vs local brands

Brand	Country	Product name	11.11 price on TMall	Sales vol. in the past 365 days	Ingredients category
La Roche Posay	France	Cicaplast Baume B5 cream	80 / 40 ml	500 k +	Bioactive
Avene	France	Cicalfate cream	68 / 40 ml	80 k +	Bioactive
Cetaphill	France	Smoothing & Comforting facial cream	130 /45 ml	100 k+	Bioactive
Winona	China	Tolerance Extreme cream	168 / 50 g	400 k+	Plant based
Grain Rain	China	Whitening Restore cream	168 / 130 g	300 k+	Plant based

Source: TMall, CMBIGM

Figure 22: Foreign brands are turning more proactive on social media

	No. of posts on Red			No. of fans on Red		
	Jul 2021	Nov 2023	Chg.	Jul 2021	Nov 2023	Chg.
Winona	60 k+	186 k+	210%	131 k+	187 k+	43%
Dr. YU	20 k+	60 k+	200%	23 k+	56 k+	143%
Skinceuticals	80 k+	300 k+	275%	66 k+	111 k+	68%
La Roche Posay	110 k+	192 k+	75%	109 k+	146 k+	34%
Vichy	30 k+	31 k+	3%	61 k+	67 k+	10%
CeraVe		58 k+			29 k+	
Cetaphil		55 k+			36 k+	

Source: CMBIGM

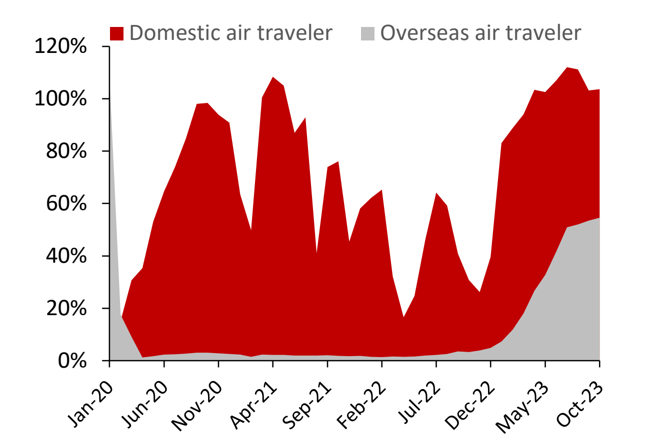
Fine retail

In 2024, we expect global tourism consumption to maintain a steady recovery as Chinese travellers resume their travel activities. By the end of October, international flights in China had rebounded to 55.6% of the 2019 level, with Chinese carriers and foreign carriers operating at 57.5% and 42.5% of the 2019 level, respectively. Although Chinese travellers' willingness to travel has rapidly recovered this year, the full restoration of international flights should be gradual. As flight availability continues to improve, we expect that China's cross-border travel demand will further increase in 2024, boosting global travel retail.

While the pent-up demand for global business and leisure travel post the pandemic is still releasing, Samsonite is expected to maintain strong growth momentum. In the third quarter of this year, net sales in the Asia region grew by 41%, driving overall sales growth of 21%, and this positive trend has continued into the fourth quarter. The high-end Tumi brand achieved year-on-year sales growth of 29%. Next year, we anticipate the company will achieve moderate single-digit growth in ASP by launching the Tumi women's series, reducing discounts for the main Samsonite brand, and enhancing brand image.

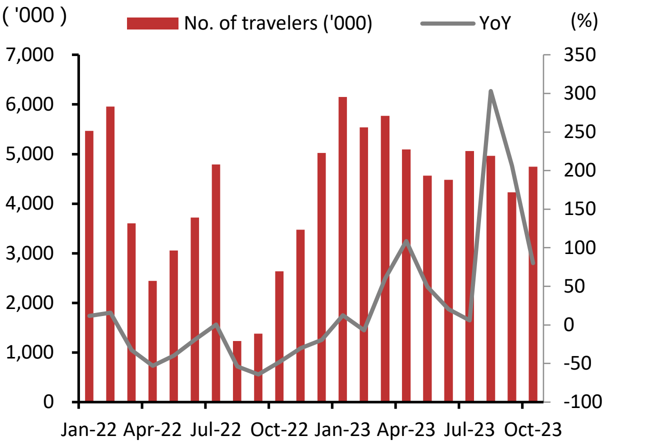
Regarding the Chinese tourism market, despite a decrease in the conversion ratio accompanying the surge in travel activities, we expect CTG Duty Free's ASP and sales to stabilize and improve in 2024. In terms of island visits, passenger traffic at Sanya Phoenix and Haikou Meilan International Airports in October exceeded the same period in 2019. Customs data indicates that duty-free consumption in Hainan reached RMB3.3bn in October, representing a year-on-year increase of 44%, driven by 544,000 duty-free shoppers, a year-on-year increase of 117%. We observe that the trend of middle-class customers shifting their preference to value-for-money destinations may favor the growth of domestic duty-free shopping demand. Additionally, the entry of new brands in CTG malls and upgrades to airport stores will further enhance the product portfolio and improve inventory levels.

Figure 23: Domestic/overseas air travellers vs. 2019



Source: Wind, CMBIGM

Figure 24: Hainan overnight visits



Source: Wind, CMBIGM

In the realm of luxury brands, we estimate Prada is poised to increase its ASP and maintain steady market share growth. The company anticipates a 4% ASP increase in 2024, aligned with its pricing adjustments in 2023 and remaining comparatively less intense than other top luxury brands. In contrast, Chanel has raised prices twice in China this year, with increases of 7-12% and 6-8% respectively. Hermès has already implemented a price hike in 2023 and plans another by year-end, estimating an increase of 6-12%. Similarly, LV has executed three significant price increases this year. It is evident that top luxury brands intend to continue raising prices in the Asian market, while the European market relies heavily on travel retail. We believe an upswing in Chinese travellers' visits next year will facilitate steady regional growth. Prada Group's pricing adjustments demonstrate a cautious approach in line with current consumer sentiment. Additionally, Miu Miu is experiencing robust growth momentum in the Chinese and Japanese markets, which is likely to extend into 2024.

Figure 25: Price hikes of luxury brands in the past 4 years

Louis Vuitton	2019.7	2020.1	2020.7	2021.1	2022.2	2023.2	2023.6	2023.9	Accum. Chg.
Neverfull Medium	¥ 10,000	¥ 10,900	¥ 11,700	¥ 12,000	¥ 14,400	¥ 14,400	¥ 14,400	¥ 14,800	48%
Pochette Metis Medium	¥ 13,300	¥ 13,800	¥ 14,900	¥ 15,900	¥ 17,400	¥ 17,400	¥ 19,100	¥ 19,700	48%
Nano Speedy	¥ 8,250	¥ 8,600	¥ 9,250	¥ 9,250	¥ 10,200	¥ 12,800	¥ 13,900	¥ 14,800	79%
Chanel	**2019.5**	**2019.11**	**2020.5**	**2020.11**	**2021.7**	**2022.11**	**2023.3**	**2023.6**	**Accum. Chg.**
CF Medium	¥ 38,100	¥ 42,600	¥ 48,900	¥ 51,500	¥ 56,100	¥ 66,500	¥ 74,900	¥ 80,500	111%
2.55 Medium	¥ 38,100	¥ 42,600	¥ 48,900	¥ 51,500	¥ 56,100	¥ 66,500	¥ 74,900	¥ 80,500	111%
19 Small	¥ 34,200	¥ 34,700	¥ 36,500	¥ 36,500	¥ 40,100	¥ 41,500	¥ 47,100	¥ 50,500	48%

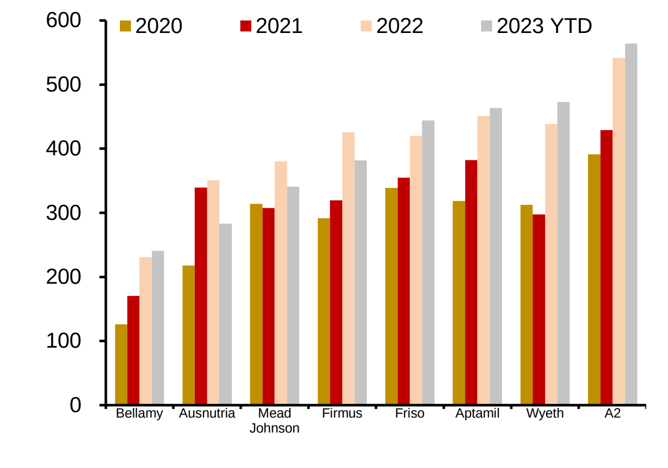
Source: Brands' websites, CMBIGM

Dragon-year impact on fertility rates is on a flimsy footing

We expect the negative influence of the COVID-19 pandemic on the birth rate to fade out gradually by 2024. From 2019 to 2021, China's birth rate decreased from over 10% to 7.5% and further declined to 6.8% in 2022. We estimate that the number of women aged 20 to 35 in China is normalizing at an annual decline of 2%. Taking aspects of youth unemployment rates and income expectations into account, the trend of population postponing childbirth plans may persist. Based on our observations, the influence of zodiac preferences on people's fertility decisions is insignificant supported by historical data, and we anticipate that China's birth rate will remain within a normal range in 2023-2024.

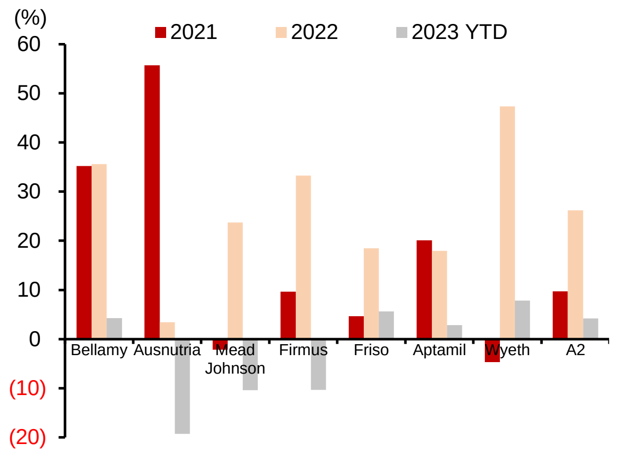
Looking ahead to 2024, we expect the price wars in the IMF market to diminish further as smaller brands exit the market. The "New National Standard" adjustments in the infant formula industry were completed in the second half of this year. Despite this, the trend of total market size shrinking should continue. In the long term, we believe that the trend of consumption upgrade in the Chinese IMF market remains unchanged, but the extent of price increases by brands may remain weak in the near term. Data from Taobao/Tmall platforms indicates that high-end brands nonetheless achieved ASP increases in the year, but the magnitude of price hikes noticeably declined, indicating competition intensified in the high-end market.

Figure 26: IMF brands' ASP trends on Taobao & Tmall



Source: Moojing, CMBIGM

Figure 27: IMF ASP YoY trends on Taobao & Tmall



Source: Moojing, CMBIGM

Cost-efficiency is under the limelight

We expect breweries' cost efficiency to ramp up in 2024. The Australian barley tariffs, which had been in effect since May 2020, was officially scraped in August 2023. This move is positive to breweries, and its impact is likely to be more apparent in early 2024. In terms of packaging costs, premiumization has led to a higher demand for canned beer, resulting in a surging canning rate that jumped from 26.3% in 2021 to 32.5% in 2023. This has led to lower sales from glass bottle SKUs, which typically offer lower profit margins. Breweries' aluminum hedging, since the onset of supply chain disruptions during the pandemic, has also been effective in mitigating any input cost fluctuations.

Regarding dairy products, we expect raw milk prices to plateau and stabilize in 2024. Raw milk prices have consistently weakened since August 2021, declining from RMB4.4 per kg to RMB3.7 per kg at present. In 2022, China witnessed an 8% YoY decrease in milk consumption, marking the first decline in eight years. The growth rate of national dairy product output has remained lower than that of milk production since the beginning of 2023, and financial pressure has led to the closure of numerous dairy farms. Nevertheless, the national inventory of cows has not decreased, and the expansion of dairy farming groups persists. In the first three quarters of 2023, milk production in the country's five main production regions saw growth rates ranging from 6% to 27%. According to Frost & Sullivan, large-scale farms (those with over a thousand cows) supplied approximately 24% of the total raw milk in 2015, which increased to 44% in 2022. In 2024, we expect China's raw milk supply to further integrate into large-scale farms and low raw milk prices are unlikely to see meaningful rebounds.

Figure 28: Sensitivity analysis of food and beverage companies to raw materials

(RMB mn)	Assumed % change	CRB	Tsingtao	Budweiser (USD mn)	Mengniu	Yili	Feihe	Nongfu	UPC	Tingyi	Nissin (HKD mn)
Revenue (2023E)		38,441	35,702	6,783	99,315	127,901	20,371	40,843	29,549	83,970	38,722
Gross profit		15,491	13,416	3,493	36,151	41,018	12,616	23,999	8,983	25,670	13,204
GPM		40.3%	37.6%	51.5%	36.4%	32.1%	61.9%	58.8%	30.4%	30.6%	34.1%
Packaging & raw mat cost change	-10%	1,276	1,284	222	3,790	5,213	620	862	641	2,711	1,276
GPM impact		**3.3%**	**3.6%**	**3.3%**	**3.8%**	**4.1%**	**3.0%**	**2.1%**	**2.2%**	**3.2%**	**3.3%**

Source: Company data, CMBIGM

Our revised pecking order; stock-for-action

We caveat that languishing pricing power could lure another wave of valuation de-rating (or already happening), and this will likely be snowballed by the subsequent reset of expectations that were stalely based on inefficacious corporate guidance. We prefer 1) fine retailers with regional exposure that benefit from the unwavering spending power of Chinese outbound tourists, 2) F&B names with up-sloping price curve, and 3) an overall healthy cash inflow with a shareholder-friendly dividend policy. **Moutai** is our top pick (price hike/dividend), followed by **Yili** (stabilizing expectation) and **Samsonite** (price hike/regional exposure).

Figure 29: Peers' valuation

Name	Ticker	Rating	TP (LC)	Price (LC)	Upside	Mkt Cap (US$ mn)	P/E (x) FY23E	P/E (x) FY24E	P/B (x) FY23E	P/B (x) FY24E	ROE (%) FY23E	ROE (%) FY24E
F&B/staples												
CR Beer	291 HK	BUY	69.8	34.0	105.3%	14,115	18.5	14.7	3.3	2.8	17.8	19.4
Tsingtao Beer	168 HK	BUY	82.1	50.3	63.2%	11,394	14.2	12.7	2.3	2.1	16.0	16.7
Budweiser APAC	1876 HK	HOLD	16.9	13.4	26.1%	22,708	23.4	20.8	2.0	1.9	8.6	9.3
Moutai	600519 CH	BUY	2219.0	1750.7	26.7%	308,103	29.6	24.9	9.5	7.8	33.0	32.8
Yili	600887 CH	BUY	34.5	26.8	28.7%	23,902	16.6	15.3	3.1	2.9	18.6	19.2
Mengniu	2319 HK	BUY	36.5	22.9	59.7%	11,504	14.0	12.4	1.9	1.7	13.3	13.6
China Feihe	6186 HK	HOLD	4.9	4.4	11.4%	5,106	8.1	8.0	1.3	1.2	16.7	15.6
Nongfu Spring	9633 HK	BUY	56.9	44.9	26.9%	64,545	44.5	37.4	17.2	15.5	38.6	41.4
Pagoda	2411 HK	BUY	7.7	6.0	29.0%	1,214	20.3	18.4	2.5	2.3	12.3	12.5
Hongjiu Fruits	6689 HK	BUY	6.4	5.6	13.5%	1,023	4.5	4.1	0.9	0.7	20.6	19.1
						Average	**19.4**	**16.9**	**4.4**	**3.9**	**19.6**	**20.0**
Duty free/cosmetics/jewelry/luxury												
CTG Duty Free	601888 CH	BUY	124.4	86.6	43.6%	24,902	25.9	19.2	3.4	3.0	13.0	15.7
Giant Biogene	2367 HK	BUY	48.9	35.3	38.7%	4,488	25.1	20.3	7.7	5.5	31.3	27.9
Proya	603605 CH	BUY	138.3	98.5	40.4%	5,475	37.4	30.3	9.1	7.5	24.3	24.6
Botanee	300957 CH	HOLD	81.6	69.2	18.0%	4,104	26.3	21.9	4.6	4.0	17.4	18.1
Shanghai Jahwa	600315 CH	HOLD	21.4	23.1	-7.2%	2,184	31.3	24.5	2.1	1.9	6.6	7.9
Chow Tai Fook	1929 HK	BUY	18.6	11.1	67.0%	14,255	16.2	14.2	3.0	3.3	16.6	26.8
Samsonite	1910 HK	BUY	30.0	23.2	29.3%	4,295	11.1	9.5	3.1	2.4	27.3	25.1
Prada	1913 HK	BUY	70.2	43.3	62.3%	14,161	20.2	18.1	3.4	3.1	16.3	17.0
Smoore Int'l	6969 HK	BUY	11.0	6.7	63.7%	5,278	23.8	18.1	1.8	1.7	7.5	9.3
						Average	**23.2**	**18.9**	**3.9**	**3.4**	**17.8**	**19.2**

Source: Bloomberg, CMBIGM

China Consumer Discretionary

MARKET-PERFORM

Analysts: Walter WOO – walterwoo@cmbi.com.hk

The year of break and build; in the midst of every crisis lies great opportunity

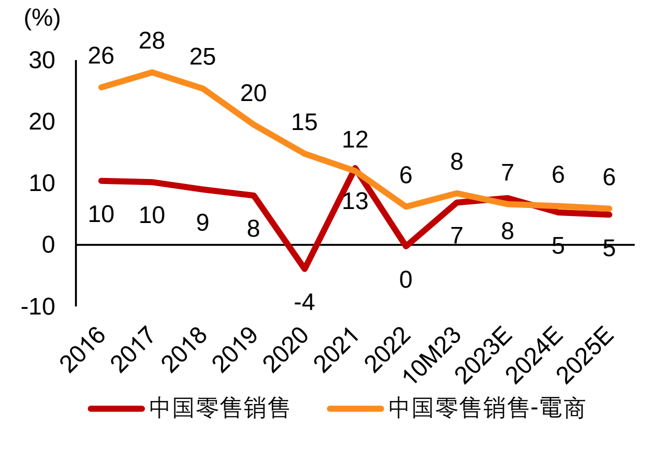
Expect further slowdown in economic growth to drag consumption, prefer exporters and high-dividend-yield plays

Although the consumer industry has rebounded in 2023, it is still significantly lower than expected

We estimate China's retail sales growth may rebound from 0% in 2022 to about 7% in 2023, mainly driven by the recovery of offline foot traffic, while e-commerce sales growth has only accelerated slightly due to a high base. Apart from the beginning of the year, where sales and earnings in Jan-Mar 2023 were boosted by the pent-up demand during the pandemic, numbers had started to fall below expectations after the 5-1 golden week. Since the middle of 2023, even though industrial profits and exports have started to improve, the wave of layoffs and unemployment and the negative wealth effect induced by the property price crash have adversely affected consumer confidence and purchasing power. Therefore, it had led to a not-as-robust Mid-Autumn and 10-1 holidays (vs 5-1) and a weakening trend in terms of sales recovery rate (vs 2019), and this could point to an even more pessimistic 2024.

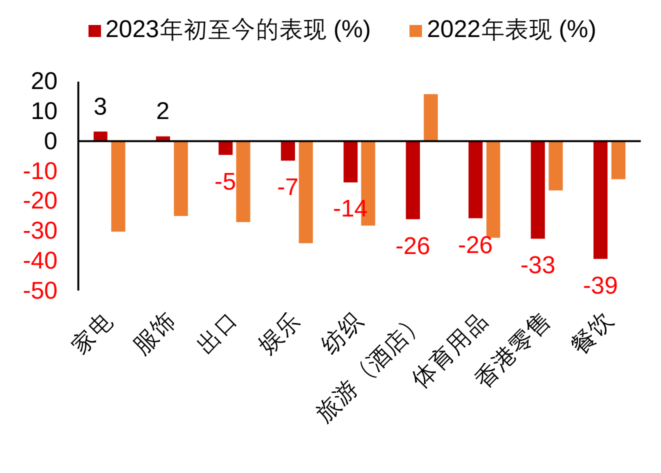
By sub-industry, sportswear, catering, HK retail, and tourism (hotels) have had the most drops in terms of share price performance YTD; the first three were due to consumption trade-down, where price wars ha led to drops in sales and GP margins (more discounts and promotion) while the last one was due to weaker-than-expected sales recovery (traffic and ASP). We also note that these sectors are generally higher in terms of valuation. In contrast, only home appliances and apparel sectors have achieved positive returns this year, thanks to the lower valuations and higher dividend yields, improved housing completion, better-than-expected air-conditioner and export sales, low industry inventory and strong post-pandemic demand, etc.

Figure 1: Growth rate of Chinese retail sales – offline and e-commerce



Source: NBS, CMBIGM estimates

Figure 2: Stock price performance YTD 2023 and in 2022, by industry



Source: Bloomberg, CMBIGM estimates

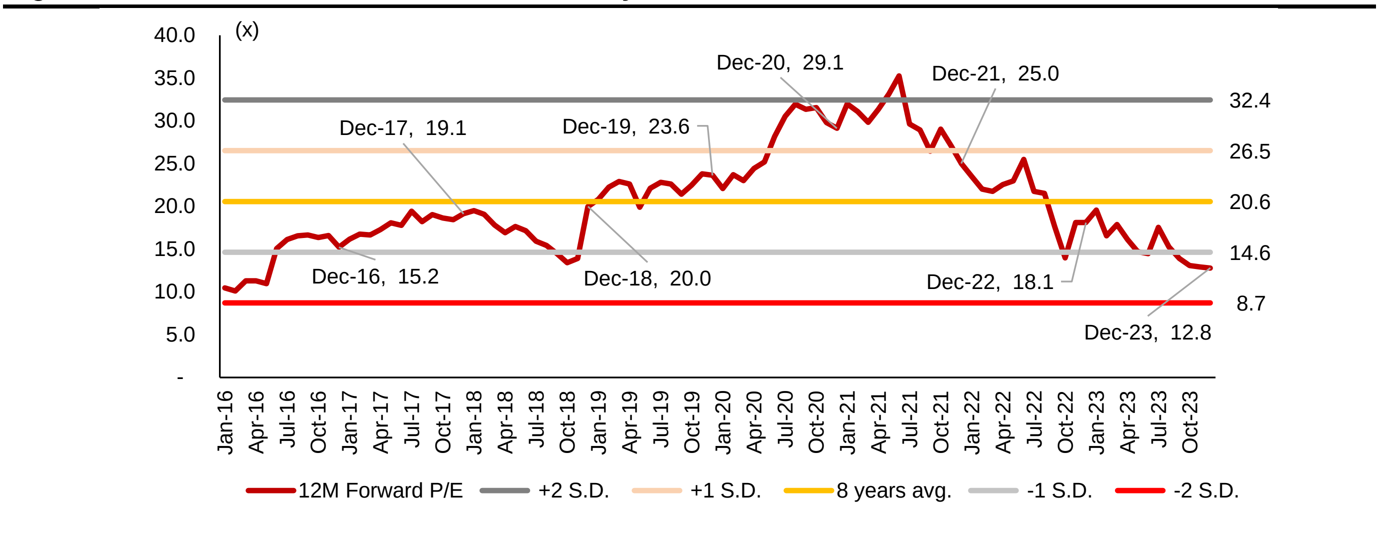
Valuation may continue to fall in the near term but may bottom out in the mid to long run

In terms of sector valuation, the forward 12-month PE had dropped from about 18x in 2022 to around 13x in 2023, mainly because of cuts in earnings forecasts, increases in interest costs, and risk premium.

Comparing to the 8-year average of 21x P/E, current valuation is certainly cheap (max and min are at around 33x and 10x), in our view. However, given the potential miss in fundamentals and geo-political uncertainty, the basis of investment might have already changed, and the entire PE band may need a downward shift.

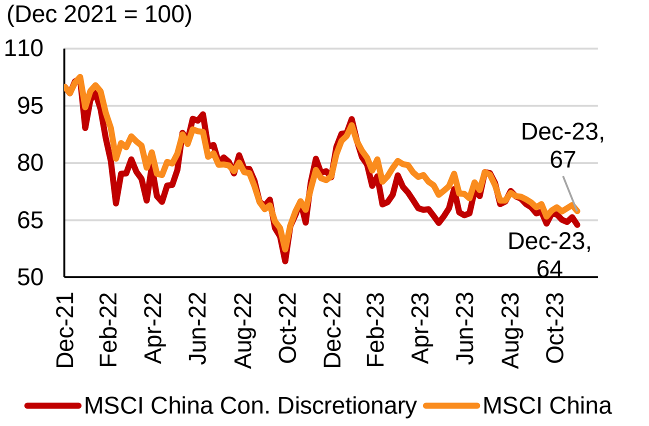
As we foresee a further drop in property prices and net capital outflow, we still see a downward pressure for the industry valuation in the short run (around six months); but thanks to the normalization of investors' expectations, we also expect it to reach the bottom of the cycle and turn around in terms of valuation in the mid to long run (a horizon of 12 months and beyond).

Figure 3: Valuation of the consumer discretionary sector



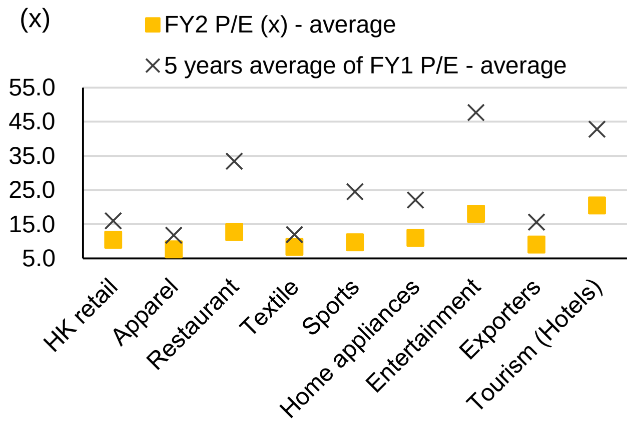
Source: Bloomberg, CMBIGM estimates

Figure 4: MSCI China vs MSCI China Consumer Discretionary



Source: Bloomberg, CMBIGM estimates

Figure 5: Industry valuation – current vs 5-year average



Source: Bloomberg, CMBIGM estimates

Our view for consumer discretionary sector in 2024E is market-perform

We are expecting 5% China retail sales growth in 2024E, driven by a further recovery in offline sales and foot traffic, and resumption of normal e-commerce sales growth. However, from the investors' point of view, we are still pessimistic. Because even if we assume the geo-political environment and the level of interest rate to remain constant, we feel the chance for China to face a further slowdown in economic growth is still high. Therefore, even with a relaxation in government policies and releases of more stimulus, it would still take time to transmit policy effects and for overall business and consumer confidence to restore. At the moment, based on the current job market, business environment and property prices, we still find those worrying and hence we do think the bottom of the fundamentals has yet to come.

In terms of Investment themes, we now prefer:

1) Consumption downgrade (we like brands that can "substitute" another with a cheaper price),

2) Recovery of overseas economies (we like companies that can leverage the supply chain superiority in China and sell to overseas customers),

3) Defensive plays (high certainty of sales and earnings plus an exceptionally high dividend yield).

In addition, aided by the late Chinese New Year (CNY) in 2024 (in Feb, about three weeks later than last year), the entire consumer sector should benefit from a longer peak season. However, for sporting goods and apparel, as we see a high chance of a warm winter during 2023 and 2024, the overall sales and outlook are still more negative than last year's.

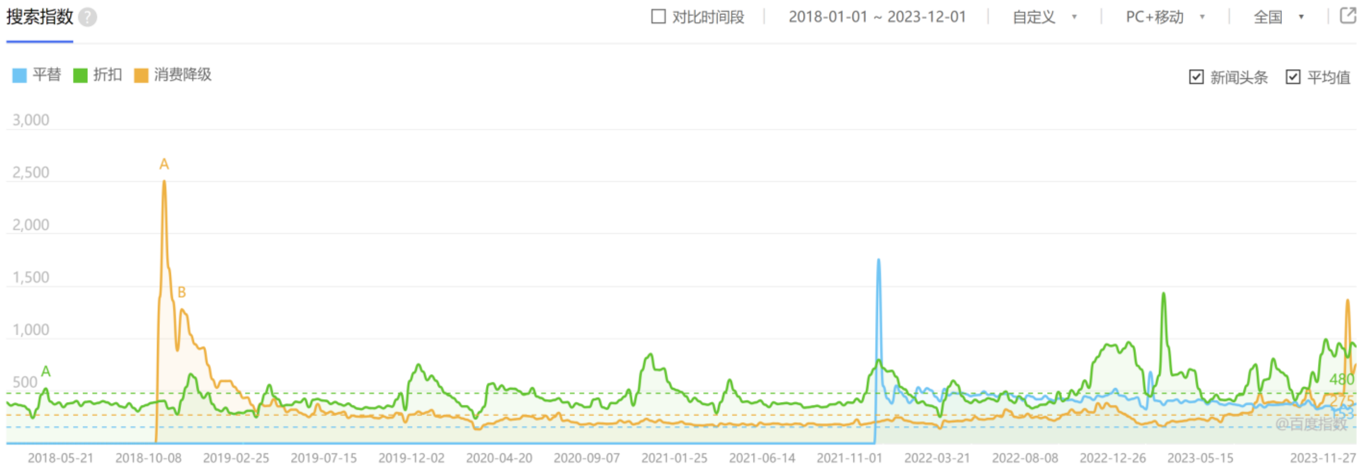
However, we do want to remind investors that, if the government policies change significantly, property prices stabilize and even rebound, and RMB appreciates again, we still promptly turn positive on catering, mid-range to high-end consumer names, tourism and HK retail etc., and we will continue to be positive on home appliances and apparel sectors.

1) Consumption downgrade (we like brands that can "substitute" another with a cheaper price)

Since the start of the pandemic in 2020, various industries were hit hard, including education, real estate, internet, finance and retail; plus the weaker-than-expected recovery in 2023 and falls in asset prices (stocks and properties), consumers have all become more rational and cost-conscious. According to Baidu Index, starting from 2022, the popularity of keywords such as "replacement", "discount" and "consumption downgrade" continues to rise. According to a consumer survey conducted by People's Daily Online in November 2023, during this year's Double 11 festival, 40% of consumers believed that their impulse consumption had decreased, and for some products, as long as the same functions are met, the one with a cheaper price is highly preferred. Therefore, when the industry growth further slows down and is more driven by market share gains, on top of changes in consumer behaviour, "substitution" has become the most effective way out.

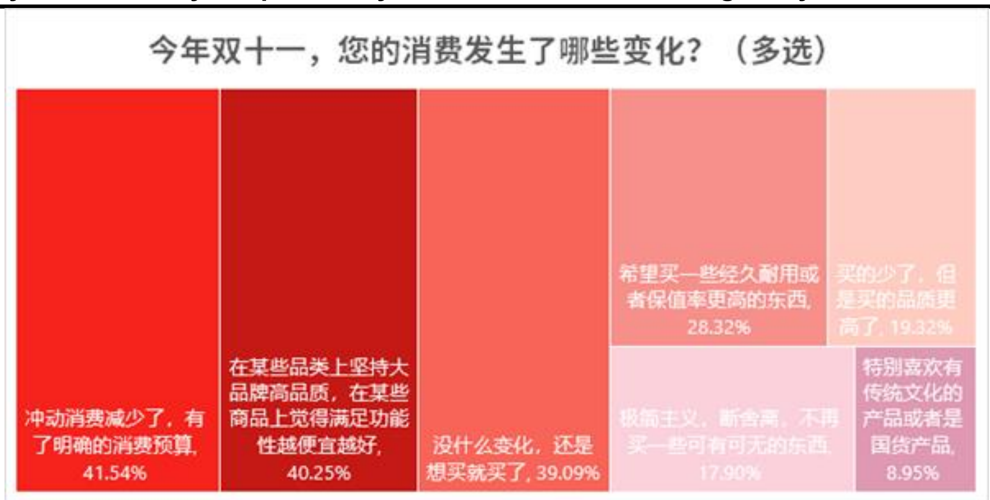
We recommend: ANTA (2020 HK, BUY), DPC Dash (1405 HK, BUY), Luckin Coffee (LKNCY US), Yum China (9987 HK, BUY), Midea (000333 CH, BUY), etc.

Figure 6: Baidu Index - popularity of keywords like "replacement", "discount" and "consumption downgrade"



Source: Baidu Index, CMBIGM

Figure 7: Survey conducted by People's Daily Online in Nov 2023, during this year's Double 11 festival



Source: People's Daily Online, CMBIGM

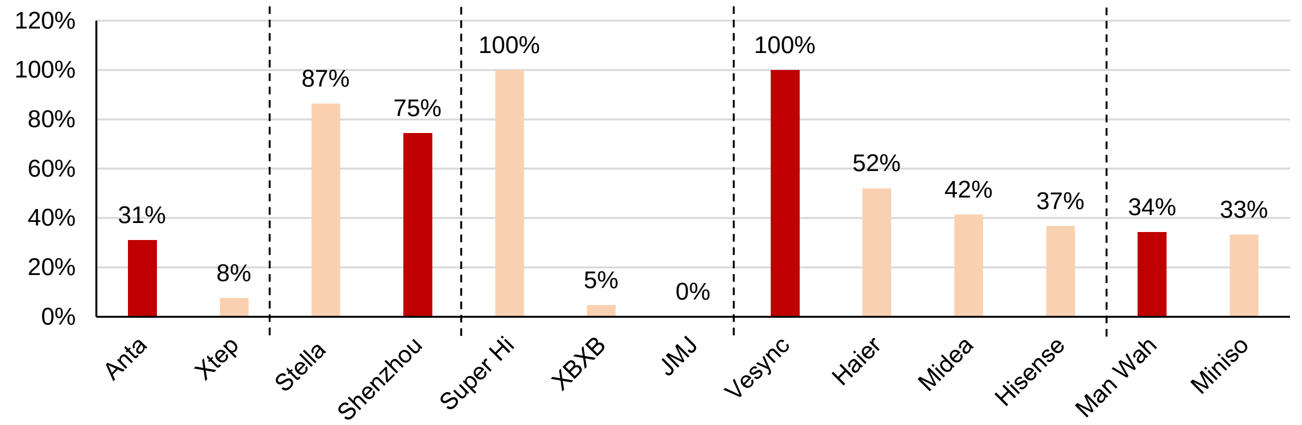
2) Recovery of overseas economies (we like companies that can leverage the supply chain superiority in China and sell to overseas customers)

Although economic growth in the EU is relatively weak, the recovery in the US is rather solid.

With the US dollar strengthening, shipping costs declining, overseas retail sales growth improving, and inventory levels peaking and starting to fall, we cautiously expect consumer brands to gradually shift from destocking to restocking, which will benefit companies owning overseas brands, manufacturing for, or exporting products to overseas brands.

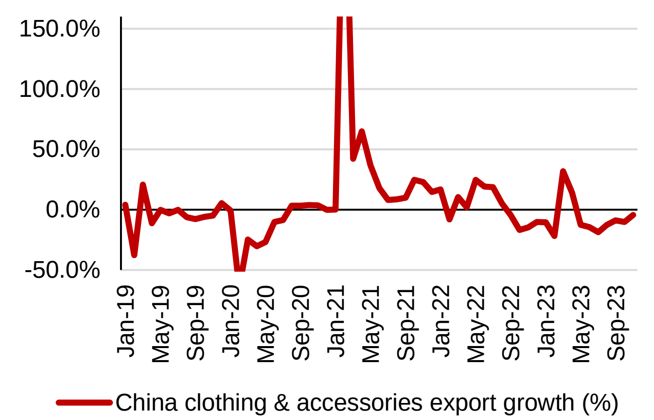
On top of the improvements in China's exports, Vietnam's figures are experiencing a similar trend. Therefore, we are optimistic about brands such as Vesync (2148 HK, BUY), Haier (6690 HK, BUY) and Anta (2020 HK, BUY; because of Amer Sports), and at the same time, we are optimistic about manufacturers such as Shenzhou (2313 HK), Stella (1836 HK), Man Wah (1999 HK), among others.

Figure 8: Share of overseas sales revenue in FY22 - by brand



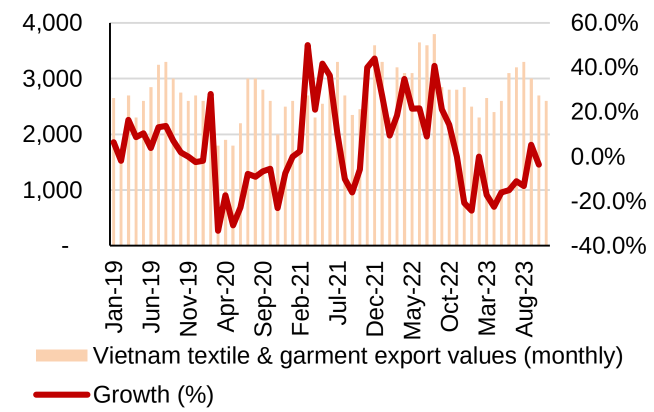
Source: Company data, CMBIGM

Figure 9: China clothing and accessories export growth



Source: NBS, CMBIGM

Figure 10: Vietnam textile and garment export value and growth



Source: General Statistics Office of Vietnam, CMBIGM

3) Defensive plays (high certainty of sales and earnings plus an exceptionally high dividend yield)

In the context of a high interest rate environment, stocks are less attractive and capital flows will naturally be fairly unfavorable.

Assuming that the US federal funds rate will remain at around 4-5%, we do agree that only the companies with high dividends can be attractive.

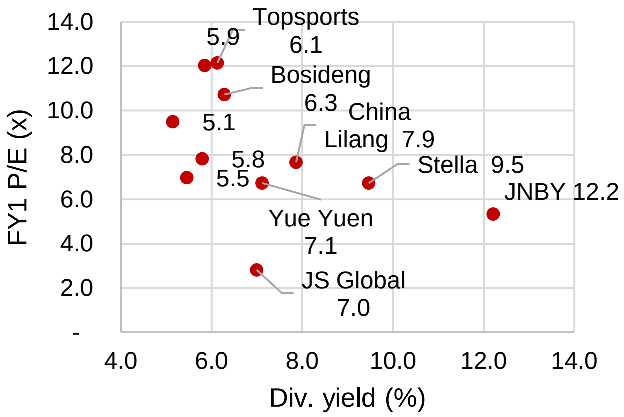
Therefore, after fulfilling the growth guidance (at least no miss in future sales and earnings), we now recommend: JNBY (3306, BUY), Stella (1836 HK, BUY), China Lilang (1234 HK, BUY), JS Global (1691 HK, BUY), Bosideng (3998 HK, BUY), Topsports (6110 HK, BUY) and Café de Coral (341 HK, BUY), etc.

Figure 11: Details of the high-dividend-yield names

Name (eng)	Ticker	Year End	FY2 Sales growth	FY2 NP growth	FY2 P/E	FY1 Div. yield
Topsports	6110 HK	Feb	12%	18%	12.2	6.1
Bosideng	3998 HK	Mar	14%	17%	10.7	6.3
Jnby Design	3306 HK	Jun	12%	15%	5.3	12.2
China Lilang	1234 HK	Dec	9%	12%	7.7	7.9
Cafe De Coral	341 HK	Mar	8%	33%	12.0	5.9
Js Global	1691 HK	Dec	10%	12%	2.8	7.0
Hisense Home	921 HK	Dec	9%	17%	7.0	5.5
Midea Group	000333 CH	Dec	8%	10%	9.5	5.1
Yue Yuen	551 HK	Dec	8%	48%	6.7	7.1
Stella	1836 HK	Dec	9%	12%	6.7	9.5
Man Wah	1999 HK	Mar	12%	14%	7.8	5.8

Source: Bloomberg, company data, CMBIGM estimates

Figure 12: FY1 P/E vs FY1 dividend yield



Source: Bloomberg, CMBIGM estimates

Outlook of sub-sectors in the consumer sector

Overall, for 2024E, among the all the sub-sectors, we prefer

1) Home appliance sector (Outperform)

Although the Chinese government has relaxed many property-related policies, we believe policy transmission will still take time. Moreover, if the real economy continues to be weak, we think both house prices and property sales are likely to drop further. In the long run, we still think the property industry could still be a drag or a hidden issue on the home appliances sector.

But in the short run, in 2024E, since we do expect housing completion to grow and reach a new high, and the majority of the demand are replacement demand, we forecast home appliances sales growth to be positive. But since consumers are now more rational and interested in value-for-money items, we do expect the ASP hike to be limited. As spending on small appliances is more at the consumer's own discretion, we think sales growth for small appliances in 2024E could be slower than that of large appliances.

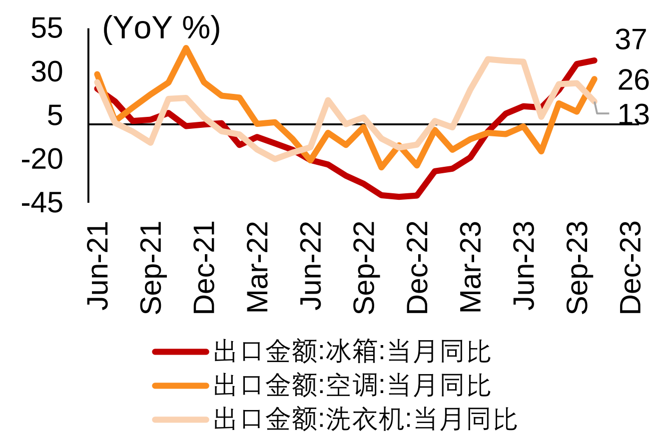
Benefiting from resilient US economic growth (slightly worse off for the EU), a strong US dollar, ending of the inventory de-stocking cycle, the massive drops in shipping costs and freight rates, we do foresee home appliances export sales growth to turn around and achieve accelerated growth in 2024E.

Top pick: Vesync (2148 HK, BUY)

Benefiting from 1) successful new product launches, 2) rapid offline expansion, penetration into EU and Japanese markets, the company is expected to deliver a 20% or above growth in 2024. In addition, due to 3) drops in shipping and raw material costs, 4) increases in ASP and more value engineering and 5) operating leverage, its net profit margin may exceed management's guidance.

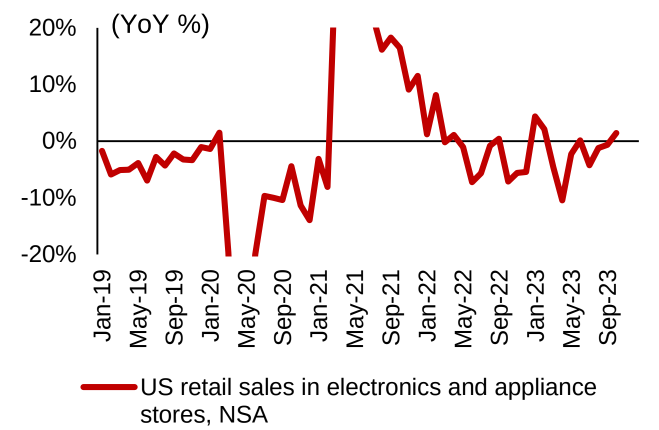
Focus list: JS Global (1691 HK, BUY), Hisense (921 HK), Haier (6690 HK, BUY), Midea (000333 CH, BUY), Roborock Technology (688169 CH), Ecovacs (603486 CH), Gree (000651 CH), Joyoung (002242 CH), Supor (002032 CH).

Figure 13: China large home appliances export sales growth



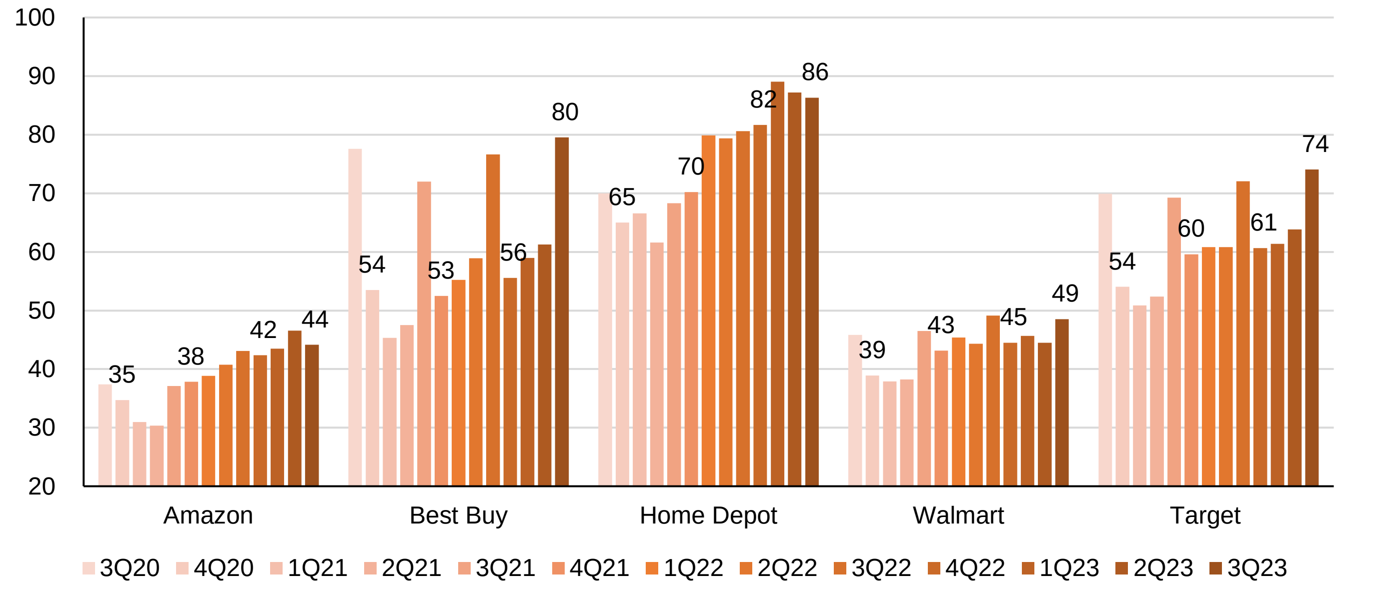
Source: Wind, CMBIGM

Figure 14: US retail sales growth in electronics and appliances stores



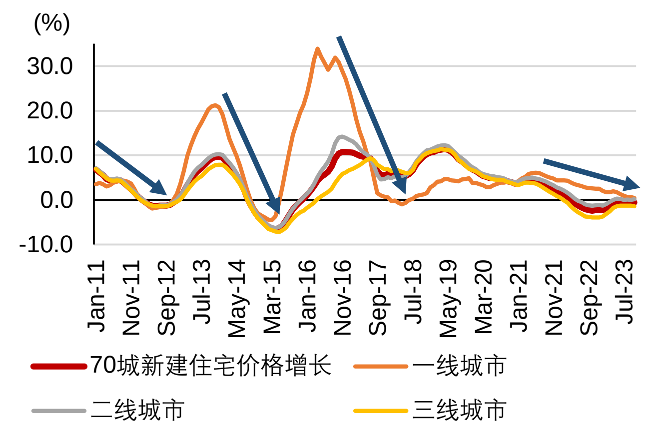
Source: Wind, CMBIGM

Figure 15: US retailers' inventory days



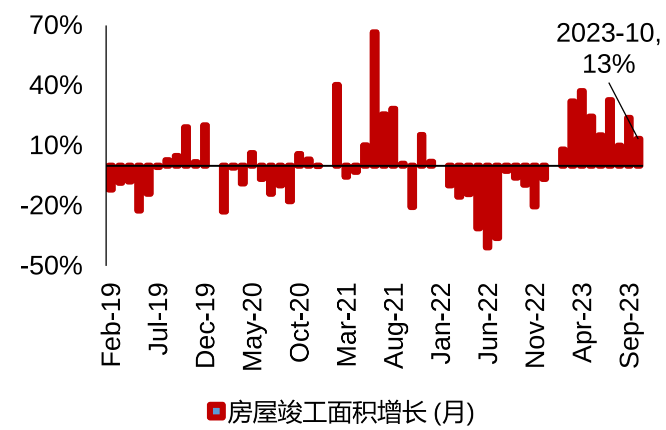
Source: Bloomberg, company data, CMBIGM

Figure 16: Changes in sales price of residential flats in top 70 large- to mid-sized cities in China (monthly)



Source: NBS, CMBIGM estimates

Figure 17: China property – housing completion growth



Source: Wind, CMBIGM estimates

2) Apparel sector (Outperform)

As the economy returns to normal after the pandemic, many social events are resumed, and consumers' demands for various kinds of clothing for different scenes are greatly stimulated. Moreover, as the brand building and marketing activities return, the interest in both menswear and womenswear has rebounded significantly. During Jan-Oct 2023, retail sales growth of the apparel industry in China was at 10.2%, slightly faster than that of the sportswear industry.

In 3Q23, despite a high base last year, retail sales for China Lilang and JNBY increased by more than 10% and 20%. Heading into 4Q23E and 2024E, even with the likely warmer winter vs last year, we still expect their retail sales growth and discounts to be relatively healthy because the inventories are not that high at all. We do prefer companies with a higher certainty of growth and particularly high dividend yields.

Top pick: JNBY (3306 HK, BUY)

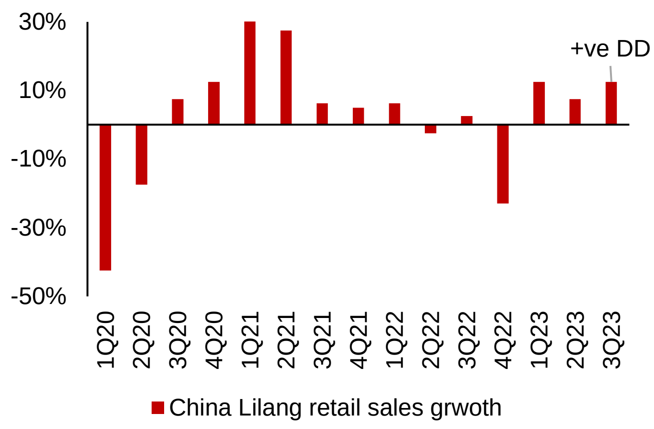
The company has been consistent in its long-term investment in its branding, products and store formats (no reductions even during the pandemic). Therefore, various upgrades in recent years, such as store renovation, optimization of customer services and interaction, as well as fans management and the strengthening of new retail channels and digitalization, have been achieved as planned. More importantly, the company is now offering a 12% forward yield. Also, since 2024 is the 30th anniversary of the company, we look forward to strong performance of the company in all aspects.

Focus list: Bosideng (3998 HK, BUY), China Lilang (1234 HK, BUY)

Figure 18: China retail sales & apparel sales growth

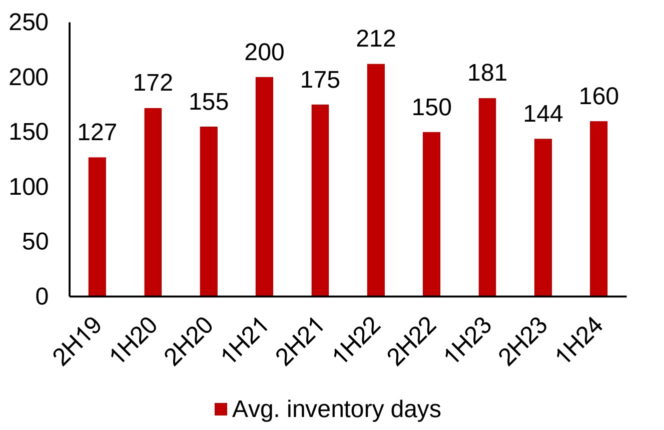
Source: NBS, CMBIGM

Figure 19: China Lilang retail sales growth



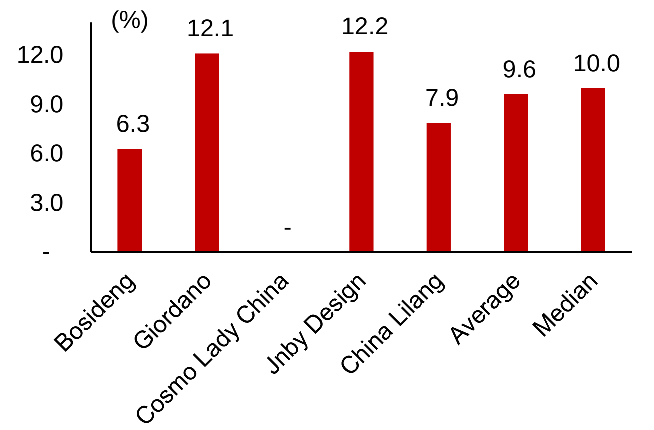
Source: Company data, CMBIGM estimates

Figure 20: Bosideng's inventory days



Source: Company data, CMBIGM estimates

Figure 21: FY1 dividend yield



Source: Bloomberg, CMBIGM estimates

3) Textile sector (Outperform)

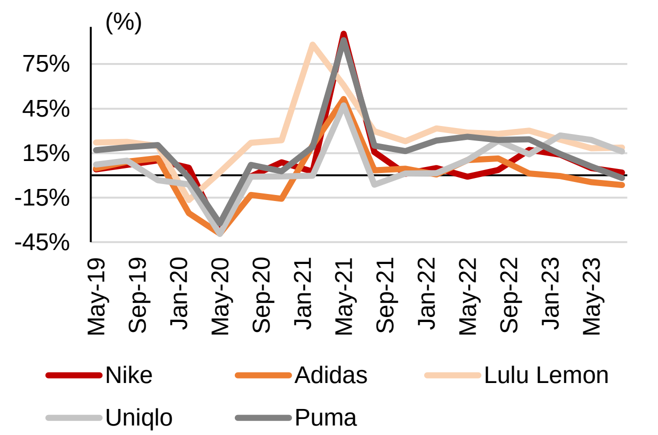
Although sales growth of overseas brands has slowed down QoQ, their inventory levels have peaked and been falling at a faster rate. It has been over a year since 3Q22, even though the level of inventory still has not returned to the level in 2019. We still expect the de-stocking cycle to end soon and perhaps in half a year's time and could eventually turn into a new round of re-stocking. As the sales growth re-accelerates in the future (our view is a bit more conservative, but the direction of a turnaround is still the same), we do expect the factory utilization to gradually go back up. Meanwhile, we are also positive on overseas brands (e.g. Nike and Adidas) and expect those to grow faster in 2024, once they have launched more new products and done more brand building activities.

Top pick: Shenzhou (2313 HK)

Referring to the performance of its Taiwan peers, we do expect Shenzhou's sales growth to resume in 4Q23E and to accelerate onwards, hence its utilization rate will continue to ramp up. Also, we believe its overseas factory expansion, orders from its new client and category expansion (to produce more types of products) will all drive better net profit growth in FY24E and FY25E.

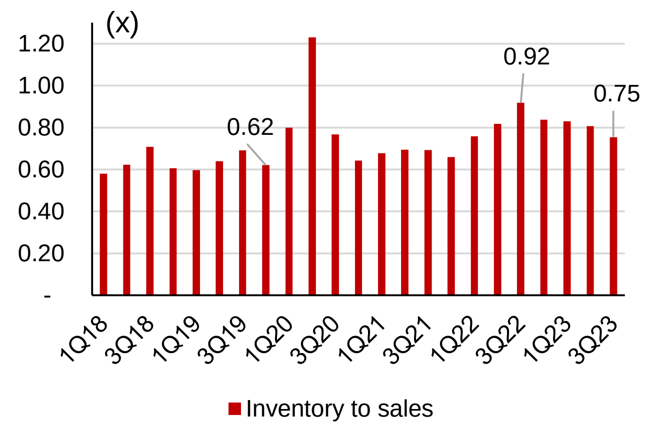
Focus list: Stella (1836 HK), Yue Yuen (551 HK), Huali Group (300979 CH).

Figure 22: Overseas sports and apparel brands' sales growth



Source: Company data, CMBIGM

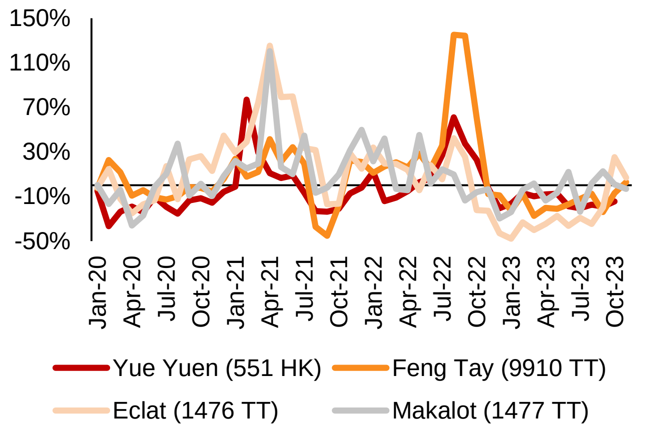
Figure 23: Overseas sports and apparel brands' average inventory to sales ratio*



Source: Company data, CMBIGM,

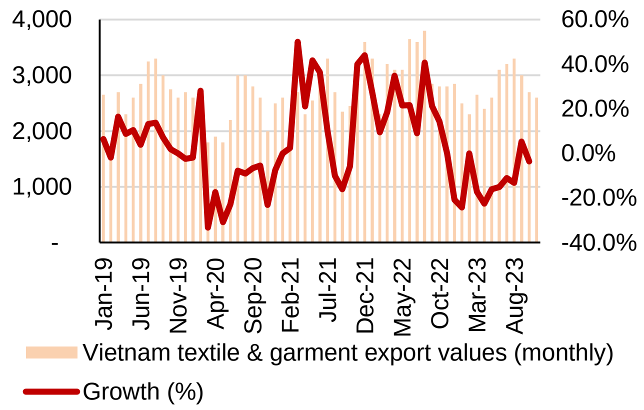
Note: *average of Nike, Adidas, Lulu Lemon, Uniqlo and Puma

Figure 24: Sports and apparel makers' sales growth



Source: Company data, CMBIGM

Figure 25: Vietnam textiles export sales and growth



Source: General Statistics Office of Vietnam, CMBIGM

We are **neutral** on the following sub-sectors:

4) Sportswear sector (Neutral)

In the long run, we still think the Chinese citizens' interest in sports will climb (i.e. the sports participation rate will catch up with the more developed regions).

But in the short run, even though retail sales growth will potentially speed up in 4Q23E (vs 3Q23) due to the low base last year, it could still be lower than market expectation. That is partly due to the declining purchase power and a warmer winter vs last year, and partly because of the rise in competition in the apparel space (more marketing by the apparel brands this year) and the drop in interest in "China-chic" products. Also, the YoY improvement of retail discounts has been lower than expected, due to greater-than-expected de-stocking demand (industry-wise).

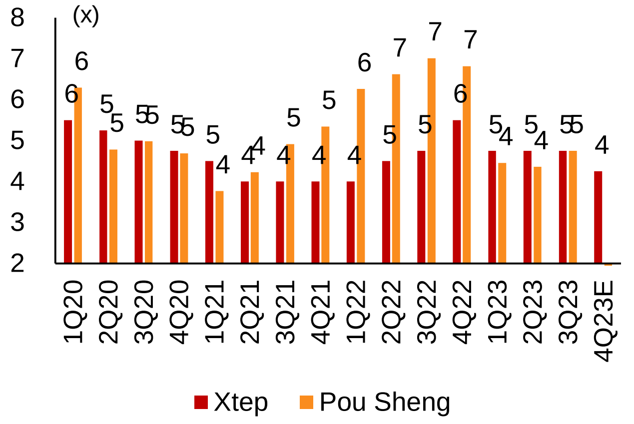
Therefore, as we head into 1Q24E, despite the help from a longer-than-last year's peak season (a late CNY in 2024), our view on retail sales growth and discount rates is still fairly conservative. In general, considering the downward revision of market expectations (investors' consensus on the industry sales growth in 2024E has been trimmed down to about 5% to 15%), the end of de-stocking, the upcoming Paris Olympics, we do not rule out a potential rebound in 2024E (after a rather sluggish 1Q24E).

Top pick: Anta (2020 HK, BUY)

Amid the highly intense industry competition, a multi-brand operation has provided Anta a certain degree of earnings stability. On top of the successful transformation of FILA in 2023, we are still looking forward to the reform of the Anta brand in 2024, and the potential listing of Amer sports (perhaps in the US) also being a potential catalyst.

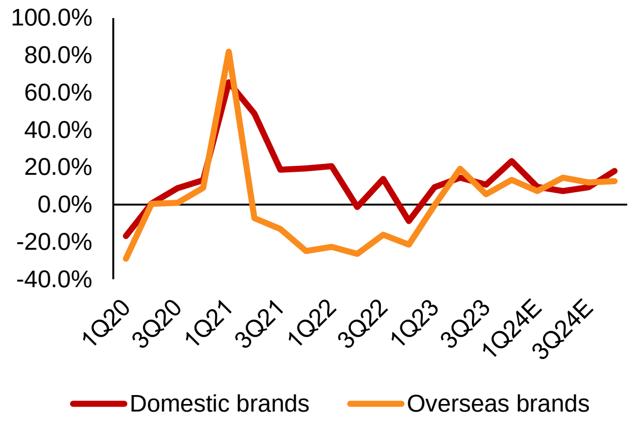
Focus list: Topsports (6110 HK, BUY), 361 Degrees (1361 HK), Xtep (1368 HK, BUY), Pousheng (3813 HK) and Li Ning (2331 HK, BUY).

Figure 26: Channel inventory to sales ratio – Xtep vs Pou Sheng



Source: Company data, CMBIGM

Figure 27: Retail sales growth – China domestic brands vs overseas brands



Source: Company data, CMBIGM

Note: China domestic brands – Li Ning, Anta, Xtep, and FILA; overseas brands – Nike China, Adidas China, and Pou Sheng

5) Tourism sector (Downgrade to neutral)

Benefiting from the suppressed tourism demand during the pandemic and the drop in overall hotel supply, RevPAR has strongly recovered in 2023 (mainly driven by the surge in ADR).

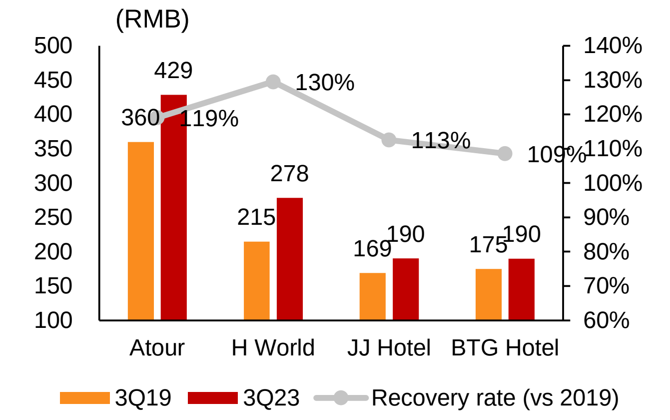
Considering the slower-than-expected economic recovery, more rational consumers, the weak trend of PMI, cannibalization from the normalization of overseas travel, and the increase in hotel supply, we only expect a mild increase in RevPAR recovery in 2024E.

While we think the growth rate of leisure travel is likely to slow down, the growth rate of business travel, in our view, could stay strong (even though consumption trade-down and cuts in business travel budgets will still be around), because business activities are still essential in order to generate more revenue during an economic downturn and the interaction with overseas should continue to ramp up.

We do prefer hotel groups with a midscale, upscale and economy-grade positioning.

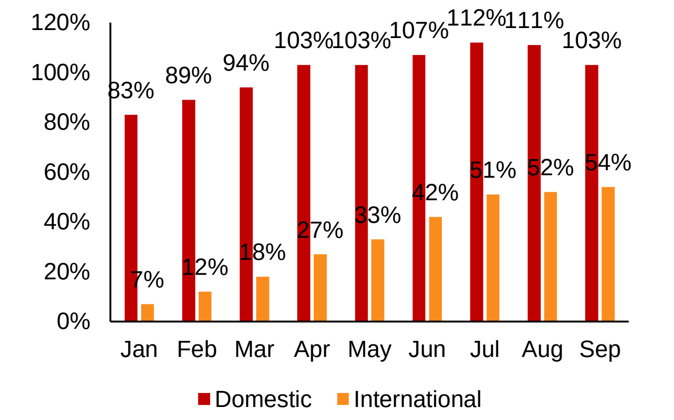
Focus list: H World (1179 HK), Jinjiang Hotels (600754 CH), BTG Hotels (600258 CH).

Figure 28: RevPAR recovery rate (3Q23 vs 3Q19) - by brand



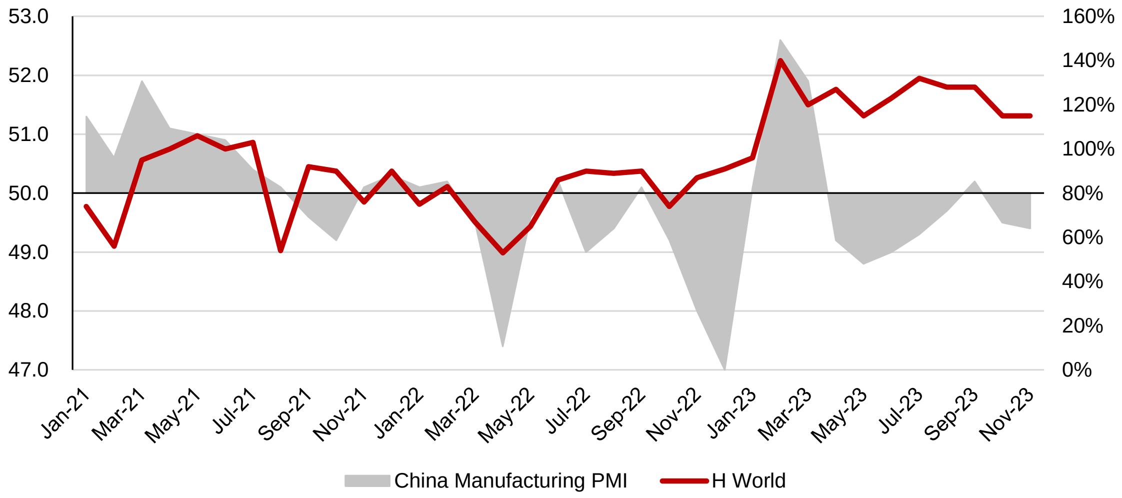
Source: Company data, CMBIGM

Figure 29: Air passenger recovery rate - by domestic and international flights (vs 2019)



Source: Company data, CMBIGM

Figure 30: China manufacturing PMI vs H World's RevPAR recovery rate (vs 2019)



Source: NBS, Company data, CMBIGM

6) Catering sector (Neutral)

Although catering sales rebounded sharply YoY, overall performance was much worse than expected, as we can see that the industry average recovery rate (vs 2019) actually declined QoQ in 3Q23 (except Haidilao). For one thing, the consumption trade-down is obvious, as job security drops and the negative wealth effect kicks in (hence people cooking at home may have increased). For another, many brands have arisen after the pandemic, esp. the low-end to mass-market brands such as Mr. Rice, Tustin, Luckin coffee, and MXBC, providing consumers with even more choices. Therefore, in such an extremely fragmented catering industry, we are seeing more price wars and various kinds of discounts and promotions coming in 2024E.

For the tea drink industry, we believe it has now become a red ocean (a robustly competitive market), as the number of shops peaks in tier-1 and new tier-1 cities and the lower-tier market becomes the major growth driver. Moreover, the performance between brands may start to diverge more. For the coffee industry, supported by its higher margin and lower penetration compared with other categories in China, a price war could still drive effective sales and certain net profit growth, in our view.

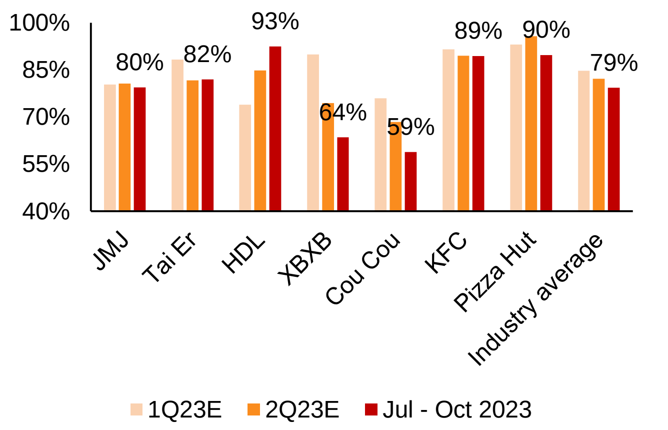
We are more positive on brands that can effectively take market share (by selling a better product with a similar price vs its competitors) and have ample room for store expansion.

Top pick: DPC Dash (1405 HK, BUY)

Given its highly competitive products (tastier and with great value), rapid food delivery growth, as well as its high growth potential in new markets, we are fairly optimistic on the companies' development in the near future. Moreover, since its market cap is still low (vs many other Domino's Pizza distributors all over the world), we believe the room for more surprises is there.

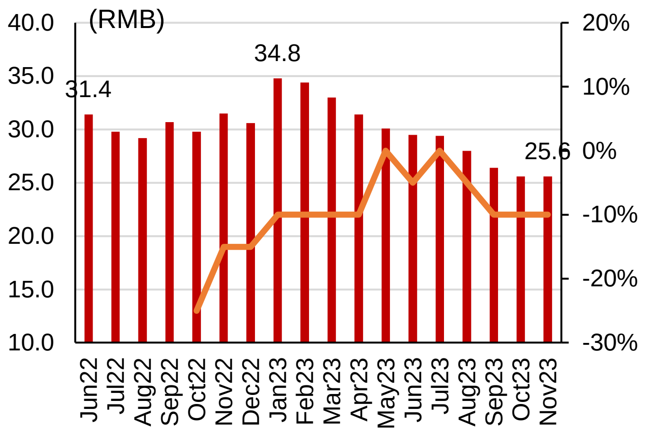
Focus list: Luckin Coffee (LKNCY US), Yum China (9987 HK, BUY), Haidilao (6862 HK, BUY), Jiumaojiu (9922 HK, BUY), Xiabu Xiabu (520 HK, BUY) and Helens (9869 HK).

Figure 31: Same-store sales recovery rate (vs 2019) - by brand



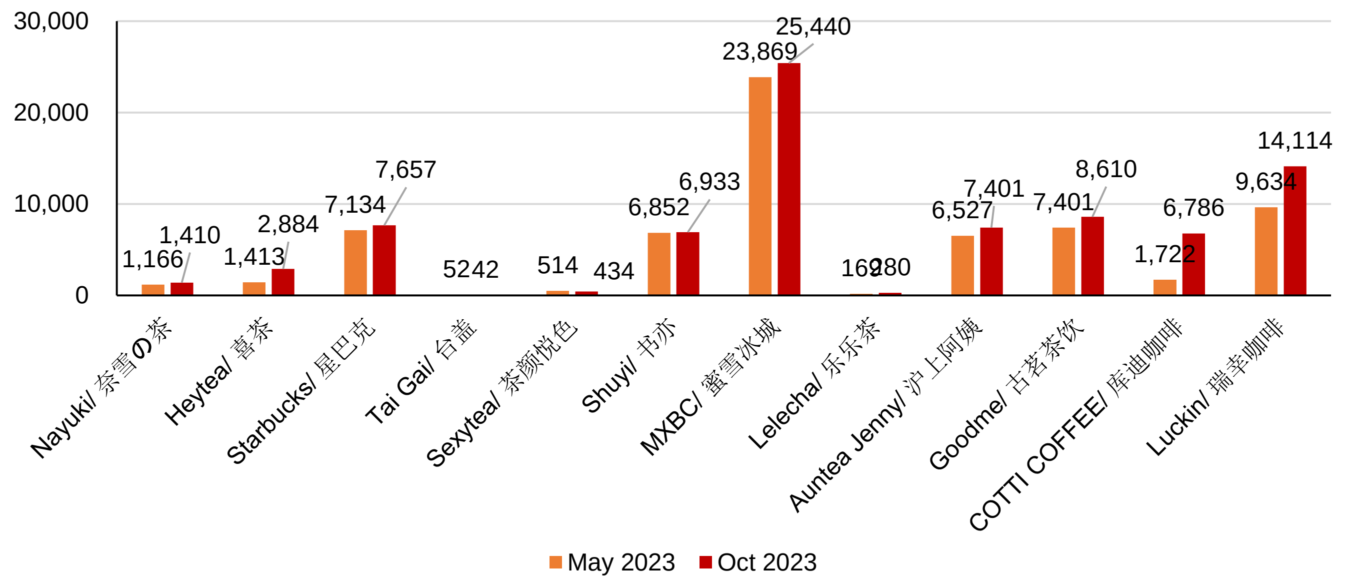
Source: Company data, CMBIGM

Figure 32: Nayuki's ASP and growth



Source: Company data, CMBIGM

Figure 33: Number of stores in China - by tea drink and coffee brands



Source: canyandata.com, CMBIGM

Peers' valuation

Figure 34: Peer's valuation – table 1

Company		Ticker	Price L.C.	Mkt cap HK$ mn	Rating	TP L.C.	Year End	PER (x) FY1	PER (x) FY2	EV/EBITDA (x) FY1	EV/EBITDA (x) FY2	PBR (x) FY1	PBR (x) FY2	Yield (%) FY1	Net gearing FY0	YTD performanc
Sports																
Anta Sports	安踏体育	2020 HK	74.20	210,181	BUY	109.99	Dec-22	19.5	16.3	10.2	8.6	4.4	3.7	2.3	(23.2)	(27.5)
Li Ning	李宁	2331 HK	19.06	50,038	BUY	32.93	Dec-22	12.1	10.1	6.4	4.9	1.7	1.5	3.1	(21.3)	(71.9)
Xtep	特步国际	1368 HK	4.51	11,913	BUY	8.58	Dec-22	10.1	8.3	5.2	4.3	1.2	1.1	5.0	(15.2)	(48.1)
361 Degrees	３６１度	1361 HK	3.35	6,927	-	-	Dec-22	6.8	5.7	0.7	0.1	0.7	0.6	4.3	(58.9)	0.6
Topsports	滔搏	6110 HK	5.92	36,711	BUY	9.23	Feb-23	14.1	11.9	6.6	6.0	3.2	2.9	6.2	18.6	(2.1)
Pou Sheng	宝胜国际	3813 HK	0.67	3,569	-	-	Dec-22	7.4	4.8	0.6	0.4	0.4	0.4	3.7	18.1	(10.7)
China Dongxiang	中国动向	3818 HK	0.24	1,395	-	-	Mar-23	10.9	7.3	n/a	n/a	0.1	0.1	9.2	(43.5)	(21.1)
Average								**11.5**	**9.2**	**5.0**	**4.1**	**1.7**	**1.5**	**4.8**	**(17.9)**	**(25.8)**
Median								**10.9**	**8.3**	**5.8**	**4.6**	**1.2**	**1.1**	**4.3**	**(21.3)**	**(21.1)**
Apparel																
Bosideng	波司登	3998 HK	3.39	36,971	BUY	3.86	Mar-23	13.2	11.2	7.5	6.4	2.5	2.2	6.1	(47.0)	(8.6)
Giordano	佐丹奴国际	709 HK	2.51	4,049	-	-	Dec-22	10.7	9.7	4.2	3.8	1.8	1.8	12.7	(13.3)	45.1
Esprit	思捷环球	330 HK	0.34	962	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.9	(59.5)
Cosmo Lady China	都市丽人	2298 HK	0.25	556	-	-	Dec-22	5.7	3.8	n/a	n/a	0.3	0.2	n/a	16.1	22.9
Jnby Design	江南布衣	3306 HK	9.53	4,944	BUY	14.26	Jun-23	6.1	5.4	3.0	2.5	2.0	1.8	12.2	(24.4)	2.1
China Lilang	中国利郎	1234 HK	4.10	4,910	BUY	4.73	Dec-22	8.6	7.6	n/a	n/a	1.1	1.1	8.0	(10.4)	11.8
Lachapelle	拉夏贝尔	6116 HK	0.25	137	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(2.0)
Average								**8.8**	**7.5**	**4.9**	**4.2**	**1.5**	**1.4**	**9.7**	**(13.0)**	**1.7**
Median								**8.6**	**7.6**	**4.2**	**3.8**	**1.8**	**1.8**	**10.1**	**(11.8)**	**2.1**
Restaurant																
Haidilao	海底捞	6862 HK	14.34	79,931	BUY	24.76	Dec-22	16.3	14.2	7.9	6.4	6.5	4.7	1.5	37.8	(36.0)
Jiumaojiu	九毛九	9922 HK	6.59	9,467	BUY	15.46	Dec-22	16.2	10.3	5.9	4.1	2.4	2.0	1.3	18.5	(68.4)
Nayuki	奈雪的茶	2150 HK	3.18	5,454	BUY	7.53	Dec-22	24.6	11.1	4.2	3.4	1.0	0.9	0.6	0.7	(57.8)
Xiabuxiabu	呷哺呷哺	520 HK	2.64	2,868	BUY	4.89	Dec-22	22.3	9.0	3.2	2.9	1.7	1.6	2.1	58.8	(70.1)
Helens	海伦司	9869 HK	4.23	5,359	-	-	Dec-22	15.9	12.7	7.7	5.3	2.3	2.0	1.3	(19.5)	(71.0)
Super Hi	特海国际	9658 HK	11.04	6,837	-	-	Dec-22	35.4	12.3	6.1	3.7	3.4	2.8	0.0	61.3	11.1
Dpc Dash	Dpc Dash	1405 HK	59.45	7,730	BUY	75.51	Dec-22	n/a	n/a	n/a	n/a	8.2	8.4	n/a	64.5	n/a
Cafe De Coral	大家乐集团	341 HK	9.11	5,336	BUY	14.82	Mar-23	15.8	11.2	7.4	6.5	1.8	1.8	6.3	56.5	(38.9)
Tam Jai	谭仔国际	2217 HK	1.21	1,623	-	-	Mar-23	11.0	9.0	0.4	0.4	1.0	1.0	5.4	(38.1)	(54.0)
Tai Hing	太兴集团	6811 HK	0.78	784	-	-	Dec-22	7.8	6.0	n/a	n/a	78.0	78.0	10.0	86.5	(35.5)
Fairwood	大快活集团	52 HK	9.42	1,220	-	-	Mar-23	n/a	n/a	n/a	n/a	n/a	n/a	n/a	71.0	(32.1)
Ajisen China	味千（中国）	538 HK	0.91	993	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(32.9)	9.6
Tsui Wah	翠华控股	1314 HK	0.19	262	-	-	Mar-23	n/a	n/a	n/a	n/a	n/a	n/a	n/a	27.2	(34.0)
Yihai	颐海国际	1579 HK	11.46	11,881	-	-	Dec-22	12.1	10.7	6.4	5.4	2.1	1.8	2.4	(52.9)	(58.0)
Yum China	百胜中国	9987 HK	310.80	126,842	BUY	435.82	Dec-22	20.4	17.6	10.9	9.6	2.4	2.2	1.3	(10.5)	(29.2)
Yum China	百胜中国	YUMC US	39.92	127,162	BUY	78.66	Dec-22	20.4	17.6	10.9	9.6	2.4	2.2	1.3	(10.5)	(27.0)
Average								**18.2**	**11.8**	**6.4**	**5.2**	**8.7**	**8.4**	**2.8**	**19.9**	**(39.4)**
Median								**16.3**	**11.1**	**6.4**	**5.3**	**2.4**	**2.0**	**1.4**	**22.8**	**(36.0)**
Home appliances																
Haier Smart Home	海尔智家	6690 HK	21.15	205,018	BUY	26.34	Dec-22	10.9	9.6	6.0	5.0	1.7	1.5	3.6	(1.5)	(20.5)
Js Global Lifestyle	Js环球生活	1691 HK	1.40	4,864	BUY	1.84	Dec-22	2.4	3.3	1.8	1.4	0.4	0.4	6.1	20.3	(6.8)
Vesync	Vesync Co Ltd	2148 HK	5.14	5,977	BUY	6.71	Dec-22	11.8	9.5	n/a	n/a	2.3	1.9	1.7	(26.3)	6.4
Hisense Home	海信家电	921 HK	17.10	29,074	-	-	Dec-22	7.3	6.4	n/a	n/a	1.6	1.3	6.0	19.3	98.6
Midea Group	美的集团	000333 CH	51.28	391,735	BUY	66.70	Dec-22	10.6	9.6	8.5	7.1	2.2	2.0	5.1	1.1	(1.0)
Gree Electric	格力电器	000651 CH	33.19	203,297	-	-	Dec-22	7.0	6.4	5.1	4.4	1.6	1.4	7.2	8.0	2.7
Haier Smart Home	海尔智家	600690 CH	20.70	205,018	-	-	Dec-22	11.6	10.2	5.9	4.8	1.9	1.6	3.0	(1.5)	(15.4)
Joyoung	九阳股份	002242 CH	13.21	11,021	-	-	Dec-22	17.9	15.4	14.0	11.9	2.9	2.8	4.5	(2.6)	(19.8)
Sharkninja	Sharkninja	SN US	47.65	51,716	-	-	Dec-22	15.2	14.4	n/a	n/a	n/a	n/a	n/a	16.7	n/a
Zhejiang Supor	苏泊尔	002032 CH	53.65	47,075	-	-	Dec-22	19.7	17.6	17.2	15.4	6.1	5.5	3.8	(39.6)	8.5
Ecovacs Robotics	科沃斯	603486 CH	40.35	25,299	-	-	Dec-22	21.4	15.8	14.9	10.4	3.3	2.8	1.7	(55.0)	(44.7)
Beijing Roborock	石头世纪科技	688169 CH	267.61	38,270	-	-	Dec-22	18.8	15.9	15.1	12.5	3.1	2.6	0.8	(57.7)	51.2
Hangzhou Robam	老板电器	002508 CH	22.11	22,823	-	-	Dec-22	11.2	10.0	7.1	6.0	1.9	1.7	2.9	(68.6)	(20.4)
Average								**12.7**	**11.1**	**9.6**	**7.9**	**2.4**	**2.1**	**3.9**	**(14.4)**	**3.2**
Median								**11.6**	**10.0**	**7.8**	**6.6**	**2.1**	**1.8**	**3.7**	**(1.5)**	**(3.9)**
Hotels																
H World Group Ltd	华住酒店	HTHT US	34.43	85,665	-	-	Dec-22	20.6	18.6	11.5	9.6	6.5	5.1	1.0	437.5	(18.8)
Shanghai Jinjiang	锦江国际酒店	600754 CH	31.59	33,032	-	-	Dec-22	27.8	19.2	11.0	8.5	1.9	1.8	1.6	86.7	(45.9)
Btg Hotels Group	首旅酒店	600258 CH	16.93	20,574	-	-	Dec-22	24.3	18.8	7.5	6.5	1.7	1.6	0.8	79.8	(31.7)
Ssaw Hotels	君亭酒店	301073 CH	23.39	4,947	-	-	Dec-22	84.7	32.8	n/a	n/a	4.1	3.7	1.0	22.6	(50.0)
Greentree Hospitality	格林酒店	GHG US	3.59	2,863	-	-	Dec-22	8.5	8.6	n/a	n/a	1.6	1.5	1.7	80.4	(3.2)
Average								**31.8**	**19.3**	**10.8**	**8.7**	**4.1**	**3.3**	**1.1**	**125.6**	**(26.2)**
Median								**24.4**	**18.7**	**11.2**	**9.1**	**3.0**	**2.7**	**1.0**	**80.1**	**(25.3)**

Source: Bloomberg, CMBIGM

Figure 35: Peer's valuation – table 2

Company		Ticker	Price L.C.	Mkt cap HK$ mn	Rating	TP L.C.	Year End	PER (x) FY1	PER (x) FY2	EV/EBITDA (x) FY1	EV/EBITDA (x) FY2	PBR (x) FY1	PBR (x) FY2	Yield (%) FY1	Net gearing FY0	YTD performanc
HK retail																
Chow Tai Fook	周大福	1929 HK	10.72	107,127	-	-	Mar-23	13.7	11.9	9.3	8.2	3.2	2.8	5.5	31.1	(28.9)
Luk Fook	六福集团	590 HK	21.50	12,623	-	-	Mar-23	7.0	6.2	3.9	3.2	0.9	0.9	6.4	(12.2)	(7.3)
Chow Sang Sang	周生生	116 HK	9.04	6,124	-	-	Dec-22	5.5	4.8	4.6	4.0	0.5	0.5	7.8	32.7	(12.6)
HK Technology Venture	香港科技探索	1137 HK	2.59	2,324	-	-	Dec-22	n/a	17.3	7.3	5.3	1.0	1.0	0.0	(6.9)	(51.8)
Sa Sa	莎莎国际	178 HK	1.01	3,134	-	-	Mar-23	15.1	8.9	7.5	6.3	2.5	2.3	4.8	28.1	(44.5)
Cafe De Coral	大家乐集团	341 HK	9.11	5,336	BUY	14.82	Mar-23	15.8	11.2	7.4	6.5	1.8	1.8	6.3	56.5	(38.9)
Wharf Real Estate Inves	九龙仓置业	1997 HK	25.20	76,513	-	-	Dec-22	12.0	10.5	12.1	11.1	0.4	0.4	5.4	23.2	(44.6)
Average								**11.5**	**10.1**	**7.4**	**6.4**	**1.5**	**1.4**	**5.2**	**21.8**	**(32.6)**
Median								**12.9**	**10.5**	**7.4**	**6.3**	**1.0**	**1.0**	**5.5**	**28.1**	**(38.9)**
Textile																
Shenzhou	申洲国际	2313 HK	77.65	116,725	-	-	Dec-22	23.2	18.7	16.7	13.2	3.2	3.0	2.5	(14.3)	(11.6)
Crystal	晶苑国际	2232 HK	2.87	8,188	-	-	Dec-22	6.2	5.7	2.4	1.9	0.7	0.7	5.2	(24.0)	18.1
Huali	中山华利实业集	300979 CH	49.12	62,350	-	-	Dec-22	18.1	15.4	11.5	9.9	3.8	3.2	2.4	(35.7)	(14.0)
Regina Miracle	维珍妮	2199 HK	2.08	2,546	-	-	Mar-23	6.9	4.9	n/a	n/a	0.7	0.6	5.1	97.1	(42.7)
Pacific Textiles	互太纺织	1382 HK	1.28	1,796	-	-	Mar-23	6.0	4.8	3.9	3.0	0.6	0.6	13.5	4.3	(50.0)
Nameson	南旋控股	1982 HK	0.50	1,140	-	-	Mar-23	n/a	n/a	n/a	n/a	n/a	n/a	n/a	15.2	2.0
Best Pacific	超盈国际控股	2111 HK	1.04	1,081	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	36.4	(11.1)
Texwinca	德永佳集团	321 HK	1.01	1,396	-	-	Mar-23	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(21.5)	(19.2)
Win Hanverky	永嘉集团	3322 HK	0.13	166	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	37.4	(46.0)
Eagle Nice	鹰美	2368 HK	4.28	2,285	-	-	Mar-23	n/a	n/a	n/a	n/a	n/a	n/a	n/a	7.0	7.1
Texhong	天虹国际集团有	2678 HK	4.89	4,489	-	-	Dec-22	n/a	5.2	n/a	n/a	0.4	0.4	0.3	64.4	(21.8)
Yue Yuen	裕元集团	551 HK	8.66	13,962	-	-	Dec-22	9.5	6.5	3.4	2.6	0.4	0.4	7.4	14.8	(21.0)
Stella	九兴控股	1836 HK	9.65	7,673	-	-	Dec-22	7.6	6.8	3.9	3.4	0.9	0.9	9.4	(18.8)	31.3
Average								**11.1**	**8.5**	**7.0**	**5.7**	**1.4**	**1.2**	**5.7**	**12.5**	**(13.7)**
Median								**7.6**	**6.1**	**3.9**	**3.2**	**0.7**	**0.7**	**5.2**	**7.0**	**(14.0)**
Entertainment																
Imax China	Imax China	1970 HK	6.85	2,326	-	-	Dec-22	8.8	6.8	n/a	n/a	1.2	1.0	5.7	(26.6)	(2.8)
Television Broadcasts	电视广播	511 HK	3.15	1,380	-	-	Dec-22	n/a	n/a	n/a	20.3	0.5	0.5	31.7	32.4	(14.6)
Maoyan Entertainment	猫眼娱乐	1896 HK	9.03	10,355	-	-	Dec-22	11.1	9.2	5.7	4.0	1.1	1.0	0.0	(17.0)	0.2
Alibaba Pictures	阿里影业	1060 HK	0.50	14,744	-	-	Mar-23	17.7	13.9	15.4	9.6	0.9	0.8	n/a	(26.7)	(12.3)
Maoyan Entertainment	猫眼娱乐	1896 HK	9.03	10,355	-	-	Dec-22	11.1	9.2	5.7	4.0	1.1	1.0	0.0	(17.0)	0.2
Huace Film & Tv	浙江华策影视股	300133 CH	7.05	14,578	-	-	Dec-22	27.1	22.0	15.1	11.3	1.8	1.7	0.4	(55.3)	32.3
Ciwen Media	慈文传媒股份有	002343 CH	7.92	4,091	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(29.4)	21.7
Strawbear Entertainmen	稻草熊娱乐	2125 HK	0.48	333	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	4.0	(53.4)
Beijing Enlight Media	北京光线传媒股	300251 CH	8.50	27,122	-	-	Dec-22	38.3	24.4	36.7	23.7	2.8	2.5	0.8	(22.3)	(1.8)
China Film	中国电影股份有	600977 CH	13.10	26,603	-	-	Dec-22	27.3	22.6	n/a	n/a	2.1	1.9	0.5	(48.8)	(3.7)
Huayi Brothers Media	华谊兄弟传媒股	300027 CH	2.93	8,842	-	-	Dec-22	122.1	34.5	n/a	n/a	5.1	4.4	0.0	124.5	5.4
Bilibili Inc	哔哩哔哩	BILI US	12.22	40,180	-	-	Dec-22	n/a	n/a	n/a	39.6	2.8	2.9	0.0	3.3	(48.4)
Iqiyi Inc	爱奇艺	IQ US	4.57	34,111	-	-	Dec-22	15.1	11.6	9.5	7.3	3.2	2.5	0.0	219.4	(13.8)
Mango Excellent Media	芒果超媒股份有	300413 CH	29.95	60,901	-	-	Dec-22	25.8	21.5	6.6	5.6	2.7	2.4	0.5	(50.4)	(0.2)
Average								**30.4**	**17.6**	**13.5**	**13.9**	**2.1**	**1.9**	**3.6**	**6.4**	**(6.5)**
Median								**21.7**	**17.7**	**9.5**	**9.6**	**2.0**	**1.8**	**0.4**	**(19.7)**	**(2.3)**
Exporters																
Man Wah	敏华控股	1999 HK	5.07	19,807	-	-	Mar-23	8.6	7.7	5.6	5.0	1.5	1.3	5.9	2.5	(34.7)
Goodbaby	好孩子国际	1086 HK	0.60	1,001	-	-	Dec-22	8.6	4.0	n/a	n/a	0.2	0.2	n/a	48.7	(4.8)
Dream	德林国际	1126 HK	3.90	2,640	-	-	Dec-22	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(15.7)	40.3
Vtech	Vtech Holdings	303 HK	43.40	10,975	-	-	Mar-23	8.6	7.9	n/a	n/a	n/a	n/a	11.2	(2.9)	(13.7)
Techtronic	创科实业	669 HK	78.45	143,902	-	-	Dec-22	19.0	15.9	12.5	10.5	3.2	3.1	2.2	46.4	(9.9)
Average								**11.2**	**8.9**	**9.0**	**7.7**	**1.6**	**1.5**	**6.4**	**15.8**	**(4.6)**
Median								**8.6**	**7.8**	**9.0**	**7.7**	**1.5**	**1.3**	**5.9**	**2.5**	**(9.9)**

Source: Bloomberg, CMBIGM

China Automobiles

OUTPERFORM

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2024 Outlook: Competition pushes technological advancement, overseas expansion

After a strong sales beat in 2023, we expect China's passenger-vehicle (PV) sales growth to be moderate in 2024E. While it is still difficult to identify long-term winner in China's auto industry, competition, overseas expansion and technological advancement would still be the key topics for 2024.

Exports, Chinese brands' share gain and competition still key topics
We project China's PV retail sales volume to decline 1.6% YoY in 2024E and wholesale volume to rise 2% YoY amid 25% YoY growth from exports. We have accessed Chinese brands' penetration in different countries and estimate there could be 70% growth room for the next few years. We expect Chinese brands to continue gaining market share in both NEV and ICE segments in 2024E given their strong model pipeline. Traditional luxury brands could face more challenges from NEVs.

Exports to expand sales, technological advancement to mitigate price-war dent, as NEVs to reign vehicles priced RMB 150-350k in 2024
We project China's NEV retail sales volume to rise 21% YoY to 8.9mn units and wholesale volume to rise 24% YoY to 11mn units in 2024E. We estimate NEVs to take up more than 50% of total PVs sold with RMB 150,000-350,000 in 2024E, aided by a plethora of new competitive models. Outside China, about 19% of total NEV sales volume were exported from China YTD. Europe is likely to be the next destination for Chinese NEV makers. As competition continues to rise with less differentiated exterior design and more flexible chassis design, technology advancement is crucial to increase pricing power.

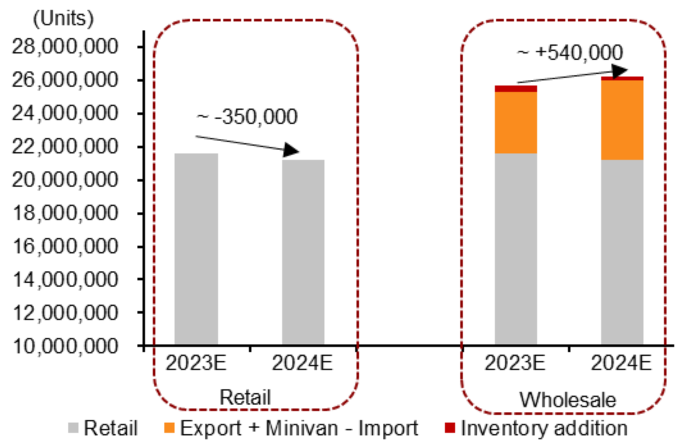
Dilemma between competition and long-term market share gain for Chinese brands makes range trading a good option
Although Chinese OEM peer group outperformed the benchmark YTD, the huge share-price volatility makes market timing more important than stock selection in trading. Investors' sentiment has been shifting between market share gain from foreign brands and competition to result in sales and margin miss. We believe such sentiment shift will continue, as the themes (rising competition and market share gaining from foreign brands) are not to change in 2024. Technological advancements could become increasingly important to Chinese automakers' profitability amid prolonged price war.

Top picks: Li Auto (LI US/2015 HK, BUY), Geely (175 HK, BUY)
As the only profitable Chinese NEV start-up, Li Auto is better positioned than other start-ups amid increasing competition, in our view. Li Auto's superior product design capabilities, along with reasonable investment priorities, have made it enter a virtuous cycle. Healthy balance sheet could help it catch up in AD.

The current industry dynamics also provides more survival room for traditional Chinese automakers. Geely's NEV product mix, aided by Zeekr and Galaxy, could be better positioned than peers.

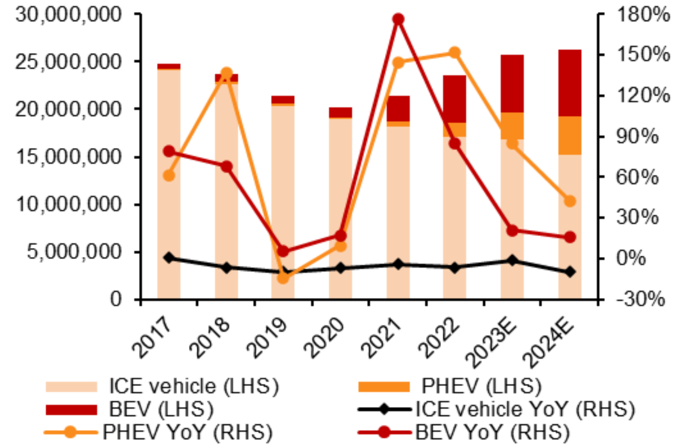
Focus Charts

Figure 1: Retail vs wholesale volume in 2023-24E



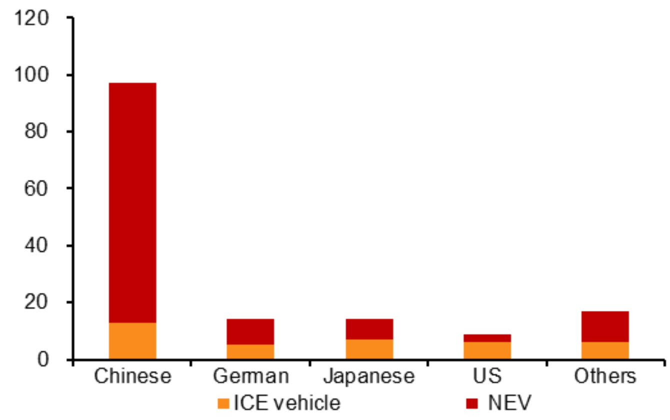
Source: CAAM, CATARC, CMBIGM estimates

Figure 2: China's PV wholesale volume breakdown



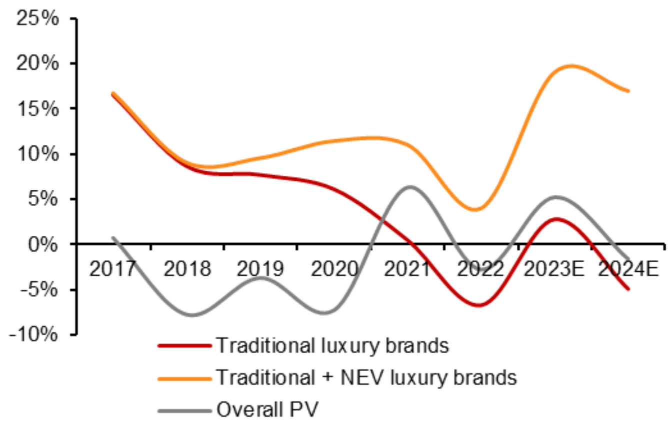
Source: CAAM, CMBIGM estimates

Figure 3: No. of new models by brand origin in 2024



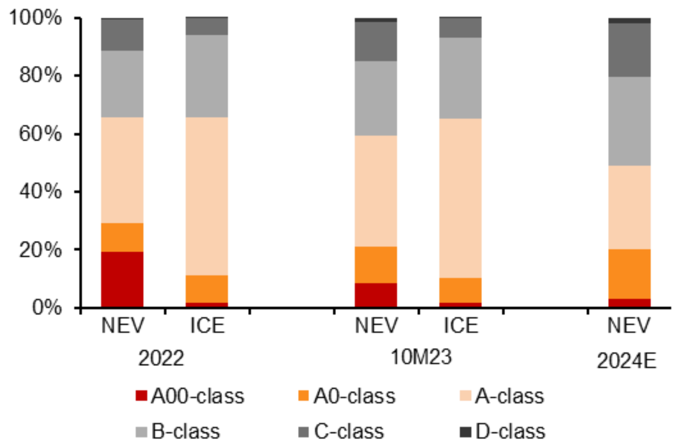
Source: Company data, CMBIGM estimates

Figure 4: YoY growth for luxury brands vs overall



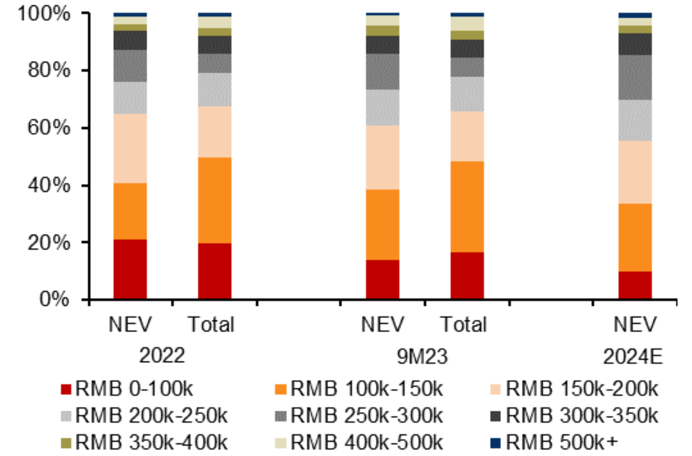
Source: CATARC, CMBIGM estimates

Figure 5: NEV wholesale volume breakdown by vehicle size



Source: CAAM, CMBIGM estimates

Figure 6: NEV wholesale volume breakdown by MSRP range



Source: CAAM, CPCA, CMBIGM estimates

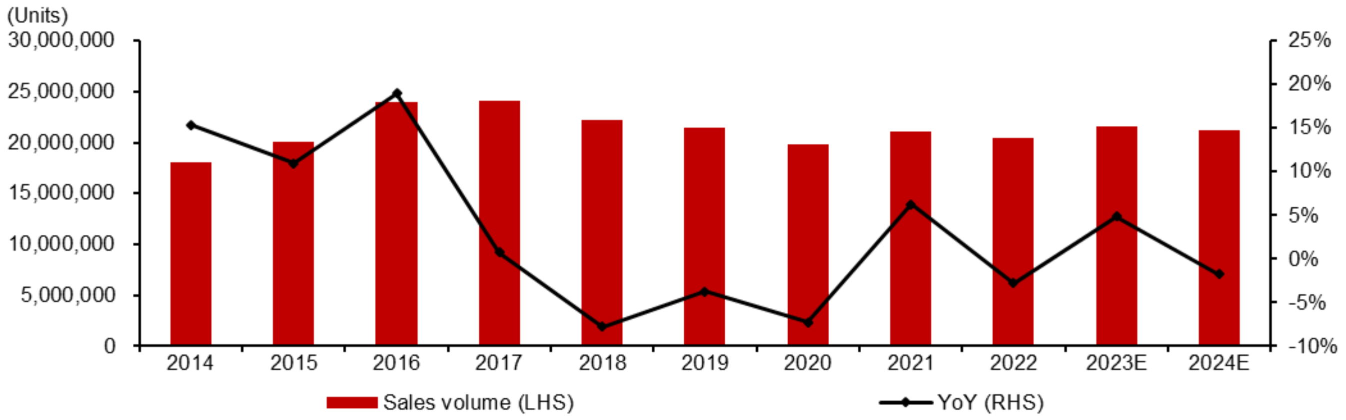
Industry 2024 Outlook: Still about exports, Chinese brands

Retail sales volume: -1.6% YoY in 2024 after 2023 beat

We project China's PV retail sales volume to fall 1.6% YoY from 21.57mn units (+5% YoY) in 2023E to 21.22mn units in 2024E. Forecasting auto sales in China has become increasingly difficult, as more automakers have been struggling to survive, coupled with unexpected stimulus measures, especially from local governments. In the past seven years (2017-2023), PV retail sales volume in China posted four years of declines and three years of increases, with the highest YoY growth of 6.3% (in 2021) and the lowest as -7.8% (in 2018). Nevertheless, we do not expect a sharp retail sales decline in 2024 for the following reasons:

1) The production overcapacity in China, especially for foreign brands, will push these automakers to maintain sales level with higher discounts. Based on the data that we have compiled, the PV production capacity utilization rate in China hit the lowest level of 57% in 2020 and gradually recovers to 62% in 2023E. However, the capacity utilization rate for foreign brands in China has dropped from 90% in 2016 to 62% in 2023E. In addition, NEV production capacity utilization rate in China has also been falling from this year amid aggressive capacity expansion, providing more incentives for automakers to raise discounts for higher sales volume.
2) Consumption for vehicles is now one of the most important ways, if not the most important, to stimulate China's economy. Although there were no nationwide stimulus measures, such as purchase tax cuts, for PVs in 2023, some local governments offered generous subsidies to spur auto sales, which is one of the reasons for the sales beat this year, in our view.
3) Replacement purchase could make the demand more stable. The historical-high annual PV retail sales volume in China occurred in 2017 (24.1mn units), followed by 23.9mn units in 2016. The replacement demand for the sales boom 7-8 years before could make sales volume in 2024 resilient.

Figure 7: China's PV retail sales volume

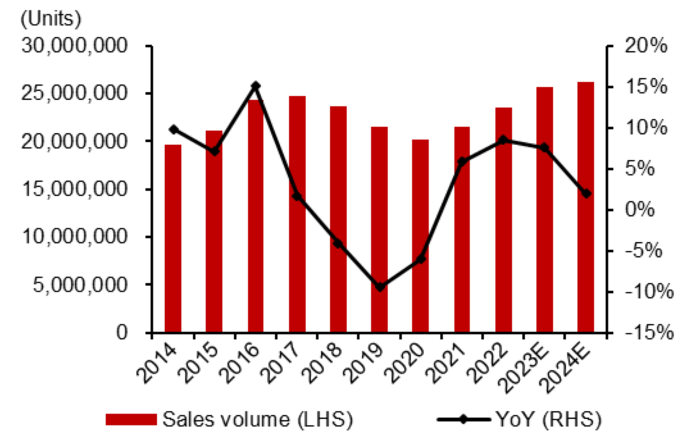


Source: CATARC, CMBIGM estimates

Wholesale volume: +2% YoY amid surging exports

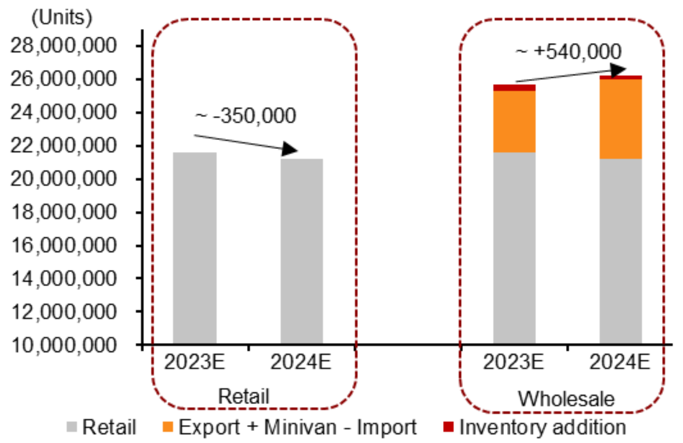
We project China's PV wholesale volume to rise 2% YoY from 25.69mn units in 2023E to 26.23mn units in 2024E, based on our assumption for retail sales volume of 21.22mn units. We also assume both import volume and minivan wholesale volume (excl. minivan exports) to drop mid-to-low single digit YoY to 0.72mn units and 0.21mn units in 2024E, respectively. The difference between wholesale and retail sales volume mainly depends on exports and inventory changes.

Figure 8: China's PV wholesale volume



Source: CAAM, CMBIGM estimates

Figure 9: Retail vs wholesale volume in 2023-24E

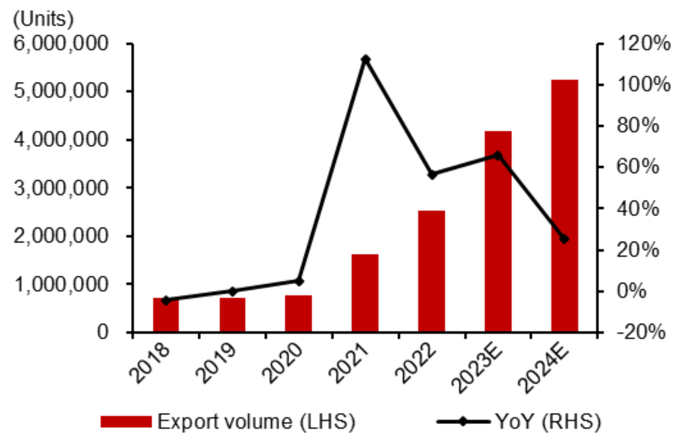


Source: CAAM, CATARC, CMBIGM estimates

Export: Still the driver of wholesale volume, but the fastest growth may be over

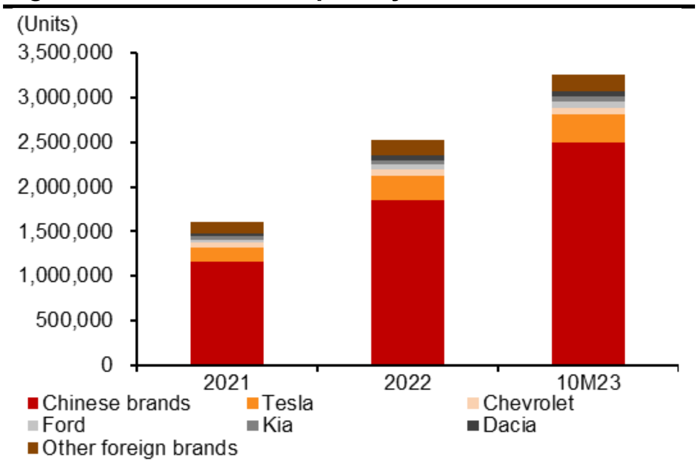
We project China's PV exports to rise 25% YoY from 4.2mn units in 2023E to 5.3mn units in 2024E, as more Chinese automakers have been exploring overseas markets especially with their NEV models. We expect China's NEV exports to rise 70% YoY from about 1.1mn units in 2023E to 1.8mn units in 2024E, with the majority of growth coming from Chinese brands. China's PV export volume has consistently beaten our expectations during 2021-23. Exports are likely to account for 16% of China's total PV wholesale volume in 2023, up from 4% in 2020.

Figure 10: China's PV export volume



Source: CAAM, CMBIGM estimates

Figure 11: China's PV export by brand



Source: CAAM, CMBIGM

We divide overseas markets into different regions based on their auto industry development and local consumers' brand loyalty: 1) Japan, India and South Korea, 2) Western Europe with own brands (Germany, France, Italy etc), 3) Europe without own brands (such as Norway, Netherlands etc), 4) Latin America, 5) ASEAN, 6) East Europe, 7) Oceania, 8) Africa and the Middle East. We exclude the US given the current geopolitical tensions between the US and China. We project Chinese brands' market share to be ranged 1-40% in these regions in the foreseeable future and calculate potential market size of 5.4mn units for Chinese brands in overseas markets in the short to medium term. In other words, there is probably 70% growth potential for Chinese brands in overseas markets in the next 3-4 years, in our view.

Figure 12: Our forecast for Chinese brands' potential overseas market size in the foreseeable future

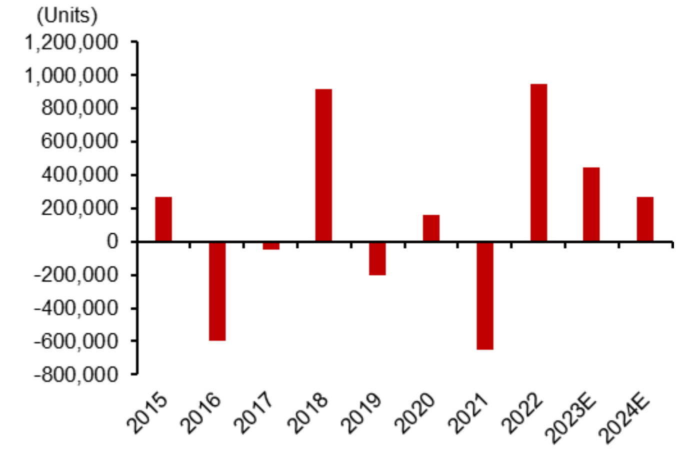
Regions (excl. China & US)	Total sales (units)	Our market share assumption for Chinese brands	Potential market size for Chinese brands (units)	Current EV market share in each region
Japan, India, South Korea	11,100,000	1%	110,000	3%
Western Europe	9,000,000	5%	450,000	20%
Europe without own brands	4,500,000	15%	675,000	25%
Latin America	5,000,000	20%	1,000,000	1%
ASEAN	3,500,000	25%	875,000	3%
Eastern Europe	4,000,000	30%	1,200,000	2%
Oceania	1,400,000	35%	490,000	7%
Africa and the Middle East	1,500,000	40%	600,000	5%
Total	**40,000,000**	**14%**	**5,400,000**	

Source: Marklines, CMBIGM estimates

Inventory: We assume mild inventory restocking in 2024

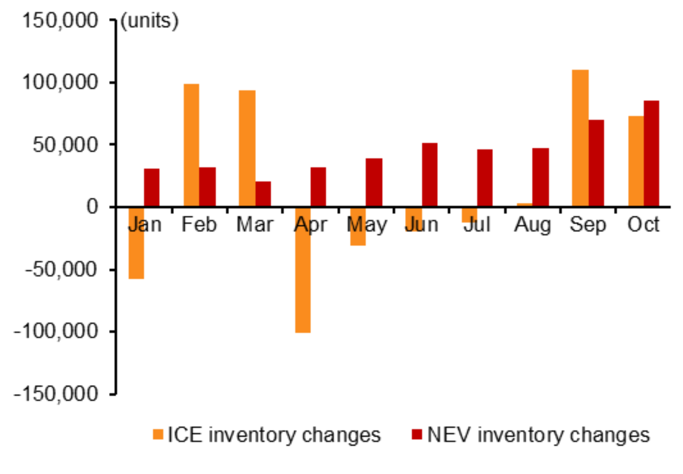
2023 is likely to be ended with an inventory restocking as we had expected last year. We expect such restocking to be around 0.44mn units, higher than our prior forecast of 0.2mn units. We assume a mild inventory restocking of 0.27mn in 2024E, given the current high inventory level. We expect the inventory addition in 2024E to come from NEVs, as its sales volume continues to rise. We project ICE inventories to decline in 2024E.

Figure 13: Our est. inventory changes at dealers



Source: CAAM, CATARC, CMBIGM estimates

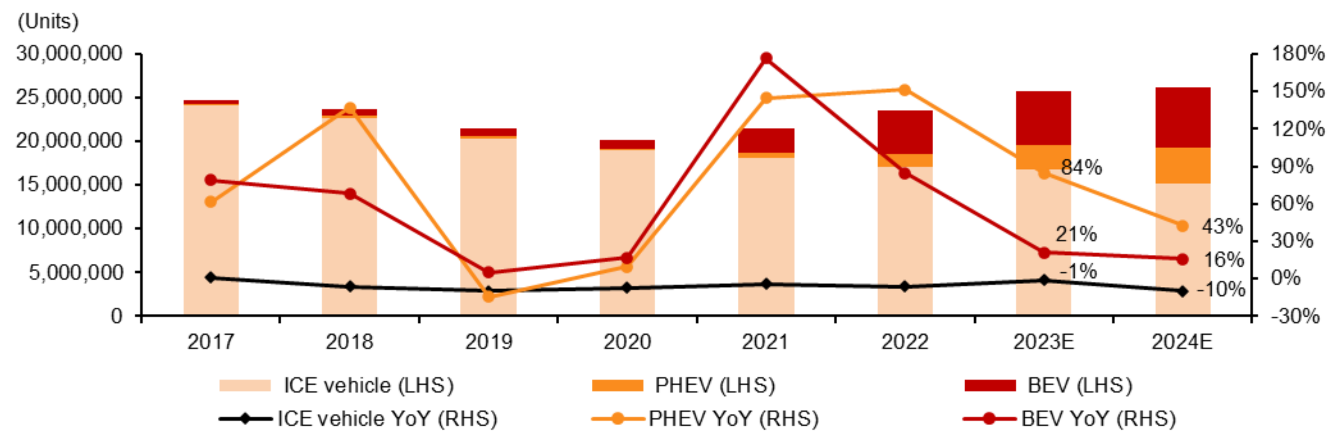
Figure 14: Inventory changes for NEV and ICE in 2023



Source: CAAM, CATARC, CMBIGM

Accordingly, we project China's PV wholesale volume to rise 2% YoY to 26.23mn units in 2024E. From the powertrain perspectives, NEV is to be the driver for China's auto sales again. We forecast China's NEV wholesale volume to rise 24% YoY from 8.85mn units in 2023E to 11mn units in 2024E, details of which will be discussed in the NEV outlook section of this report. Our industrywide and NEV forecasts imply that China's ICE wholesale volume is to decline 10% YoY in 2024E.

Figure 15: China's PV wholesale volume breakdown by powertrain

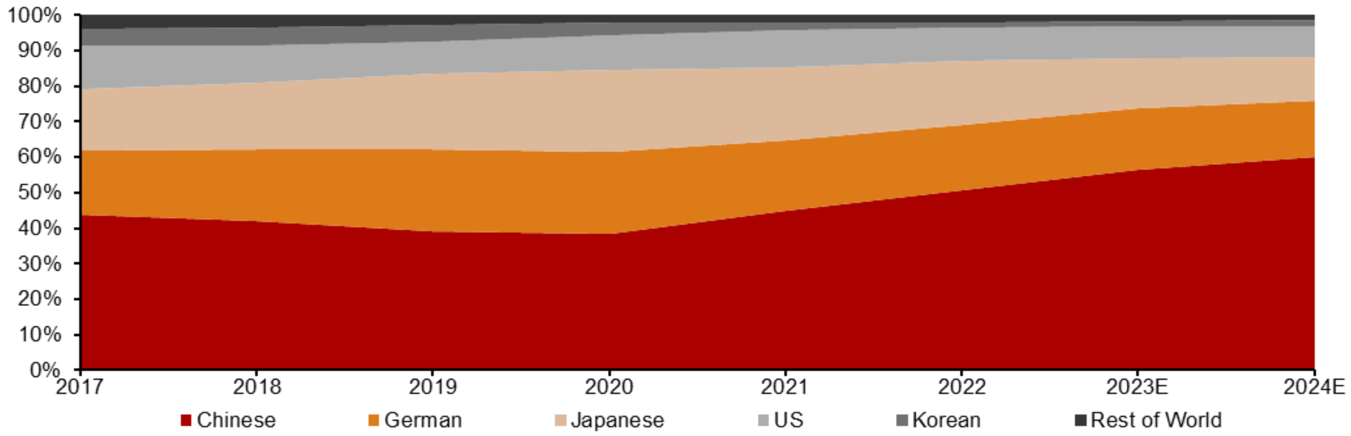


Source: CAAM, CMBIGM estimates

Strong NEV model pipeline to continue lifting Chinese market share

We project Chinese brands to continue gaining market share for four years in a row in 2024E to exceed 60%, from 56% in the first 10 months of 2023 and 38% in 2020, on a wholesale volume basis. We had correctly projected market share gain for Chinese brands since 2021 but underestimated such gains for the past three years. Unlike 2022 when the gain was purely driven by NEVs, Chinese brands' market share also widened in the ICE segment in 2023, reflecting the improving brand image helped by Chinese brands' competitive NEV products. We project Chinese brands' market share in the ICE segment to continue rising slightly to 44% in 2024E. In our view, such continued market share gain is largely driven by Chinese brands' strong model rollouts.

Figure 16: PV market share by brand origin in China



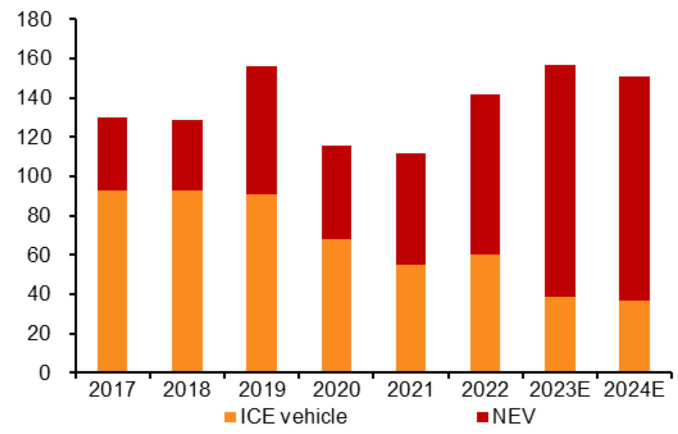
Source: CAAM, CMBIGM estimates

Model pipeline: Foreign brands' electrification still lagging

We have compiled about 151 new-model launches in 2024E, slightly lower than the number in 2023E. About 76% of new models in 2024E would be NEVs or with NEV powertrain available, compared with 75% in 2023E and 58% in 2022, based on the data we have compiled.

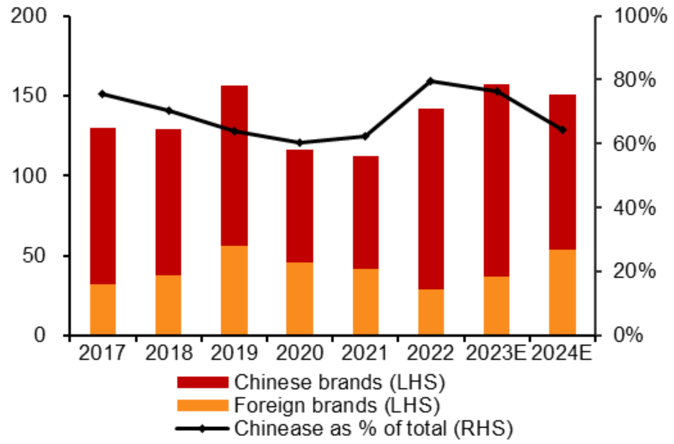
We project 97 new models for Chinese brands in 2024E, driven by 84 new NEV models (or 87%). Foreign brands have also been accelerating model rollouts in a bid to withstand the competition, with 54 new models in 2024E, 56% (30 models) of which are to be NEVs, based on our estimates. Still, the number of new NEV models of Chinese brands is almost three times of foreign brands', and we have not seen any competitive NEV models from foreign brands' model pipeline in 2024E yet. We had projected 30 new NEV models in 2023 for foreign brands and about 1/3 have been delayed.

Figure 17: No. of new model launches in China



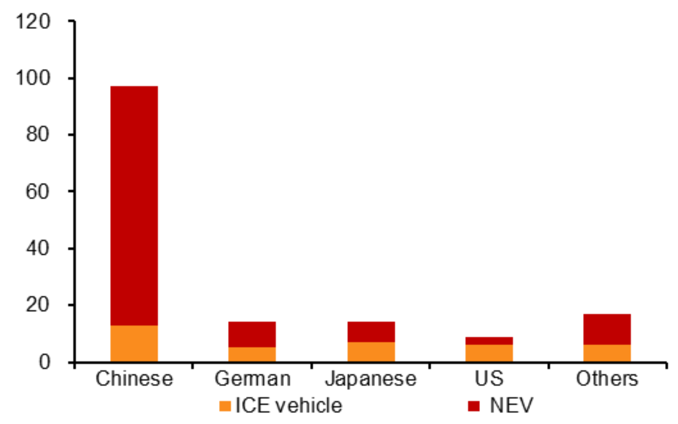
Source: Company data, CMBIGM estimates

Figure 18: No. of new models by brand origin



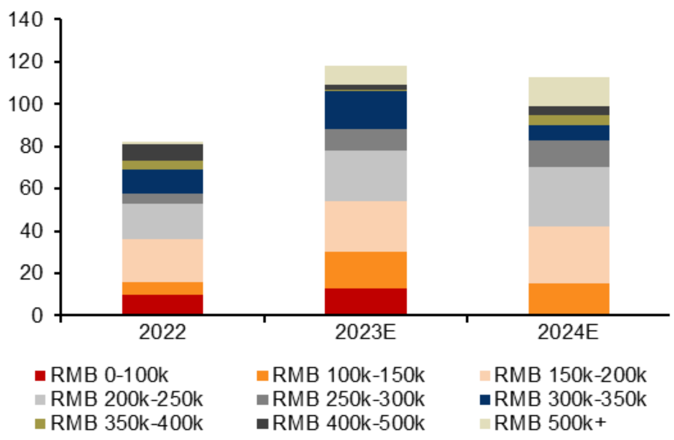
Source: Company data, CMBIGM estimates

Figure 19: No. of new models by brand origin in 2024



Source: Company data, CMBIGM estimates

Figure 20: No. of new NEV models by price range



Source: Company data, CMBIGM estimates

Luxury car: A replica of 2023: traditional brands down, NEV up

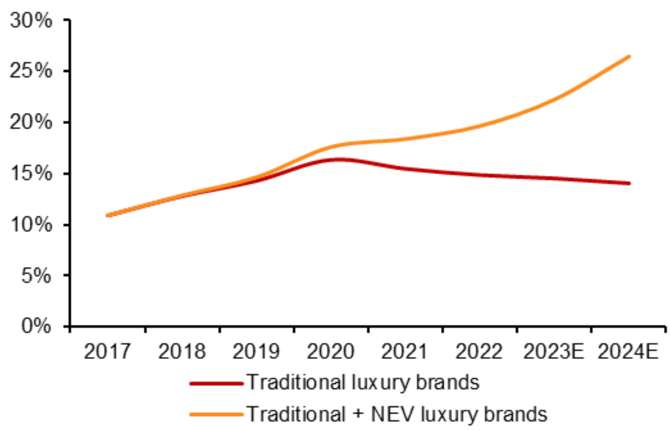
We divide luxury-auto segment into two categories to better reflect the industry landscape changes: traditional luxury and NEV luxury, as premium NEV models have already contributed a significant portion to high-end vehicle sales. Traditional luxury-brand market share reached the peak of 16.4% in 2020 and followed by a three-year decline. We project such market share to narrow to 14.5% in 2023E, in line with our prior forecast. Such trend is likely to continue, and we expect traditional luxury-brand market share to fall to 14.0% in 2024E, or 2.98mn units.

Retail sales volume for NEV luxury brands is likely to rise 69% YoY to 1.68mn units in 2023E, based on our estimates, driven by Li Auto (+173% YoY) and Denza (+68% YoY). Tesla accounted for 37% of total NEV-luxury retail sales volume in the first 10 months of 2023, followed by Li Auto's 23%. We project NEV-luxury market share on a retail basis to rise from 7.8% in 2023E to 12.5% in 2024E, or 2.65mn units, as more NEV premium brands ramp up next year, including Fangchengbao, Avatr and Aito.

Figure 21: Retail sales YoY growth for traditional luxury brands, overall luxury brands and overall PV

Source: CATARC, CMBIGM estimates

Figure 22: Market share for overall luxury brands and traditional luxury brands in China



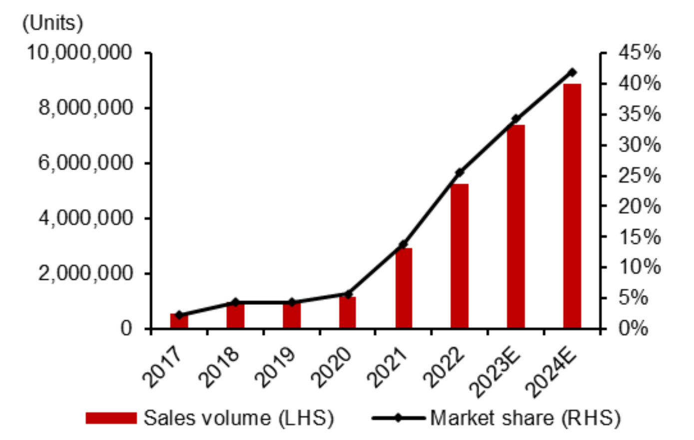
Source: CATARC, CMBIGM estimates

NEV 2024 Outlook: Technologies to withstand competition

We project China's passenger NEV retail sales volume to rise 21% YoY from 7.4mn units in 2023E to 8.9mn units in 2024E, which implies NEV market share of 42% in 2024E, up from 34% in 2023E. We project China's passenger NEV wholesale volume to rise 24% YoY to 11mn units in 2024E, assuming NEV export of 1.8mn units and inventory restocking of 0.3mn units next year.

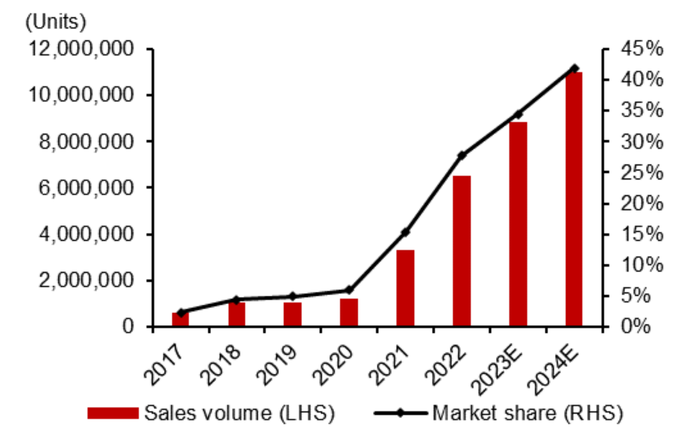
China's NEV retail sales volume is likely to hit 7.4mn units in 2023E, largely in line with our prior forecast made in Dec 2022. NEV wholesale volume in 2023E should beat our initial expectation by about 7%, largely due to higher-than-expected exports and inventory destocking.

Figure 23: China's NEV retail sales and market share



Source: CATARC, CMBIGM estimates

Figure 24: China's NEV wholesale and market share

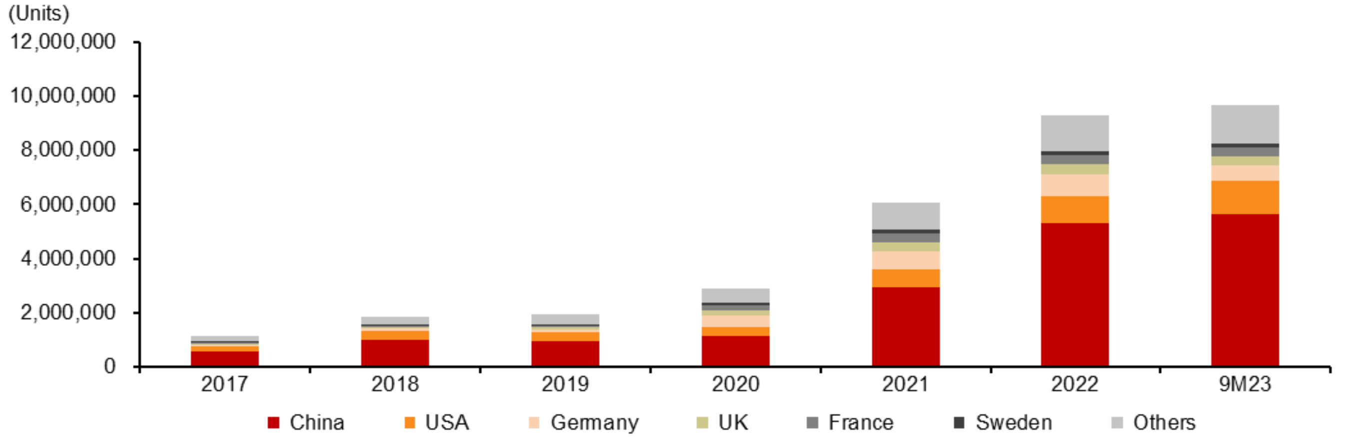


Source: CAAM, CMBIGM estimates

Global NEV in a nutshell: China is expanding its global footprint

In the first nine months of 2023, global NEV (BEV, PHEV and fuel-cell electric vehicle (FCEV) only) retail sales volume rose 39% YoY to 8.7mn units, according to Marklines and our estimates. China accounted for 57% of global NEV sales, the same as in 2022. Europe accounted for 24% of global NEV sales volume and the US took up 13% in the first nine months of 2023. Interestingly, China exported 0.7mn units of NEVs in the first nine months of 2023, taking up about 19% of total NEV retail sales volume outside China.

Figure 25: NEV sales volume by country



Source: Marklines, CMBIGM estimates

NEV size continues to be larger in China in 2024

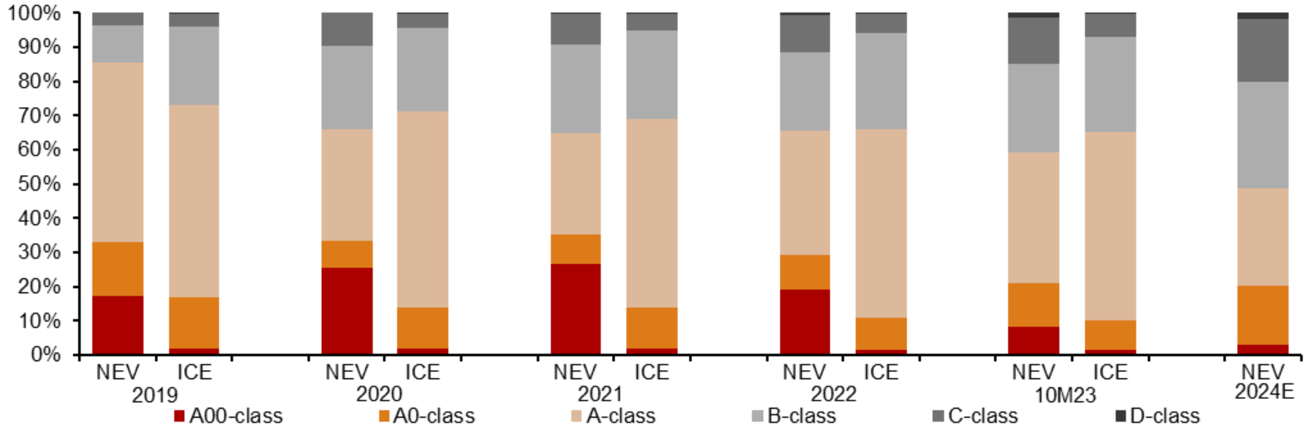
With all the new NEV models being compiled, we also forecast NEV sales volume at model level by assessing about 400 NEV models, in a bid to better understand possible industry dynamics changes in 2024.

NEV vehicle size is likely to be even larger in 2024E, as the chassis flexibility provided by NEVs could make wheelbase longer, which is consistent with Chinese consumers' preference towards lengthy legroom and large vehicles. We project B-class (medium size) vehicles to take up about 30% of total NEV wholesale volume in 2024E, 5 ppts higher than that in the first 10 months of 2023 and the highest ratio among all the vehicle size. We project C-class (medium-to-large size) vehicles to take up 18% of total NEV wholesale volume in 2024E, also 5 ppts higher than that in the first 10 months of 2023.

The NEV sales volume breakdown by vehicle size has been changing drastically in the past four years. The sales ratio for the C-class NEVs has already surpassed that in the ICE segment and the sales ratio for the B-class NEVs will likely exceed such ratio in the ICE segment in 2024E. That underscores our previous argument in Dec 2022 that NEV vehicle size preference should slightly lean towards larger and more premium vehicles, as most NEVs are replacement or additional purchases in families.

We estimate A00-class (mini size) NEVs to only account for about 3% of total NEV wholesale volume in 2024E, 5 ppts lower than that in the first 10 months of 2023. The sales plunge of the A00-class NEVs has been more severe than expected. We expect A00-class NEVs to be largely replaced by A0-class (small size) NEVs amid consumption upgrade and a larger number of supplies, such as the BYD *Seagull*, *Dolphin*, *Yuan*, VW *ID.1*, Smart and MINI.

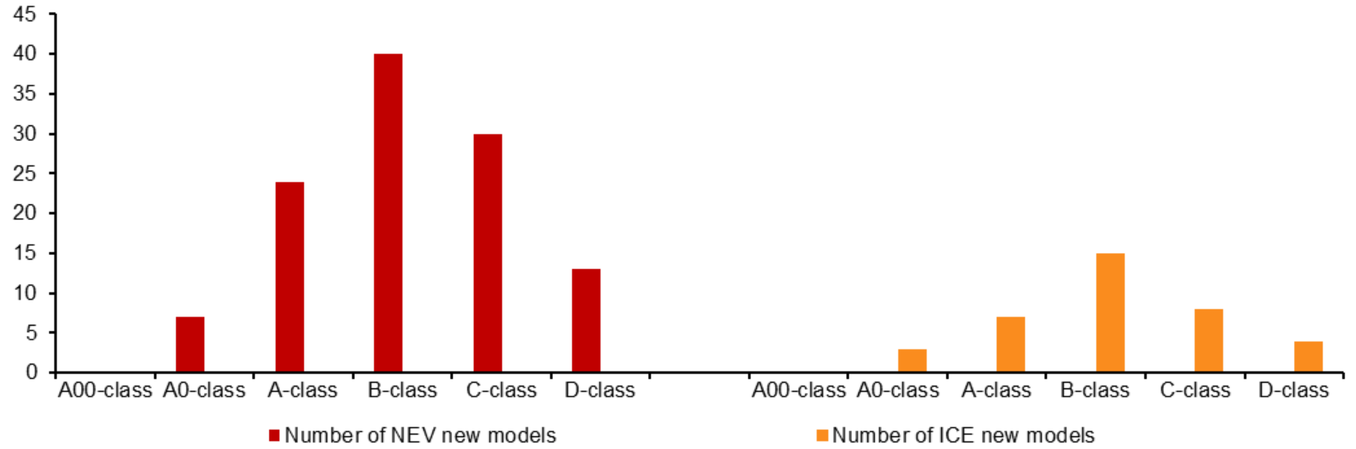
Figure 26: NEV wholesale volume breakdown by vehicle size



Source: CAAM, CMBIGM estimates

We could also see higher sales volume from the D-class (large size) NEVs in 2024, following the Li *L9*'s success. Lixiang, Fangchengbao, Denza and Tank are likely to launch large-size SUVs and MPVs next year. We expect wholesale volume of D-class NEVs in China to more than double to 0.26mn units in 2024E, taking up 2.3% of total NEV sales.

Figure 27: New model pipeline breakdown by vehicle size in 2024

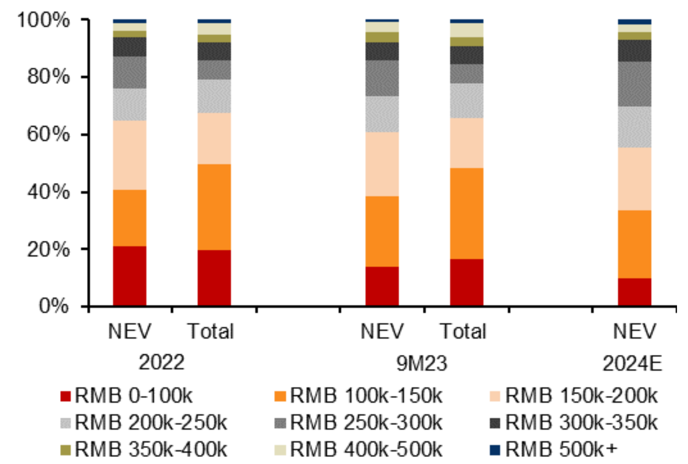


Source: Company data, CMBIGM estimates

NEV to become mainstream of vehicles priced RMB150-350k in 2024

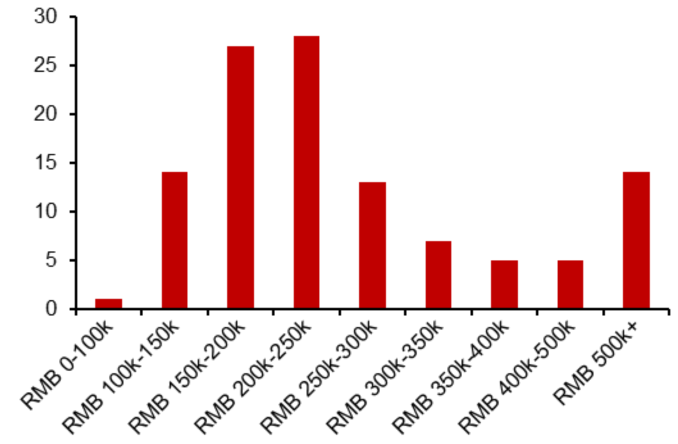
We estimate the average MSRP for NEVs sold in China fell from RMB 184,000 in 2022 to RMB 180,000 in the first 10 months of 2023. On the surface, it largely reflects the NEV subsidy phase-out. We believe it is more than just the subsidy changes. Price war does not only mean consumption downgrade, in our view. In fact, it urges automakers to accelerate technological advancement for better products in order to increase pricing power.

Figure 28: NEV wholesale volume breakdown by MSRP range



Source: CAAM, CPCA, CMBIGM estimates

Figure 29: NEV new model pipeline in 2024 by MSRP range



Source: Company data, CMBIGM estimates

Among all the PVs sold with the MSRP of RMB 250,000-300,000 in China in the first nine months of 2023, about 60% were NEVs on a wholesale basis, based on our estimates, in line with our forecast made in Dec 2022. We projected last year that NEVs could dominate the segment priced RMB 250,000-300,000 in 2023. Now we believe NEVs are going to become the mainstream for the segments priced RMB 150,000-350,000. ICE vehicles are likely to be squeezed into the price range of below RMB 150,000 in order to be competitive.

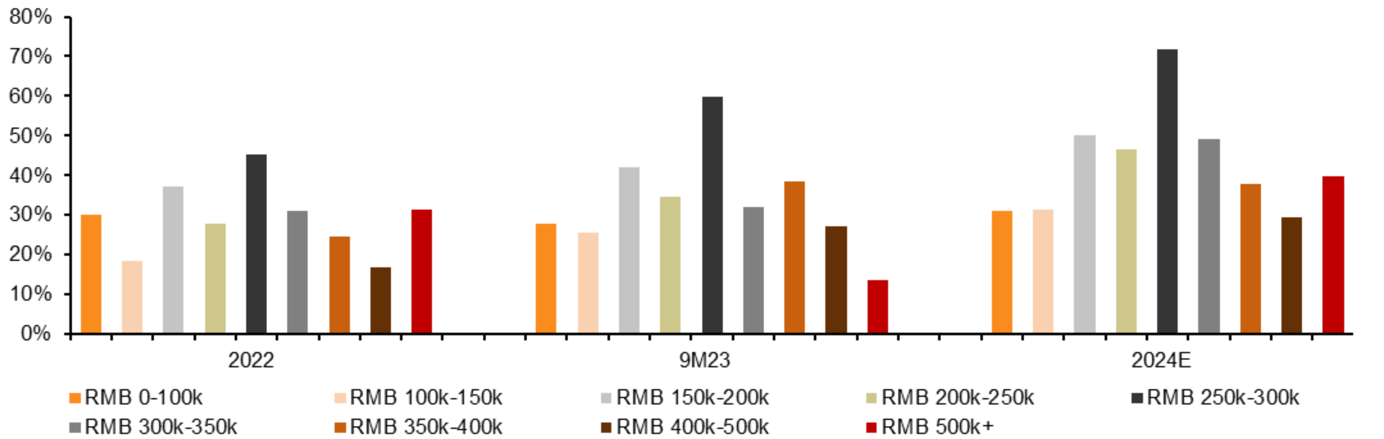
We project NEVs to account for around 50% of total wholesale volume in the segment priced RMB 150,000-250,000. We estimate that BYD accounted for almost 40% of total NEVs sold with the MSRP of RMB 150,000-250,000 in the first nine months of 2023 and we expect such dominance to be lowered to about 35% in 2024E amid heightened competition. The majority of medium-size smart EVs will compete in the price range of RMB 200,000-250,000 in 2024E, or even lower, such as the *Zeekr 007*, IM *LS6*, Aion *Hyper HT*, Exeed *Sterra ES*, BYD *Song L* and VW *ID.7*. Although Tesla raised its facelifted *Model 3*'s price to RMB 250,000-300,000, we believe it is possible to have its price cut in 2024E.

NEV's dominance in the segment priced RMB 250,000-300,000 in China will continue in 2024E, in our view. We expect NEV's market share in this price segment to widen to above 70% in 2024E. We estimate that Tesla accounted for about 63% of total NEVs sold (including exports) with the MSRP of RMB 250,000-300,000 in the first nine months of 2023. We also expect Tesla's market share in this price segment to decline in 2024E, as it faces competition from the redesigned Aito *M7* and upcoming Li *L6*. We project Tesla's total wholesale volume in China (including exports) to rise 11% YoY to 1.04mn units in 2024E.

NEVs' existence in the segment priced RMB 300,000-350,000 will likely accelerate in 2024E, in our view. We project NEV's market share in the price segment of RMB 300,000-350,000 to rise 17 ppts from 32% in the first nine months of 2023 to 49% in 2024E, as we expect the wholesale volume for NEVs priced RMB 300,000-350,000 to rise 47% YoY to 0.85mn units in 2024E, with models such as the Li *L7*, *L8*, *Tank 500*, BYD's *Bao 5*, Denza's new sedan, Wey *Gaoshan*, Trumpchi *E9* and *Polestones 01*. That means traditional luxury brands will start to be hit significantly. That is also one of the important reasons why we project YoY sales volume declines for BMW, Mercedes-Benz and Audi in 2024E.

We are of the view that Li Auto's *MEGA* could reshape the segment priced above RMB 500,000 in 2024E. As most models priced above RMB 500,000 are imported, models with MSRPs higher than RMB 500,000 only account for less than 2% of total wholesale volume in China. The locally-produced BMW *X5* takes up 30% of the segment. We project NEVs to take up more than 30% of the total wholesale volume for PVs priced above RMB 500,000 in 2024E, up from 14% in the first nine months of 2023, driven by Li Auto's *MEGA*.

Figure 30: NEV market share estimates in each price segment (on a wholesale basis)



Source: CAAM, CPCA, CMBIGM estimates

Will Huawei reign intelligent connected vehicles? If yes, what is next?

It has become a consensus for investors that intelligent connectivity, including AD and smart cockpit, would be automakers' one of the most important, if not the most important, product differentiations in this stage. 2024 could be a very interesting year for intelligent connected vehicles (ICV) as:

1) Huawei is to move its core technologies and resources of its smart car unit into a joint company, which is open to automakers for equity stake. Changan is to be the first one to join with up to 40% equity stake. Regardless of the formation of partnership, Seres, JAC, Chery and BAIC have already been Huawei's partners in the auto industry.
2) There is increasing possibility for the Chinese government to give permissions to Tesla's FSD functionalities in China.
3) The *Jiyue 01*, equipped with Baidu's AD system, was launched in Oct 2023 and Xiaomi's (1810 HK, BUY) smart EV is to be rolled out in 1H24.

As noted in our roadshow takeaways report in Oct 2023, we are of the view that Xpeng and Huawei are leading in AD technologies in China now and Huawei is likely to overtake Xpeng given its technological advantages in V2X and chips. Xiaomi could be a positive surprise in terms of intelligent connectivity. In our view, it is still possible for other automakers to catch up, such as Li Auto and BYD, as they have been spending billions on R&D.

On the other hand, Huawei's move could make weak players survive for a longer time, which would make the bottom of the cycle last longer. Nevertheless, we still believe weak players would be out of game in the long term even with Huawei's help, as such partnerships are not exclusive. We think that the current partnership formation between Huawei and some automakers could also change over the time.

In summary, it is still too early to draw a conclusion about the industry landscape of the ICVs, in our view. However, the entry of giant players could make Chinese automakers even more difficult monetize such technologies.

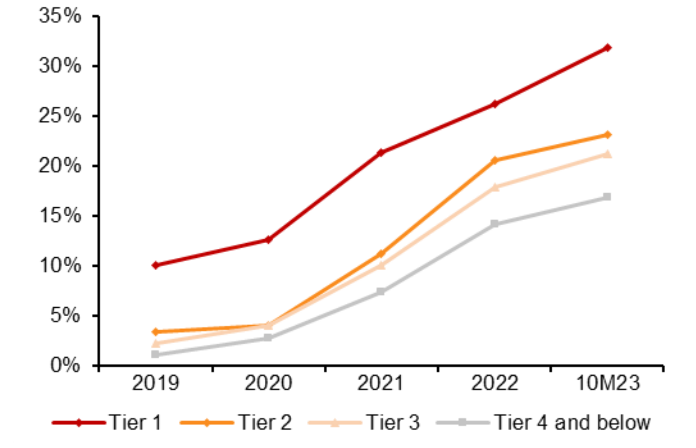
Larger NEV market share gain potential for lower-tier cities

Tier-3 cities have become the NEV sales driver in 2023. The NEV market share in the tier-3 cities in the first 10 months of 2023 on a retail basis rose 8.3 ppts from the 2022 level, the fastest growth among all the city tiers. That was in line with our forecast made last year that lower tier cities may outpace in the NEV sales growth, especially for PHEVs. Now NEVs account for about 31% of total PVs sold in tier-3 cities.

NEV retail sales volume in tier-2 cities continued to outpace the overall market in the first 10 months of 2023, driven by PHEVs. PHEVs accounted for 11.5% of total PVs sold in tier-2 cities in the first 10 months of 2023, the highest among all the city tiers. The PHEV market share in tier-1 cities narrowed in 2023, largely due to the cancellation of green license plates for PHEVs in Shanghai. Instead, the BEV market share in tier-1 cities rose the most among all the city tiers in the first 10 months of 2023 (+5.7 ppts), as consumers in Shanghai shifted from PHEVs to BEVs.

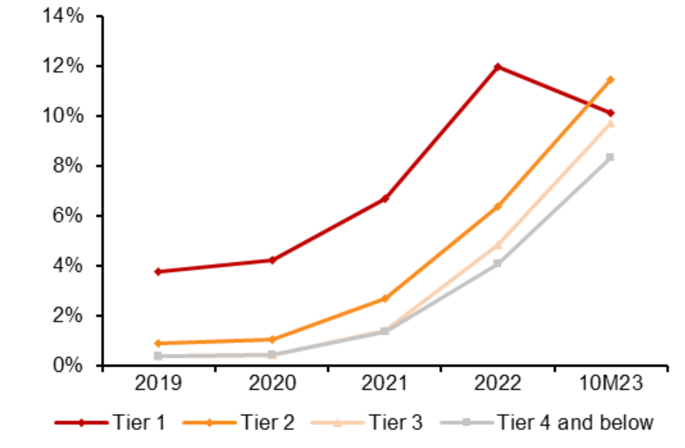
NEV market share growth in tier-4 and below cities trailed the overall market in the first 10 months of 2023, which was below our expectation. Its BEV market share only rose 2.6 ppts in the first 10 months of 2023 after widening 6.8 ppts during 2022. That was partially due to sales volume plunge of mini BEVs.

Figure 31: BEV market share in different city tiers (on a retail basis)



Source: CATARC, CMBIGM

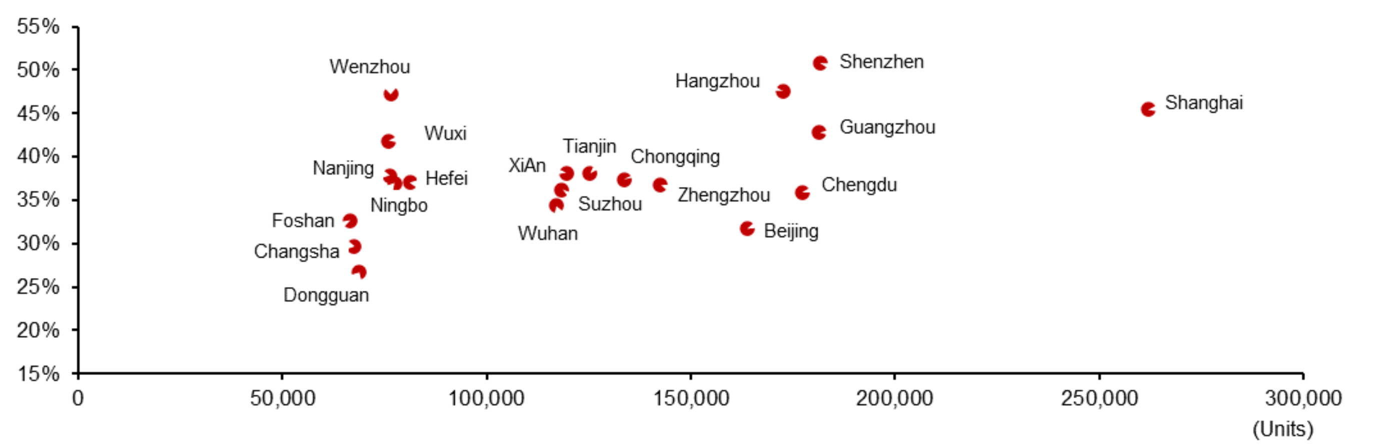
Figure 32: PHEV market share in different city tiers (on a retail basis)



Source: CATARC, CMBIGM

We are of the view that lower-tier cities are likely to outperform the overall NEV retail sales volume growth in 2024E. We maintain our last year's view: we still see market share growth room for lower-tier cities. Chinese automakers including Changan, Geely and Great Wall have started to launch more PHEV models, which could help lift PHEV market share in lower-tier cities. The consumption upgrade from A00-class BEVs to A0-calss BEVs could also help widen the BEV market share in lower-tier cities gradually, in our view. The NEV market share in tier-1 cities reached 42% in the first 10 months of 2023 and its future growth could be dragged by Beijing's NEV license registration limits. Tier-2 cities take up more than 50% of NEV retail sales volume in China and will continue to be the key market for NEV makers.

Figure 33: NEV retail sales volume in top 20 cities with corresponding NEV market share (10M23)



Source: CATARC, CMBIGM

Investment Thesis, Top Picks and Valuation

Although Chinese OEM peer group outperformed the benchmark YTD, the huge share-price volatility makes market timing more important than stock selection in trading. Investors' sentiment has been shifting between market share gain from foreign brands and competition to result in sales and margin miss. We believe such sentiment shift will continue, as the themes (rising competition and market share gaining from foreign brands) are not to change in 2024. Technological advancements could become increasingly important to Chinese automakers' profitability amid prolonged price war.

The highly complex industry landscape (foreign OEMs, SOEs, start-ups, tech giants etc) would likely make the bottom of the cycle longer than previously expected. For example, the recent move by Huawei to set up joint company with different automakers to jointly develop smart EV system could help those laggards survive longer. Foreign giant automakers could leverage resources overseas to support its China business and local governments back up SOEs. It is still difficult for us to identify long-term winners in China's auto industry. Therefore, valuation changes and catalysts such as new competitive models could be important for range trading.

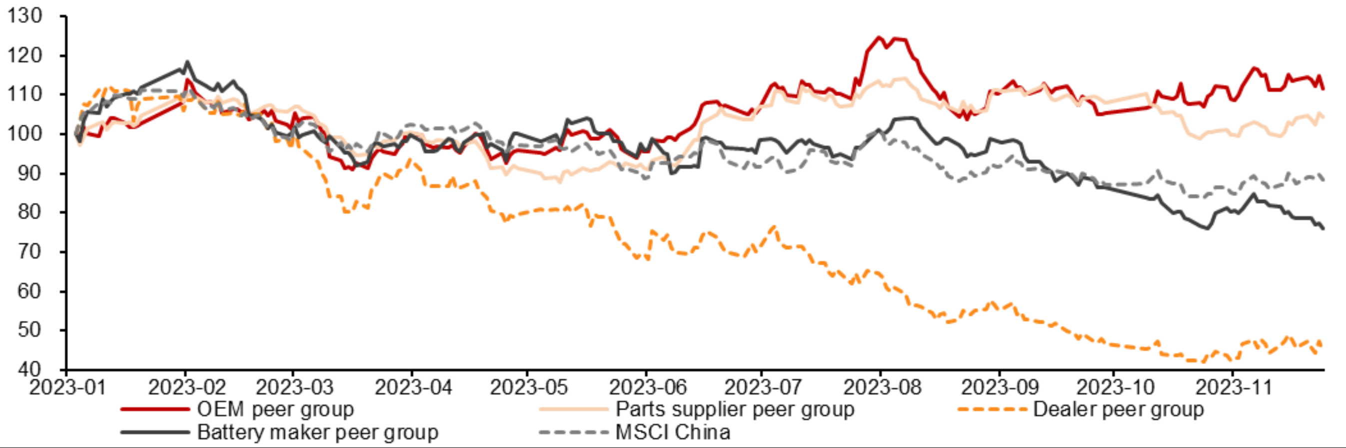
Top picks: Li Auto, Geely

Our top picks still focus on OEMs, as we have not seen a clear signal for dealers to rebound in sales volume and margins. The most leading parts suppliers, in our view, related to intelligent connectivity are not listed yet, including Huawei, Horizon Robotics, Momenta and Dji.

As the only profitable Chinese NEV start-up, Li Auto is better positioned than other start-ups amid increasing competition, in our view. The debut of its first BEV, the *MEGA*, has increased our confidence on its upcoming BEV products. Li Auto's superior product design capabilities, along with reasonable investment priorities, have made it enter a virtuous cycle. We have not seen clear signs for Xpeng and NIO to turn profitable yet. We are of the view that there is still a chance for Li Auto to catch up in the autonomous driving (AD) technologies.

The current industry dynamics also provides more survival room for traditional Chinese automakers. Despite its higher-than-expected sales volume in FY23, Geely's share price underperformed its peers YTD. We still see sales growth potential for Zeekr when the *Zeekr 007* and a medium-size SUV are launched. Galaxy has a good start in 2023 and we believe its new models could drive its NEV sales in FY24. In addition, its parent company's cooperation with Baidu (BIDU US, BUY) could be a positive catalyst, should the Jiyue's sales volume exceed expectation, as little has been priced in from this partnership.

Figure 34: Share performance for different automotive peer groups YTD (normalized on 1 Jan 2023)



Source: Bloomberg, CMBIGM
Notes: OEM peer group consists of Li Auto, NIO, Xpeng, BYD, Geely, Great Wall, GAC, Leapmotor (9863 HK, NR), BAIC (1958 HK, NR), BAIC BluePark (600733 CH, NR), SAIC Group (600104 CH, NR), Changan (000625 CH, NR), Seres (601127 CH, NR), Dongfeng Motor Group (489 HK, NR) and JAC (600418 CH, NR).
Dealer peer group consists of Zhongsheng (881 HK, NR), Meidong and Yongda.
Parts supplier peer group consists of Inovance Technology (300124 CH, NR), Fuyao Glass (600660 CH, NR), HASCO (600741 CH, NR), Xingyu (601799 CH, NR), Desay SV Automotive (002920 CH, NR), Tuopu Group (601689 CH, NR), Minth (425 HK, NR), Ningbo Joyson (600699 CH, NR), and Nexteer (1316 HK, NR).
Battery maker peer group consists of CATL (300750 CH, NR), Eve (300014 CH, NR), Gotion High-Tech (002074 CH, NR), Farasis (688567 CH, NR), Sunwoda (300207 CH, NR) and CALB (3931 HK, NR).

Figure 35: Peers' valuation

			Mkt Cap	Price	TP	Up/Down	P/E (x)		P/S (x)		ROE (%)	
Company	Ticker	Rating	(US$ mn)	(LC)	(LC)	-side	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Li Auto	LI US	BUY	43,788	41.27	50.00	21.2%	34.4	21.5	2.5	1.6	18.1	23.1
Li Auto	2015 HK	BUY	43,836	161.10	194.14	20.5%	34.5	21.5	2.5	1.6	18.1	23.1
NIO	NIO US	HOLD	12,434	7.40	10.00	35.1%	N/A	N/A	1.5	1.1	(101.0)	(210.1)
NIO	9866 HK	NR	12,539	58.20	N/A	N/A	N/A	N/A	1.5	1.1	(101.0)	(210.1)
Xpeng	XPEV US	HOLD	16,551	18.48	16.00	-13.4%	N/A	N/A	3.8	2.2	(33.9)	(34.7)
Xpeng	9868 HK	HOLD	16,596	72.25	62.12	-14.0%	N/A	N/A	3.8	2.2	(33.9)	(34.7)
Tesla	TSLA US	NR	748,477	235.45	N/A	N/A	70.6	55.1	7.7	6.3	19.4	20.7
	Average						**46.5**	**32.7**	**3.3**	**2.3**	**(30.6)**	**(60.4)**
			Mkt Cap	Price	TP	Up/Down	P/E (x)		P/S (x)		ROE (%)	
Company	Ticker	Rating	(RMB mn)	(LC)	(LC)	-side	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Geely	175 HK	BUY	84,195	9.17	14.00	52.7%	18.8	12.7	0.5	0.4	5.8	8.2
Great Wall	2333 HK	BUY	93,022	12.00	13.00	8.3%	12.8	11.4	0.5	0.5	10.8	11.2
Great Wall	601633 CH	BUY	232,036	27.31	32.00	17.2%	31.8	28.5	1.3	1.2	10.8	11.2
GAC	2238 HK	BUY	35,303	3.69	6.50	76.2%	7.6	5.8	0.3	0.3	4.1	5.1
GAC	601238 CH	BUY	102,763	9.80	14.00	42.9%	22.0	16.8	0.7	0.7	4.1	5.1
BYD	1211 HK	BUY	606,639	228.40	290.00	27.0%	19.4	15.4	1.0	0.8	25.0	25.3
BYD	002594 CH	BUY	631,281	216.85	300.00	38.3%	20.2	16.0	1.0	0.8	25.0	25.3
EVA	838 HK	BUY	1,239	0.78	1.50	92.3%	5.0	4.2	0.2	0.2	8.4	9.3
Yongda	3669 HK	BUY	5,598	3.17	5.00	57.7%	6.4	4.6	0.1	0.1	6.1	8.2
Meidong	1268 HK	BUY	6,412	5.22	7.20	37.9%	18.9	8.6	0.2	0.2	6.8	12.5
	Average						**16.3**	**12.4**	**0.6**	**0.5**	**10.7**	**12.1**

Source: Bloomberg, WIND Database, CMBIGM. Note: Market data as of 24 Nov 2023

China Insurance

OUTPERFORM

Analyst: Nika MA – nikama@cmbi.com.hk

Riding on a wave of recovery

Worst case priced in, NB growth potential unleashed

Life: asset recovery catalyze in short-term; top insurers win over time

In 2023, China's insurance sector navigated through ups and downs along the journey, with the market initially seeing insurers' assets resonating with liability recovery, before divergence gradually setting in along with tightening regulations in the second half of the year. The sector investment logic shifted from focusing on the sunny side of insurers' liability outcomes, i.e., new business undertaken, to asset-side woes in investment returns and profitability. A tightening regulatory environment amid volatile market performance and weak sentiment have aroused market concerns about the sector's new business value growth in 2024.

In our view, although the sector is weighed by externalities, we believe life insurers have embarked on a new growth cycle after a more-than-three-year transformation since 2018. Going forward, we expect asset recovery to catalyze a sector re-rating and buck the trend of the present long-subdued valuation. By reviewing the history of insurance development, we regard tightened regulatory practice the touchstone for top winners, from where the insurers can enhance capabilities of both their channel and product mix. We maintain a positive view that top insurers' new business value (NBV) growth will sustain in 2024, with the driver to shift from acceleration of first-year premiums (FYP) in 2023, to more consistent margin improvement. In the short term, the scheduled interest rate cut to 3.0% in August released certain demands for traditional life insurance products in July, and we expect the disruptions to new business sales will be absorbed within 1-2 quarters. Namely, the counter effects to underwriting new business sales shall normalize by the end of the fourth quarter this year.

With a stabilized agent scale and improved productivity in conjunction with new products launched in bancassurance after suspensions under the requirement of "unified commission fees in reporting and underwriting" ("报行合一"), we anticipate the new business sales of the sector to maintain steady growth in 2024. In contrast to a low base of the 1Q23 jumpstart, we expect the sector's premium growth to trend upward before normalizing in 2024.

P&C: Auto steadied with volume growth; non-auto profit boosted by structural improvement

P&C insurers diversified in auto and non-auto business throughout 2023. In the first half of the year, auto underwriting combined ratio increased due to heightened industry competition and a rebound in travel rates, evident in both increased claim and expense ratios. Heading into 2H23, auto premiums returned to a steady level, with the monthly increase on par with the vehicle sales volume increase of 6%. Over the long run, we expect auto premium growth to remain steady at around 6%, and with the NEV penetration foreseeably increasing, the average premium per case may progressively rise in accordance. For non-auto business, insurers' catastrophic claims resulted in losses beyond expectations, primarily caused by increased typhoons and tropical cyclones in 3Q23. Yet, through sufficient reserves and proactive risk mitigation and management, top PC players took initiatives to scale back lines with low underwriting profits or high risks, i.e., liability and employer guaranteed insurance, to cut cost levels and control the underwriting COR from further rising. The optimized structure in non-auto lines helped top PC insurers improve strategic resource and capital allocations, and thus resulted in a favorable COR and enhanced operating efficiency.

Looking ahead to 2024, we view the tightened regulations on limiting fees and fee placement in auto competition as beneficial-to-all in the industry. Besides, increased claims this year may weigh on the underwriting profits of small and medium-sized insurers such that they could have less capital surplus for expense expansion in 2024, which may help improve the industry expense ratio. Top PC insurers leveraged their better-than-peers digitalization and pricing capabilities to control risks beforehand and thus kept the underwriting COR within a profitable range. We expect top PC insurers' COR to rise by 1-2bps in 2023, yet remaining profitable under 100%.

Investment: 2024 fiscal expansion expect to support economic growth

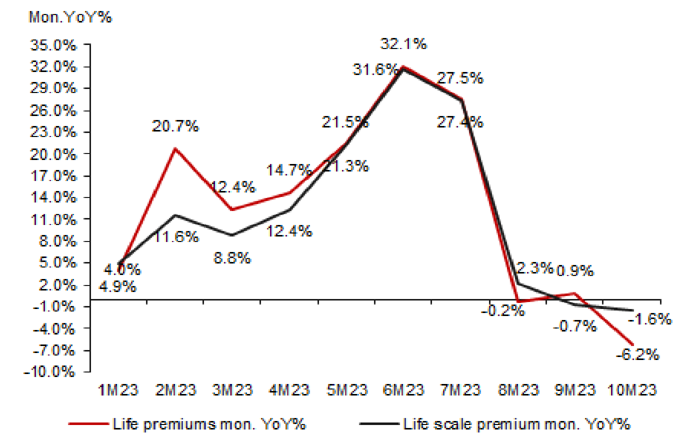
Long-term interest rates trended downward in 2023 under a moderate economic recovery. China's 10-year government bond yield has been hovering around 2.7% since 2Q23, down from above 3.0% at the beginning of the year. The equity market slipped sequentially amid seasonal volatilities, with sentiment about the CSI 300 index continuing to be weak. The benchmark index had retreated 11.7% year to date as of 11 December. Volatilities in both bond and equity markets pressured listed insurers' investment returns and net profits. In the first year of IFRS 9&17 adoption, we estimate that more financial assets categorized into measurement by fair value through profit and/or loss (FVTPL) increased the portfolios' exposure to market volatility, which adversely influenced the sector's 3Q23 profitability.

Looking forward to 2024, we envisage China's economic recovery to maintain a moderate pace. With support of the central government's fiscal expansion and local governments' debt resolution, we believe continued efforts recently, including the issuance of RMB1trn additional treasury bonds in 4Q23, and some new local debt quotas issued by the Ministry of Finance, show the government's resolve to pursue stable economic growth in 2024. Combined with our macro team's views, we believe the early-on effects from fiscal policies will continue into next year, and the proactive fiscal policy will serve as the driver for recovery.

Looking ahead, we expect sentiment rebound to shore up the equity performance, and thus drive insurers' asset returns upward. Given a low base since 2Q23, a mild return in equity will result in solid growth in investment and net profit in 2024. Besides, the resolution of real estate debt repayments will ease concerns on credit risks, which is conducive to improving the long-subdued valuation. The sector is now trading at a historical trough, with major H-share listed insurers trading at 0.1-0.4x FY23E P/EV. In the short term, we maintain our view of a sector rebound on the back of improved asset returns, while in the long run, we like top players in both segments. Our recommendations are CPIC (2601 HK) and PICC P&C (2328 HK). Reiterate BUY on both.

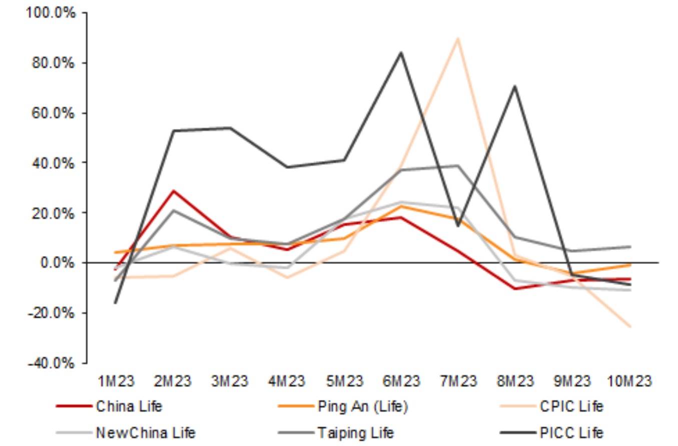
Focus Charts

Figure 1: Life premiums cum/mon. growth (industry)



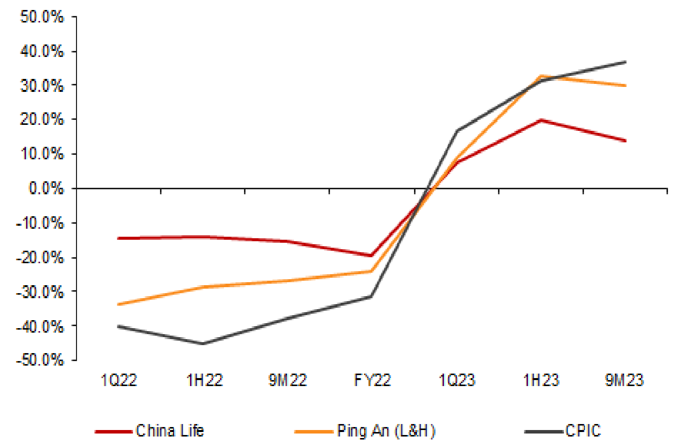
Source: Company data, CMBIGM

Figure 2: Life insurers' premiums cum/mon. growth



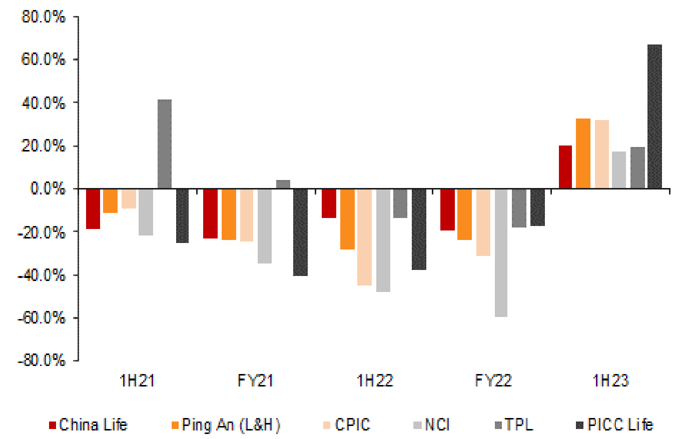
Source: Company data, CMBIGM

Figure 3: China Life, Ping An and CPIC NBV growth



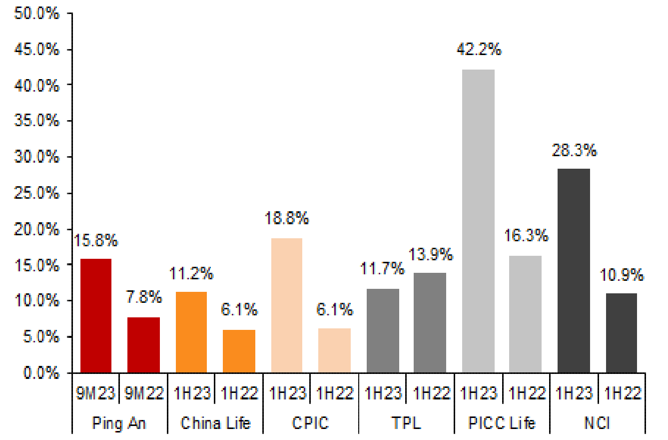
Source: Company data, CMBIGM

Figure 4: Listed life insurers NBV growth by period



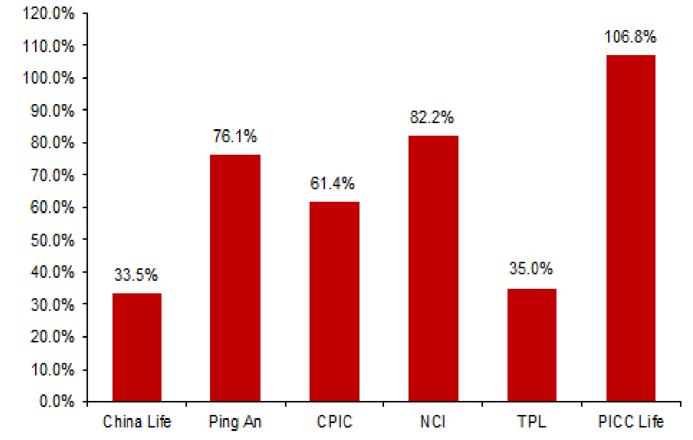
Source: Company data, CMBIGM estimates

Figure 5: 1H23 life insurers' agent scale



Source: Company data, CMBIGM

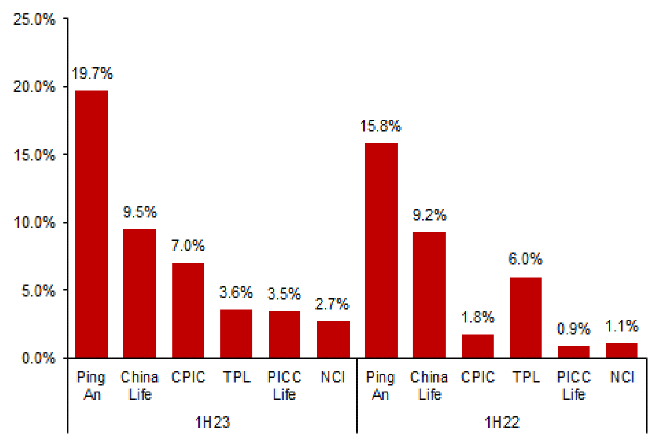
Figure 6: 1H23 life insurers agent productivity, VNB



Source: Company data, CMBIGM

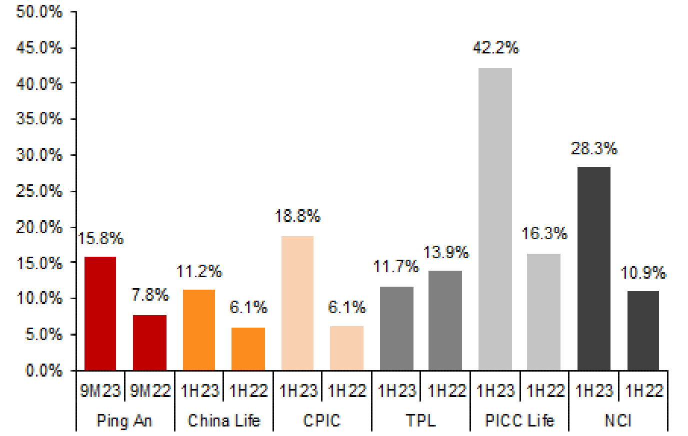
Note: VNB – value of new business

Figure 7: Life insurers' bancassurance VNB margin



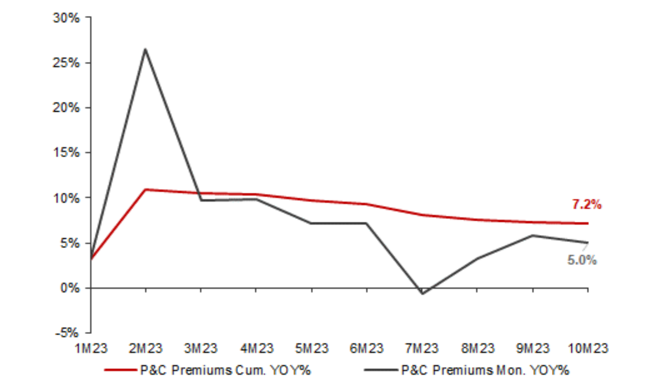
Source: Company data, CMBIGM

Figure 8: Life insurers' VNB% in bancassurance



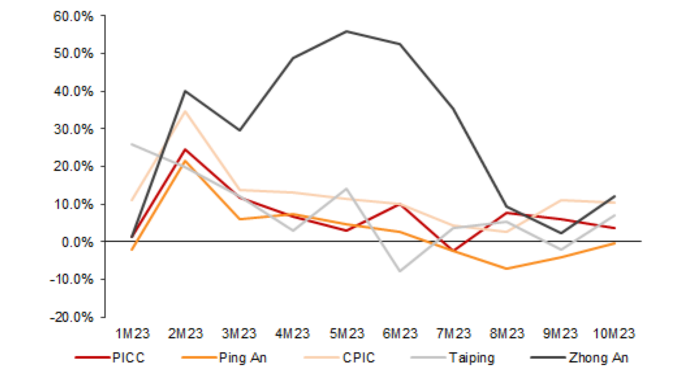
Source: Company data, CMBIGM

Figure 9: P&C premiums cum/mon. growth (industry)



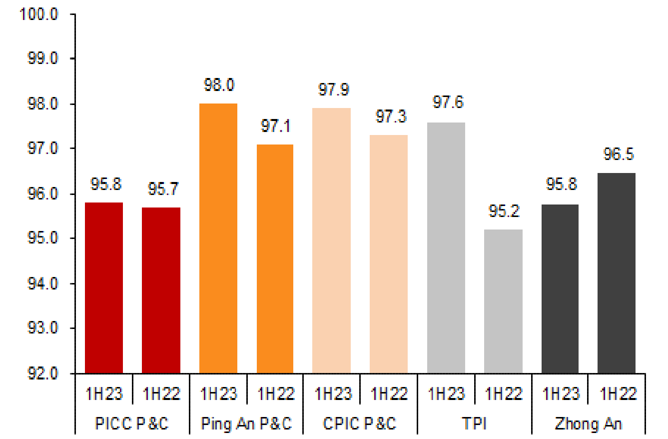
Source: Company data, CMBIGM

Figure 10: P&C insurers' premiums cum/mon. growth



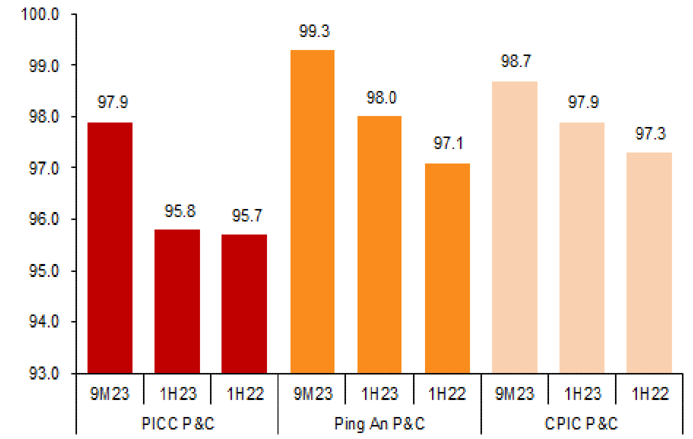
Source: Company data, CMBIGM

Figure 11: 1H23 P&C insurers' underwriting COR



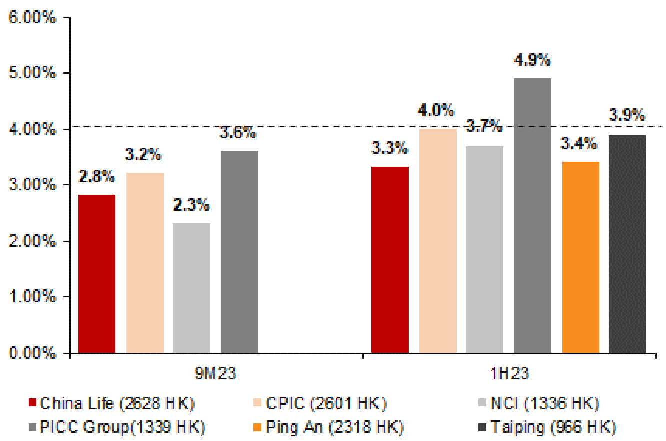
Source: Company data, CMBIGM

Figure 12: Top 3 P&C insurers' COR increased in 3Q23



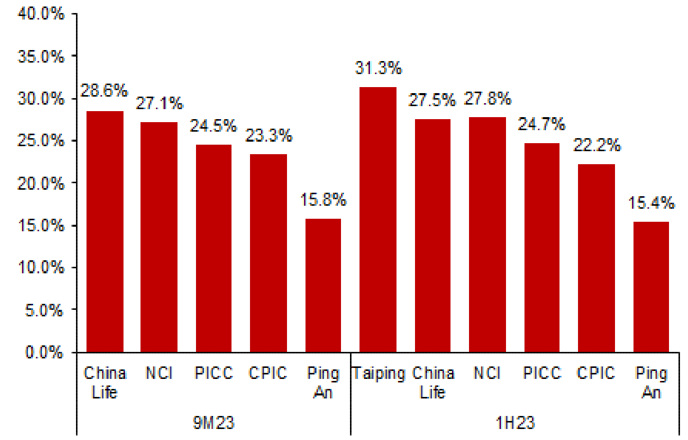
Source: Company data, CMBIGM

Figure 13: 9M23/1H23 total investment yields (%)



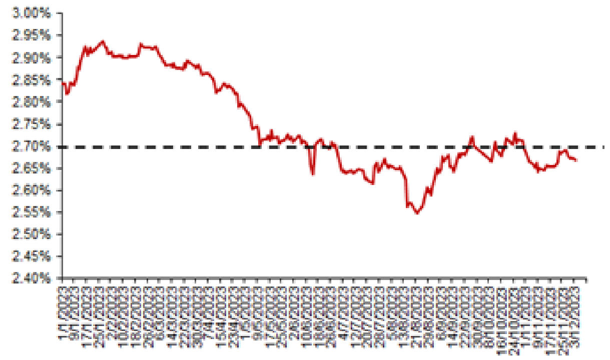
Source: Company data, CMBIGM

Figure 14: Listed insurers' FVTPL as a % of total assets



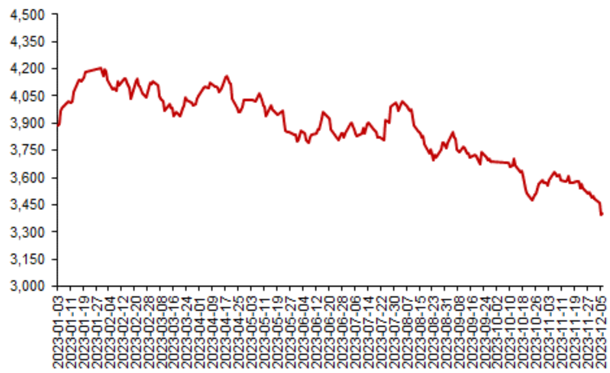
Source: Company data, CMBIGM

Figure 15: China 10-year govt. bond yield (%)



Source: Wind, CMBIGM

Figure 16: China CSI 300 Index, trending downward



Source: Wind, CMBIGM

Life: New business growth potential unleashed

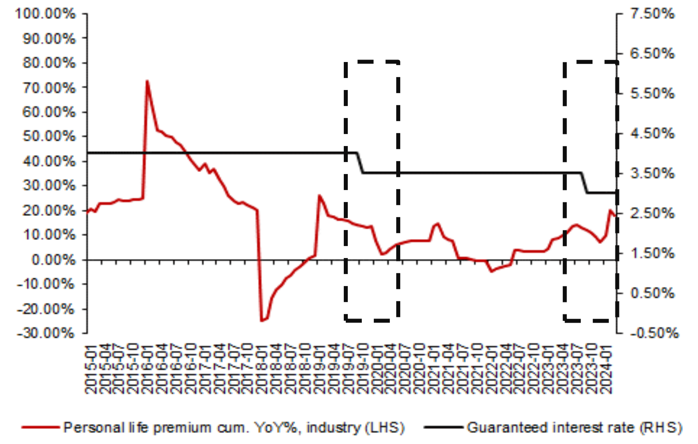
Tightened regulations as the touchstone for top winners

The insurance industry plays the role of a “stabilizer” for the economy and is a significant source of long-term funds in the market, subject to a series of regulations for risk protection. We regard tightened regulatory practice as the touchstone for the industry’s top winners, for which they can promote high-quality underwriting, and build capabilities on both the channel and product front. In 3Q23, the regulators successively introduced a series of policies to prevent the risks of loss on spreads and expense margin, with most regulating competition among insurance companies and exerting a great impact on the insurers’ liabilities.

To be specific, recent major regulations include: 1) the interest rate cut for traditional life insurance products from 3.5% to 3.0%, and for participating policies the upper limit of guaranteed rate lowered to 2.5%. 2) In late August, the regulators required major insurers to “unify reporting and underwriting” (“报行合一”) on bancassurance product commissions and transaction fees, causing suspension on product sales within the channel. 3) On October 18, the regulators issued a notice to promote stable and healthy development of personal life business, indicating the need to regulate the jumpstart sales among life insurers.

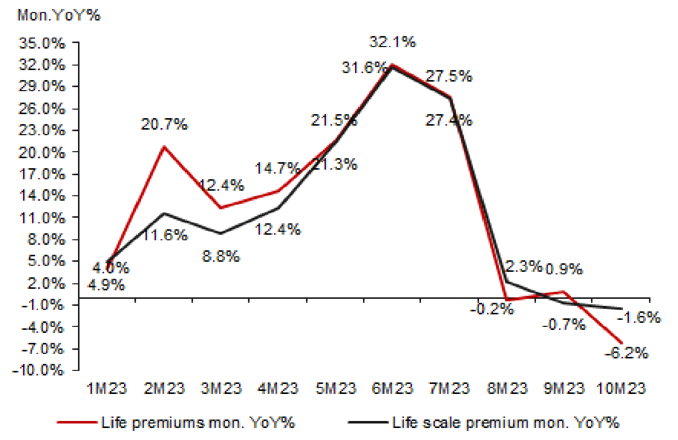
For the interest rate cut to 3.0%, we expect the impact on major insurers’ new business sales to be temporary, with disruptions to be absorbed within 1-2 quarters, referring to a similar situation in August 2019 when the pricing interest rate for traditional life products dropped from 4.025% to 3.5%. The monthly year-over-year growth of personal life premiums, on an industry basis, implied the disruption after a peak in July, at -0.2%/+0.9%/-6.2% in August/September/October 2023 respectively (Fig.17). As the jumpstart sales progressively proceed in December, we expect personal life premium growth to be steady on both the industry and company levels, trending upward before normalizing through 2024. Over the long run, the regulated interest rate cut helps relieve insurers’ investment pressure. In 3Q23, annualized total investment yields for major insurers slipped compared to the first half of the year, dragged primarily by the equity market volatilities and the first-year adoption of IFRS 9&17. By 3Q23, the total investment yields of China Life/CPIC/NCI/PICC amounted to 2.8%/3.2%/ 2.3%/3.6%, evidently down from 3.3%/4.0%/3.7%/4.9% in 1H23 (Fig.19). We anticipate moderate economic recovery to sustain in 2024, and the interest rate cut should serve the need of insurance companies, esp. lifers, to ride on a wave of recovery and recovering sentiment.

Figure 17: Interest rate cut for traditional life products



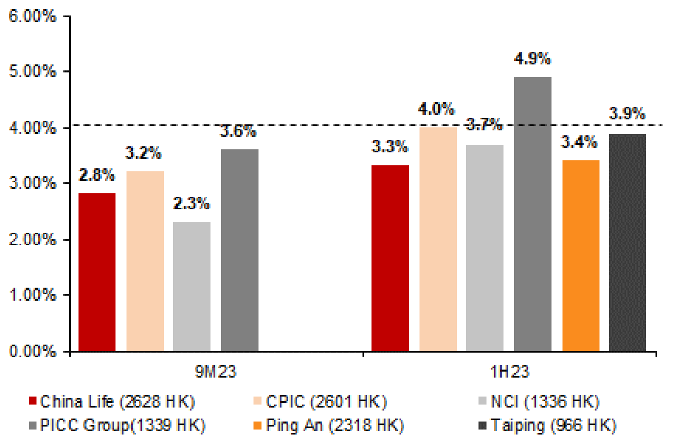
Source: Company data, CMBIGM estimates

Figure 18: Life premiums cum/mon. growth (industry)



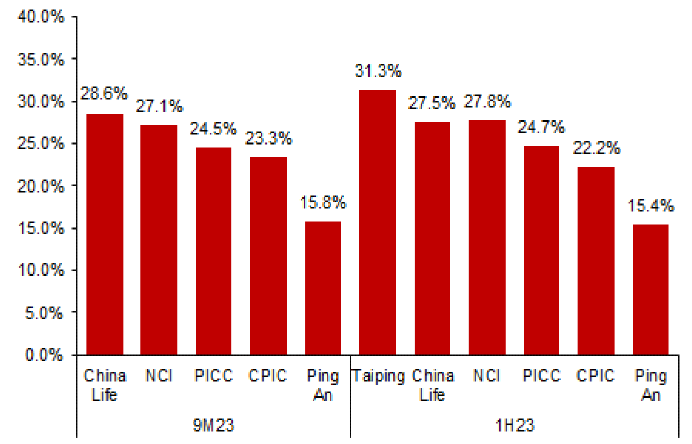
Source: Company data, CMBIGM

Figure 19: 9M23/1H23 total investment yields (%)



Source: Company data, CMBIGM

Figure 20: Listed insurers' FVTPL as a % of total assets

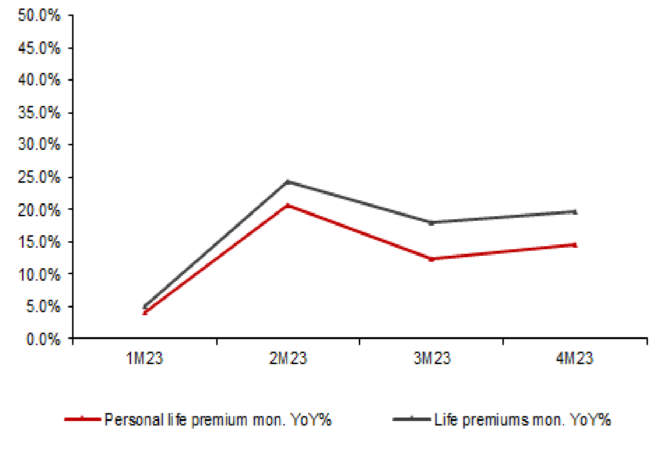


Source: Company data, CMBIGM

Agency: stabilized scale with heightened productivity

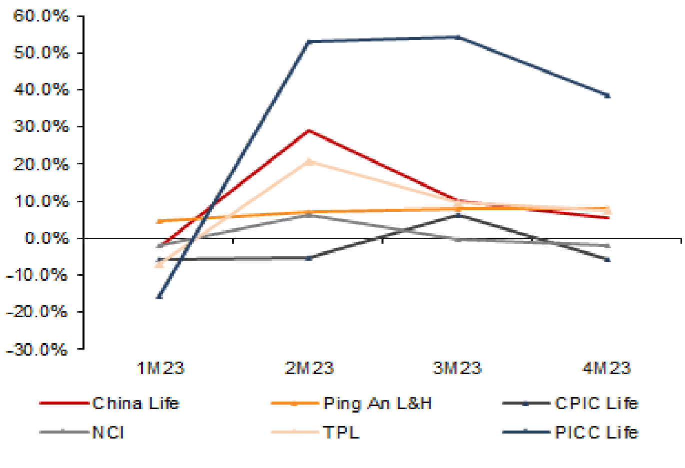
At end-3Q23, China Life and Ping An recorded total number of agents at 66k and 36k, mildly down by 0.2% and 3.7% respectively compared to 1H23. The decline narrowed compared to the year-beginning level of -1.2% and -19.2%. We expect the decline in agent scale to stabilize quarter by quarter in 2024, and the number of core agents, who serve as the fundamental driver for agency NBV growth, to remain solid. In 1H23, agent productivity measured by VNB basis per agent increased 34%/61%/82%/94% for China Life/CPIC/NCI/Ping An, respectively. For 2024, we think there is room for agent productivity to improve, as it is included as one of the key metrics after the three-year transformation. Given the low base of jumpstart sales in 1Q23, we expect the agency sales in 1Q24 to deliver high single-digit to low double-digit growth, and sequentially normalize to a steady level in 2024.

Figure 21: Life premium YoY in jumpstart 2023, industry



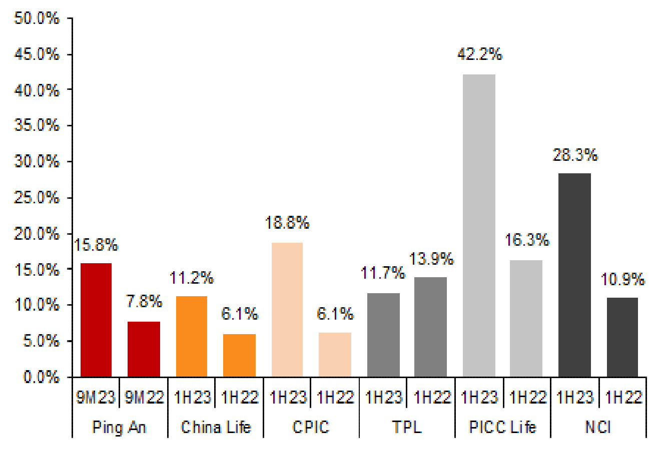
Source: Company data, CMBIGM

Figure 22: Life insurers' premium YoY in jumpstart 2023



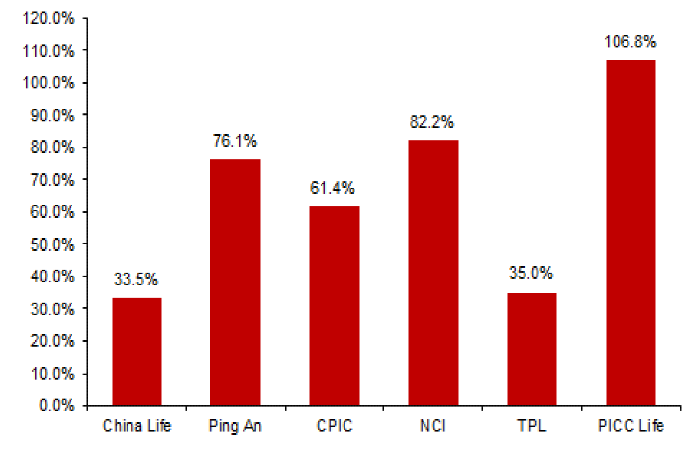
Source: Company data, CMBIGM

Figure 23: 1H23 life insurers' agent scale



Source: Company data, CMBIGM

Figure 24: 1H23 life insurers agent productivity, VNB

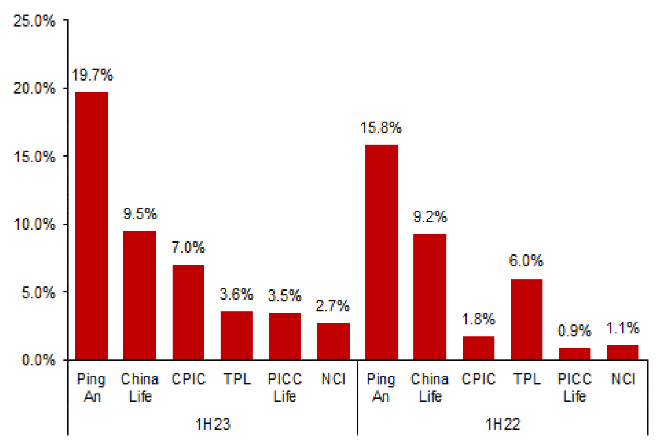


Source: Company data, CMBIGM

Bancassurance: VNB driver shifting from FYP growth to margin increase

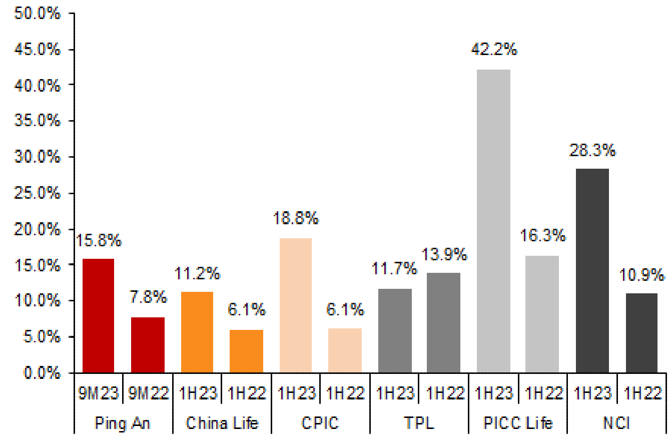
On the bancassurance front, we notice that most insurers have completed the process of signing new contracts with banks and filing regulatory reporting for new products sold, based on our channel check. We suppose the suspension-induced sales disruption was largely priced in by the market, and with the 2024 jumpstart sales to begin, we believe the regulatory impact on channel premium income will progressively ease over time. In 1H23, top insurers' bancassurance VNB contribution to total VNB ranged 10%-20%, except NCI and PICC Life, whose ratios were a bit higher, at 28.3% and 42.2%. Yet, the channel VNB margin, except Ping An, was still low at below 10%. With the new regulatory policy (“报行合一”), we expect the channel expense control to benefit product margin expansions, and the driver of bancassurance VNB growth is likely to shift from the acceleration of first-year premium (FYP) increase in 2023, to more consistent margin improvement in 2024 instead.

Figure 25: Life insurers' bancassurance VNB margin



Source: Company data, CMBIGM

Figure 26: Life insurers' VNB% in bancassurance



Source: Company data, CMBIGM

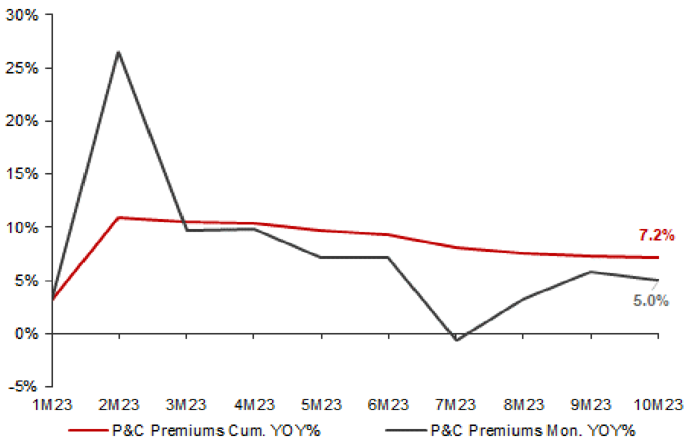
To sum up, although the life sector was weighed down by seasonal externalities, we believe that life insurers have embarked on a new growth cycle, following a more-than-three-year transformation since 2018. **Going forward, we expect asset recovery to catalyze a sector re-rating and buck the trend of the present long-subdued valuation. On the agency front, we anticipate core agents' productivity to be the highlight for channel VNB growth; and on the bancassurance side, margin improvement to be the silver lining. We expect the sector's VNB to achieve mid-single-digit growth in 1H24.**

P&C: Auto steadied with volume growth; non-auto profit boosted by structural improvement

P&C insurers diversified in auto and non-auto business throughout 2023. In the first half of the year, auto underwriting combined ratio increased due to heightened industry competition and a rebound in travel rates, evident in both increased claim and expense ratios. In 2H23, auto premiums returned to a steady level, with the monthly increase on par with the vehicle sales volume increase of 6%. Over the long run, we expect auto premium growth to remain steady at around 6%, and with the NEV penetration foreseeably increasing, the average premium per case may progressively rise in accordance. For non-auto business, insurers' catastrophic claims resulted in losses beyond expectations, primarily caused by increased typhoons and tropical cyclones in 3Q23. Yet, through sufficient reserves and proactive risk mitigation and management, top PC players took initiatives to scale back lines with low underwriting profits or high risks, i.e., liability and employer guaranteed insurance, to cut cost levels and control the underwriting COR from further rising. The optimized structure in non-auto lines helped top PC insurers improve strategic resource and capital allocations, and thus resulted in a favorable COR and enhanced operating efficiency.

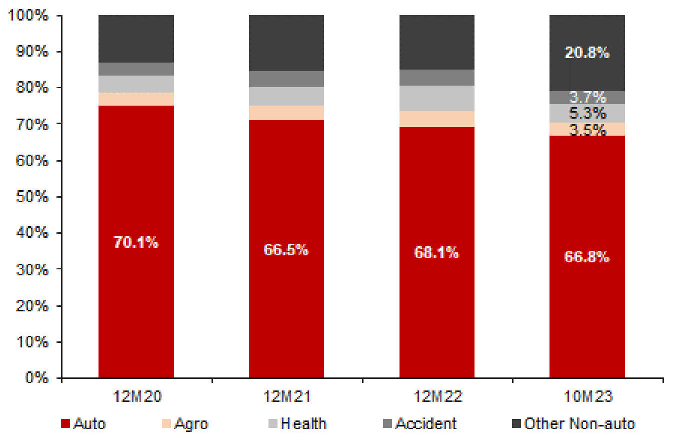
For 2024, we view the tightened regulations on limiting fees and fee placement in auto competition as beneficial-to-all in the industry. Besides, increased claims this year may weigh on the underwriting profits of small- and medium-sized insurers such that less capital surplus can be utilized for expense expansion in 2024, which may help improve the industry expense ratio. Top PC insurers leveraged better-than-peers digitalization and pricing capabilities to control risks beforehand and thus kept the underwriting COR within a profitable range. We expect top PC insurers' COR to rise by 1-2bps in 2023, yet remaining profitable under 100%.

Figure 27: P&C premiums cum/mon. growth (industry)



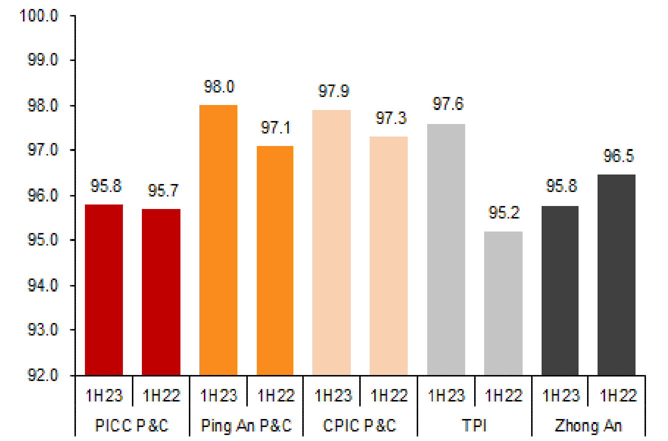
Source: Company data, CMBIGM

Figure 28: P&C auto and non-auto premium structure



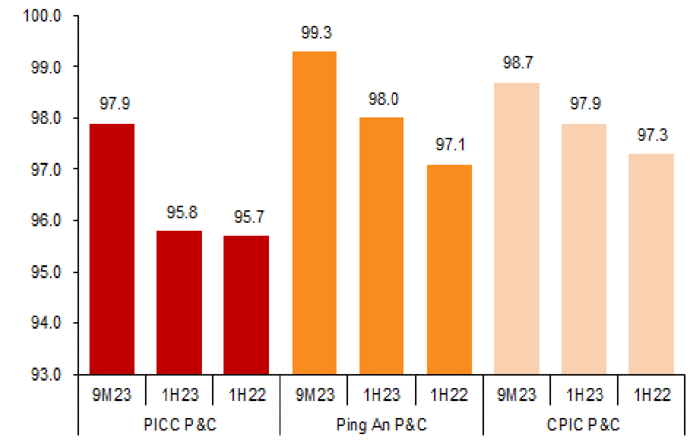
Source: Company data, CMBIGM

Figure 29: 1H23 P&C insurers' underwriting COR



Source: Company data, CMBIGM

Figure 30: Top 3 P&C insurers' COR increased in 3Q23



Source: Company data, CMBIGM

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Valuation

Fig. 31: Valuation of comparable peers

Company	Ticker	Rating	12m TP (LC)	Price (LC)	Upside/ Downside	Mkt. Cap (US$ mn)	P/EV (x) FY23E	P/EV (x) FY24E	P/B (x) FY23E	P/B (x) FY24E	ROE (%) FY23E	ROE (%) FY24E
H share												
Ping An	2318 HK	BUY	68.7	33.6	104%	713.8	0.4 x	0.3 x	0.6 x	0.5 x	12.2%	13.1%
China Life	2628 HK	BUY	16.1	9.7	65%	724.2	0.2 x	0.2 x	0.5 x	0.5 x	9.9%	11.8%
CPIC	2601 HK	BUY	22.9	15.0	52%	214.8	0.2 x	0.2 x	0.5 x	0.5 x	11.9%	12.8%
NCL	1336 HK	BUY	23.7	14.7	61%	84.7	0.2 x	0.2 x	0.4 x	0.3 x	11.2%	11.6%
Taiping	966 HK	HOLD	11.8	6.6	279%	23.7	0.1 x	0.1 x	0.3 x	0.2 x	12.7%	7.8%
PICC Group	1339 HK	BUY	3.10	2.4	29%	212.6	0.3 x	0.3 x	0.4 x	0.4 x	9.6%	10.9%
PICC P&C	2328 HK	BUY	11.7	8.7	34%	193.7	n.a	n.a	0.7 x	0.7 x	12.7%	13.4%
Zhong An	6060 HK	BUY	27.5	19.1	44%	28.1	n.a	n.a	1.4 x	1.3 x	10.3%	7.4%
AIA	1299 HK	BUY	98.4	63.6	55%	724.4	1.4 x	1.2 x	2.3 x	2.2 x	11.3%	16.6%
Prudential	2378 HK	BUY	143.0	85.8	67%	236.3	0.7 x	0.7 x	1.6 x	1.5 x	11.2%	13.2%
						Average	**0.4 x**	**0.4 x**	**0.9 x**	**0.8 x**	**11.3%**	**11.1%**
A share												
Ping An	601318 CH	BUY	62.17	39.60	57%	656.2	0.5 x	0.5 x	0.8 x	0.7 x	8.5%	9.0%
China Life	601628 CH	SELL	14.57	28.77	-49%	665.7	0.6 x	0.6 x	1.7 x	1.6 x	10.6%	9.0%
CPIC	601601 CH	BUY	20.75	23.24	-11%	197.5	0.4 x	0.4 x	0.9 x	0.8 x	7.1%	6.9%
NCL	601336 CH	SELL	21.43	30.63	-30%	77.9	0.4 x	0.4 x	0.8 x	0.8 x	2.3%	4.1%
PICC Group	601319 CH	SELL	2.81	4.96	-43%	195.4	0.7 x	0.6 x	0.9 x	0.8 x	12.8%	9.8%

Source: Bloomberg, CMBIGM

Company	Ticker	Rating	P/E (x) FY23E	P/E (x) FY24E	P/E (x) FY25E	Dividend yield (%) FY23E	Dividend yield (%) FY24E	Dividend yield (%) FY25E	ROEV FY23E	ROEV FY24E	ROEV FY25E
Ping An	2318 HK	BUY	5.0 x	2.9 x	2.6 x	8.1%	8.9%	9.5%	8.5%	9.0%	8.5%
China Life	2628 HK	BUY	6.1 x	4.8 x	4.3 x	7.3%	8.0%	8.9%	10.6%	9.0%	8.7%
CPIC	2601 HK	BUY	4.6 x	3.0 x	2.6 x	7.7%	8.7%	9.4%	7.1%	6.9%	6.3%
NCL	1336 HK	BUY	3.6 x	2.7 x	2.5 x	8.4%	9.8%	10.3%	2.3%	4.1%	3.7%
Taiping	966 HK	HOLD	3.5 x	3.2 x	3.0 x	0.0%	0.0%	0.0%	13.6%	19.0%	13.9%
PICC Group	1339 HK	BUY	4.4 x	3.1 x	2.8 x	7.8%	9.3%	10.4%	5.2%	8.9%	8.4%
PICC P&C	2328 HK	BUY	6.1 x	5.2 x	4.6 x	6.6%	7.2%	7.9%	n.a	n.a	n.a
Zhong An	6060 HK	BUY	15.6 x	16.2 x	13.1 x	0.0%	0.0%	0.0%	n.a	n.a	n.a
AIA	1299 HK	BUY	19.7 x	11.1 x	9.8 x	2.6%	2.8%	3.2%	7.9%	13.2%	13.8%
Prudential	2378 HK	BUY	15.4 x	7.6 x	6.5 x	1.9%	2.0%	2.2%	6.7%	14.5%	15.1%

Source: Bloomberg, CMBIGM

Company	Ticker	Rating	Premium Income growth FY23E	Premium Income growth FY24E	Premium Income growth FY25E	Underwriting COR FY23E	Underwriting COR FY24E	Underwriting COR FY25E	Insurance revenue growth FY23E	Insurance revenue growth FY24E	Insurance revenue growth FY25E
P&C insurers											
Ping An	2318 HK	BUY	5.2%	5.5%	5.5%	99.3%	98.5%	97.9%	5.9%	1.9%	3.2%
CPIC	2601 HK	BUY	9.6%	6.4%	6.8%	98.7%	98.3%	98.3%	15.2%	7.0%	6.6%
Taiping	966 HK	BUY	25.6 %	-7.3%	5.0%	98.9%	98.7%	98.5%	6.3%	7.9%	6.8%
PICC P&C	2328 HK	BUY	7.6%	7.3%	7.5%	98.2%	98.0%	97.8%	7.9%	10.1%	10.1%
Zhong An	6060 HK	HOLD	21.9 %	15.2%	13.0%	98.4%	97.9%	98.0%	23.8%	16.5%	15.0%

Source: Bloomberg, CMBIGM

China Property

OUTPERFORM

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Tough way ahead

Sluggish new home sales; volume up, price down in secondary market

Property sales in 10M23 reached 926mn sqm, marking a YoY decline of 7.8%, further expanding the downturn. High-frequency data (in 30 major cities) indicates a continued 6% MoM decline in Nov as the year-end seasonal peak was dampened by sluggish home-buying sentiment. Structurally, divergence intensified between high/low-tier cities and state-owned-enterprises (SOEs)/private-owned-enterprises (POEs). The increased listing volume of second-hand homes has led to continuous price decreases. In key cities, housing prices have declined by ~12% since the peak in Aug 2021 (Figure 22). This, coupled with the demand shifting from the new home market due to delivery concerns, has resulted in a notable performance for second-hand homes. As of the end of Nov, the transactions in 14 tracked cities had increased by 25% YoY.

Policy support continued, financing pressure remains

Proactive policies have been frequently introduced throughout the year, and yet their marginal weakening effect on stimulating demand and a slow economic recovery pace made it challenging to restore confidence in property purchases, offsetting some of the positive impacts of policies. The implementation of financing-side policies faces numerous challenges, leading to continued liquidity pressure for developers. Among the 160 sampled developers, the average annual maturing debt in 2024-25 exceeds RMB700bn, with domestic debt accounting for ~63-67%. Among overseas debt maturing in 2024-25, 80% originates from POEs. POEs will face another debt repayment peak in 2024, especially in 1H24. Against the backdrop of sluggish sales recovery, we believe only further facilitation of the implementation of financing-side policies can help prevent further defaults.

Outlook: Sales decline in 2024 may continue to narrow

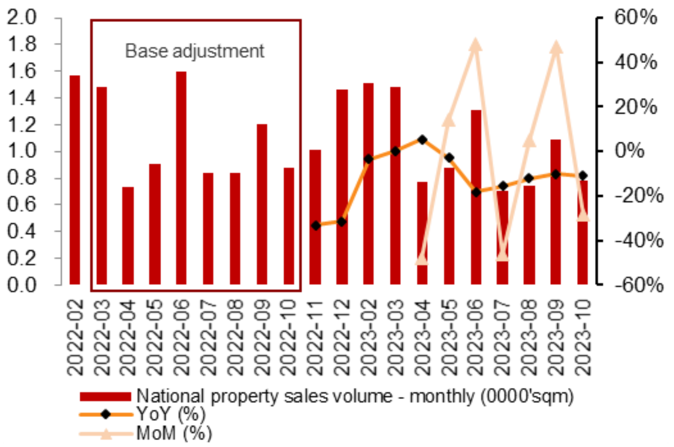
New home: We expect property sales volume in 2023 and 2024 to be -7% YoY and -4% YoY, respectively, based on 1) the difficulty in generating strong purchasing sentiment as seen in earlier 2023 even with continued policy tightening, as the market has a clear understanding of the industry's long-term direction of development; 2) persistent debt pressure on developers, causing concerns on housing delivery; 3) less high-quality saleable resources in 2024 due to scaled-back land supply in 2023; and 4) policy adjustments for the proportion of affordable housing supply to commercial housing supply (5:5 to 6:4) indicating lower growth demands for commercial housing. **Secondary market**: We forecast sales growth for 2023 and 2024 to be +13% and +11%, respectively, based on 1) the delayed effect of new policy (No. of houses owned identified by unit other than mortgage record) to support transactions; 2) concerns on new home delivery caused by developer defaults continuing shifting demand to the secondary market; 3) sustained declines in second-hand home prices providing support for transaction volumes; and 4) natural improvement in the turnover rate of the existing home market. **Property investment**: We anticipate that in 2024, new starts / GFA completion / property investment growth will be -10%/0%/-9%.

Investment thesis

Before fundamental improvements become apparent, we recommend: 1) Focus on beneficiaries in the existing home market. From a sales perspective, the long-term performance of the secondary market may surpass that of the new home market due to the natural increase in turnover rates and the continued demand shifting caused by concerns about new project delivery. From a service perspective, as the scale of new housing shrinks, the existing home market provides substantial business potential. 2) Pay attention to developers with ample saleable resources in core areas or cities, or those focusing on good bargains in cities surrounding core areas. 3) Consider companies benefiting from concepts such as affordable housing supply and urban village renovations. 4) In the short term, pay attention to those who actively manage defaulted or potentially defaulted debts by restructuring, and proactively repair their creditworthiness, thereby gaining opportunities to sustain operations. For stock picking, among asset-light companies, BEKE is one of the biggest beneficiaries of the secondary market, though its possibly higher-than-expected investment in asset-heavy business may arouse investors' concerns; we also prefer PJM name Greentown Mgmt., and PM names CR MixC, COPH, Poly Services, Onewo and Yuexiu Services; among developers, we like CR Land, Yuexiu Property and Binjiang Group.

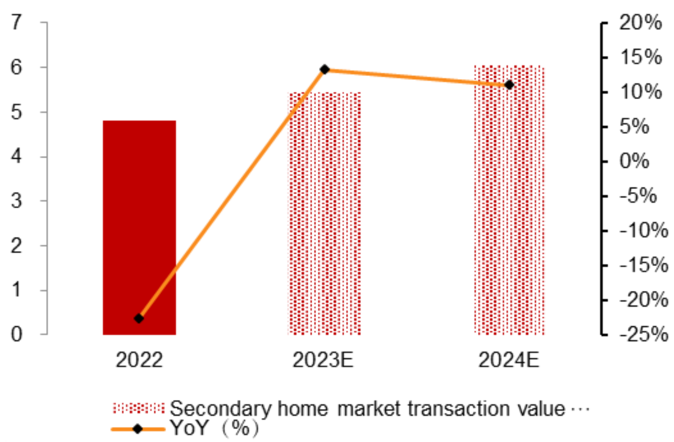
Focus Charts

Figure 1: National property sales volume



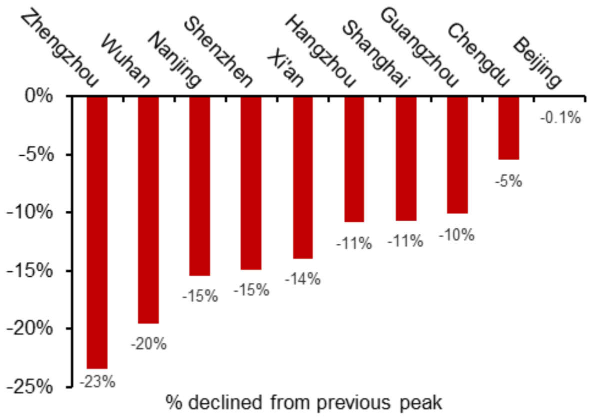
Source: NBS, CMBIGM estimates

Figure 2: Secondary home market transaction value



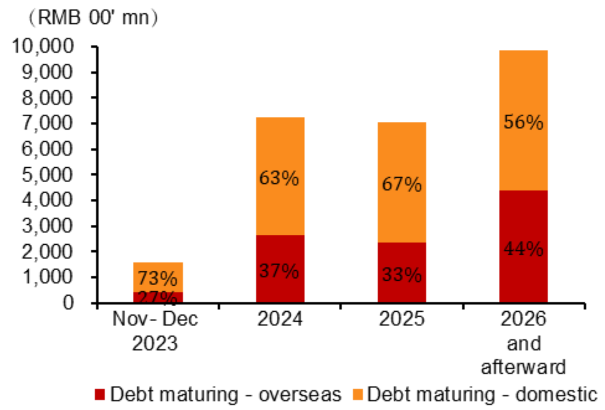
Source: BEKE, CMBIGM estimates

Figure 3: Second-hand home transaction price (Oct 2023 vs. Aug 2021)



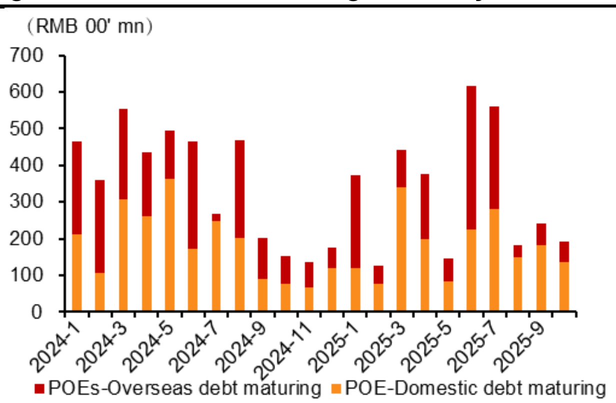
Source: Fang.com, CMBIGM

Figure 4: Sampled developers' debt maturing (Overseas vs Domestic)



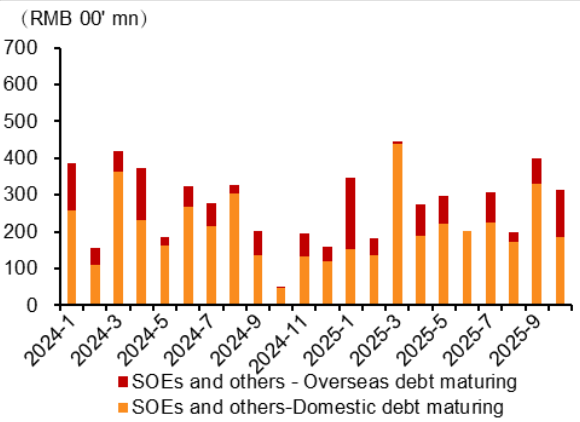
Source: CRIES, CMBIGM

Figure 5: POEs debt maturing - monthly



Source: CRIES, CMBIGM

Figure 6: SOEs/semi-SOEs debt maturing - monthly



Source: CRIES, CMBIGM

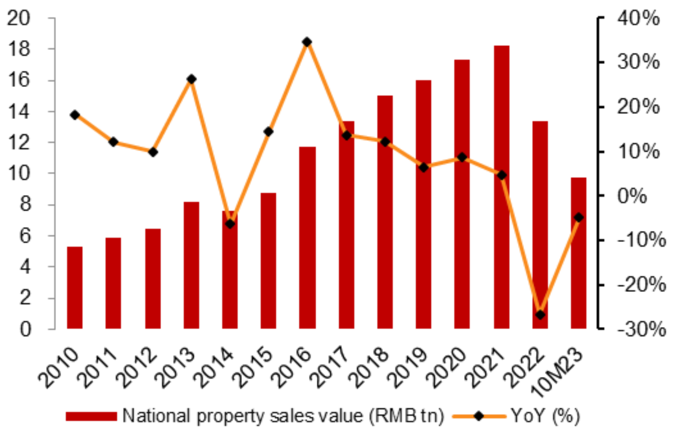
Sales: Weak recovery, dual-dimensional divergence

New home market

■ **Weak national sales recovery**

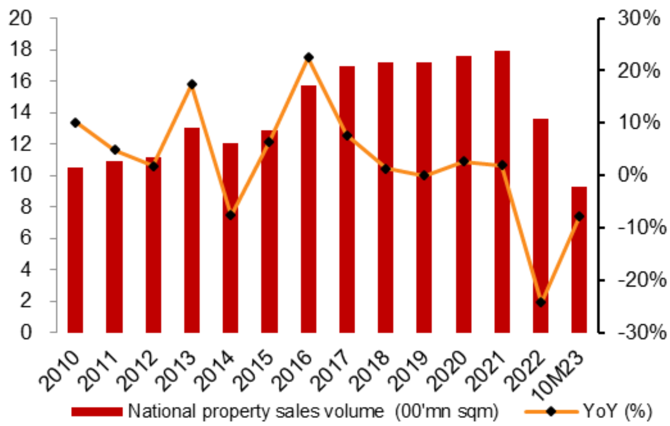
According to the National Bureau of Statistics (NBS) real estate data, the cumulative sales of commercial housing nationwide reached RMB9.72tn in 10M23, marking a YoY decline of 4.9%. The cumulative sales volume totaled 926mn sqm, reflecting a YoY decrease of 7.8%, further widening the decline compared to 9M23. Despite continued policy relaxation on the demand side, the sales recovery remains weaker than anticipated. In October, the monthly sales amounted to RMB809.1bn, down 25.9% MoM and 8.1% YoY after base adjustment. The sales volume reached 77.73mn sqm, which dropped 28.4% MoM and 11% YoY.

Figure 7: National property sales value



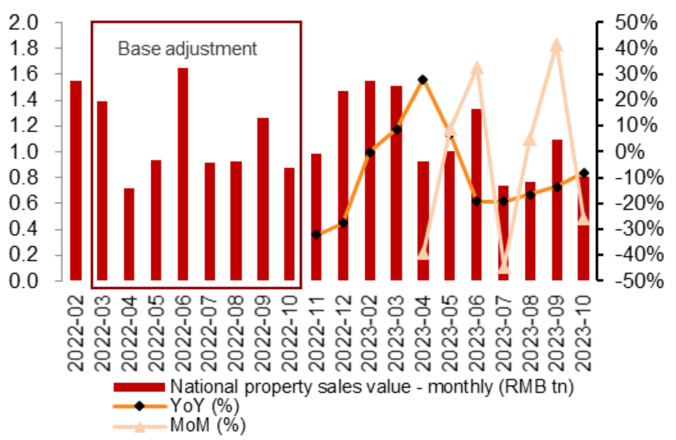
Source: NBS, CMBIGM

Figure 8: National property sales volume



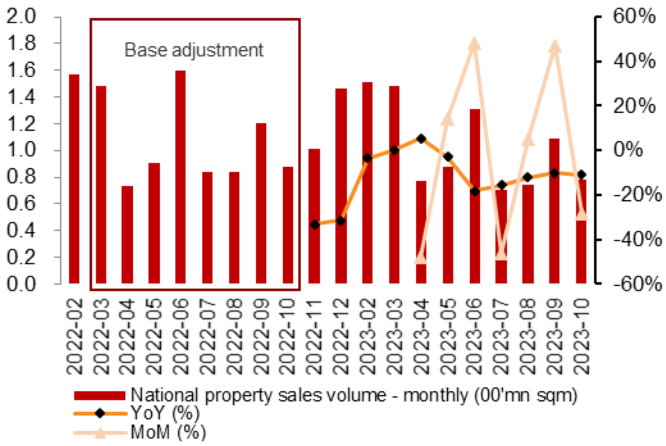
Source: NBS, CMBIGM

Figure 9: National property sales value - monthly



Source: NBS, CMBIGM

Figure 10: National property sales volume - monthly



Source: NBS, CMBIGM

Based on the high-frequency data we have tracked, as of Nov 28, 2023, MTD new home sales in 30 major cities recorded -18% /-6% YoY/MoM. Year-to-date sales declined 7% YoY.

Figure 11: New home sales in 30 major cities – Daily

YoY		vs 2022	vs 2021	vs 2020	vs 2019
Jul		-27%	-51%	-53%	-47%
Aug		-23%	-37%	-51%	-41%
Sep		-22%	-33%	-51%	-43%
Oct		-1%	-20%	-39%	-35%
Nov MTD	As of 28th	-18%	-39%	-51%	-46%
QTD	As of 28th	-9%			
YTD	As of 28th	-7%			

MoM		
Jul		-24%
Aug		-1%
Sep		8%
Oct		3%
Nov MTD	As of 28th	-6%
WoW		
Nov	As of 28th	-4%

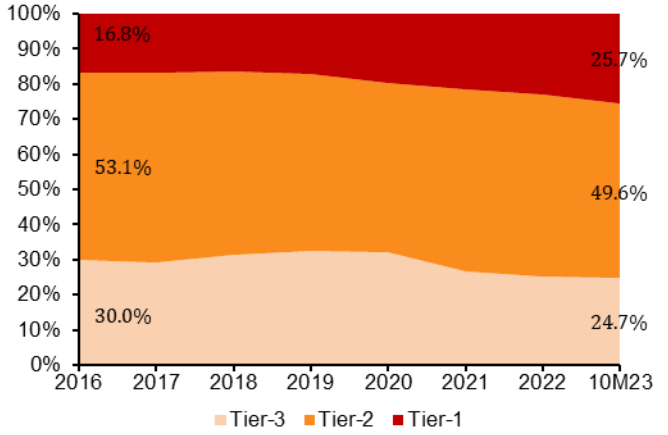
Source: Wind, CMBIGM

■ **Intensified divergence on two dimensions**

1) Divergence between high- and low-tier cities

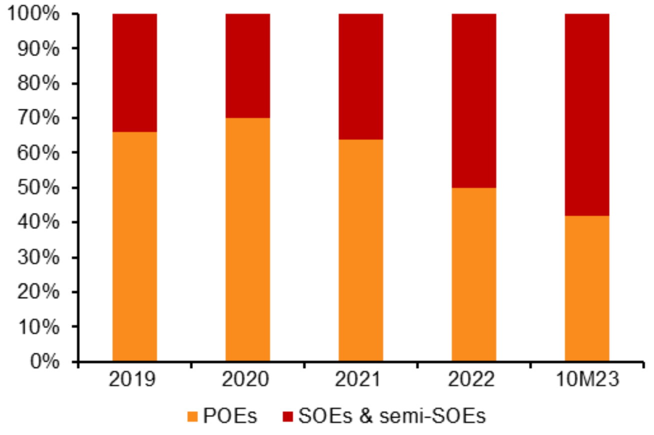
As China's population has peaked and may see a decline trend, and the urbanization process comes to a conclusion stage, only high-tier cities continue to sustain net population inflows due to their industrial advantages and economic resilience. Consequently, these cities maintain good expectations for housing prices and investment returns. Among the 30 major cities, the proportion of housing units sold in tier-1 cities increased gradually from 16.8% in 2016 to 25.7% in Oct 2023. The proportion for tier-2 cities and tier-3 cities decreased from 53.1% and 30% in 2016 to 49.5% and 24.8% in Oct 2023, respectively. The trend is likely to continue as the population trend is hard to reverse, in our view.

Figure 12: Housing units sold in different city tiers



Source: Wind, CMBIGM

Figure 13: Top 50 developers breakdown by type



Source: CRIES, CMBIGM

2) Divergence between SOEs and POEs

During the previous upward cycle, POEs expanded more aggressively while SOEs stayed relatively conservative; thus SOEs have been far less affected than POEs in the current downward cycle. In terms of financing, SOEs hold a significant credit advantage over POEs, and significant liquidity pressures among POEs led to a slowdown or cessation of land acquisitions, while some SOEs have taken the opportunities to expand. Due to constraints on saleable resources and the impact of "project delivery concerns" resulting from default risks, POEs have demonstrated a substantial divergence in sales performance compared to SOEs. According to data from CRIES, the number of POE names in the Top 50 sales ranking decreased gradually from 33 in 2019 to 21 as of Oct 2023.

Secondary market

■ **Secondary market sales recorded impressive performance**

In 2023, the overall performance of the secondary home market has outperformed the new home market. Based on our tracked high-frequency data, as of Nov 28, 2023, YTD transaction volume in 14 cities increased by 27% compared to the same period last year, marking a notable improvement from the 9% decline observed in 2022. MTD volume in Nov 2023 increased 15% MoM and 25% YoY. We believe the impressive performance in the second-hand home transactions is mainly attributed to several factors: **1)** A significant increase in supply (listing) due to the expiration of resale limitations of new homes sold in the past few years in the last upward cycle (2-5 years' resale limitation), continuous relaxations in resale restrictions speeding up the expiration, and cash-out demand of investment-oriented home buyers naturally increasing second-hand home listings. **2)** The increase in listings induces competitive pressures, leading to a natural decline of prices (Figure 15), which makes second-hand homes cost-effective compared to new homes. **3)** Concerns about "new project delivery" resulting from developers' defaults continue shifting homebuyer demand to the second-hand market from the new home market. **4)** Amid an economic downturn and consumption downgrade, homebuyers emphasize more the purpose of living than investment, giving second-hand homes an advantage over new ones. **5)** The increased maturity of the secondary market significantly enhances turnover rates. For one thing, technological advancements continuously innovate house agent platforms' marketing models and customer acquisition methods, ensuring better matching between buyers and sellers. For another, regulatory simplification of the resale housing transaction process significantly improves transaction efficiency.

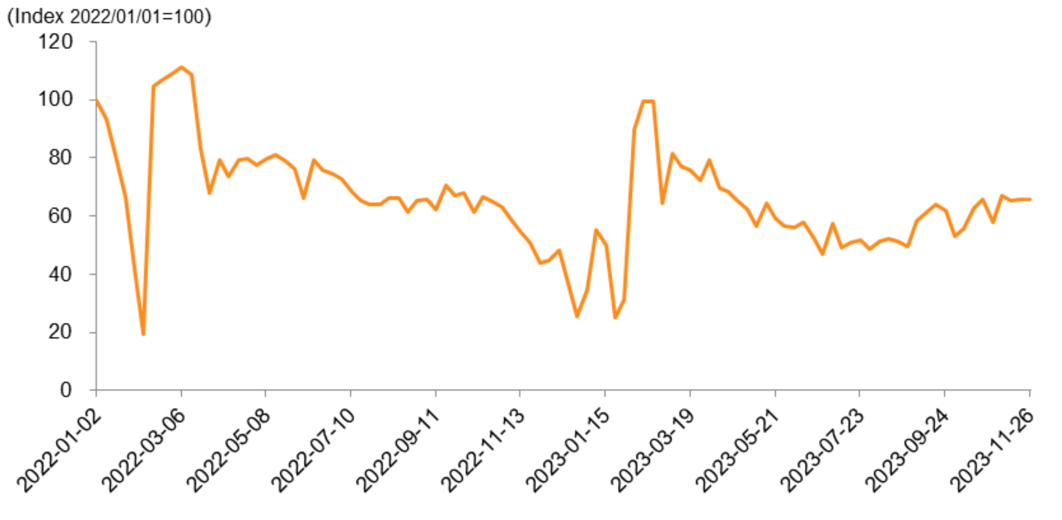
Figure 14: Secondary home sales in 14 cities – Daily

YoY		vs 2022	vs 2021	vs 2020	vs 2019
Jul		-12%	-32%	-32%	-21%
Aug		0%	18%	-18%	-13%
Sep		11%	35%	-20%	-8%
Oct		31%	98%	15%	17%
Nov MTD	As of 28th	**25%**	54%	3%	12%
QTD	As of 28th	**28%**			
YTD	As of 28th	**27%**			

MoM		
Jul		-14%
Aug		8%
Sep		-3%
Oct		6%
Nov MTD	As of 28th	**15%**
WoW		
Nov	As of 28th	**0%**

Source: Wind, CMBIGM

Figure 15: Second-hand home listing volume index



Source: Wind, CMBIGM

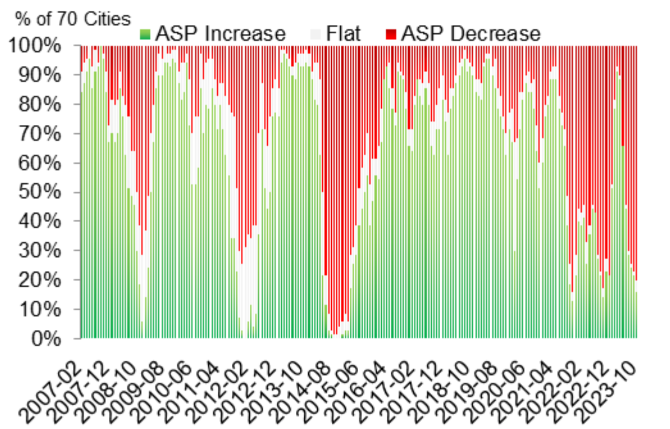
Housing price

- **New home price decline narrows, with divergence between high- and low-tier cities**

According to data from the NBS, in Oct 2023, among 70 major cities, prices of new homes declined MoM in 56 cities, marking the highest number since Oct 2022. From Jan to Oct 2023, 42 cities booked new home price decreases and 28 cities booked increases, a slight improvement from 53 cities and 16 cities respectively in 2022. When considering different tiers, the cumulative decline in new home prices across the 70 cities was 0.2% in 10M23（narrowed from -2.3% in full-year of 2022). Tier-3 cities performed worse (with a cumulative decline of 0.9%), while tier-1 and tier-2 cities showed accumulative increases of 0.7% and 0.8% respectively.

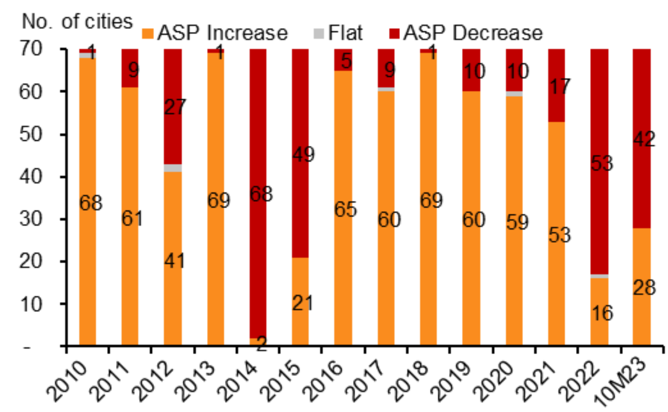
Figure 18 shows that since the third quarter of 2021, there has been a gradual divergence in the trend of new home prices between high- and low-tier cities. Tier-2 and tier-3 cities dragged the overall prices of the 70 cities into a downward trend, while tier-1 cities continued to experience fluctuating upward trends.

Figure 16: New home price MoM change in 70 cities



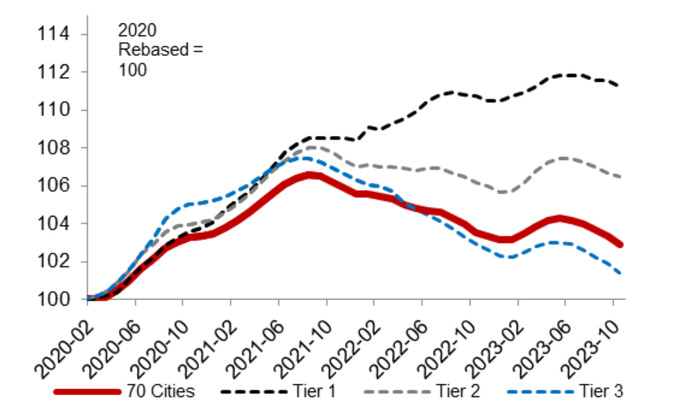
Source: NBS, CMBIGM

Figure 17: New home price annual change in 70 cities



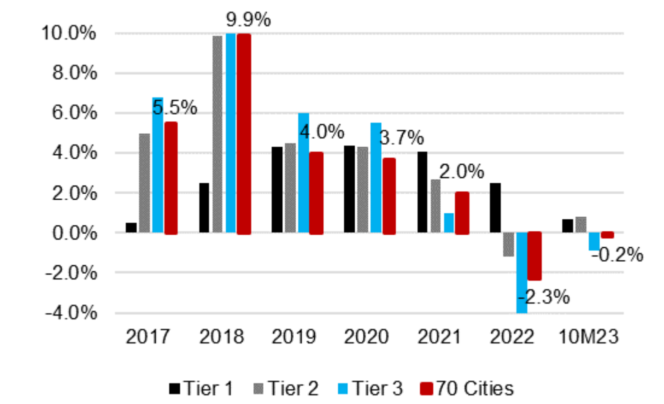
Source: NBS, CMBIGM

Figure 18: New home price in 70 cities - monthly



Source: NBS, CMBIGM

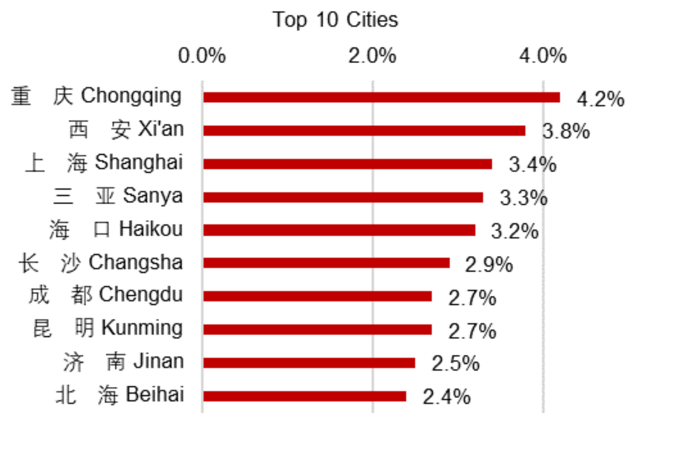
Figure 19: New home price in 70 cities - annual



Source: NBS, CMBIGM

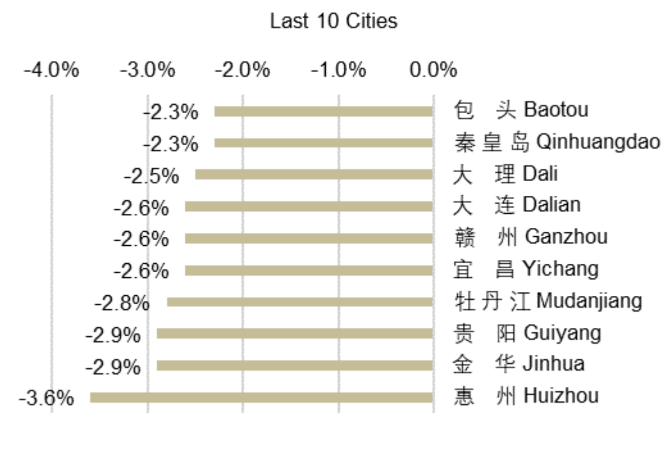
In terms of city performance, from Jan to Oct 2023, the top 10 cities with the highest cumulative increase in prices of new homes are shown in the following figure. Among them, Chongqing, Xi'an, and Shanghai recorded increases of 4.2%, 3.8%, and 3.4% respectively. Among the cities witnessing the sharpest declines, Huizhou, Jinhua, and Guiyang recorded decreases of -3.6%, -2.9%, and -2.9% respectively.

Figure 20: New home price change (Jan-Oct 2023)



Source: NBS, CMBIGM

Figure 21: New home price change (Jan-Oct 2023)

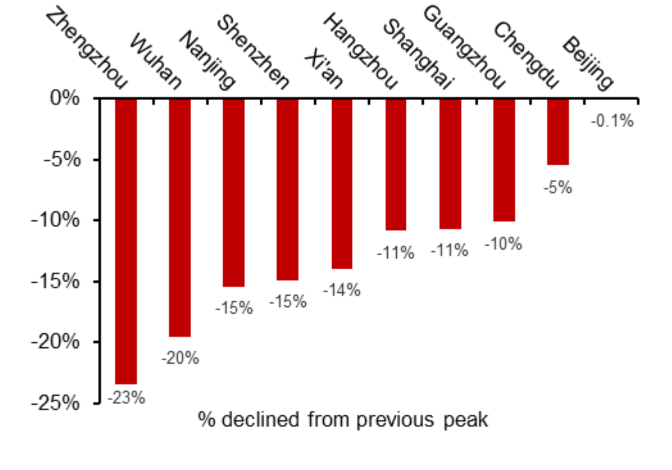


Source: NBS, CMBIGM

- **Second-hand home price keeps weakening even in tier-1 cities**

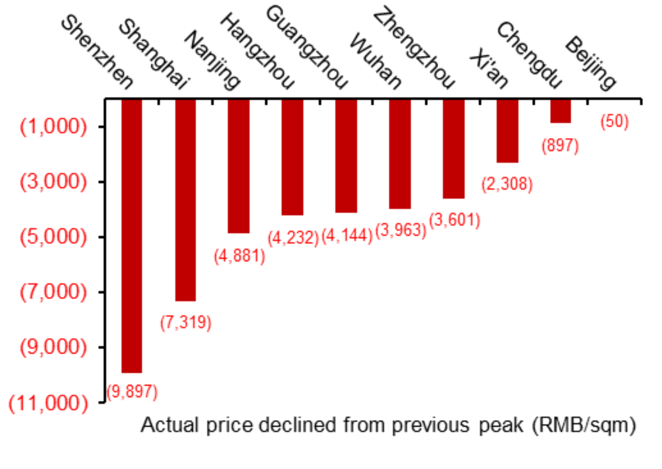
Reviewing recent years based on transactional data obtained from Fang.com, we note that second-hand home transaction prices have shown a downward trend for over two years since the last peak in Aug 2021, without a strong signal of recovery. As of Nov 2023, among the ten key cities we have tracked, second-hand home transaction prices had, on average, decreased by 12% from the previous peak in Aug 2021. Cities experiencing more pronounced declines include Zhengzhou, Wuhan, and Nanjing, which have seen decreases of 23%, 20%, and 15% respectively. Among the tier-1 cities, Shenzhen, Shanghai, and Guangzhou had experienced declines of 15%, 11%, and 10% respectively, while Beijing had shown relatively stable performance. In terms of actual transaction prices per sqm, Shenzhen, Shanghai, Nanjing, and Hangzhou had seen decreases of ~ RMB9,900, RMB7,300, RMB4,900, and RMB4,200 per sqm respectively.

Figure 22: Second-hand home transaction price (Oct 2023 vs. Aug 2021)



Source: Fang.com, CMBIGM

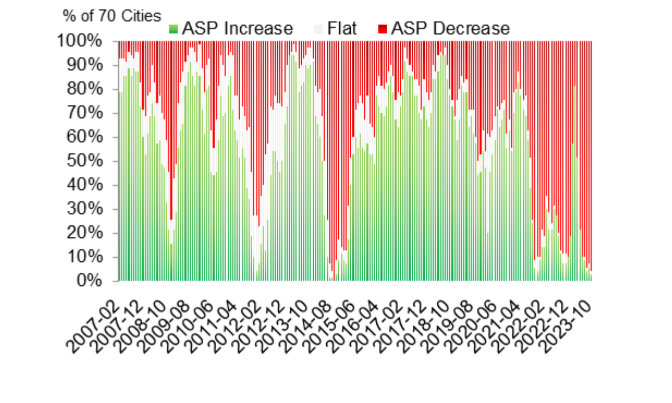
Figure 23: Second-hand home transaction price (Oct 2023 vs. Aug 2021)



Source: Fang.com, CMBIGM

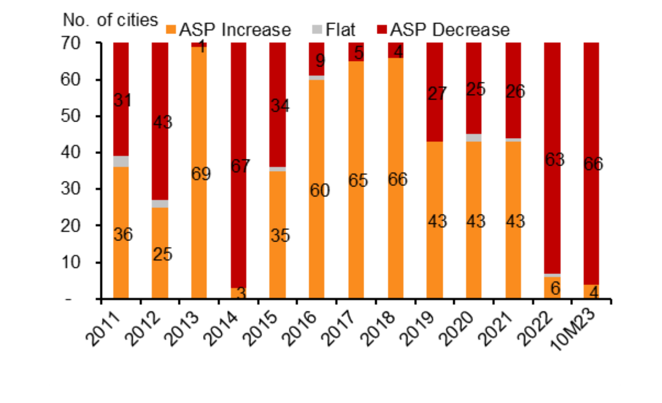
In terms of YTD performance, the overall decline in second-hand home prices across the nation is more pronounced compared to the decline in new home prices. According to data from the NBS, in Oct 2023, 67 cities out of the 70 major cities recorded declines of second-hand home prices, marking the highest number since Oct 2014. From Jan to Oct 2023, a total of 66 cities witnessed cumulative decreases, with only 4 cities experiencing increases. This was better than in 2022, when 63 cities saw decreases and 6 cities saw increases. The overall cumulative decline in second-home prices across the 70 cities was 2.6% YoY, narrowed from -4.0% in the full-year of 2022. In terms of city tiers, tier-2 and tier-3 cities recorded cumulative declines of -2.6% and -2.7% respectively in 10M23, showing a narrower decline compared to -3.4% and -4.9% for the full year of 2022. Meanwhile, tier-1 cities, which experienced an increase of +0.5% for the entire year of 2022, turned to -0.9% by 10M23. The divergent trend of the secondary market mirrors that of the new home market. Since the third quarter of 2021, tier-2 and tier-3 cities have been dragging down the overall prices of the 70 cities, gradually entering a downward trend, while tier-1 cities continue to experience horizontal fluctuations.

Figure 24: Second-hand home price MoM change in 70 cities



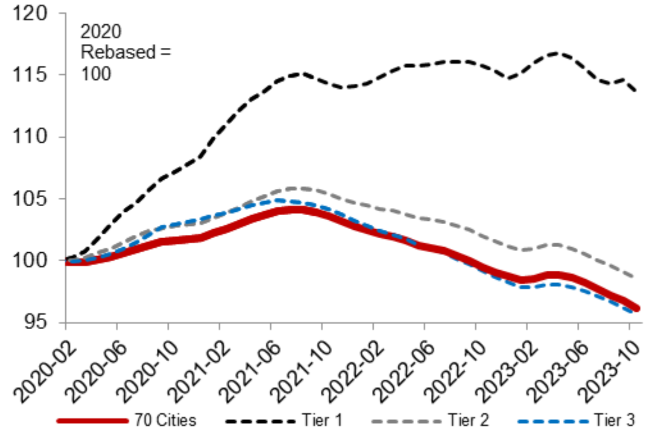
Source: NBS, CMBIGM

Figure 25: Second-hand home price annual change in 70 cities



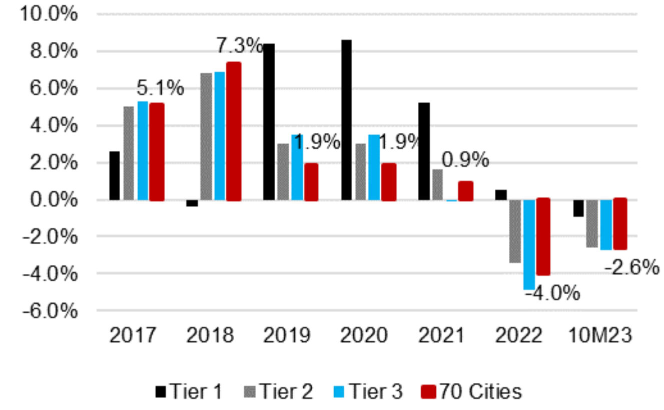
Source: NBS, CMBIGM

Figure 26: Second-hand home price in 70 cities - monthly



Source: NBS, CMBIGM

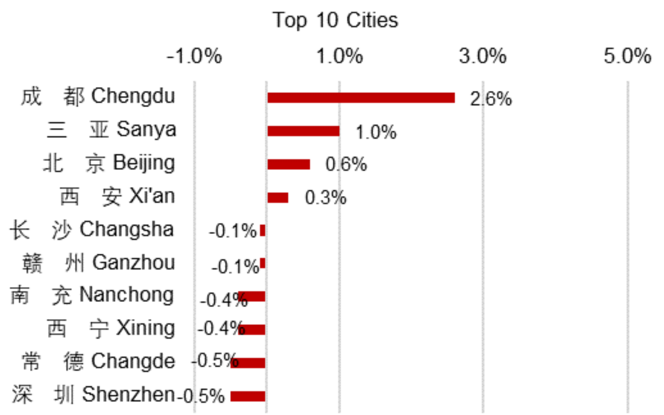
Figure 27: Second-hand home price in 70 cities – annual



Source: NBS, CMBIGM

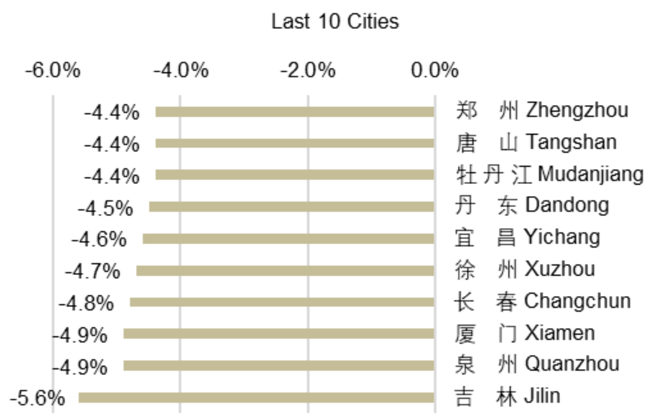
Based on city performance in 10M23, the following figure illustrates the top 10 cities with the best cumulative performance in secondary home prices. Among them, Chengdu, Sanya, and Beijing recorded cumulative increases of 2.6%, 1.0%, and 0.6% respectively. On the lower end of the performance spectrum, Jilin, Quanzhou, and Xiamen registered declines of -5.6%, -4.9%, and -4.9% respectively.

Figure 28: Second-hand home price change (Jan-Oct 2023)



Source: NBS, CMBIGM

Figure 29: Second-hand home price change (Jan-Oct 2023)



Source: NBS, CMBIGM

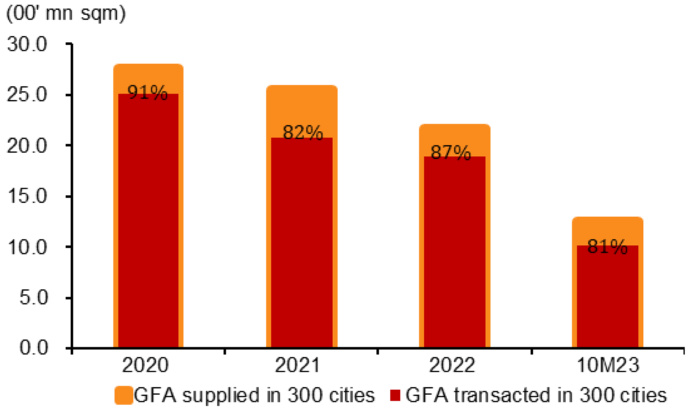
Supply: Continuous shrinkage in land supply

Land supply continues to shrink, with a decrease in proportion of residential land

■ Contracting total land supply with lower residential land transaction rate

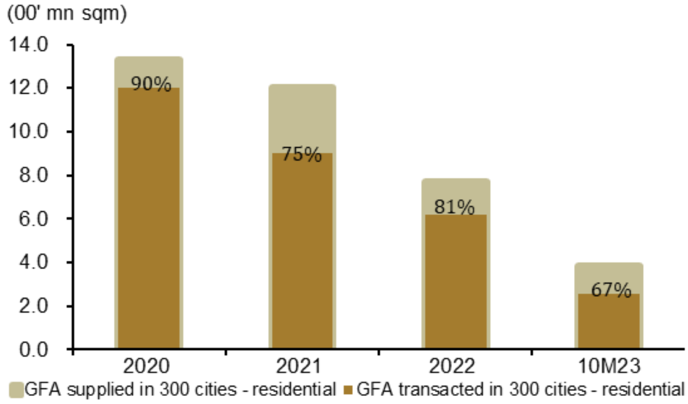
From Jan to Oct 2023, 300 cities supplied a total of 1.25bn sqm of various types of land, marking a 24% YoY decline, accounting for only 58% of the total in full-year 2022.GFA transacted amounted to 1.01bn sqm, a 25% YoY decrease, reaching only 53% of the previous year's total. The transaction rate dropped to 81% in 10M23 from 87% of the full year of 2022. Residential land supply in 10M23 amounted to 380mn sqm, down 32% YoY, representing only 50% of the total from the previous year. GFA transacted totaled 260mn sqm, a 35% YoY decrease, equivalent to just 41% of the previous year's total. The transaction rate of residential land plummeted from 81% of the previous year's total to 67% in 10M23, significantly lower than total land.

Figure 30: Total land supply/transaction



Source: NBS, CMBIGM

Figure 31: Residential land supply/transaction

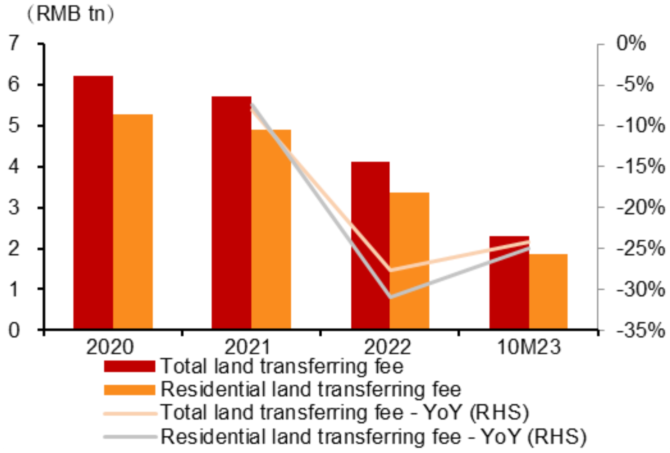


Source: NBS, CMBIGM

■ Lower residential proportion, accommodation value surge reflects divergence

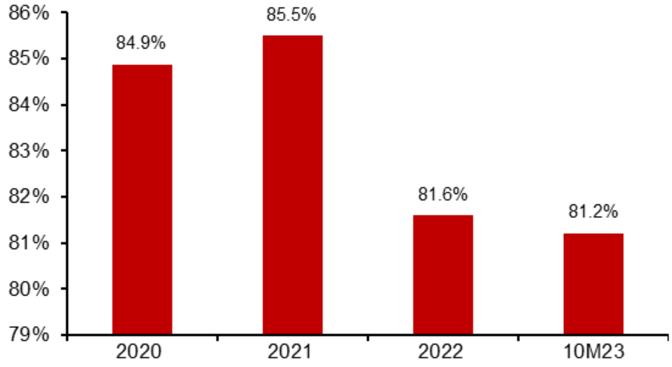
The proportion of residential land within all types of land decreased from 35% for the entire year of 2022 to 30% in 10M23 in terms of supplied GFA. Similarly, within transacted GFA, the proportion of residential land decreased from 33% for the full year of the previous year to 25% by 10M23. In terms of land-transferring fees, the amount for various land types totaled RMB2.3tn in 10M23, marking a 24% YoY decrease, while residential land transferring fees amounted to RMB1.9tn, a 25% YoY decrease, accounting for 81.2% of the total for all types of land in 10M23 vs. 81.6% in 2022. A milder decrease in the proportion of transferring fee than that of transacted GFA for residential land reflects a substantial increase in the accommodation value (transferring fee/GFA). In 10M23, the accommodation value for residential land surged by 16% YoY to RMB 7,158 per sqm. This is primarily due to multiple factors such as the ongoing instability in property sales and continued financial pressures on developers, leading to a cautious investment attitude with the focus put only on core cities and high-demand areas. As competition intensifies in core regions and several cities remove land auction price limits, we anticipate further potential increases in the accommodation value.

Figure 32: Land transferring fee



Source: NBS, CMBIGM

Figure 33: Land transferring fee – residential %



Source: NBS, CMBIGM

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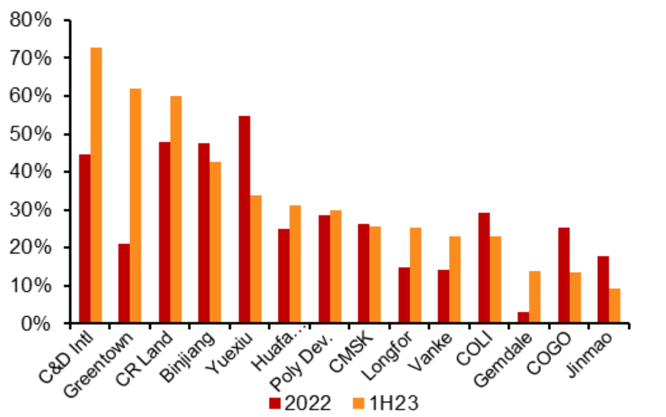
■ **Land to sales ratio improved for key developers**

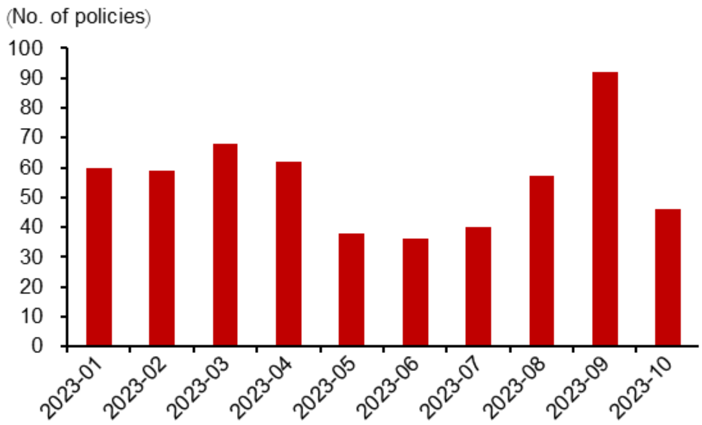
From the land to sales ratio of key developers we have followed, it is evident that their land acquisition activities in 1H23 were notably stronger than that in 2022, except for Binjiang and Yuexiu, which showed a slight slowdown in 1H23 compared to last year, primarily because their land to sales ratios were at the forefront of the market in the previous year. Among the POEs, only Binjiang and Longfor fell within the comparable range.

Figure 34: Land to sales ratio in 1H23



Source: NBS, company data, CMBIGM

Figure 35: No. of policies released in each month



Source: CRIES, CMBIGM

Policy: Ongoing loosening with effects offset by weak buying sentiment

Amidst a comprehensive downturn in property sales, property investment and financing, various property-related policies were frequently introduced. A break point emerged on July 24th during a political bureau meeting where the leadership highlighted a "significant change in the real estate supply-demand structure." Following this, provinces and cities actively responded by issuing or implementing policies. By Oct 2023, a total of 558 pieces of policies were enacted nationwide at various administrative levels, covering optimizations in purchase restrictions, reductions in down payment ratios and mortgage rates, enhancements in housing provident fund policies, the provision of home purchasing subsidies, and optimizations in pre-sale fund supervision, etc.. Observations indicate that the stimulating effects of policy released have gradually weakened since the third quarter of last year. Against the backdrop of slow economic recovery, weak expectations in household incomes, persistently low housing purchase confidence, and the difficulty in implementing part of policies lead to decreased short-term trust in policy effectiveness. Given the current scenario where sales recovery falls short of expectations, we believe there is still room for continued policy relaxation.

Figure 36: Key policy/events in 2H23

Date	Type	Entities	Policy/Event
2023/07/24	Demand side	Polical bureau meeting	The meeting proposed that **significant changes have occurred in the supply-demand dynamics of the real estate market**, suggesting the timely adjustment and optimization of related policies.
2023/07/27	Demand side	MOHURD	Indicated further implementation of policies such as **reducing the down payment ratio and loan rates for first-time homebuyers**, providing tax relief for the exchange of improved housing, and implementing policies like 'No. of house-owned identified by unit other than mortgage record"
2023/08/03	Financing side	PBOC	The forum of supporting the development of POEs proposed to support the reasonable financing needs of POEs.
2023/08/25	Demand side	MOHURD、PBOC、CBIRC	Promoting the implementation of the policy measure 'No. of house-owned identified by unit other than mortgage record' for first-time homebuyers and incorporating it into the 'One City, One Policy' toolbox
2023/08/25	Demand side	MoF、Taxation bureau、MOHURD	Continuing to implement the individual income tax policy supporting residents' housing upgrades
2023/08/25	Supply side	State Council	Deliberate and passed "guidelines on planning and constructing affordable housing", aiming to expand effective investments in such housing.
2023/08/27	Financing side	CSRC	Released "regulations for balancing the primary and secondary markets, optimizing IPO and refinancing supervision arrangements" , removed some limitations on refinancing for listed real estate companies
2023/08/30	Demand side	Local government	**Guangzhou and Shenzhen announced the implementation of the "No. of house-owned identified by unit other than mortgage record" policy.**
2023/08/31	Demand side	PBOC、CBIRC	Announced reductions in interest rates for existing first-time home mortgage
2023/09/01	Demand side	Local government	**Multiple cities, including Beijing and Shanghai announced the implementation of the "No. of house-owned identified by unit other than mortgage record" policy.**
2023/09/07	Demand side	Local government	Nanjing officially lifting citywide restrictions on property purchases, as the first strong second-tier cities did so
2023/09/20	Demand side	Local government	Relaxing property purchase restrictions in Guangzhou (the first first-tier city) by reducing the social security requirement from five years to two years and adjusting the value-added tax exemption period from five years to two years in nine districts.
2023/10/09	Supply side	Ministry of Natural Resources	According to EEO.com , the Ministry of Natural Resources issued a document at the end of September recommending the cancellation of land auction price limits in various provinces and cities.
2023/10/26	Supply side	State Council	"The guidelines on planning and constructing affordable housing," were passed to various provinces and cities.
2023/10/31	Financing side	National financial work conference	**Expressed to address the financing needs of different ownership real estate enterprises equally.**
2023/11/17	Financing side	Financial regulatory authorities	According to media, the financial department held a forum proposed a "three no less than" policy regarding real estate loans to ensure a lower limit for real estate enterprise financing, it involves the loan growth rate for real estate enterprises.
2023/11/22	Demand side	Local government	**Shenzhen reduced the down payment ratio for second home and adjusted the standard for ordinary housing**
2023/11/27	Financing side	8 department including PBOC, CBIRC	A joint issuance of a notification of "Strengthening Financial Support Measures to Strengthen and Develop the Private Economy", the file outlined 25 specific measures to support the growth of the private economy, including "reasonably fulfilling the financial needs of private real estate enterprises"

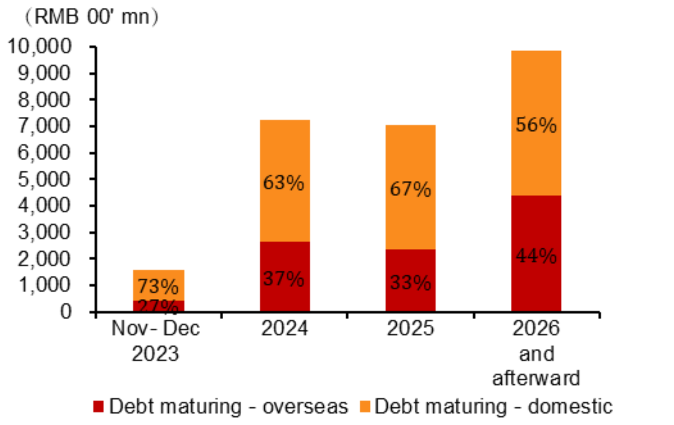
Source: CRIES, CMBIGM

Financing: Debt repayment pressure remains, awaits more policy support

■ Higher pressure from domestic debt repayment

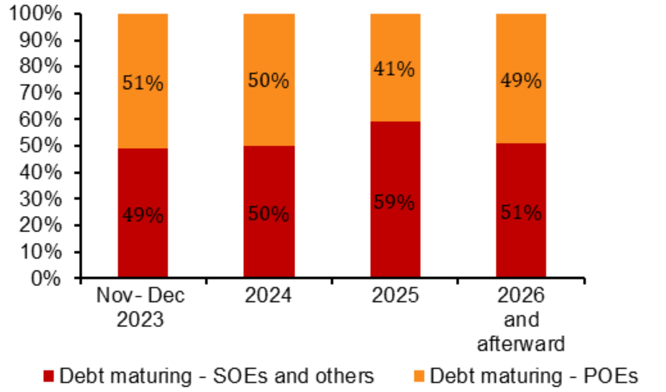
Developers continue to grapple with substantial debt burdens. According to data from the CRIES, a sample of 160 developers faces ~ RMB160bn in debt maturing in Nov-Dec 2023. Of this amount, overseas debt constitutes 27%, while domestic debt accounts for 73%. We saw a notable reduction in the overall maturity scale from 2023 to 2024-25, totaling RMB7tn annually, and the proportion of overseas debt is only 33-37%. This is primarily due to increasing credit risks in the sector making it more challenging for developers to issue overseas debt. In terms of company nature, SOEs and mixed-ownership developers comprise 49% of the maturing debt in Nov-Dec 2023, with the remaining 51% belonging to POEs. In the following years, the proportion of maturing debt for SOEs will increase to 50% in 2024 and further rise to 59% in 2025.

Figure 37: Sampled developers' debt maturing



Source: CRIES, CMBIGM

Figure 38: Sampled developers' debt maturing

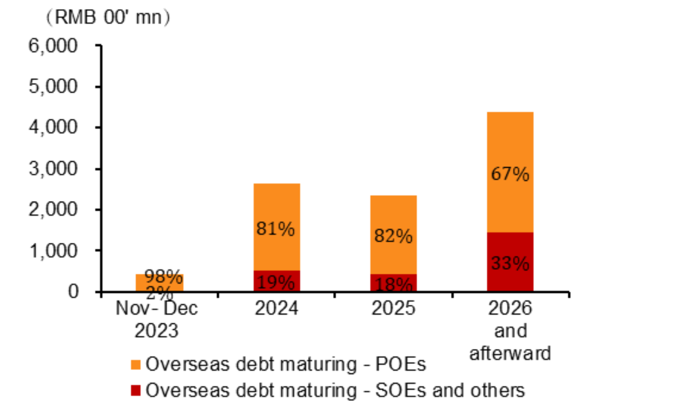


Source: CRIES, CMBIGM

- **POEs face more pressure from overseas than domestic debt and SOEs on the contrary**

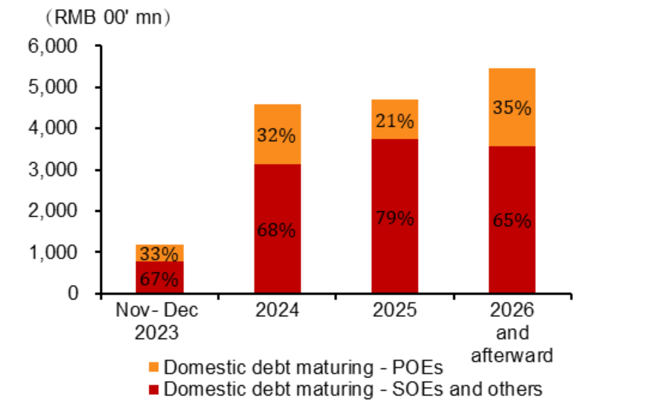
The amount of overseas debt within the year is primarily attributed to POEs, accounting for 98%. In the upcoming years of 2024 and 2025, this figure will stand at 81% and 82% respectively, as SOEs have relatively less demand for issuing overseas debt due to their more accessible domestic financing channels. Concerning the amount of maturing domestic debt within the year, SOEs and mixed-ownership developers account for 67%, which is projected to increase to 68% and 79% in 2024 and 2025, respectively. This increasing proportion is partly due to severe recent credit deterioration among POEs, resulting in considerable difficulty in refinancing domestically. Overall, SOEs and mixed-ownership developers face more pressure from maturing domestic debt, while POEs predominantly encounter debt pressure from overseas obligations. The proportion of POEs' domestic debt is smaller than that of SOEs, mainly stemming from hindered refinancing options for POEs, highlighting the potential for further enhancement in financial support to POEs.

Figure 39: Sampled developers' debt maturing - overseas



Source: NBS, CMBIGM

Figure 40: Sampled developers' debt maturing - domestic

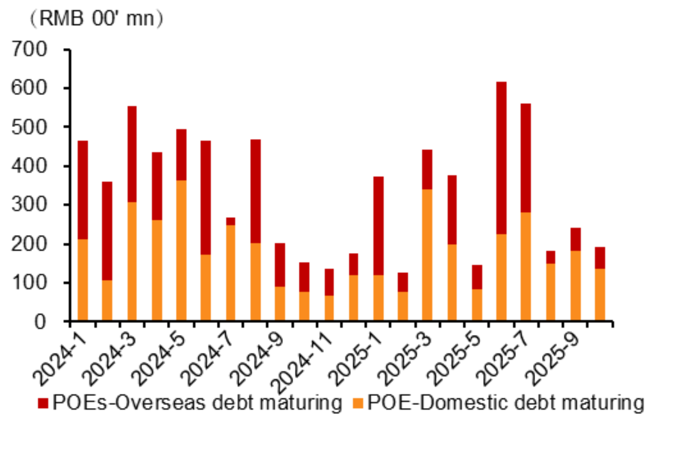


Source: CRIES, CMBIGM

■ **POEs face another debt payment peak in 1H24**

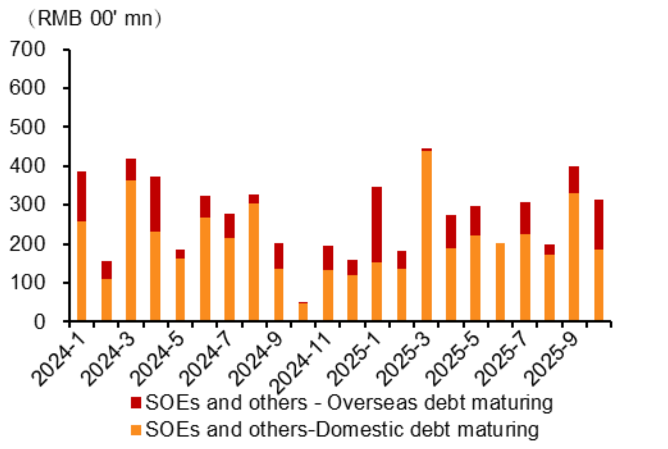
According to data provided by the CRIES, POEs are anticipated to experience substantial debt pressure, particularly concerning overseas debt, in the first half of 2024. The peak months for debt maturities fall predominantly within the first half of the year, with a gradual decrease in debt maturities following August. SOEs and mixed-ownership developers, on the other hand, have a relatively even distribution of debt maturities. The highest debt repayment months for SOEs and mixed-ownership developers are Jan, Mar and Apr, the subsequent highest months are Jun, Jul, and Aug, while the remaining months present relatively lower pressure. Against the backdrop of significant debt repayment pressure in the first half of next year and a significantly slower-than-expected sales recovery, without further financing support, we anticipate that POEs may encounter more situations involving debt extensions or defaults.

Figure 41: POEs debt maturing - monthly



Source: CRIES, CMBIGM

Figure 42: SOEs/semi-SOEs debt maturing - monthly



Source: CRIES, CMBIGM

Outlook: Strong sales recovery in 2024 is unlikely

New home sales outlook

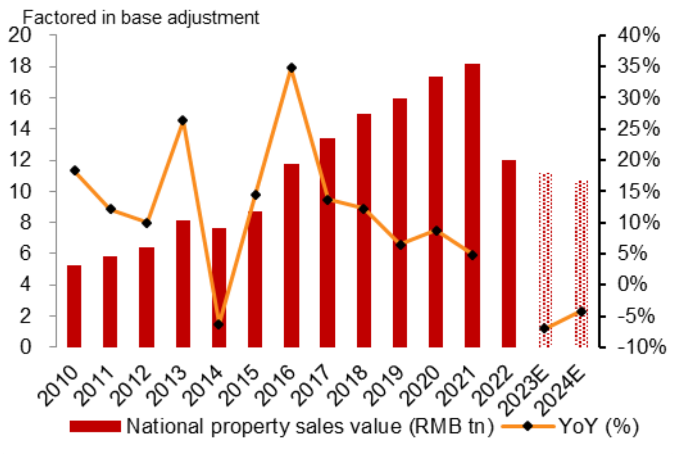
■ **Year-end seasonal surge in 2023 offset by low buying sentiment**

As previously mentioned, we have observed a marginally weakening of effect imposed by positive policies on the demand side since the beginning of the year. Given the current economic environment, which shows a slower-than-expected recovery, it might be challenging to reverse the subdued buying sentiment, even with the potentially more loosening policies aimed at stimulating demand. Sales data from the NBS for 10M23 indicate that apart from three months (March, June, and September) where monthly sales area exceeded 100mn sqm under strong policy stimulus, the average monthly sales in other months, without strong stimuli, remained around 75mn sqm. We believe these figures reflect the normal buying sentiment in the current market environment without strong policy incentives. Firstly, we assess that it will be challenging to reverse the current buying sentiment, hence assuming that the year-end buying sentiment will remain as it is. Secondly, considering the seasonal factors - the year-end seasonal surge typically driven by concentrated property launches by developers and online registration - the average MoM growth in Nov and Dec over the past five years have been around 11% and 45%, respectively. Additionally, the base adjustment should be taken into account, which has resulted in a roughly 10% adjustment in the YTD 2023. Based on these considerations, we estimate that the decline in the property sales volume for 2023 will be around 7%. Since a significant nationwide decline in new home prices has not been evident at this point, we predict that the decline in property sales value in 2023 will be similar to that of the sales volume.

- **Might be difficult to show strong rebound in 2024**

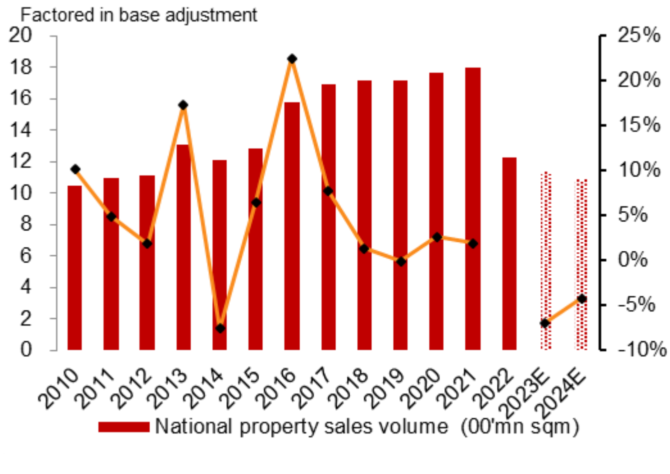
Looking ahead to 2024, we expect the following. **1)** Although demand-side policies continue to relax, the market has gained a deeper understanding of the industry's long-term development mechanisms. Therefore, it is challenging to generate strong purchasing sentiment seen in certain months of 2023. **2)** As mentioned earlier, developers still face significant debt pressures, especially in the first half of 2024. Given the lack of actual improvement in the developers' re-financing environment, developers might experience more debt extensions or defaults. The related negative news may continue to dampen purchasing enthusiasm and new home sales. **3)** Land transaction volumes in 2023 continued to shrink. Except for top-tier developers which have restored their land acquisition activities, the overall land acquisition amount for the top 100 developers decreased by 10% in 10M23. Compared to the old inventory, newly-acquired land parcels represent the prime available resources for sale. Hence, in 2024, the market might face a scarcity of high-quality saleable resources. **4)** Taking into account the Ministry of Housing and Urban-Rural Development's (MOHURD) October 26th document, which states a future goal of achieving a 6:4 ratio between affordable housing and commercial housing supply within 3-5 years, as opposed to the previous 5:5 ratio, regulators show less appeal for growth from commercial housing. Given this backdrop, we continue to base our estimations for 2024 on purchasing sentiment and seasonal factors. We anticipate a potential 4% decline in property sales volume. While the overall ASP of new homes may remain stable (price drops are heavier in lower-tier cities but high-tier cities with higher ASPs contribute more), we forecast a similar decrease in property sales value.

Figure 43: National property sales value estimation



Source: NBS, CMBIGM estimates

Figure 44: National property sales volume estimation

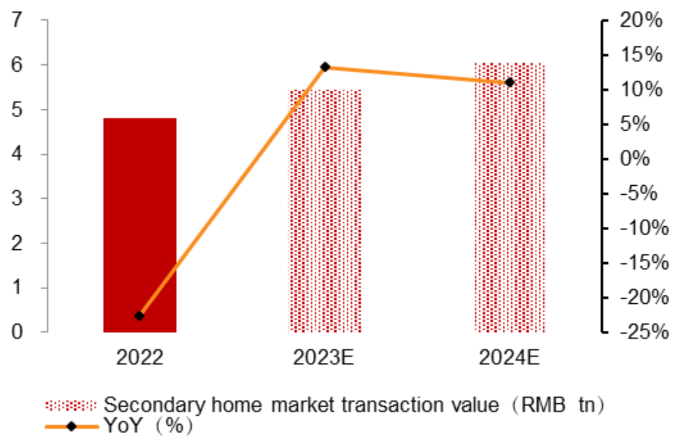


Source: NBS, CMBIGM estimates

Secondary home sales outlook

The leading property agent platform BEKE estimates that the scale of the second-hand housing market in 2022 was approximately RMB4.8tn. For 2023, it is projected to reach around RMB5.3-5.4tn, marking a 13% YoY increase. According to CMBIGM estimation, the total existing home market is around RMB371tn. This suggests that the turnover rate of the existing home market in 2023 is ~1.4%. Looking ahead to 2024, we anticipate the following factors. **1)** Continued effects of policies like "No. of houses owned identified by unit other than mortgage record" to support demand for second-hand homes as people trade their old homes for new ones. **2)** Sustained debt repayment pressure on developers may retain buyers' concerns about project delivery in the new home market, shifting purchase demand from the new home market toward second-hand homes. **3)** The continued downward trend in second-hand home prices is expected to offer some support to transaction volumes. **4)** Taking into account the experience of mature markets, the turnover rate of the existing home market is likely to naturally increase after the new home market reaches a certain scale. Therefore, assuming a 1 percentage-point increase in the turnover rate for 2024, we estimate the size of the second-hand housing market to rise to RMB6tn in 2024, marking ~11% YoY growth.

Figure 45: Secondary home market transaction value



Source: BEKE, CMBIGM estimates

Property investment outlook

Figure 46: Estimation of key indicators in property market

2023-24 forecast	2024E	YoY	2023E	YoY	2022	YoY	Comments
Property GFA sold (mn sqm)	1,089	-4%	1,137	-7%	1,358	-24%	Assume base number of 2022 to adjust -10%
Property sales (RMB bn)	10,690	-4%	11,160	-7%	13,331	-27%	
New starts (mn sqm)	814	-10%	905	-25%	1,206	-39%	no base adjustment
GFA completion (mn sqm)	1,034	0%	1,034	20%	862	-15%	no base adjustment
Property investment (RMB bn)	10,178	-9%	11,124	-10%	13,290	-10%	Assume base number of 2022 to adjust -7%

Source: NBS, CMBIGM estimates

- **New starts by area**

In 10M23, new starts by area decreased 23% YoY. Given the current weak sales recovery, ongoing debt maturity pressure, and limited financial support for developers, liquidity challenges should continue, in our view. We estimate that the growth rate of new starts by area for 2023 and 2024 will fall approximately by 25% and 10%, respectively.

- **GFA completion**

In 10M23, the completed GFA increased by 19% YoY. Considering that November typically achieves twice the completion of an average of normal months and December accomplishes 5-6 times the average monthly completion, and factoring in that 2023 is the first full year of the "housing delivery" campaign, we estimate GFA completion growth for

2023 to be around 20%. Looking ahead to 2024, despite the continued support from the "housing delivery" campaign, difficulties faced by developers, as mentioned earlier, are unlikely to substantially ease. Additionally, with the high base established in 2023, we anticipate the growth rate of GFA completion to be flat YoY in 2024.

■ **Property investment**

In 10M23, property investment growth stood at -9.3% YoY. Considering its composition, the segment closely linked to the trend of new starts by area is gradually reducing its proportion in total property investment due to declining growth rates in new starts. Meanwhile, the segment associated with completion, supported by the "housing delivery" campaign, maintains higher growth rates and is increasing its proportion. Regarding land acquisition, there has been a significant decrease in land transaction for two consecutive years, coupled with a slight decrease in accommodation value of land sold in 2022 and a substantial rebound in 2023. Hence, we tentatively assume that land acquisition to decrease slightly in proportion to overall property investment. Factoring in these changes in proportions and their respective growth rates, we estimate that property investment growth will be at -10% and -9% in 2023 and 2024, respectively.

Investment thesis

Although demand-side policy relaxation is likely to continue, their positive impact on property sales is largely limited by a slow recovery of the economy and low house purchasing sentiment. We saw several follow-ups in financing-side policies but their implementation still faces numerous challenges and needs further enhancement. Before fundamental improvements become apparent, we recommend the following. **1)** Focus on beneficiaries in the existing home market. From a sales perspective, the long-term performance of the secondary market may surpass that of the new home market due to the natural increase in turnover rates and the continued demand shifting caused by concerns about new project delivery. From a service perspective, as the scale of new housing shrinks, the existing home market provides substantial business potential. **2)** Pay attention to developers with ample saleable resources in core areas or cities, or those focusing on good bargains in cities surrounding core areas. **3)** Consider companies benefiting from concepts such as affordable housing supply and urban village renovations. **4)** In the short term, pay attention to those who actively manage defaulted or potentially defaulted debts by restructuring and proactively repair their creditworthiness, thereby gaining opportunities to sustain operations. For stock picking, among asset-light companies, BEKE is one of the biggest beneficiaries of the secondary market, though its possibly higher-than-expected investment in asset-heavy business may arouse investors’ concerns. We also prefer PJM name Greentown Mgmt., PM names CR MixC, COPH, Poly Services, Onewo and Yuexiu Services; among developers, we like CR Land, Yuexiu Property and Binjiang Group.

Risk

The risks include macroeconomic recovery falling short of our expectations, property sales declining beyond our anticipated levels, developers’ liquidity risk spreading to even SOEs or semi-SOEs, and the possibility of more developers defaulting.

Valuation

Figure 47: Valuation comps – developers

Company	Ticker	Last price	Mkt Cap	Rating	TP	P/E				PB	Dividend Yield	
		(LC)	(LC mn)		(LC)	21A	22A	23E	24E	23E	22A	23E
Vanke - H	2202 HK	7.50	135,554	BUY	33.92	3.2	3.4	4.2	4.4	0.3	11%	8%
COLI	688 HK	13.94	152,572	BUY	27.90	3.2	4.0	5.6	5.1	0.4	6%	5%
CR Land	1109 HK	27.50	196,101	BUY	45.10	6.1	6.2	6.2	5.7	0.7	6%	6%
Longfor	960 HK	13.36	88,066	HOLD	24.90	2.9	3.0	3.6	3.6	0.5	10%	8%
Agile	3383 HK	0.85	4,289	NA	NA	0.4	0.8	-1.0	-3.0	0.1	0%	0%
Times China	1233 HK	0.36	757	NA	NA	0.2	-1.1	-0.4	-0.5	0.2	0%	0%
China SCE	1966 HK	0.18	756	NA	NA	0.2	0.3	-1.1	-1.2	0.0	0%	0%
CIFI	884 HK	0.28	2,916	NA	NA	0.3	0.5	-2.0	1.8	0.1	24%	0%
Seazen	1030 HK	1.34	9,468	NA	NA	1.0	2.0	4.6	3.7	0.2	0%	0%
Midea	3990 HK	5.86	8,412	NA	NA	1.5	2.6	4.6	4.4	0.3	16%	10%
Vanke - A	000002 CH	11.18	123,835	NA	NA	5.8	5.6	6.8	7.0	0.5	6%	5%
Poly Development	600048 CH	9.96	119,226	NA	NA	4.3	5.2	6.2	5.8	0.6	5%	5%
Binjiang Group	002244 CH	7.76	24,145	NA	NA	8.0	6.4	5.5	4.6	0.9	3%	4%
Average						**2.7**	**2.9**	**3.0**	**2.8**	**0.3**	**6.1%**	**3.7%**

Source: Company data, Bloomberg, CMBIGM estimates
Note: Data as of 5 Dec 2023

Construction Machinery/HDT

OUTPERFORM

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Slowdown of overseas demand along with lack of growth in China; be selective

For Chinese machinery manufacturers, penetration overseas remains a long-term driver. That said, with growth trend reversing since mid-2023 after 2-3 years of extraordinary growth, the way to overseas expansion will likely be bumpy in 2024E, especially when the overseas competitors are recovering from the supply chain bottleneck. Geographically, we expect strong demand to continue in the US and the Middle East, but weakness in Europe and China. By segment, we expect an upcycle for heavy-duty trucks (HDTs) driven by replacement demand and on-track export growth. On the contrary, we expect the down-cycle to continue for concrete machinery, tower cranes and excavators, as the weak China property investment will remain a drag.

Our top pick is **Weichai Power-H** (HDT growth proxy + market share gain on strong gas HDTs). We stay positive on **SANYI** (resilient demand for mining trucks overseas) and **Dingli** (on-track penetration into the US AWP market). Meanwhile, we have **HOLD** rating **for Zoomlion-A/H** (weak property-related machinery) and **SANY Heavy** (peak of overseas sales).

Positive on HDTs: Expect 15% YoY growth in 2024E

(1) The fleet size of HDTs is highly correlated with China's GDP growth. We expect moderate economic growth in 2024E (CMBI estimate: 4.8%) to boost the HDT fleet size by a similar rate. We estimate this, together with recovery of replacement demand, will translate to ~14% YoY increase in domestic sales volume; (2) We expect a solid export growth rate of 18% in 2024E. In terms of product mix, we expect natural gas HDTs to continue to account for 25-30% of total sales.

Neutral on AWPs: Strong in the US; Slowdown in China in 2024E

Following years of growth, we estimate China's AWP fleet size is now equivalent to >70% of the US fleet size, versus only ~12% in 2018. We expect a slowdown of fleet size growth as major AWP leasing companies such as **Horizon Construction (9930 HK, BUY)** and **Huatie (603300 CH, NR)** have reduced their capex on AWP and switched to the asset-light model. We forecast AWP sales in China market to drop ~5% YoY in 2024E. On the contrary, we expect AWP demand growth in the US to be strong on the back of mega projects and replacement demand.

Negative on excavators: Expect 5% YoY decline in 2024E

In China, we forecast a stabilization of sales volume (+1% YoY), underpinned by infrastructure spending that should offset the decline in property investment. For overseas business, we expect the export volume to drop 10% YoY in 2024E due to high base effect (in particular in 1H24E).

Valuation

Figure 1: Peers comp table

Ticker	Company	Rating	Price (local currency)	TP (local currency)	Upside/ (downside)	Market cap (US$ mn)	PE (x) FY23E	PE (x) FY24E	PB (x) FY23E	PB (x) FY24E
Hong Kong										
631 HK Equity	SANY INTERNATIONAL	BUY	7.11	15.40	117%	2,902	8.9	7.0	1.7	1.5
1157 HK Equity	ZOOMLION HEAVY-H	HOLD	3.91	4.40	13%	7,008	8.5	8.9	0.6	0.5
2338 HK Equity	WEICHAI POWER-H	BUY	13.26	19.40	46%	16,390	12.3	10.4	1.3	1.2
3808 HK Equity	SINOTRUK HK LTD	BUY	14.66	19.30	32%	5,180	10.5	8.9	1.0	0.9
1839 HK Equity	CIMC VEHICLES -H	NR	6.87	-	-	2,436	4.8	5.8	0.9	0.8
564 HK Equity	ZHENGZHOU COAL-H	NR	7.40	-	-	2,778	3.9	3.3	0.7	0.5
	HK listed average						**8.1**	**7.4**	**1.0**	**0.9**
A share										
000338 CH Equity	WEICHAI POWER-A	BUY	13.88	17.80	28%	16,511	14.1	11.9	1.5	1.4
601100 CH Equity	JIANGSU HENGLI-A	BUY	52.10	83.00	59%	9,786	26.5	22.2	4.8	4.2
603338 CH Equity	ZHEJIANG DINGLI -A	BUY	46.70	70.00	50%	3,312	14.0	12.0	2.8	2.3
600031 CH Equity	SANY HEAVY-A	HOLD	12.60	12.30	-2%	14,977	20.8	20.6	1.6	1.5
000157 CH Equity	ZOOMLION HEAVY-A	HOLD	6.30	5.60	-11%	7,060	15.0	15.8	1.0	1.0
000425 CH Equity	XCMG-A	NR	5.21	-	-	8,624	9.8	8.0	1.1	1.0
000528 CH Equity	GUANGXI LIUGONG-A	NR	6.41	-	-	1,752	12.3	9.2	0.8	0.7
603638 CH Equity	YANTAI EDDIE P	NR	16.36	-	-	1,921	46.1	39.1	4.1	3.8
600761 CH Equity	ANHUI HELI CO-A	NR	15.46	-	-	1,603	8.9	7.4	1.5	1.3
603298 CH Equity	HANGCHA GROUP-A	NR	21.50	-	-	2,818	12.9	11.1	2.5	2.1
000951 CH Equity	CNHTC JINAN T-A	NR	13.99	-	-	2,302	17.2	11.6	1.1	1.0
301039 CH Equity	CIMC VEHICLES -A	NR	9.60	-	-	2,454	7.3	8.6	1.3	1.2
601717 CH Equity	ZHENGZHOU COAL-A	NR	11.92	-	-	2,799	6.8	5.8	1.2	0.9
600582 CH Equity	TIAN DI -A	NR	5.35	-	-	3,102	9.7	8.2	1.0	0.9
	A-share average						**15.8**	**13.7**	**1.9**	**1.7**
Overseas										
CAT US Equity	CATERPILLAR INC	NR	259.5	-	-	132,107	12.6	12.6	6.9	5.8
DE US Equity	DEERE & CO	NR	363.7	-	-	104,737	12.9	12.6	5.5	5.0
CMI US Equity	CUMMINS INC	NR	230.6	-	-	32,684	11.6	11.9	3.1	2.8
6305 JP Equity	HITACHI CONST	NR	3,589.0	-	-	5,262	7.4	7.5	1.0	1.0
6301 JP Equity	KOMATSU LTD	NR	3,611.0	-	-	23,969	9.1	9.2	1.2	1.1
042670 KS Equity	DOOSAN INFRACORE	NR	7,600.0	-	-	1,163	4.5	4.5	0.8	0.7
VOLVB SS Equity	VOLVO AB-B	NR	252.7	-	-	49,611	8.9	11.4	2.9	2.7
	Average						**9.6**	**10.0**	**3.1**	**2.7**
Hydraulic components										
PH US Equity	PARKER HANNIFIN	NR	438.6	-	-	56,353	19.0	17.6	4.7	4.1
7012 JP Equity	KAWASAKI HVY IND	NR	3,083.0	-	-	3,529	11.9	8.0	0.9	0.8
7242 JP Equity	KYB CORP	NR	4,700.0	-	-	825	5.8	5.4	n/a	n/a
6474 JP Equity	NACHI-FUJIKOSHI	NR	3,610.0	-	-	613	7.5	6.8	0.5	0.5
6268 JP Equity	NABTESCO CORP	NR	2,659.0	-	-	2,194	18.9	18.8	1.3	1.2
	Average						**12.6**	**11.3**	**1.9**	**1.7**
Aerial work platform										
TEX US Equity	TEREX CORP	NR	51.4	-	-	3,460	7.3	7.2	2.2	1.9
OSK US Equity	OSHKOSH CORP	NR	99.8	-	-	6,530	10.4	9.8	1.8	1.6
LNR CN Equity	LINAMAR CORP	NR	58.0	-	-	2,638	6.7	6.0	n/a	n/a
PIG FP Equity	HAULOTTE GROUP	NR	2.5	-	-	85	14.0	3.9	0.4	0.3
6345 JP Equity	AICHI CORP	NR	994.0	-	-	510	13.1	12.0	0.9	0.9
	Average						**10.3**	**7.8**	**1.3**	**1.2**

Source Bloomberg, company data, CMBIGM estimates
Note: For stocks under coverage, earnings estimates are from CMBIGM

Figure 2: Overseas revenue breakdown for major Chinese players

Company	Ticker	% of overseas revenue 2022	% of overseas revenue 1H23
Zhejiang Dingli	603338 CH	65%	63%
SANY Heavy	600031 CH	47%	58%
Sinotruk	3808 HK	47%	52%
SANY International	631 HK	27%	30%
Zoomlion	1157 HK / 000157 CH	24%	35%
Jiangsu Hengli	601100 CH	21.5%*	-
Weichai Power	2338 HK / 000338 CH	54.3%**	52%

Source: Company data, CMBIGM estimates
* Certain domestic sales will become final products for export.
** Weichai owns 46.5% interest in KION (KGX GR), the major source of overseas revenue. Together with the direct and indirect exports, we estimate Weichai's attributable overseas revenue accounted for 30-40% of total revenue.

Global machinery demand: Strong in the US and the Middle East

In the post-results calls in Oct and Nov 2023, **Caterpillar (CAT US)** and **Komatsu (6301 JP)** provided clues about the global machinery outlook. In terms of regions, **the US** remains the most resilient market, driven by a strong pipeline of construction projects on the back of government-related infrastructure investment and the energy sector. **The Middle East** also has a strong growth outlook driven by large projects in Saudi Arabia and the UAE. **Europe** and **China** are expected to stay weak. In terms of machinery type, **mining equipment** remains strong driven by commodity demand. On pricing, **ASP hike is expected** but the magnitude will likely be less than before as supply chain constraint has been easing.

Figure 3: Latest comments on global machinery outlook by Caterpillar and Komatsu

Categories	Segments	Caterpillar	Komatsu
Market outlook	Overall	• FY23 forecast: better than previous projection during 2Q23 • FY24 forecast: another good year	• FY23 (year-end Mar 2024) sales forecast (excl. China): -10% to -15% YoY (Jul projection: -5% to -10%; Apr projection: 0% to -5%)
	North America	• Overall: continue to see positive momentum • Non-residential: continue its growth driven by the government-related infrastructure investments and a healthy pipeline of construction projects • Residential: remain healthy although it has moderated • More benefit from government-led infrastructure investments to be seen in 2024	• FY23 (year-end Mar 2024) sales forecast: 0% to -5% YoY (unchanged) • Residential construction: showed signs of a slowdown due to interest rate hikes • Rental industry/ infrastructure/ energy-related sector: Demand remained strong
	APAC (excl. China)	• To see growth driven by public infrastructure spending in support of commodity prices	• FY23 (year-end Mar 2024) sales forecast: -15% to -20% YoY (Apr projection: 0% to -5% YoY) • Indonesia market: mining equipment demand highly correlated with coal price, with uncertainties include 1) new regulation on deposit related to coal export, and 2) declining import volume of China, especially among small and medium-sized users, (3) presidential election
	Japan	n/a	• FY23 (year-end Mar 2024) sales forecast: about flat YoY (unchanged) • Public and private sector construction: strong demand
	China	• Weakness to continue and expect China sales to remain well below typical range of 5% to 10% of total sales	• FY23 (year-end Mar 2024) sales forecast: -30% to -40% YoY (Jul projection: -20% to -30%; Apr projection:-5% to -15%) • Chinese makers have abundant excess production capacity, which will be applied to export, esp. for Russia

	Europe, Africa, the Middle-East (EAME)	• Overall: slightly decline
		• Europe: weakness to continue
		• Middle East: strong construction demand to continue
			• Europe:
			  • FY23 (year-end Mar 2024) sales forecast: -10% to -15% YoY (Jul projection: -5% to -10%; Apr projection: remain about flat)
			  • Economic downward pressure caused by tighter monetary policy and decline in demand
			• Middle East:
			  • Business to remain robust
			  • Ongoing large projects in Saudi Arabia and the UAE

	Latin America	• Construction activity to be about flat versus strong 2022	n/a
Product outlook	Construction industries	• Demand remains healthy in most of the end markets.	• FY23 (year-end Mar 2024) sales forecast: +3.3% YoY (Apr projection: -5% YoY), with the support of favourable FX rates and improved selling prices • FY24 (year-end Mar 2025) sales forecast: will be tough due to the slowdown of economy and inflation of higher interest rates
	Mining	• Positive outlook • Seeing capital discipline by our customers but high level of quotation activity • Energy transition will support increased commodity demand over time, coupled with the increasing customer acceptance of autonomous solutions	• FY23 (year-end Mar 2024) sales forecast: 0% to +10% YoY (unchanged) • FY24 (year-end Mar 2025) sales forecast: will be robust
	Heavy Construction & Quarry	• To maintain at healthy levels driven by major infrastructure and non-residential construction projects.	n/a
	Oil & Gas	• To continue its strong demand for CAT reciprocating engines and gas compression. • North America: Well servicing is showing short-term moderation, but remain optimistic about future demand. • New equipment and services for Solar turbines to remain robust.	n/a
	Power Generation	• Demand to remain strong, driven by data center growth • New equipment and services for solar turbines to remain robust • Industrial demand to soften slightly from recent high levels but remains well above historical average	n/a
	Transportation	• High-speed marine to continue its growth with the demand of upgrading aging fleet	n/a
Price trend	-	• Price realization to remain positive, yet the magnitude of the favorability to moderate.	• More difficult to raise product price due to the normalized supply chain and production capacity issues • Price for parts will continue to increase (though not as much as FY23) given the high onsite utilization of equipment
Backlog	-	• Backlog will come down to more normal levels with improved lead times due to better supply conditions.	• Mining equipment: backlog remains at very high level with no sign of a decline, particularly for dump trucks for North America, large hydraulic excavators for Germany, and dump trucks from Komatsu, etc. • Construction equipment: hard to forecast FY24 given the short lead time, but have revised down FY23 forecast for Europe and SEA based on the current order situation
Supply Chain	-	• Supply chain continues to improve.	• Supply chain is being normalized.
Cost trend	-	• Lower level of manufacturing cost inflation	• No raw material price hike in 2H23 anymore. • Inflation and wage hike are expected.

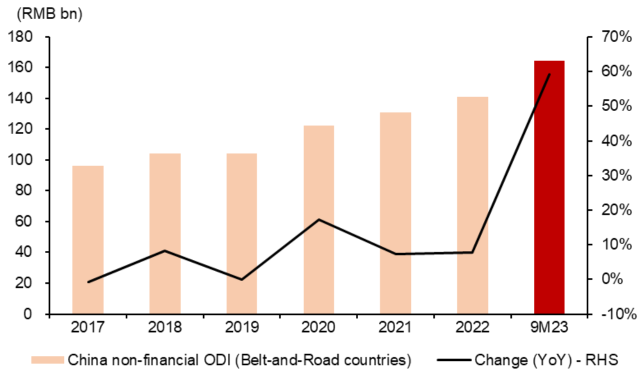
Source: Company data, CMBIGM

Belt-and-Road offers ongoing opportunities to Chinese players

China's non-financial overseas direct investment (ODI) in Belt-and-Road Initiative (BRI) countries increased from RMB96.3bn in 2017 to RMB141bn in 2022 (CAGR: 10%). The proportion of BRI countries/total ODI increased from 12% in 2017 to 18% in 2022. In 9M23, Non-financial ODI to BRI countries increased 59% YoY to RMB165bn, and the proportion further increased to 24%.

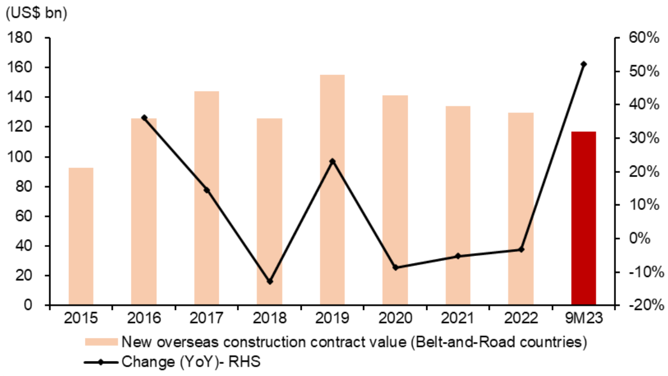
The BRI marks its tenth anniversary in 2023. In Oct, the Third Belt and Road Forum was held, while multiple cooperation projects with total contract amount of USD97.2bn were signed at the CEO Conference held during the Forum. Apart from that, a series of international summits, including the China-Central Asia Summit, BRICS Summit and ASEAN Summit, have also fostered infrastructure investment along the BRI countries. China machinery OEMs will continue to benefit from the rising Chinese investment in the BRI countries.

Figure 4: China non-financial overseas direct investment (Belt-and-Road countries)



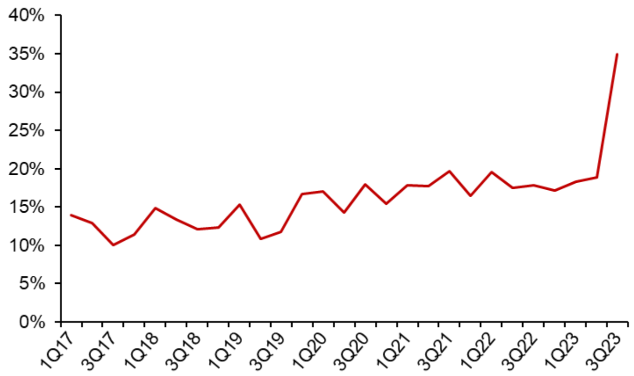
Source: Wind, Ministry of Commerce, CMBIGM

Figure 5: New contract value of China's overseas construction projects (Belt-and-Road countries)



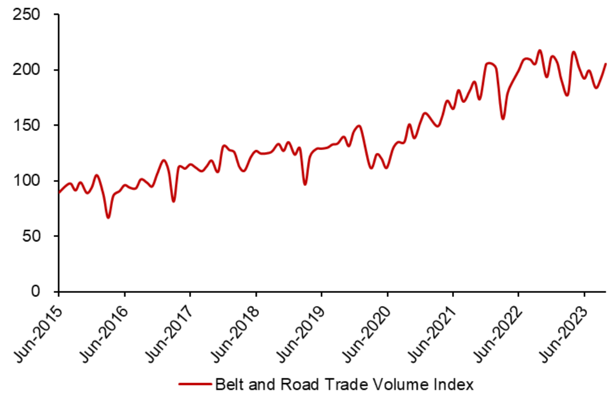
Source: Wind, Ministry of Commerce, CMBIGM

Figure 6: China's ODI to Belt-and-Road countries as % of total ODI (non-financial)



Source: Wind, NBS, CMBIGM

Figure 7: Belt and Road Trade Volume Index



Source: Wind, CMBIGM

Chinese players ready to capture the opportunities in the Middle East

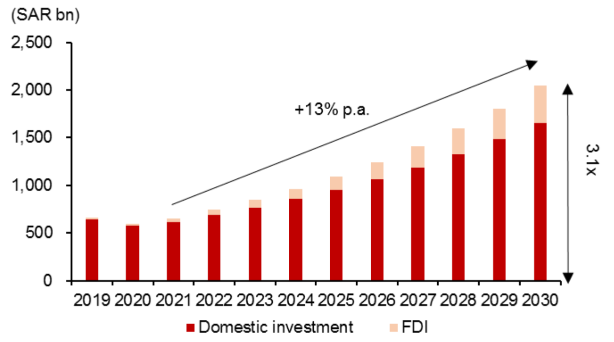
Saudi Arabia: Construction boom under Vision 2030

Since the introduction of "Vision 2030" in 2016, Saudi Arabia has made remarkable progress in the implementation of reforms in multiple non-oil strategic sectors, including renewable energy, technology, logistics, and tourism. To achieve Vision 2030's goals, the National Investment Strategy (NIS), a US$3.3tn (SAR12.4tn) investment scheme, was launched by the Saudi Arabian government in 2021, which aims to facilitate the investment from the private sector and foreign direct investments (FDI).

The NIS, together with the government spending of US$2.6tn (SAR9.8tn) and the private consumption spending of US$1.3tn (SAR4.9tn), will be equivalent to a total of US$7.1tn investment (SAR27tn) into the national economy between 2021 and 2030, fostering a strong demand in infrastructure investment.

Saudi Arabia has announced over 255 infrastructure and mega projects, such as NEOM (the US$500bn cognitive and smart city development in the Northwest region), Qiddiya (entertainment and sports projects), and Riyadh Metro (one of the world's largest urban transport projects). The total estimated value of the projects amounts to US$1.7tn, according to ABIQ Consultant. We expect construction spending to see high growth in Saudi Arabia in the upcoming five years.

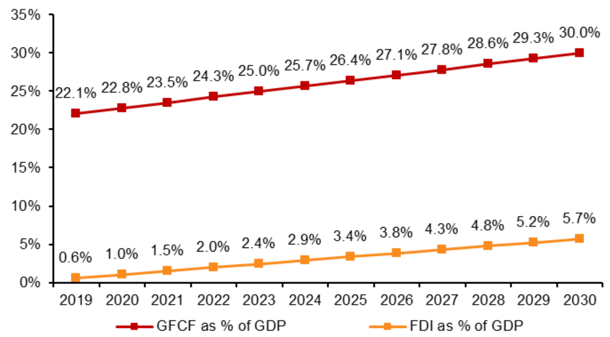
Figure 8: Saudi Arabia's investment volume (gross fixed capital foundation) breakdown



Source: National Investment Strategy (NIS), CMBIGM

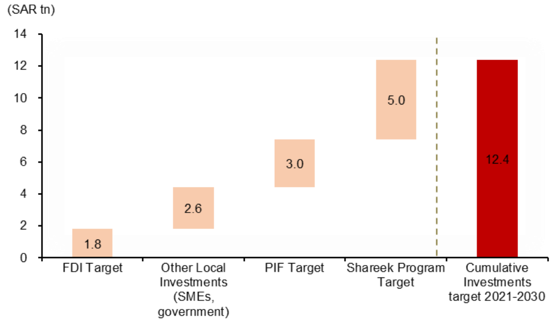
Note: The investment volume in 2030 is targeted to reach 3.1x that in 2021

Figure 9: Gross fixed capital foundation (GFCF) and FDI as % of Saudi Arabia's GDP



Source: National Investment Strategy (NIS), CMBIGM

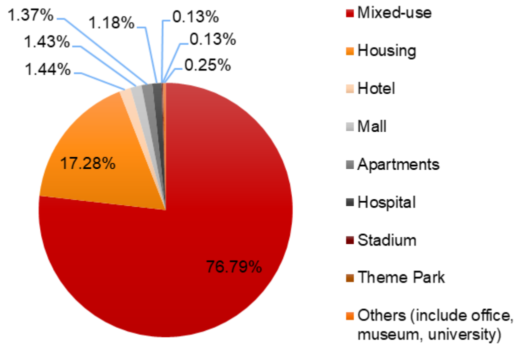
Figure 10: Cumulative gross fixed capital foundation target breakdown under NIS during 2021-2030



Source: National Investment Strategy (NIS), CMBIGM

Note: 1) Public Investment Fund (PIF), the largest SWFs of Saudi Arabia, led most of major infrastructure projects under Vision 2030. 2) Shareek Program is a program specifically designed to support large Saudi companies to enable the growth of private sector investments

Figure 11: Saudi Arabia's mega project value breakdown by land use



Source: BIG 5 Construct Saudi, ABIQ, CMBIGM

UAE: Infrastructure demand boosted by transportation and energy sectors

Similar to Saudi Arabia, to facilitate economic diversification, the UAE launched "UAE Vision 2021" in 2010, with the focus on the investment in non-oil sectors including infrastructure, renewable energy and tourism sectors. On the foundation laid by Vision 2021, a series of reforms and plans has been propelled over the past decade. In 2021, the UAE announced the "Projects of the 50" initiatives, covering several key sectors such as railway (The UAE Railway Program), tourism (UAE Tourism Strategy 2031), and space (Emirati interplanetary mission 2028). Moreover, the "UAE Energy Strategy 2050" released in 2017 specified plans to invest over AED600bn (~US$163bn) in the renewable energy sector to achieve net zero goals by 2050. The new 'We the UAE 2031' vision proposed in 2022 covers an even wider spectrum of development.

With a sizeable infrastructure and energy projects pipeline, the construction sector in the UAE is expected to deliver an annual growth of up to 4.7% in the next five years, according to the US Department of Commerce.

China construction machinery: Policy to help reduce the rate of decline, but lack of recovery in sight

China's legislature, the National People's Congress, approved a cabinet plan on 24 Oct to raise the general fiscal deficit ratio for 2023 from 3% to 3.8% of GDP. The legislature also renewed through 2027 an authorization for the cabinet to front-load at most 60% of the next year's local government bond quota. These policies indicate the policymakers' increased focus on restoring market confidence and shoring up the economy. Our macro team forecasts infrastructure spending growth of 7.8% YoY and a 7% YoY decline in property investment in 2024E.

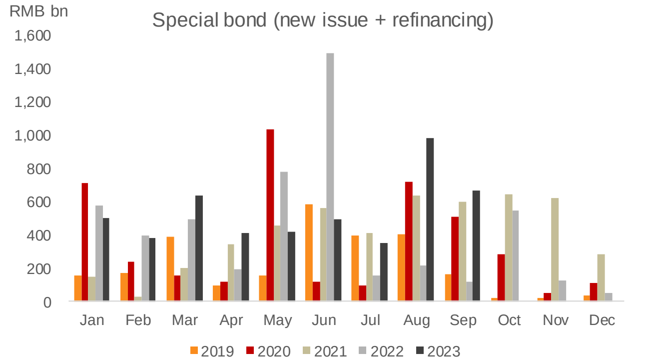
We expect the overall demand for construction machinery to remain sluggish as the infrastructure-driven demand will be offset by the decline in property-related demand. We expect property-driven machinery, such as tower crane and concrete machinery, to see a continuous decline in 2024E. Earth-moving machinery, such as excavator, will likely see a lack of growth due to structural declines in property starts (see segment analysis in the next section).

Figure 12: Downstream applications of construction machinery in China

Type of machinery	Infrastructure	Property	Mining	Manufacturing
Excavator	High	Medium	Low	Low
Wheel loader	Medium	Low	High	Low
Truck crane	High	Low	n/a	Low
Tower crane	n/a	High	n/a	n/a
Concrete machinery	Medium	High	n/a	Low
Coal mining equipment	n/a	n/a	High	n/a
Mining transport truck	n/a	n/a	High	n/a
Aerial work platform	Medium	Low	na	High

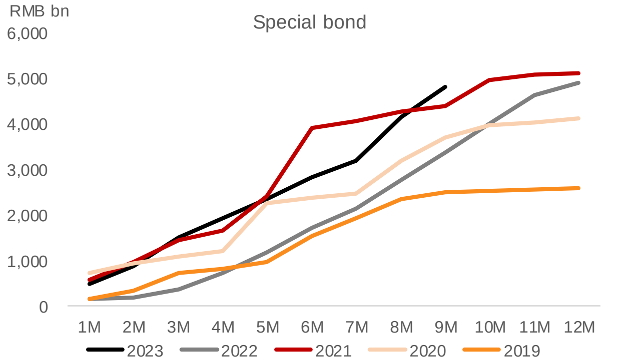
Source: CMBIGM estimates

Figure 13: Local gov't special bond issue amount (monthly)



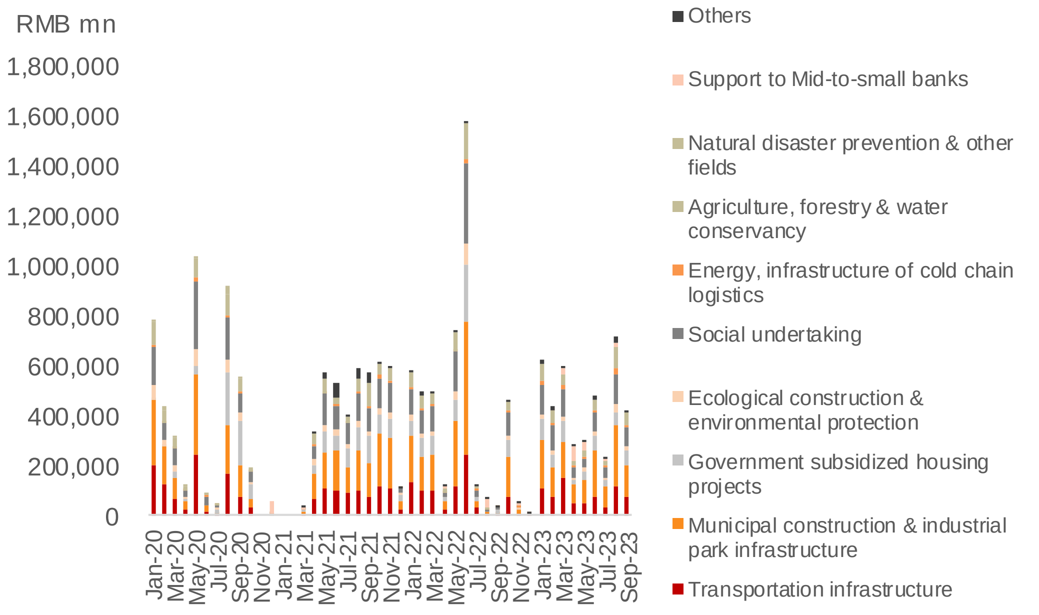
Source: Ministry of Finance, CMBIGM

Figure 14: Local gov't special bond issue amount (YTD new issue + refinancing)



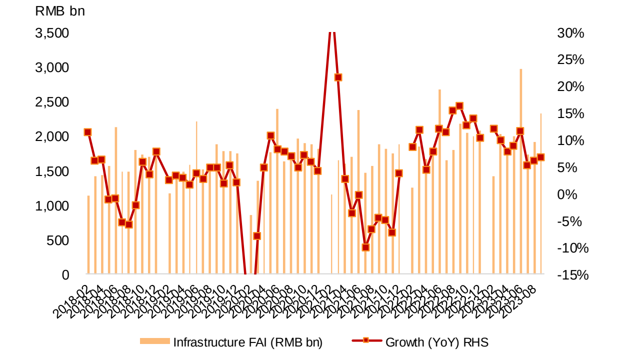
Source: Ministry of Finance, CMBIGM

Figure 15: Use of proceeds from the issuance of local gov't bonds



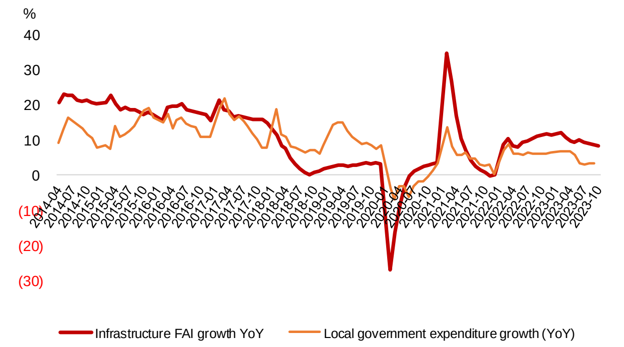
Source: Ministry of Finance, CMBIGM
Note: There were no newly issued bonds in Nov 2020 and Jan-Feb 2021.

Figure 16: China infrastructure FAI



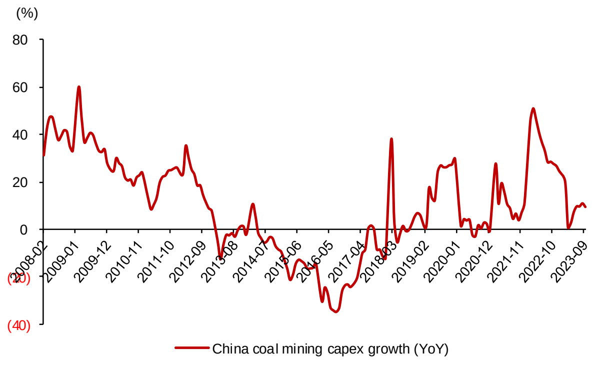
Source: Wind, NBS, CMBIGM

Figure 17: Infrastructure FAI growth vs local government expenditure growth (YTD)



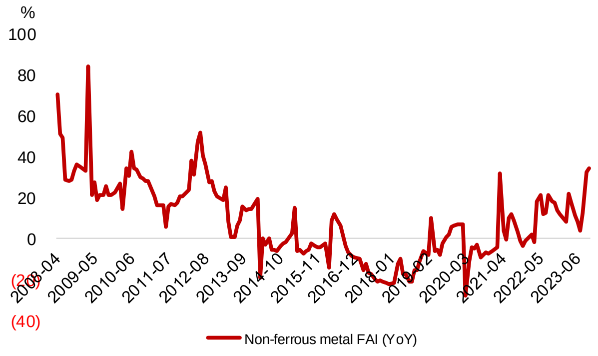
Source: Wind, NBS, Ministry of Finance, CMBIGM

Figure 18: China coal mining FAI growth (YTD)



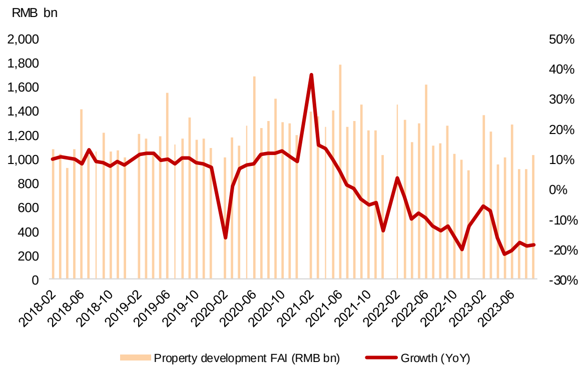
Source: Wind, NBS, CMBIGM

Figure 19: China non-ferrous metal FAI growth



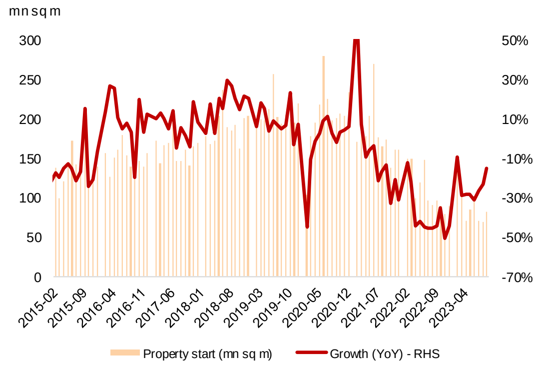
Source: Wind, NBS, CMBIGM

Figure 20: Property development FAI



Source: Wind, CMBIGM

Figure 21: Property starts



Source: Wind, CMBIGM

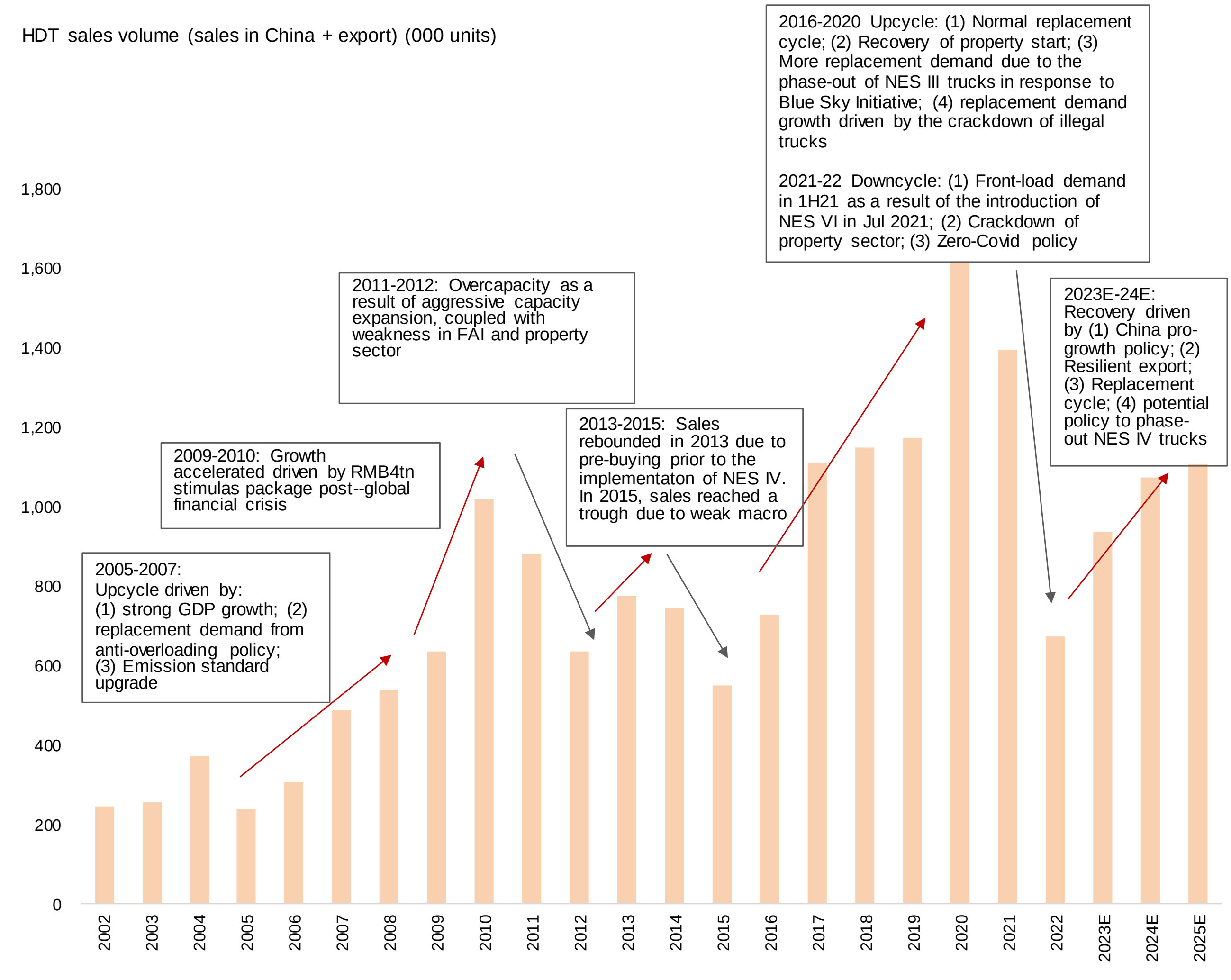
Heavy-duty truck: Expect 15% YoY growth in 2024E

On the back of an extremely low base and resilient export growth, China HDT sales volume (domestic sales + exports) saw a strong recovery in 10M23 (+38% YoY). We forecast full-year sales to grow 39% to 936k units in 2023E.

We expect 15% industry sales volume growth in 2024E:

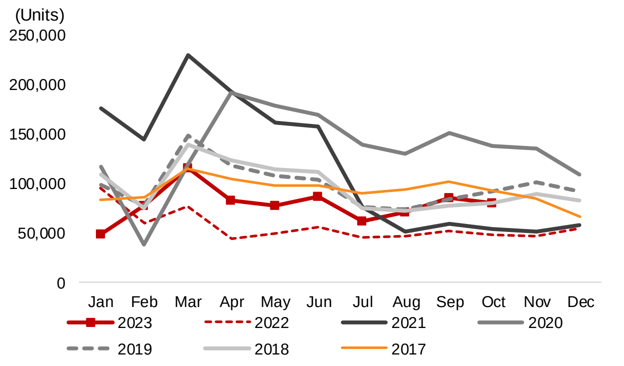
- Historically, the HDT fleet size has been highly correlated with the GDP growth. Our industry model suggests that each unit of operating HDT supports RMB12mn of GDP value. We estimate the fleet size to grow ~4.8% YoY, largely in-line with our GDP growth forecast.
- Given around 6-8 years of a HDT's useful life, we expect a relatively strong replacement demand in 2024E-25E. The replacement demand will be even higher in case of a potential speed-up of the elimination of NES IV trucks.
- We continue to expect solid export growth (18% YoY) in 2024E.
- We calculate that all these will translate to a 15% YoY increase in sales volume in 2024E.

Figure 22: Cycles of China HDT sales



Source: Wind, CMBIGM estimates

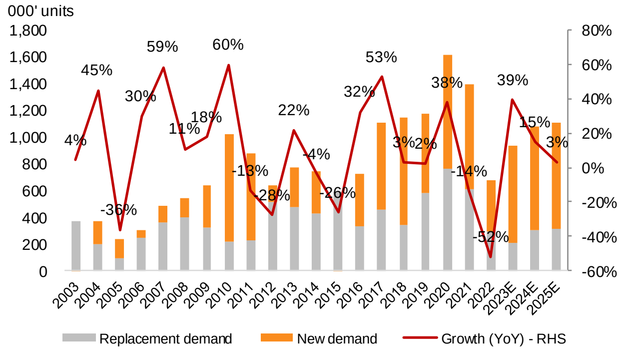
Figure 23: China HDT monthly sales



Source: Cvworld, CMBIGM

Note: Sales in China + exports

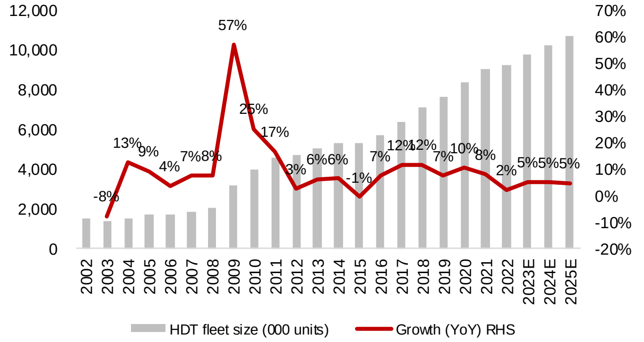
Figure 24: CMBIGM HDT sales projection



Source: Cvworld, Wind, CMBIGM estimates

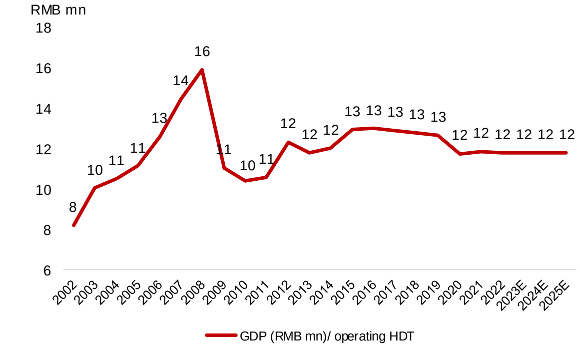
Note: Sales in China + exports

Figure 25: China HDT fleet size



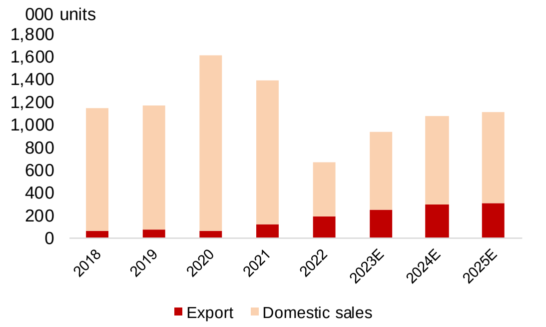
Source: Wind, CMBIGM estimates

Figure 26: GDP per unit of operating HDT



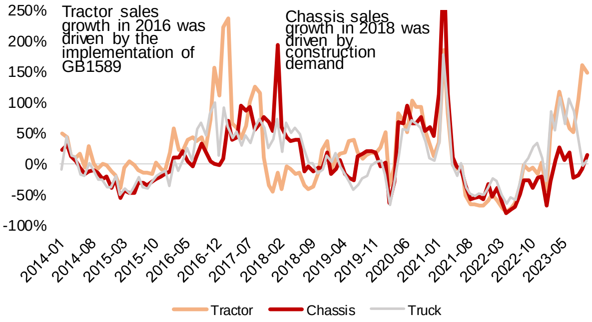
Source: Wind, CMBIGM estimates

Figure 27: Breakdown of HDT sales by region



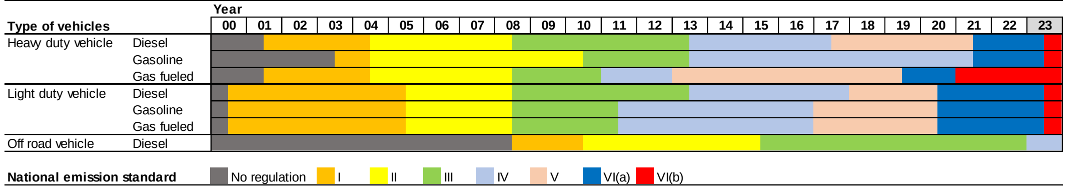
Source: Wind, CMBIGM estimates

Figure 28: Growth rates of different types of HDTs



Source: Wind, CMBIGM

Figure 29: Timetable for the implementation of NES



Source: Ministry of Ecology and Environment, CMBIGM

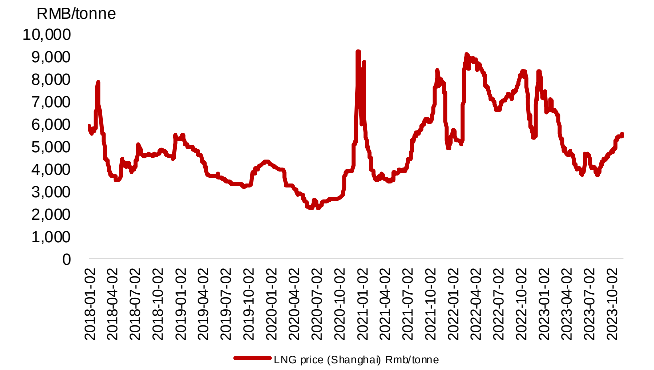
A shift to natural gas truck from diesel truck due to wide gas/diesel price spread

Driven by the wide price spread between LNG and diesel, industry sales volume of natural gas HDTs surged 5.6x/7.4x/14.8x YoY in Aug/Sep/Oct 2023, taking the percentage of total HDT sales to 27%/29%/29%. In 10M23, the sales volume of gas HDTs surged 3.1x YoY to ~130k units, accounting for ~17% of total HDTs sold.

Figure 30: Shandong diesel price

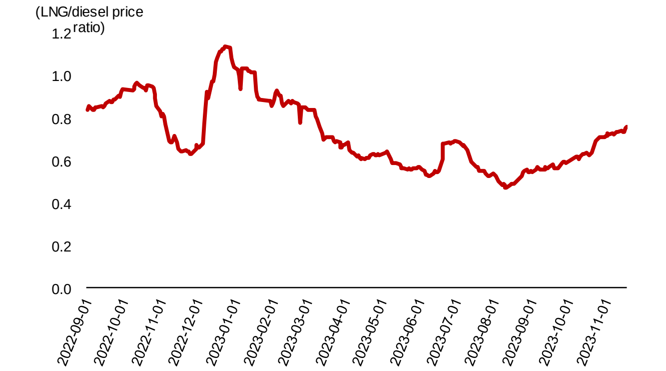
Source: Wind, CMBIGM

Figure 31: Shanghai LNG price



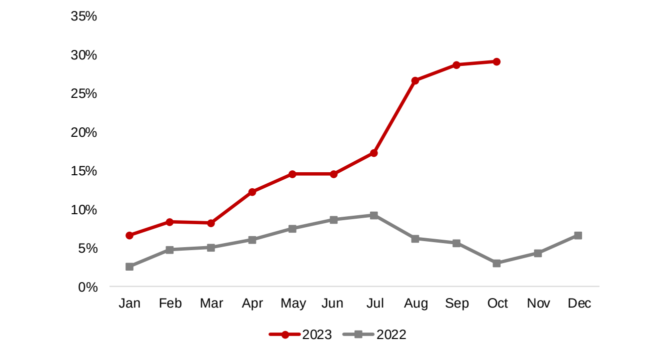
Source: Wind, CMBIGM

Figure 32: LNG/Diesel price ratio



Source: Wind, CMBIGM estimates

Figure 33: Natural gas HDTs as % of total HDTs sold



Source: Wind, Cvworld, CMBIGM

Payback period for gas HDTs is 3.1 years, versus 3.7 years for diesel HDTs

We conduct a detailed analysis on the return comparison between LNG trucks and diesel trucks. Our key assumptions include: (1) purchase price (VAT-included) of RMB468k for a LNG HDT and RMB374k for a diesel HDT; and (2) an average daily transportation distance of 500km. For truck buyers, based on the current price of LNG (RMB5.5/kg) and diesel (RMB7.4/litre), an annual net profit of RMB151k generated from the LNG truck is better than that from a diesel truck (RMB100k).

Despite an increase of the gas/diesel price ratio to 0.74x (mid-Nov) from 0.63x in mid-Oct, our payback period analysis suggests that gas HDT remains a better choice for truck buyers (LNG: 3.1 years, diesel: 3.7 years). We expect natural gas HDTs to continue to account for 25-30% of the total sales of HDTs in the foreseeable future.

Figure 34: Comparison of investment return between diesel and LNG trucks

Diesel		LNG	
Operating assumptions			
Transport service income (RMB / tonne km)	0.27	Transport service income (RMB / tonne km)	0.27
Capacity (tonne)	30	Capacity (tonne)	30
Operating days / month	20	Operating days / month	20
Daily tranportation distance (km)	500	Daily tranportation distance (km)	500
Diesel consumption (litre / 100 km)	30	Gas consumption (kg / 100 km)	30
Diesel price (RMB /litre)	**7.4**	**Gas price (RMB/kg)**	**5.5**
Urea expense (RMB / 100 km)	11.25	Urea expense (RMB / 100 km)	0
Maintenance expense (RMB / 100 km)	60	Maintenance expense (RMB / 100 km)	60
Toll fee per vehicle (RMB/km)	2.2	Toll fee per vehicle (RMB/km)	2.2
Monthly wage of a driver (RMB)	9,000	Monthly wage of a driver (RMB)	9,000
Tax rate (%)	25%	Tax rate (%)	25%
Capex			
Truck purchase price (RMB)	320,000	Truck purchase price (RMB)	400,000
Years of depreciation	5	Years of depreciation	5
VAT rate	17%	VAT rate	17%
VAT (RMB)	54,400	VAT (RMB)	68,000
Total purchase price (RMB)	**374,400**	**Total purchase price (RMB)**	**468,000**
Profitability	(RMB)		(RMB)
Revenue (annual)	931,500	Revenue (annual)	931,500
Expense:		Expense:	
Diesel	-267,084	Natural gas	-197,100
Urea	-13,500	Urea	0
Depreciation	-64,000	Depreciation	-80,000
Maintenance	-72,000	Maintenance	-72,000
Toll fee	-253,000	Toll fee	-253,000
Driver wage	-108,000	Driver wage	-108,000
Insurance and others	-20,000	Insurance and others	-20,000
Pre-tax profit	**133,916**	**Pre-tax profit**	**201,400**
Tax	-33,479	Tax	-50,350
Net profit	**100,437**	**Net profit**	**151,050**
Payback period (year)	**3.7**		**3.1**

Source: CMBIGM estimates

Figure 35: Sensitivity of payback period to diesel price

		Transport service income (RMB / tonne km)				
		0.243	0.2565	**0.27**	0.2835	0.297
	5.9	5.3	3.5	2.7	2.1	1.8
	6.7	7.4	4.4	3.1	2.4	2.0
Diesel price	**7.4**	12.2	5.7	**3.7**	2.8	2.2
(RMB/litre)	8.2	35.5	8.2	4.7	3.2	2.5
	8.9	-39.5	14.7	6.2	3.9	2.9

Source: CMBIGM estimates

Note: For diesel trucks

Figure 36: Sensitivity of payback period to LNG price

		Transport service income (RMB / tonne km)				
		0.243	0.2565	**0.27**	0.2835	0.297
	4.4	4.2	3.2	2.6	2.2	1.9
	4.9	4.9	3.6	2.8	2.3	2.0
LNG price	**5.5**	5.8	4.0	**3.1**	2.5	2.1
(RMB/kg)	6.0	7.0	4.6	3.4	2.7	2.3
	6.6	9.1	5.4	3.9	3.0	2.4

Source: CMBIGM estimates

Note: For LNG trucks

Abundant supply of LNG over the coming years

According to the International Energy Agency (IEA), global gas demand growth rate in 2022-26E is expected to slow to 1.6% p.a. from 2.5% p.a. in 2017-21. The future demand growth is expected to be driven by Asia Pacific and the Middle East, which offset the weakness in other regions.

On the supply side, global gas supply will be driven by LNG. The global LNG supply is expected to expand by 25% between 2022 and 2026, with 70% of the new supply concentrated in 2025E-26E. This is expected to drive an increasingly interconnected and globalized gas market, according to IEA.

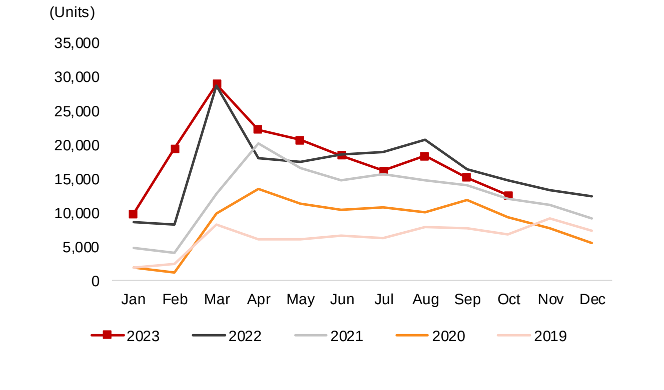
Aerial Work Platform: Strong in the US; Slowdown in China

China. Following years of growth, we estimate China's AWP fleet size is now equivalent to >70% of the US fleet size, versus only ~12% in 2018. Sales of AWPs in China have been declining (YoY) since Aug 2023. We expect a slowdown of fleet size growth as major AWP leasing companies such as **Horizon Construction (9930 HK, BUY)** and **Huatie (603300 CH)** have reduced their capex on AWPs and switched to the asset-light model. We forecast AWP sales in China market to drop ~5% YoY in 2024E.

The US. On the contrary, AWP demand growth in the US over the coming years is expected to be strong on the back of mega projects, such as government-led infrastructure spending, data centers, new energy, as well as AWP replacement demand. **United Rentals (URI US)**, the largest AWP leasing company in the US, guided that the replacement capex in 2024E is estimated at US$2.8-3.0bn, up from US$2.3-2.5bn in 2023E.

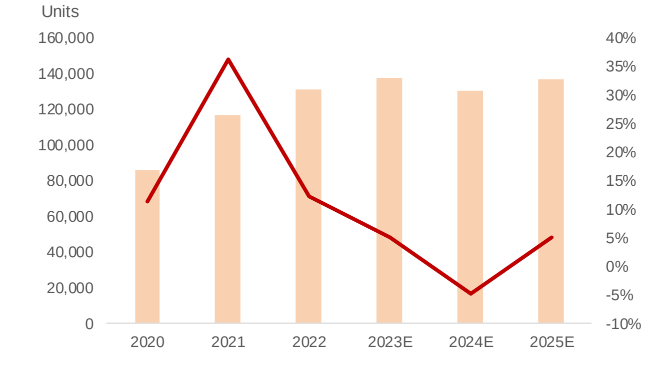
Europe. The European Commission announced in mid-Nov that it will initiate an anti-dumping proceeding concerning imports of mobile access equipment (MAE, or AWP) from China (source). While this looks negative to the Chinese AWP manufacturers at first glance, we think the estimated investigation time of 13-14 months will provide the Chinese manufacturers with time to take measures to mitigate the potential impact. For instance, they can localize their AWP production overseas to avoid the potential duties. Besides, given that different tariffs may be applied, manufacturers with more experience in dealing with the investigation will have the chance to fight for lower tariffs.

Figure 37: China AWP monthly sales (domestic + exports)



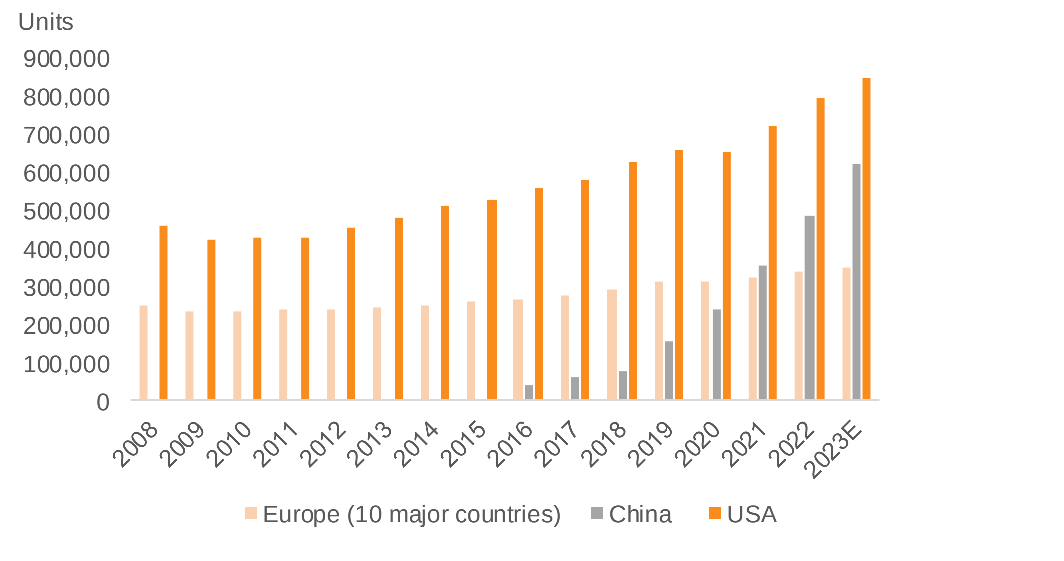
Source: China Construction Machinery Association (CCMA), CMBIGM

Figure 38: CMBIGM China AWP sales projection



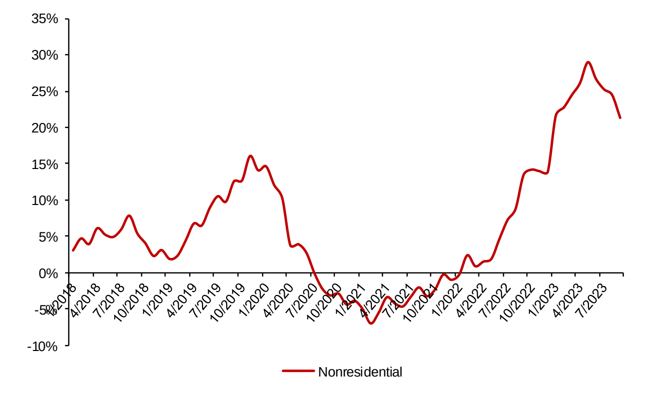
Source: CCMA, CMBIGM estimates

Figure 39: AWP fleet size breakdown by region



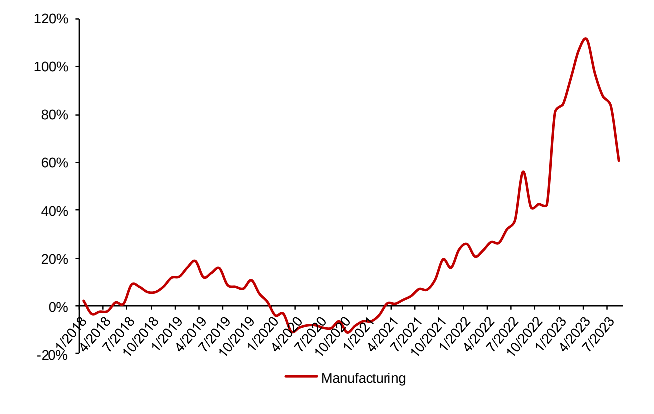
Source: The International Powered Access Federation (IPAF), CCMA, CMBIGM estimates

Figure 40: US non-residential spending growth



Source: Bloomberg, CMBIGM

Figure 41: US manufacturing spending growth



Source: Bloomberg, CMBIGM

Excavator: Expect 5% YoY decline in 2024E as the stabilization of China market to be offset by weak exports

China market:

In China market, infrastructure, property and mining investment (namely construction-related FAI) are the key demand drivers in terms of downstream application. We therefore have been applying the respective FAI figures and excavator sales to evaluate the demand and supply of the machinery. Our industry model suggests that the construction-related FAI per unit of operating excavator (note: higher amount means tighter supply of the machinery) reduced from the peak of ~RMB24mn in 2019 to RMB22mn in 2022 (Figure 48).

The domestic sales of excavators dropped 43% YoY in 10M23 (after a decline of 45% in 2022), hit hard by the weak construction activities as the decline in property investment offset the growth of infrastructure spending. This, on the positive side, results in a slowdown of the fleet size growth. We estimate the per-unit FAI of operating excavators to rebound to RMB22.6mn, which should pave the way for a stabilization of excavator sales in 2024E.

Overseas market:

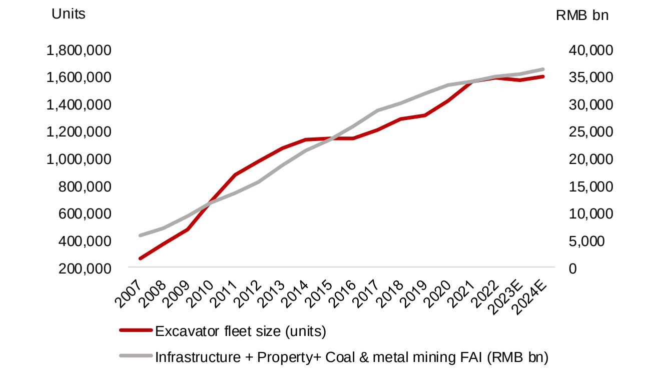
Exports of excavators, for the first time, exceed domestic sales this year (54% in 10M23). While the momentum was relatively strong in 1H23 (+11% YoY), it turned into negative territory in Jul-Oct which resulted in a 1% decrease in sales in 10M23. The decline in exports was due to several factors: (1) high inflation and interest rate affecting demand in some regions, such as Europe; (2) weakness in construction activities (despite resilient mining activities), and (3) easing supply chain constraints boosting the supply of machinery overseas. We expect the weakness of China excavator exports to continue in 2024E.

Our projection:

We forecast the excavator sales volume (domestic sales + exports) to drop 26%/ 5% YoY in 2023E/2024E. Our sales growth forecast in 2024E is based on the following assumptions:

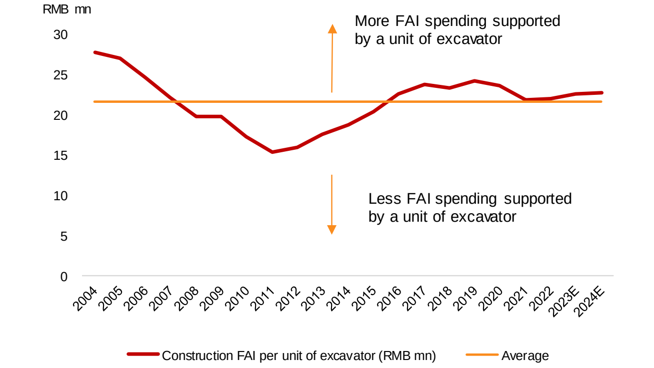
- **China market:** We forecast a stabilization of sales volume in 2024E (+1% YoY), supported by 7.8% infrastructure spending growth but offset by a 7% decline in property investment.
- **Export:** We expect the export volume to decline 10% YoY in 2024E due to the high base effect (in particular in 1H24E).

Figure 42: Excavator fleet size versus construction-related FAI



Source: CCMA, Wind, CMBIGM estimates

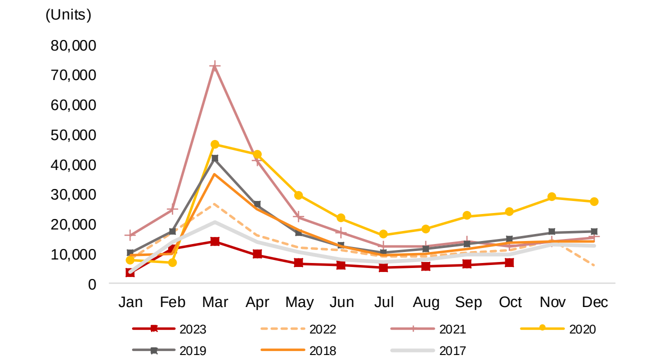
Figure 43: Construction FAI per unit of excavator in operation



Source: CCMA, Wind, CMBIGM estimates

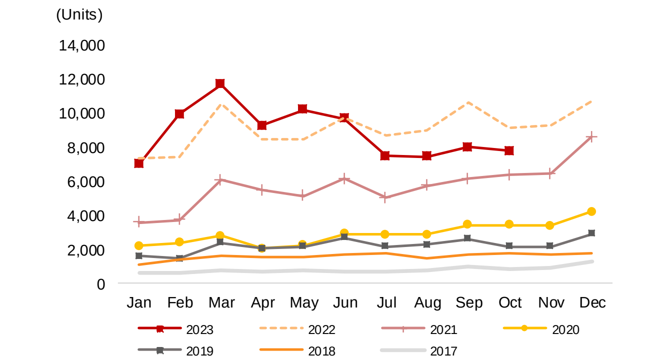
Note: Construction FAI = infrastructure + property + mining

Figure 44: Monthly excavator sales in China



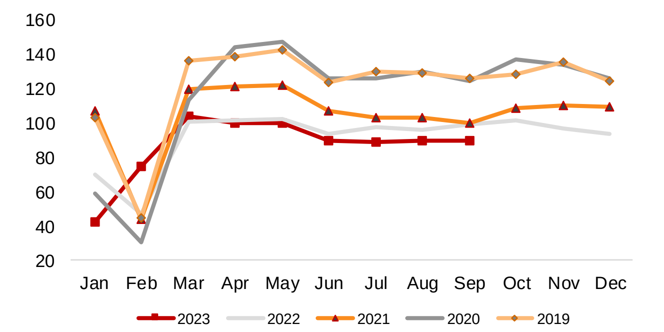
Source: CCMA, CMBIGM

Figure 45: Monthly excavator export volume



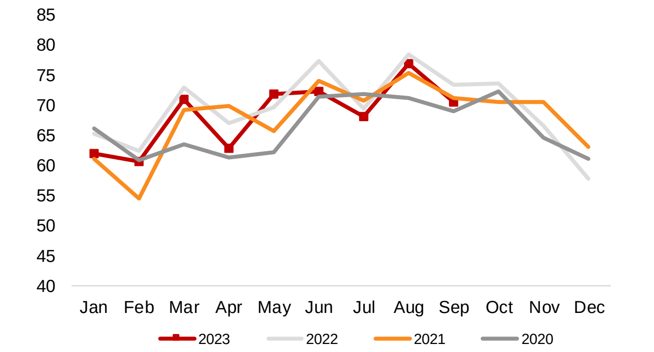
Source: CCMA, CMBIGM

Figure 46: Komatsu excavator monthly utilisation hours in China



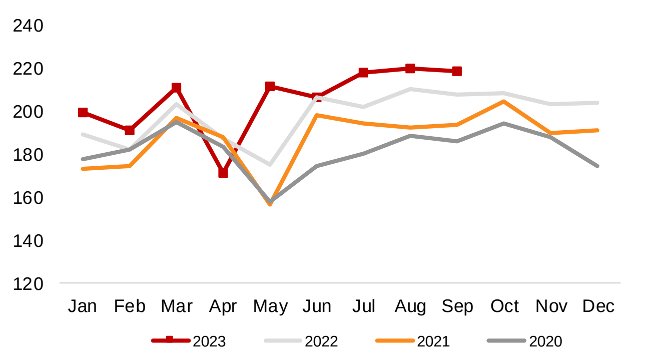
Source: Komatsu, CMBIGM

Figure 47: Komatsu excavator monthly utilisation hours in North America



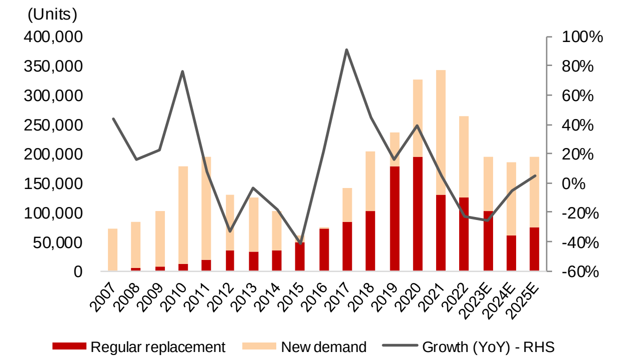
Source: Komatsu, CMBIGM

Figure 48: Komatsu excavator monthly utilisation hours in Indonesia



Source: Komatsu, CMBIGM

Figure 49: CMBIGM excavator sales projection



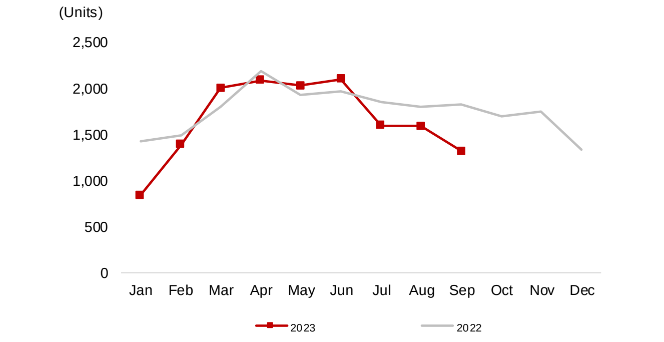
Source: CCMA, Wind, CMBIGM estimates

Tower crane and concrete machinery: Still subject to property construction decline

Visibility on the demand for tower cranes and concrete machinery remains low due to their high exposure to property investment which is subject to change in government policies. Tower crane sales (almost 100% related to property) dropped only 3% YoY in 1H23 as a result of robust exports that partially offset the weak domestic sales, but the sales decline accelerated to 8% in 10M23 as domestic sales further declined. In 2024E, we forecast the sales of tower cranes (China sales + exports) to drop 20% YoY as we expect the domestic property investment to stay weak and export momentum to lose steam.

For concrete mixers and pump trucks (2/3 related to property), we expect the demand to see a single-digit decline in 2024E.

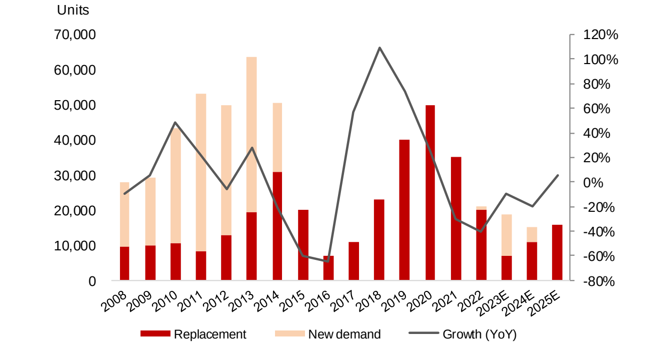
Figure 50: Tower crane monthly sales volume



Source: CCMA, CMBIGM

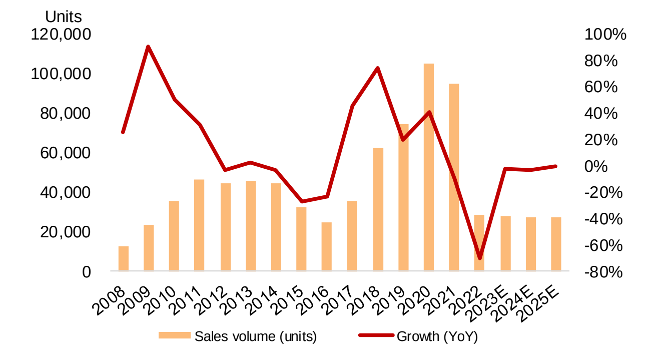
Note: Domestics sales + exports

Figure 51: CMBIGM tower crane sales projection



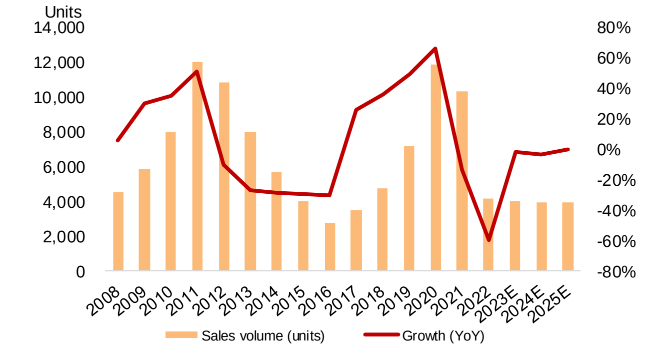
Source: CCMA, CMBIGM estimates

Figure 52: CMBIGM concrete mixer sales projection



Source: CCMA, CMBIGM estimates

Figure 53: CMBIGM concrete pump truck sales projection



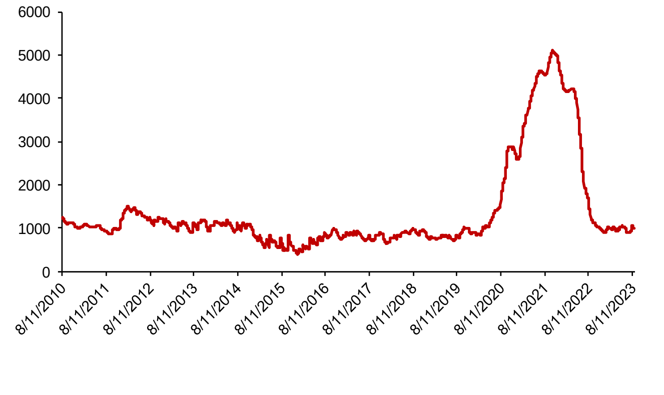
Source: CCMA, CMBIGM estimates

Margin improvement on lower freight rate and steel price

The freight rate (Shanghai Containerized freight index as reference) has significantly declined and returned to the pre-pandemic level since early this year. Since exports are now an important revenue driver for most of the Chinese machinery manufacturers, the normalization of freight rate has helped boost gross margin expansion this year. Given the easing bottleneck, we do not expect a sharp increase in the freight rate in 2024E.

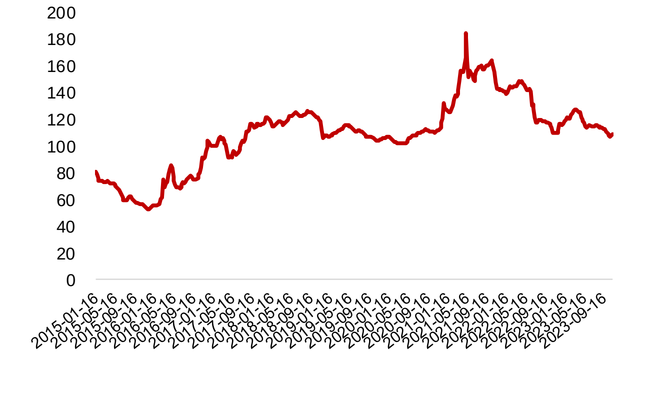
Steel generally accounts for 15-20% of construction machinery production cost. The weakness of steel price should also help drive cost reduction.

Figure 54: Shanghai Containerized freight index



Source: Bloomberg, CMBIGM

Figure 55: China medium-thick steel plate price index



Source: Wind, CMBIGM

China Entertainment Sector

OUTPERFORM

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Opportunities amid volatility

Eye on video, overseas expansion and AIGC initiatives

Despite macro uncertainty and geopolitical tension, we are cautiously positive on moderate re-rating and trading opportunities in the entertainment sector for its already-low expectation and attractive valuation. Sector sentiment will be mildly improved from 2Q24E, with interest rate hike, clearer FY24E guidance after earnings and upcoming strong summer pipeline. As subsectors or companies continued to diverge, we suggest to eye on video and overseas expansion segment, backed by clear growth path and advanced profitability. Our top picks: **Netflix (NFLX US, BUY), Kuaishou (1024 HK, BUY), and GigaCloud (GCT US).**

- **2Q24E as a good entry point, with headwinds to price in.** China's entertainment stocks have dropped 10% YTD due to multiple headwinds. The related stocks may see volatility in 1Q24, but we expect potential moderate re-rating from 2Q24E, given interest rate hike, clearer FY24E guidance after earnings and upcoming strong summer pipeline. Entertainment regulatory environment returned to normalization, while tightening self-discipline in Mini Series promotes healthy industry development. Margin enhancement would continue, but primarily driven by monetization diversification, content premiumization and AIGC initiatives, rather than aggressive staff optimization. We forecast industry earnings growth at 18% YoY in FY24E, with 17% CAGR in FY23-25E.

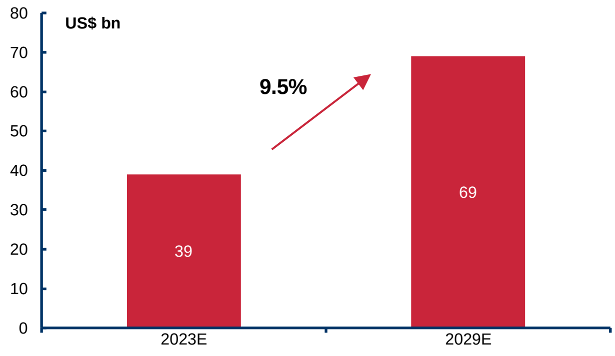
- **Seeking alpha in resilient video and overseas ecommerce.** Subsectors or companies continued to diverge from each other. We suggest to remain selective, and eye on three main themes: **1) SFV** (forecasting industry revenue +22% YoY in 2024E): resilient on its ads share gain and advanced profitability; bullish on upside from shelf-based mall expansion and popularity of mini series. We expect SFV GMV +25% YoY (up to RMB5.3tn), with market share +3ppts YoY, in which shelf-based mall to unlock AAC ceiling and category expansion. **2) Streaming**: global streaming would benefit from competition to pull back and content pick-up after strikes. We are positive on streamers' enhanced monetization and margin outlook, backed by: 1) the industrial wave of price increases to continue in 2024E; and 2) subs expansion with AVOD (TAM of 380mn) and paid-sharing initiatives. Domestic LFV momentum will be primarily driven by ARM expansion. **3) Overseas B2B ecommerce**: confident on GMV growth and solid profitability, backed by booming demand of cross-border ecommerce, sellers & buyers expansion and freight cost normalization.

- **Attractive valuation, with favorable risk reward.** Sector valuation is attractive at 13x 24E P/E (still at 5-year historical trough), and we suggest to buy the dips. Our top picks are Netflix, Kuaishou, and GigaCloud. **Netflix (NFLX US, BUY)**: 1) clear growth drivers from AVOD expansion and paid-sharing initiatives; 2) original content edge for share gains and price hikes; and 3) high margin visibility with competition to pull back. **Kuaishou (1024 HK, BUY)**: 1) positive on its ads & ecommerce share gain (ads +17% YoY; ecommerce GMV +24% YoY) and margin improvement (57% earnings CAGR in FY23-25E); 2) bullish on its long-term ecommerce upside, with higher traffic efficiency and shelf-based mall expansion. **GigaCloud (GCT US, BUY):** 1) attractive valuation (7x FY23E P/E) and above-industry growth (25% earnings CAGR in FY23-25E); 2) high barrier with supply chain, end-to-end logistics and data-driven operations; 3) benefit from M&A synergy and booming demand of cross-border ecommerce and sellers & buyers expansion.

■

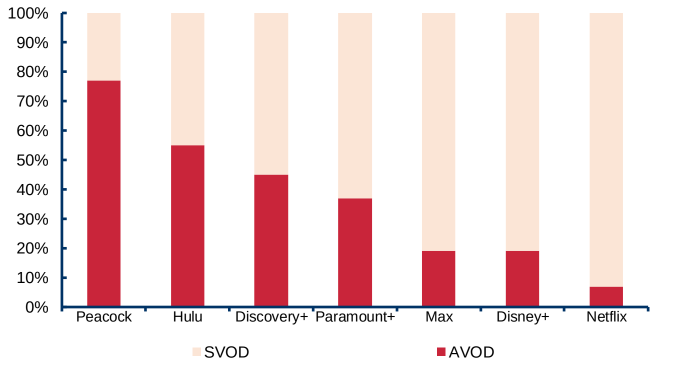
Focus Charts

Figure 1: Global AVOD market size and growth



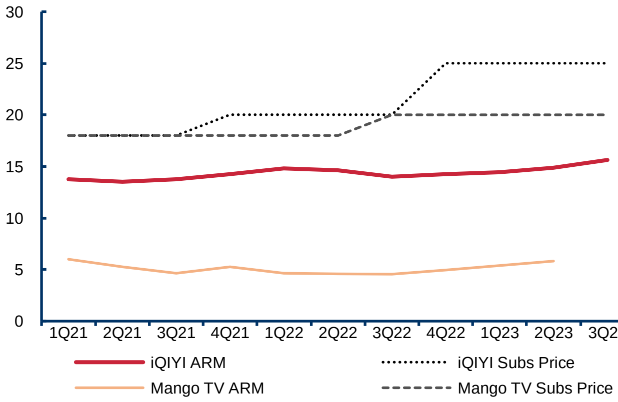
Source: Digital TV Research, CMBIGM estimates

Figure 2: Subs breakdown of key streaming platforms



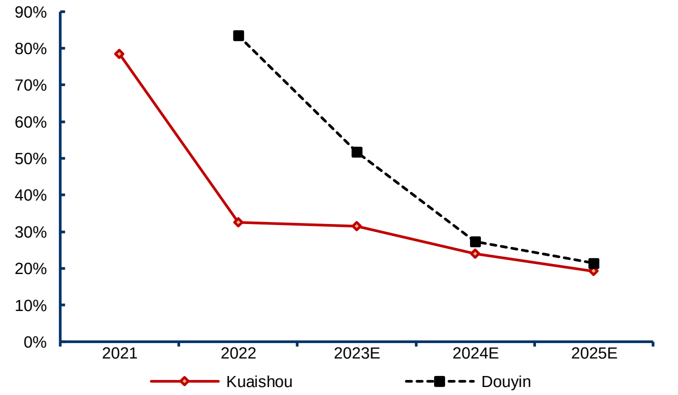
Source: Antenna, CMBIGM

Figure 3: ARM growth of LFV



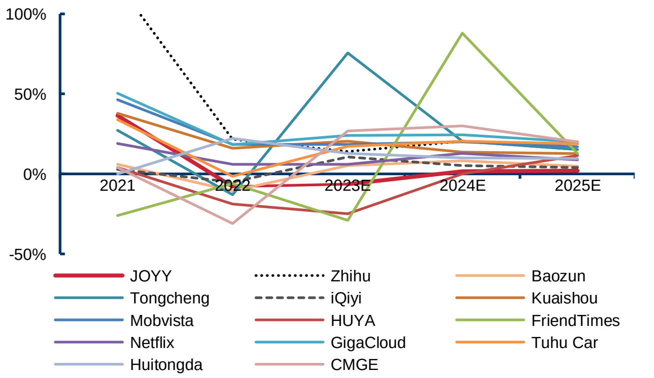
Source: Company data, CMBIGM estimates

Figure 4: GMV growth of key SFV platforms



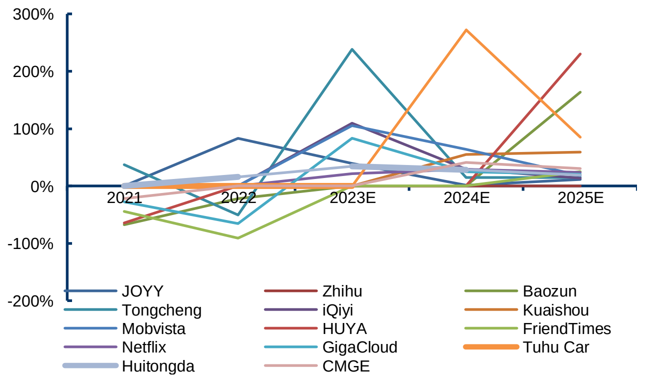
Source: Company data, CMBIGM estimates

Figure 5: Revenue growth of key platforms



Source: Company data, CMBIGM estimates

Figure 6: Margin trend of key players



Source: Company data, CMBIGM estimates

Global streaming: competition to pull back, with AVOD & paid-sharing initiatives as dual-engines

With competition to pull back and strikes to settle, we expect global streaming to embrace content pick-up and margin improvement in FY24E. Moreover, we are bullish on streamers' enhanced monetization, backed by: 1) the industrial wave of price increases to continue in 2024E; and 2) subs expansion with AVOD and paid-sharing initiatives. Netflix (NFLX US) is our top pick in this segment, for its 1) high barrier with vibrant original content pipeline and efficient investment; 2) solid long-term subs trend with AVOD expansion and paid-sharing rollout; and 3) clear margin expansion and increasing FCF. Netflix is trading at 29x FY24E P/E, still below historical multiple of 39x.

Competition to pull back.

We are positive on growth potential of streaming in 2024E, backed by: 1) ramp-up of non-paid TV viewers; 2) competition among LFVs to normalize; and 3) time spent on SFVs to stay stable. Streaming platforms are now prioritizing content quality and cost control since 1H23, and we view this trend to continue, with rising demand for profitability and free cash flow. For example, Warner Bros has reduced DTC (direct-to-consumer) movie releases and license them out under flat budgets. Disney aggressively cut streaming cost in 2023, and target to achieve breakeven in 2024E.

AVOD & paid sharing initiatives to enhance monetization.

We are bullish on AVOD (ad-based video-on-demand) expansion and expect positive impact on both net adds and ARPU. With a lower-priced package, AVODs can help streamers spread global reach and tap into price-sensitive users (forecasting TAM of ad-supported subs at 380mn worldwide). After Netflix rolled out AVOD, ads plan sign-ups rose 70% QoQ in 3Q23, accounting for 30% of sign-ups of its ads countries. Looking ahead, we expect Netflix's AVOD subs to increase to 23mn/32mn in FY24/25E (11% of the subs mix in FY25E), from 14mn in FY23E, with a 51% CAGR. Disney also released its ad-supported package in Dec 2022 in the US and planned to expand it into Canada & Europe in Nov 2023, while Amazon Prime Video will test the water in early 2024. Ads marketing, formats innovation and ad tech enhancement would be the priority for streamers in 2024, in our view. Paid sharing initiatives would be another subs driver, with streamers began password-sharing crackdown in 2023 (e.g. Netflix, Disney). We expect paid-sharing initiatives to transfer more users into add-on subs (>100mn password-sharing users in Netflix). For Netflix, we forecast ~30mn extra subs from paid initiatives by 2025E (6% revenue mix), implying ~30% of conversion rate.

Rising ARM with price hikes and AVOD expansion.

In 2023, the streaming industry has seen a price hike wave (+7%-27% across streamers) for creeping inflation and rising costs (especially after Hollywood strikes). Netflix slightly raised its price for premium plan by 11%-15% in Oct 2023 after strikes. We expect price increase trend to continue in 2024E, and forecast blended ARPU to grow at single-digit YoY in 2024E, coupled with AVOD expansion (higher ARPU) and removal of basic plan.

Content to pick up after strikes, with higher mix of non-English titles.

Netflix's 4Q23 pipeline is expected to be moderate with estimated 52 originals, vs. 82/105 in 4Q22/3Q23. We expect industry content to pick up gradually in 1H24E after strikes, and popularity of non-English content in Netflix would partially alleviate content gaps (no. of non-English content was on par with that of English content). Eyes on key pipeline in 4Q23E for Netflix: The Crown (Season 6), Squid Game: The Challenge, etc. For 2024E, industry key titles include: Stranger Things 5 (Netflix), 3 Body problem (Netflix), Masters of the Air (Apple+), House of the Dragon 2 (HBO), etc.

Clear margin expansion with cost discipline and higher ARPU.

We are positive on streamers' margin expansion in 2024E, attributable to 1) efficient content spending with competition to pull back; 2) incremental revenue driven by password-sharing crackdown and the ad-supported tier; 3) continuous price increases; and 4) higher mix of non-English content with relatively lower investment.

Figure 7: Revenue estimates for Netflix's ad-supported tier plan

US$ mn	1Q23E	2Q23E	3Q23E	4Q23E	1Q24E	2Q24E	3Q24E	4Q24E	2023E	2024E	2025E	2026E
Paid Ending Subs (mn)	**1.2**	**6.0**	**10.2**	**14.2**	**16.0**	**17.9**	**20.4**	**23.4**	**14.2**	**23.4**	**32.4**	**40.4**
QoQ Growth		400%	70%	39%	13%	12%	14%	15%				
YoY Growth					1233%	198%	100%	65%		65%	38%	25%
% mix	1%	3%	4%	6%	6%	7%	8%	9%	6%	9%	11%	13%
Average Paid Subs (mn)		3.6	8.1	12.2	15.1	17.0	19.2	21.9	7.9	19.4	27.9	36.4
Net Adds (mn)		**4.8**	**4.2**	**4.0**	**1.8**	**1.9**	**2.5**	**3.0**	**13.0**	**9.2**	**9.0**	**8.0**
QoQ Growth			-13%	-5%	-55%	6%	32%	20%				
YoY Growth						-60%	-40%	-25%		-29%	-2%	-11%
% mix		81%	48%	43%	50%	70%	55%	57%	50%	57%	62%	60%
ARPU (US$)	**15**	**15**	**15**	**15**	**15.3**	**15.3**	**15.3**	**15.3**	**15**	**15.3**	**15.6**	**15.9**
YoY Growth					2%	2%	2%	2%		2%	2%	2%
Ad-supported tier rev		**162**	**365**	**549**	**693**	**778**	**879**	**1,005**	**1,076**	**3,355**	**5,225**	**6,953**
QoQ Growth			125%	51%	26%	12%	13%	14%				
YoY Growth						380%	141%	83%		212%	56%	33%
% mix		2%	4%	6%	7%	8%	9%	10%	3%	9%	13%	15%

Source: Company data, CMBIGM estimates

Figure 8: Revenue estimates for Netflix's paid-sharing initiatives

US$ mn	2Q23E	3Q23E	4Q23E	1Q24E	2Q24E	3Q24E	4Q24E	2023E	2024E	2025E	2026E
Add-on Ending Subs (mn)	**12**	**16**	**20.00**	**21**	**22.3**	**23.8**	**25.6**	**20**	**25.6**	**29.9**	**32.3**
QoQ Growth		33%	25%	5%	6%	7%	8%				
YoY Growth					86%	49%	28%		28%	17%	8%
Average Paid Subs (mn)	12.0	14	18	20.5	21.7	23.1	24.7	16.0	23.2	27.75	31.1
Net Adds (mn)	**12.0**	**4.0**	**4.0**	**1.0**	**1.3**	**1.5**	**1.8**	**20**	**5.6**	**4.3**	**2.4**
QoQ Growth		-67%	0%	-75%	30%	15%	20%				
YoY Growth					-89%	-63%	-55%		-72%	-23%	-44%
ARPU (US$)	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**	**7.99**
YoY Growth					0%	0%	0%		0%	0%	0%
Paid-sharing rev	**288**	**336**	**431**	**491**	**519**	**553**	**592**	**1,055**	**2,155**	**2,661**	**2,982**
QoQ Growth		17%	29%	14%	6%	6%	7%				
YoY Growth					80%	65%	37%		104%	23%	12%
% mix	4%	4%	5%	5%	6%	6%	6%	3%	6%	6%	7%

Source: Company data, CMBIGM estimates

LFV: ARM expansion to unlock subs LTV, with margin expansion intact

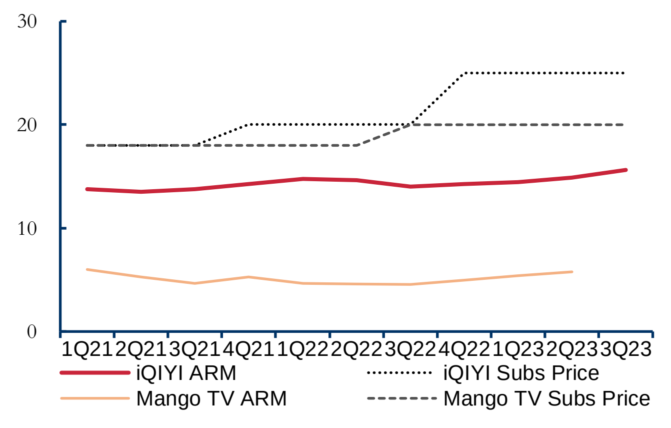
Domestic LFV embraced content recovery and multiple hot titles in 2023, with healthy regulatory environment and content premiumization. Looking into 2024E, we expect high-quality development to continue, but with higher priority on ARM expansion than net adds. Among LFV peers, we remain positive on **iQIYI (IQ US)**'s ARM upside and margin improvement, backed by its abundant unique original content, valuable IP and high barrier with "Middle platform" strategy. Valuation at 9x FY24E P/E is attractive (with 21% earnings CAGR in FY23-25E). More titles would bring further upside, including *Fox Spirit Matchmaker (狐妖小红娘)*.

Enhanced subs LTV with rising ARM.
As LFV prioritizes on long-term value of subs, ARM is a key driver for revenue growth and margin expansion. We are more positive on LTV's ARM trend, backed by narrowing discounts, enriched subs benefits and campaign. We forecast IQ's ARM to rise to RMB16.1 (3% QoQ) in 4Q23E, and achieve single-digit-growth in 2024E, with long-term target at RMB25-30 (vs. ~15 in 2023). Clear ARM expansion will support margin improvement ahead.

Seeking alpha from content differentiation.
Hot titles would still be the key factor for share gain and subs net adds, in our view. In 2023, multiple hot dramas gained tractions, including IQ's The Knockout (狂飙, market share >50%), Destined (长风渡), Mysterious Lotus Casebook (莲花楼), Kunning Palace (宁安如梦), A journey to love (一念关山) and Tencent video's Lost You Forever (长相思), The Long Season (漫长的季节). We keep positive on 2024-2025E content pipeline and vertical differentiation, and suggest to eye on: 1) IQ: Fox Spirit Matchmaker series (狐妖小红娘系列), Sihaichongming (四海重明), A Moment But Forever (念无双); 2) Tencent Video: Lost You Forever 2 (长相思第二季), Joy of Life 2 (庆余年第二季), The Legend of ShenLi (与凤行), Rose (玫瑰故事).

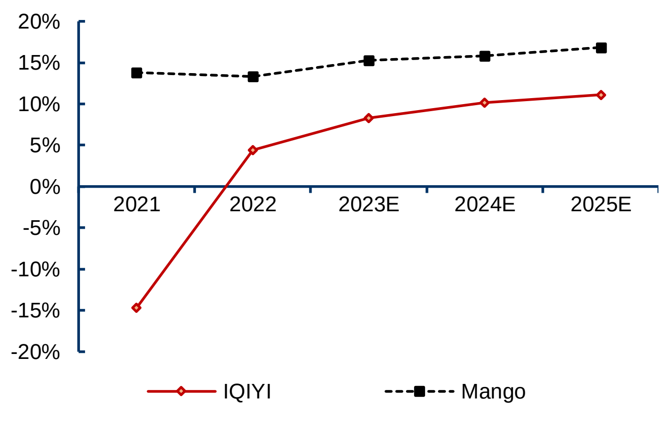
Margin improvement intact.
We keep confident on LFVs margin outlook in 2024E, backed by: 1) ARM expansion; 2) higher ROI of content investment; 3) AIGC initiatives; and 4) existing hot titles to unlock long-tail value. For IQ, we forecast non-GAAP OP to be RMB908mn in 4Q23E (implying 11.5% OPM), with stable GPM QoQ. In the long run, we expect IQ to see ~2ppts margin improvement per year, amid relatively stable competition landscape.

Figure 9: ARM growth of LFV



Source: Company data, CMBIGM estimates

Figure 10: Margin trend of LFV platforms



Source: Company data, CMBIGM estimates

SFV: ecommerce & ads share gain to continue

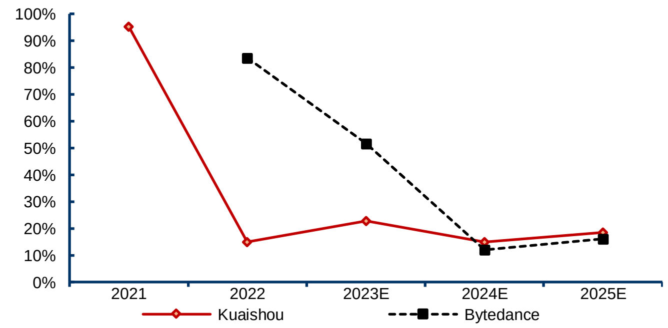
Looking into 2024E, SFV will prioritize on monetization enhancement and efficiency improvement. We forecast SFV rev +22% YoY in FY24E, with continuous share gain and margin improvement. We expect ecommerce and lifestyle services to bring further upside on monetization, while AIGC to improve traffic efficiency, content creation, scenario enrichment and export tech solutions. In SFV segment, we reiterated our confidence on KS's share gain, improving profitability and higher ecommerce monetization, with potential catalysts: 1) upbeat 4Q23E results; 2) shelf-based mall expansion; and 3) earnings upside.

Resilient ads growth ahead with algorithm optimization and strong internal ads.
We forecast SFV ads to see above-industry growth in FY24E (forecasting rev +14% YoY), in which Bytedance/Kuaishou +13%/17% YoY, supported by: 1) performance-based ads to gain share amid macro challenges; 2) enriched ads scenario from shelf-based mall and search; 3) higher ads ROI with algorithm optimization. Apart from strong internal ads, we expect external ads recovery to continue, driven by resilient media (e.g. mini shows), mini game, healthcare and education vertical. For Kuaishou, we see high visibility for KS to achieve long-term ads market share of 10% (similar to time spent share, vs. 5%~6% currrently), backed by: 1) rising DAU; 2) ad load expansion with deeper native ads penetration; 3) higher CPM on better targeting.

Ecommerce: shelf-based mall expansion to unlock TAM.
We are confident on SFV's ecommerce share gain in 2024E (forecasting GMV +25%, with market share up 3ppts to 23%), in which Bytedance/Kuaishou +25%/24% YoY. SFV will focus more on value-for-money goods, traffic efficiency enhancement and shelf-based mall expansion. We are bullish on GMV potential from shelf-based mall (forecasting 40%~50% incremental GMV in the long run). KS delivered the highest GMV growth in 11.11 promotion among key platforms, backed by Level I access open of shelf-based mall to active merchants. We expect its ecommerce GMV/others revenue +29.5%/40% YoY in 4Q23E, and to achieve >20% GMV CAGR in FY23-25E, boosted by: 1) extensive brand participation and enriched product offerings through Stream Initiative (boosting stronger ROI for KOL and merchants); 2) ecommerce deeper penetration, as KS's MAC/MAU (16-17%) still lags behind that of Douyin (20-25%); and 3) shelf-based mall GMV expansion (vs. ~30% mix of Douyin), with supply chain enrichment and higher purchase frequency.

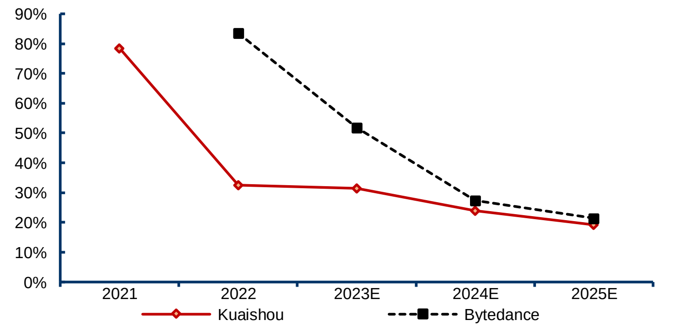
Better margin outlook.
We are positive on SFV's profitability improvement in 2024E, with enhanced monetization, operating leverage and ROI-driven overseas investment. Kuaishou has guided up its earnings for multiple times and we think there is still earnings upside for 2024E. We forecast its adj. NP to rise 3ppts/4ppts at 10.5%/14.8% in FY24/25E (still below Bytedance of 20%+), supported by aggressive overseas loss narrowing and cost control.

Figure 11: Ads growth of SFV



Source: Company data, CMBIGM estimates

Figure 12: GMV growth of key SFV platforms



Source: Company data, CMBIGM estimates

Mini drama: riding on content premiumization and diversified monetization

Mini drama boom driven by both rising supply and demand, while regulation to promote healthy development. Since the launch of online mini drama registration in 2020, mini dramas have thrived and gained tractions in 2023, boosted by: 1) fragmented viewing demand through fast-paced storytelling, plot twists, and relatable content, especially from untapped users in lower-tier cities; 2) absorbing excess production capacity from LFV, with shorter production cycle and high ROI. By Oct 2023, 2,420 mini dramas were registered, vs. 398/2,880 in 2021/2022. Recent regulation (announced on 21 Nov 2023) mainly focus on promoting healthy growth through self-discipline. Platforms have initiated self-inspections to exclude non-qualified entities and content. We expect the adjustment to foster sustainable and healthy industry development.

Tapping into RMB100bn market size. Mini-program drama is the main business model (accounting for 70% of the market), followed by free drama and revenue-sharing drama. According to Ocean Engine, daily spending on mini dramas surpassed RMB60mn in Oct 2023, indicating annualized grossing of RMB20bn-30bn, with long-term potential over RMB100bn. Although SVOD (subscription video-on-demand) serves as the primary monetization method currently, we expect free drama (monetized through advertising) to be the new engine with diverse user profiles.

Matthew Effect: high-tier players with decent profitability, and content matters more than S&M ahead. Generally, high-quality mini dramas yield margin of 30% to 50%, deducting from production costs (RMB0.2mn to 0.5mn) and S&M expenses (80% of grossing). Top mini dramas can achieve revenue of RMB400-500mn despite production costs of more than million. Looking into the value chain, taking mini drama with million grossing as an example, IP creators and production companies receive revenue sharing of 4% to 7% with minimum guarantee of RMB0.05mn-0.15mn. Publishers /distributors can earn 20% to 30% /10% to 15% profits, respectively, based on average ROI.

Stepping up overseas expansion. Mini dramas are rapidly expanding the pace for overseas market, driven by increasing domestic supply along with high traffic concentration (Douyin and Kuaishou accounting for 58% market share). Reel Short app (developed by COL, 300364 CH) has successfully launched over 21 mini dramas, with over 2.25 million downloads on Google Play and US$4.5mn monthly revenue in Oct 2023. Compared with domestic market, overseas markets, particularly the US and Europe, target the middle class, resulting in higher production costs and ARM. We expect overseas players to benefit from creative freedom, expanding supply, strong purchasing power and low industry concentration. More boutique in specific content segment might stand out, with monetization diversification and differentiated content.

More entrants engaged in the value chain: The value chain covers upstream (writers and IP such as web novels, comics, etc.), midstream (production companies, KOLs, MCNs, etc.), and downstream (SFV platforms, content communities, etc.). Both SFV and LFV are actively expanding across the value chain. **SFV:** Kuaishou launched over 100 mini dramas with over 100mn viewership supported by Xingmang Project (星芒计划). Douyin leverages its huge traffic to quickly build an ecosystem through high-quality, diverse content, and IP collaborations. In May, Kuaishou also launched the independent app Hongguo (红果免费短剧). **LFV:** while LFVs are actively developing original premium mini dramas, iQiyi pioneered the micro "vertical screen theater" in 2018. Mango also launched series of hot mini dramas (including The Killer is also Romantic 念念无明), backed by top-tier producers.

Livestreaming: looking into overseas recovery and new business expansion

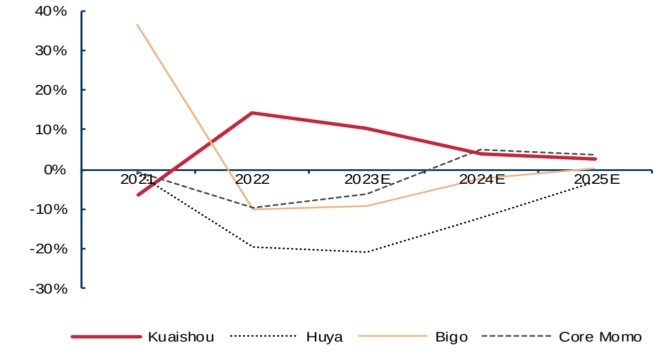
We believe the market has already factored in recent regulation headwinds. Key platforms (e.g. Kuaishou) are expected to be resilient due to pre-active adjustments. Vertical platforms are actively exploring opportunities for new drivers. We believe the downside risk for livestreaming names (JOYY and Huya, etc) is limited, on the back of the undervaluation, share buybacks and dividends. Furthermore, we expect potential re-rating in 2024E, attributable to mild fundamentals recovery. We suggest to eye on JOYY's overseas live streaming sequential growth in sight, and Huya's gaming incentives.

Regulatory normalization with manageable impact. We expect industry regulation to normalize in FY24E with manageable impact, given:1) lower frequency of policies (6/4/1 policy documents issued in 2021/22/23); 2) consensus on implementing policies and pre-active adjustments. For instance, Kuaishou's live streaming was well guided, and it will prioritize on ecological governance, high-quality content vertical expansion and fostering talented KOLs. We estimate KS's live streaming revenue +4.0%/2.5% YoY in FY24E/FY25E. Meanwhile, vertical platforms will actively explore new drivers. For example, Huya will reallocate resources to develop gaming-related businesses to offset live streaming adjustments. We anticipate Huya's revenue +0%/12% in FY24E/25E, in which livestreaming -12.3%/-3.3% YoY. Momo is accelerating the launch of new products/features and actively expanding into overseas markets.

Eye on overseas recovery and new business expansion. YY's Middle East business is gradually stabilizing, and we expect topline to resume growth in FY24E. We anticipate Bigo to bottom out and recover in 2H23E (projecting 1% QoQ in 4Q23E), with 0.7%/1.5% YoY growth in FY24/25E, primarily driven by solid growth in the US and Europe, stabilization of the Middle East, and marketing campaigns. For Newborn City, Mico's revenue is expected to remain flat YoY in 2H23E with stabilized competitive landscape in the Middle East, followed by CAGR of 10% during FY23-26E. Huya's game-related revenue (game advertising, game distribution, and virtual item sales) is likely to contribute >10%/30% in FY24E/25E, backed by its 86mn MAU (as of 3Q23) and Tencent's abundant gaming resources.

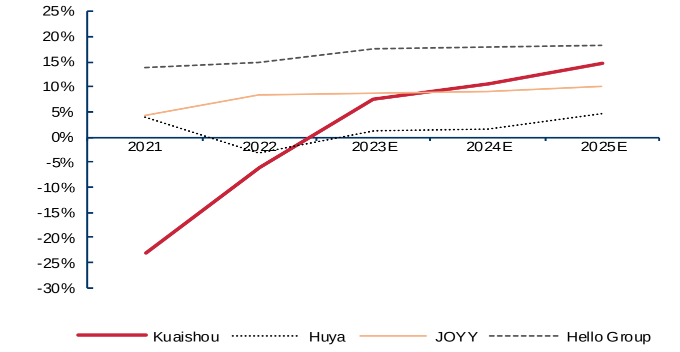
Margin expansion intact. We keep positive on JOYY's better margin outlook, with adj.NP +4.0%/15.8% YoY (9.0%/10.1% adj. NPM) in FY24E/25E, thanks to stable Bigo and loss reduction from other businesses. Huya is expected to achieve profitability ahead of schedule in FY23E. Looking into FY24E/ FY25E, thanks to rising gaming business (with GPM of ~50%), we expect Huya's adj. net profit to grow 24%/ 230% YoY, with adj. NPM of 1.6%/4.8%, respectively.

Figure 13: Key platforms' revenue growth estimates



Source: Bloomberg, CMBIGM estimates

Figure 14: Key platform's adj. NPM estimates



Source: Bloomberg, CMBIGM estimates

B2B overseas ecommerce: benefitting from booming demand and consolidation

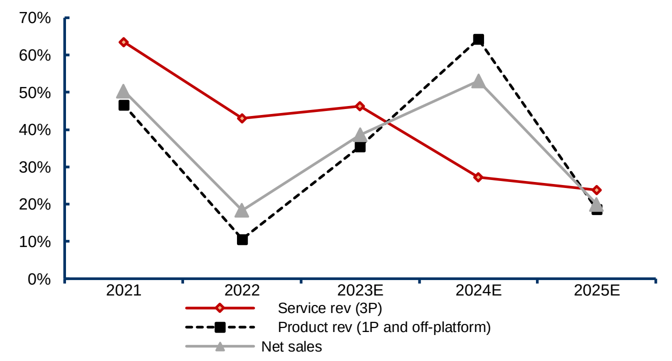
We are bullish on potential of large parcel logistics overseas ecommerce, backed by: 1) rising online penetration and improving furnishing needs; 2) value-for-money products to address the supply-demand imbalance amid inflationary environment; 3) booming cross-border ecommerce with freight cost normalization and de-stocking demand for suppliers in China and SEA. Gigacloud (GCT US, TP at US$20), is our top pick, given: 1) continuous gain share in fragmented US furniture market through its cost efficiency, end-to-end supply chain solutions, competitive pricing, and robust fulfilment capabilities; 2) strong organic growth, with 44% GMV CAGR in FY23-25E, and improving margin; and 3) acquisitions of Noble House and Wondersign to further scale up its business scale with long-term synergies. GCT is trading at 6x FY24E P/E, far below industrial average. We expect stronger 4Q23E and NH synergies to boost re-rating.

Industry consolidation to accelerate, with rising online penetration. US online furniture market is expected to grow 17% YoY in 2024E (vs. 6% YoY for US total furniture market), driven by rising online penetration (from 38% in 2023 to 42% in 2024). Even though domestic suppliers are dominating the market, imported furniture players are gaining share with cost advantages. Industry consolidation will continue (10+ US furniture companies bankrupted in 2023), benefiting cross-border e-commerce platforms to capture share.

Booming demand from global expansion, with enhanced logistics and supply chain. Despite slowing external demand, we expect cross-border ecommerce would continuously gain tractions, backed by favorable policies, price competitiveness with high manufacturing efficiency, and enhancing logistics capability. Aggressive investments on major cross-border e-tail platforms (e.g. TEMU, Shein) could reinforce this trend. According to China's General Administration of Customs (GAC), China's cross-border e-commerce imports and exports reached 1.3tn in 9M23, +14% YoY, in which export value +17% YoY. We think GCT would directly benefit from cross-border ecommerce tailwinds, and differentiate itself from TEMU & Shein through its B2B model and focus on large parcel logistics.

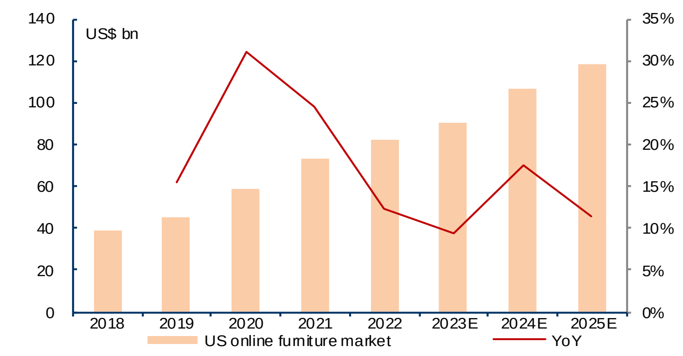
Enhancing profitability with normalized freight cost. After China's reopening, ocean freight prices declined to pre-pandemic level after its peak in 4Q21. For instance, Asia-US West Coast prices decreased to around $2,000/FEU in Sep 2023, vs. US$15,000-20,000 during 4Q21 and 1Q22. Looking ahead, we expect freight cost to stabilize with less supply chain crisis and healthy new ship deliveries. Typically, freight cost is the largest expense part for cross-border platforms (apart from COGS), accounting for 10%-30% of total revenue (according to China peers financial data). For GCT, we model its adj. NPM of organic business to reach 12% in FY24E (vs. 5%/12% in FY22/23E).

Figure 15: GCT's revenue growth



Source: Company data, CMBIGM estimates

Figure 16: US online furniture market and estimates



Source: Statista, CMBIGM estimates

Selective in potential sector re-rating

Attractive valuation with favourable risk reward.

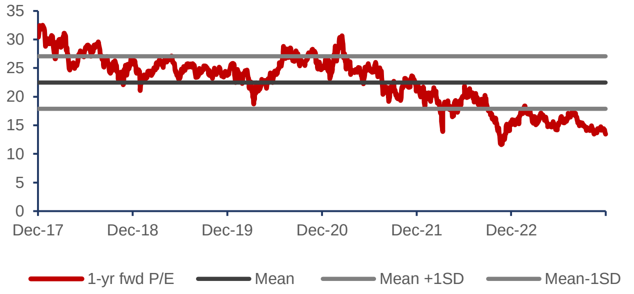
Entertainment sector may see moderate re-rating in FY24E, given interest rate hike, potential policy incentives to boost consumption, clearer financials outlook after 1Q24E and continuous margin improvement. We forecast industry earnings growth +18% YoY in FY24E (revenue +11% YoY), at 17% CAGR in FY23-25E. Sector valuation was trading at 13x FY24E P/E, still at 5-year historical trough. Suggest to buy the dips.

Prefer global streaming, SFV and overseas ecommerce.

Given macro uncertainty and competition, we believe subsectors or companies continued to diverge from each other. Suggest to keep selective, and eye on two themes: 1) growing subsectors with resilience on macro, clear growth path and margin expansion, including global streaming, SFV and overseas ecommerce, in which we recommend Netflix, Kuaishou, GigaCloud; 2) undervalued names with high earnings visibility and potential inflection point of fundamentals improvement, including iQiyi, JOYY, and Huya.

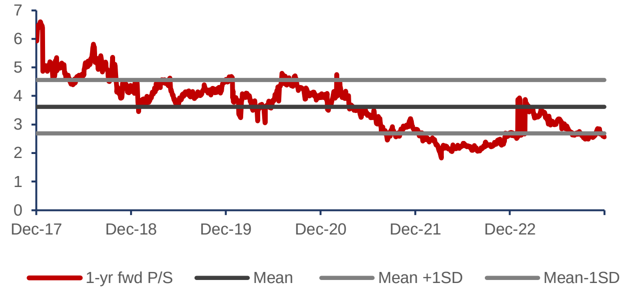
Our top pick is **Netflix (NFLX US, BUY)**, given: 1) clear growth drivers from AVOD expansion and paid-sharing initiatives; 2) original content edge for share gains and price hikes; 3) high margin visibility with competition to pull back; and 4) content to pick up after strikes. Among SFV, we prefer **Kuaishou (1024 HK, BUY)**, and keep positive on its ads & ecommerce share gain (ads+17% YoY; ecommerce GMV+24% YoY in FY24E) and margin improvement (57% earnings CAGR in FY23-25E). We are bullish on its long-term ecommerce upside, boosted by deeper MAC penetration, higher traffic efficiency, and shelf-based mall expansion. Margin would see further upside (forecast its adj. NM up 3ppts/4ppts at 10.5%/14.8% in FY24/25E, still below 20%+ of Bytedance), supported by aggressive overseas loss narrowing and cost control. For overseas ecommerce, we recommend **GigaCloud (GCT US, BUY)** for its attractive valuation (7x/6x FY23/24E P/E) and above-industry growth (25% earnings CAGR in FY23-25E), with multiple catalysts to come. GCT formed a high barrier to market entry with supply chain, end-to-end logistics and data-driven operations. We believe GCT would be relatively resilient on macro uncertainty, and keep confident on its organic GMV growth and solid profitability, backed by booming demand of cross-border ecommerce and sellers & buyers expansion. M&A would scale up its 1P&3P business, and bring further synergy in the long run.

Figure 17: Core Entertainment P/E band



Source: Bloomberg

Figure 18: Core Entertainment P/S band



Source: Bloomberg

Figure 19: Entertainment peers valuation

Company	Ticker	Mkt cap (USD mn)	Currency	Price	CMBI Raiting	CMBI TP	PE			PS			FY23-25 EPS CAGR
							FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	
Top Picks													
Netflix	**NFLX US**	**195,525**	**USD**	**447**	**BUY**	**512**	**34.3**	**26.7**	**21.5**	**5.4**	**4.7**	**4.3**	**26%**
Kuaishou	**1024 HK**	**30,031**	**HKD**	**54**	**BUY**	**97**	**35.0**	**21.0**	**13.0**	**2.3**	**2.0**	**1.8**	**56%**
GigaCloud	**GCT US**	**429**	**USD**	**14**	**BUY**	**20**	**7.0**	**5.9**	**4.5**	**0.8**	**0.5**	**0.4**	**25%**
Global digital entertainment & content													
Alphabet	GOOGL US	1,636,018	USD	130	NA	NA	21.0	18.2	16.1	6.4	5.8	5.2	19%
Meta	META US	815,803	USD	317	NA	NA	21.8	17.5	15.6	6.1	5.4	4.8	16%
Netflix	NFLX US	195,525	USD	447	NA	NA	35.7	27.5	22.5	5.8	5.1	4.6	27%
Snap	SNAP US	24,317	USD	15	NA	NA	NA	NA	92.4	5.3	4.7	4.0	86%
Spotify	SPOT US	38,466	USD	194	NA	NA	NA	NA	56.5	2.7	2.3	2.0	NA
Pinterest	PINS US	22,604	USD	34	NA	NA	30.4	27.5	21.7	7.4	6.3	5.3	19%
Match Group	MTCH US	8,929	USD	33	NA	NA	15.8	13.7	11.9	2.7	2.5	2.3	15%
Average							24.9	20.9	17.6	5.2	4.6	4.0	19%
Global streaming & VAS													
Paramount Global	PARA US	10,065	USD	15	NA	NA	44.3	12.2	10.2	0.3	0.3	0.3	61%
Disney	DIS US	167,474	USD	92	NA	NA	20.5	16.9	15.1	1.8	1.7	1.6	17%
Warner Bros Disco	WBD US	26,629	USD	11	NA	NA	NA	NA	71.4	0.6	0.6	0.6	NA
Fox Corporation	FOXA US	13,650	USD	29	NA	NA	9.0	7.8	8.5	1.0	0.9	0.9	8%
Roku	ROKU US	14,586	USD	102	NA	NA	NA	NA	NA	4.2	3.8	3.3	NA
New York Times	NYT US	7,772	USD	47	NA	NA	32.0	29.5	26.1	3.2	3.0	2.9	10%
Average							20.5	16.6	15.0	1.9	1.7	1.6	12%
China entertainment													
Kuaishou	1024 HK	30,031	HKD	54	BUY	97	24.5	14.8	9.9	1.9	1.6	1.5	58%
Iqiyi	IQ US	4,227	USD	4	BUY	9	12.4	9.4	7.8	0.9	0.9	0.8	26%
Mango	300413 CH	7,777	CNY	30	NA	NA	25.5	21.4	18.6	3.8	3.4	3.0	18%
Bilibili	BILI US	4,875	USD	12	BUY	24	NA	NA	41.5	1.5	1.3	1.2	NA
TME	TME US	13,814	USD	8	BUY	9	16.5	15.1	13.4	3.6	3.5	3.2	11%
Huya	HUYA US	818	USD	3	BUY	7	NA	45.9	17.2	0.8	0.9	0.8	157%
Douyu	DOYU US	229	USD	1	NA	NA	13.4	13.2	10.8	0.3	0.3	0.3	33%
Momo	MOMO US	1,244	USD	7	HOLD	14	4.3	4.2	3.9	0.8	0.7	0.7	5%
JOYY	YY US	2,281	USD	38	BUY	51	8.3	8.9	8.3	1.0	1.0	0.9	8%
China Literature	772 HK	3,648	HKD	28	NA	NA	17.5	15.6	13.8	3.4	3.1	2.9	14%
Zhihu	ZH US	594	USD	1	BUY	2	NA	NA	17.7	1.0	0.9	0.8	NA
CMGE	302 HK	500	HKD	1	BUY	3	11.8	6.4	4.9	1.0	0.7	0.6	41%
FriendTimes	6820 HK	382	HKD	1	BUY	2	NA	8.3	5.1	2.1	1.3	1.1	141%
Average							14.9	11.7	11.0	1.7	1.5	1.4	16%
Ecommerce & O2O verticals													
Tuhu Car	9690 HK	3,637	HKD	32	BUY	50	67.8	29.1	19.1	1.9	1.5	1.3	102%
Tongcheng	780 HK	3,931	HKD	14	BUY	25	12.9	11.6	9.5	2.4	2.0	1.7	21%
Huitongda	9878 HK	1,847	HKD	26	BUY	55	25.6	19.9	15.7	0.1	0.1	0.1	29%
Mobvista	1860 HK	596	HKD	3	BUY	6	30.2	15.6	9.4	0.6	0.5	0.4	41%
Baozun	BZUN US	166	USD	3	BUY	7	NA	7.6	3.7	0.1	0.1	0.1	NA
Average							22.9	16.7	11.5	1.0	0.9	0.7	30%
Average							**16.9**	**13.3**	**12.1**	**2.4**	**2.1**	**1.9**	**17%**

Source: Bloomberg, CMBIGM estimates, as of 7 Dec 2023

China Energy - Power Operators

OUTPERFORM

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New energy power development speeding up, capacity payment policy reshaping thermal power operators value

Investment highlights

Wind power operators: After a surge in total installations in 2020, China's wind power sector has entered a phase of grid parity. In 2021 and 2022, the newly-added wind power projects showed a significant decline, entering a phase of transitional demand balance. In 2023, however, there is an expected rebound in demand. Specifically, wind turbine prices experienced a fall followed by an increase. In 1H23, onshore wind turbine prices (ex- towers) reached a low of RMB1,000/kW but rebounded in 3Q23. In July and August, turbine prices (ex-tower) rose to approximately RMB1,600-1,700/kW (ex-framework procurement projects). From Jan to Oct, the total wind power bids declined by 18.7%YoY and reached 56.8 GW (ex-framework bidding). We estimated that wind turbine prices will stabilize at RMB1,400-1,700/kW (ex-towers) in 2024 and the overall newly-added installed wind power capacity will grow steadily, thanks to the new energy installation goals set in the 14th Five-Year Plan, a favorable project IRR, and advancements in wind turbine technology. Consequently, we expect the cumulative wind power installed capacity in China to reach 509 GW, with 77 GW of newly-added wind power installed capacity for 2024.

Solar power operators: In 2023, China's photovoltaic (PV) industry rapidly transitioned from P-type cells to N-type cells. As the cost of N-type cells continued to decline, the prices of P-type products also decreased. Additionally, there was an oversupply of PV modules and a return of some overseas module stock, resulting in the significant decline in module prices in 2023. Since the beginning of 2023, solar module prices dropped from around RMB1.8/W to approximately RMB1.15-1.2/W. The decrease in module prices reduced the costs of downstream solar power projects, increasing the IRR for new PV projects and driving an unexpected increase in terminal installation demand. According to data from the National Energy Administration (NEA), China's PV installed capacity reached 143mn kW from Jan to Oct 2023, with a significant increase of 144.78% YoY. We anticipate that solar module prices will remain relatively low in 2024 due to the time required for excess production capacity to be cleared. The lower cost of PV modules should continue stimulating solar power installations. We predict that new PV installations will reach 139 GW in 2024, with a cumulative installed capacity of 652 GW.

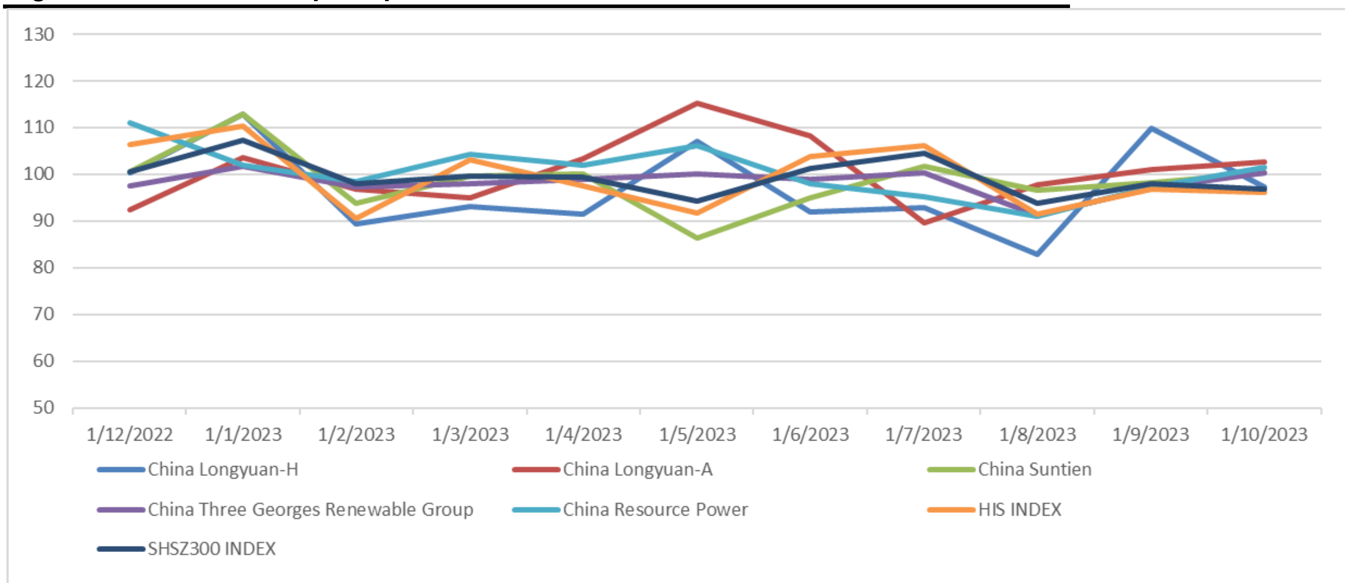
Thermal power operators: From Jan to Oct 2023, the proportion of thermal power installed capacity in China fell below 50% for the first time. However, thermal power still plays a vital role in China's power supply structure, accounting for approximately 70% of total power generation during the same period. Moreover, the price of thermal coal, a key factor in thermal power costs, has also declined. Policies ensuring coal supply have been consistently implemented, leading to increased domestic coal supply capacity and relaxed coal import policies. These factors, along with relatively high coal inventories, have improved the financial performance of most thermal power operators in 2023. In 2024, we expect the cost of thermal power will continue to improve, with a possibility of a slight increase in the on-grid electricity price while the overall trend will likely be stable. Additionally, we think the introduction of "capacity payment" policy in November 2023 should mitigate the impact of decline in thermal power's utilization hours during the medium to long-term transformation of China's power structure, reducing power supply volatility and increasing profitability for thermal power. The accelerated development of new energy business by thermal power operators should also contribute to the reassessment of their value.

Looking ahead to 2024, we have a positive outlook for downstream wind power and solar power operators. The relatively low prices of wind turbines and PV modules will boost profitability for new energy projects. Furthermore, the increased green electricity trading and rapid installation of wind and solar power are expected to drive a value reassessment.

We recommend new energy power operators, our top pick is **China Longyuan (916 HK/001289 CH)** .China Longyuan has high-quality operations and sound profitability, benefiting from the "substitution of large for small" strategy. We also focus on CTGR and China Suntien. CTGR is a leading PV installer with stable on-grid electricity prices. China Suntien (956 HK), which is expected to accelerate wind power installations and improve gas segment results.

In addition, we hold an optimistic view on thermal power operators with new energy installation, expecting improved fundamentals and a value reassessment driven by the "capacity payment" policy. We believe economic growth in 2024 is likely to drive electricity demand. **China Resources Power (836 HK)** is worth watching due to its accelerated new energy installations, potential spin-off and A-share listing of the new energy segment to further unleash value, strong performance in thermal power, and stable dividend payout ratio.

Figure 1: Focus stocks' price performance



Source: Bloomberg, CMBIGM estimates

1. Power sector fundamentals review for Jan-Oct 2023

(1) Power consumption and demand

According to data from the NEA, China's total electricity consumption increased by 5.8% YoY to 7.6trn kWh from Jan to Oct 2023, indicating a sustained economic recovery and a rise in consumption growth. The electricity consumption growth rates for the first, second, and third quarters of 2023 were 3.6%, 6.4%, and 6.6%, respectively.

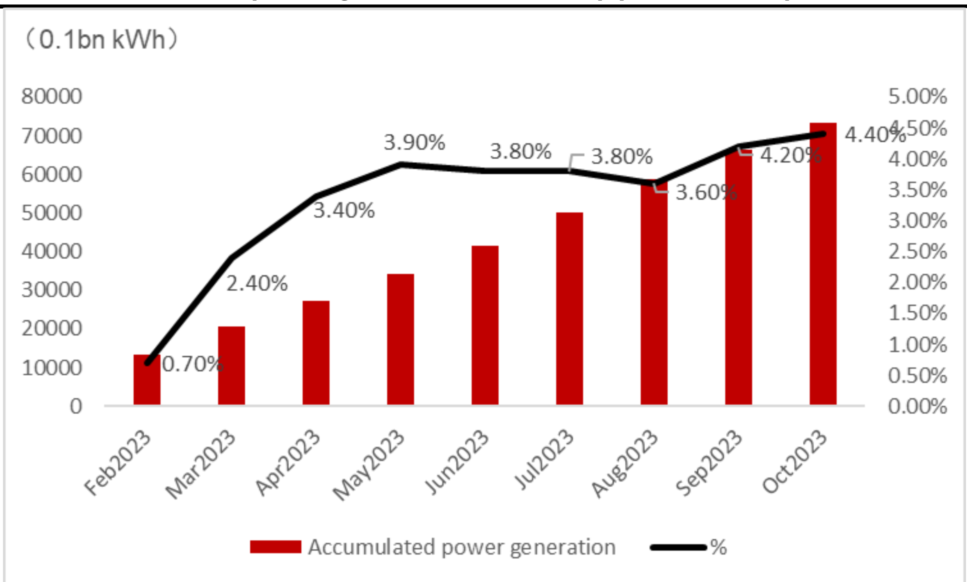
From Jan to Oct 2023, electricity consumption in the primary sector reached 107.6bn kWh, marking a significant 11.4% YoY increase. Ongoing efforts in agricultural production and rural electrification projects have contributed to the rapid growth in electricity consumption in the primary sector. In the secondary sector, which includes manufacturing, electricity consumption reached 5trn kWh, with an increase of 5.8% YoY. The tertiary industry saw electricity consumption of 1.38trn kWh, representing robust growth of 10.4%YoY. These electricity consumption figures reflected a positive trend in the economy, with steady and rapid recovery in electricity consumption for both manufacturing and service sectors.

(2) Electricity production

1) China's electricity supply and demand remained balanced during Jan-Oct of 2023, with localized areas affected by climate fluctuations.

During 1Q-3Q 2023, China's electricity supply and demand remained balanced, even though certain regions experienced tight power supply during specific periods due to climate fluctuations. Overall, electricity production showed steady growth. In Oct 2023, China's power generation increased by 5.2% YoY to 704.4bn kWh, a decrease of 2.5% compared to Sep. From Jan to Oct of 2023, China’s power generation reached 7,333bn kWh, an increase of 4.4%YoY.

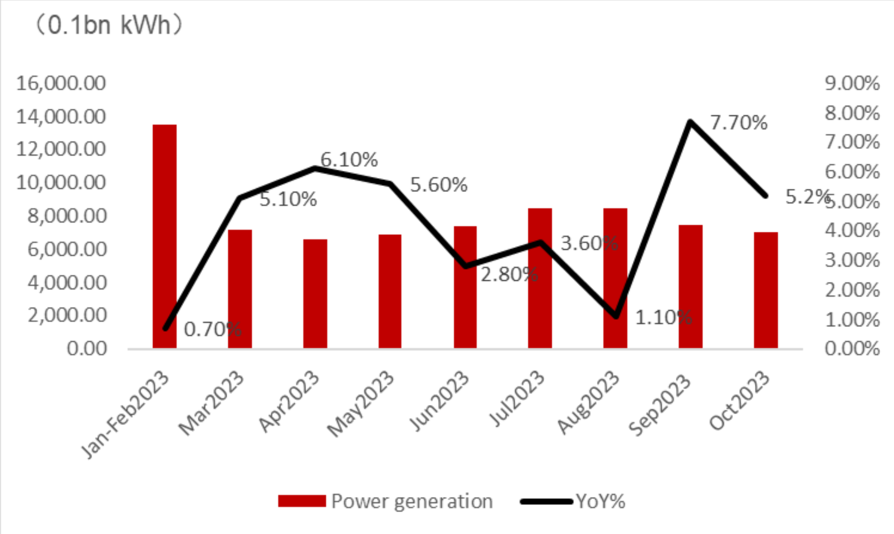
Figure 2: Accumulated power generation in China (up to Oct 2023)



Source: NEA, Wind, CMBIGM

In terms of power generation sources, in Oct 2023, thermal power and PV power saw accelerated growth, while wind power experienced a larger year-on-year decline. Hydropower growth slowed down, and nuclear power transitioned from growth to decline. Specifically, thermal power generation rose by 4.0% YoY, 1.7ppts higher than Sep growth. Wind power generation declined by 13.1% YoY, with the decline widening by 11.5% versus Sep due to unfavorable wind conditions. Solar power maintained a rapid growth rate of 15.3% YoY. Hydropower generation increased by 21.8% YoY, but with a month-on-month decline of 17.4% due to decreased rainfall. Nuclear power experienced a slight YoY decline of 0.2%.

Figure 3:Power generation (Jan-Oct 2023)



Source: NEA, Wind, CMBIGM estimates

It is worth noting that thermal power generation still accounts for around 60% to 70% of the total power generation, making coal the primary source of electricity supply in China. Coal power plays a crucial role in ensuring stable power supply. Additionally, wind power growth has been slightly fluctuating in recent months due to wind condition changes, while solar power continues to show rapid growth.

2) Slight decrease in average utilization hours

From Jan to Oct 2023, the average utilization hours of China's power generation equipment accumulated to 3,083 hours, a decrease of 103 hours compared to the same period last year. In particular, thermal power had an average utilization of 3,619 hours, a drop of 52 hours compared to last year; wind power had 1,817 hours, a decrease of 10 hours YoY; solar power had 1,120 hours, a decrease of 52 hours YoY; hydropower had 2,704 hours, a decrease of 298 hours YoY; and nuclear power had 6,226 hours, a decrease of 245 hours compared to the same period last year.

3) Rapid growth in electricity investment

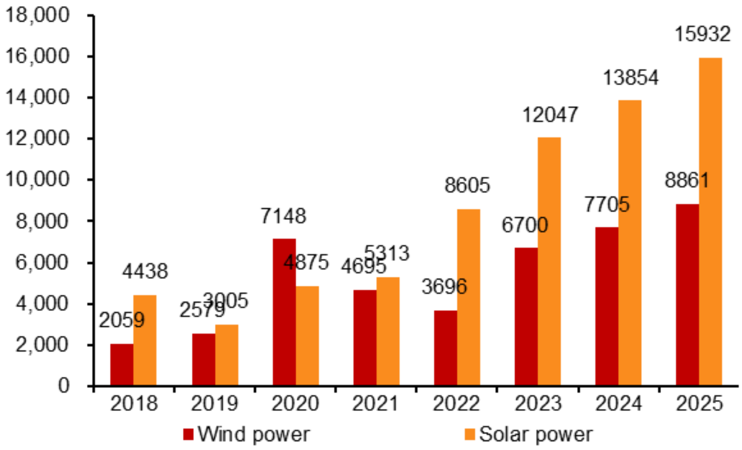
From Jan to Oct 2023, investments in power projects by major power generation companies in China increased by 27% YoY to RMB460.7bn. Considering the data from the first three quarters, investments in non-fossil fuel power generation accounted for nearly 90% of the total power investment. Among them, solar power investment showed a significant rise, by 327%YoY to RMB157.4bn. In consideration of the trend of power investment, accelerated new energy installations and changes in the power generation structure, we see the power industry in China accelerating its green and low-carbon transformation.

2. Accelerated development of new energy Installations and improved project returns through decreased upstream costs

1) Rapid growth in new energy installations

By 2022, China's cumulative wind power installed capacity had reached 37 GW, with a CAGR of 16.17% from 2016 to 2022. The plans for wind power and solar power installations in various regions of China during the 14th Five-Year Plan period are well-defined. We estimated China's wind power installed capacity will reach 600mn kW by 2025, with a CAGR of 17% from 2021 to 2025.

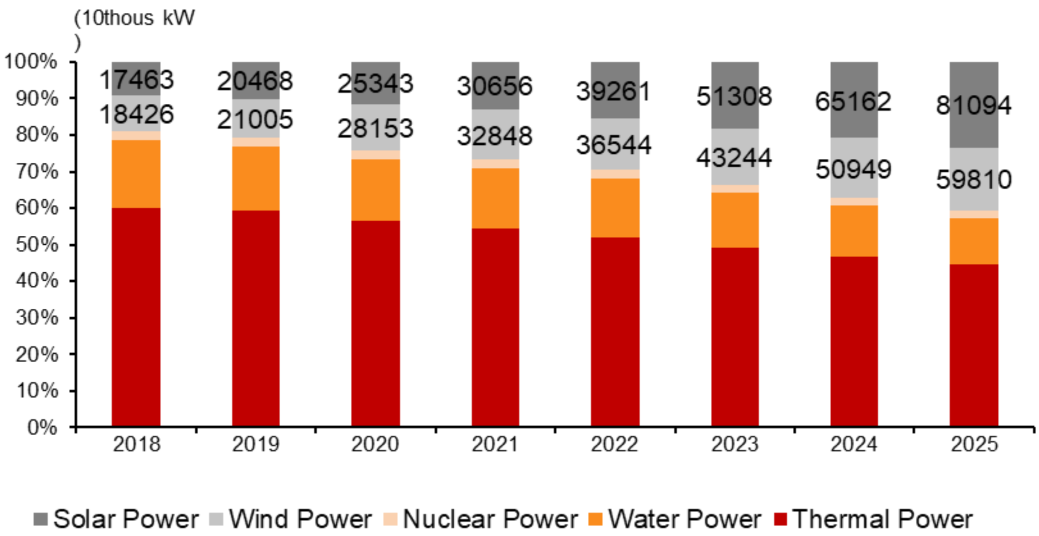
Figure 4: China newly-added installed capacity of solar and wind power (2018-25E)



Source: NEA, Wind, CMBIGM estimates

According to data of Wind Daily and the NEA, the scale of wind power tenders in China exceeded 103.27 GW in 2022, and the newly-added wind power installed capacity reached 37 GW. Given that most of the tendered capacity will be grid-connected in 2023, we estimate the newly-added installed capacity of wind power in 2023 could be 67 GW, bringing China's cumulative wind power installed capacity to approximately 432 GW. Additionally, we expect the newly-added wind power installed capacity in 2024 and 2025 to grow by 15%YoY, reaching 77 GW and 89 GW respectively. We estimated cumulative wind power installed capacity by 2024 and 2025 is 509 GW and 598 GW, with a growth rate of around 20% YoY.

Figure 5: China's accumulated installed capacity of various power sources (2018-25E)



Source: NEA, Wind, CMBIGM estimates

By Oct 2023, China's cumulative total power installed capacity had reached approximately 2.5bn kW, up by 8.3%YoY. In particular, the accumulated installed capacity of wind power and solar power was approximately 350mn kW and 360mn kW, up by 16.6%YoY and 29.2%YoY. This aligns with our optimistic expectations, and we further raise our expectations for solar power installations. We anticipate that the newly-added solar power installed capacity in 2023 may reach 120 GW, with a cumulative total installed capacity of 513 GW for the year. Additionally, we estimate solar power generation will continue to grow rapidly in 2024 and 2025. We project that the cumulative installed capacity of solar power will reach 652 GW and 811 GW respectively. By 2025, the cumulative installed capacity of wind power and solar power could reach 1,409 GW, exceeding the national target of 1,200 GW set for the 14th Five-Year Plan.

2) Lower upstream costs enhance the IRR of new energy projects

For wind power projects, after an installation rush in 2020, China's wind power installations have entered a period of grid parity. The growth of new wind power projects in 2021 and 2022 significantly slowed down, entering a transitional phase of supply and demand balance. However, in 2023, thanks to the decline in upstream costs, which boosted a rebound in demand, upstream wind turbine bidding prices experienced a significant decline at the beginning of 2023, resulting in increased profitability for new wind power projects and further stimulating the installation willingness of wind power operators. Additionally, the scaling up of wind turbines and technological advancements, as well as the steady recovery of onshore and offshore wind installation demand, have further accelerated the grid connection of wind power.

According to data from the China Tendering and Bidding Public Service Platform, the bidding prices for onshore wind power have experienced a significant decline since 2023. In 1H23, the price of onshore wind turbines (excl. towers) fell to as low as RMB1,000/kW, but rebounded in the third quarter. Excluding framework procurement projects, the turbine prices (excl. towers) in July and August rose to around RMB1,600-1,700/kW. As of October 21, 2023, the average bidding price for wind power projects was approximately RMB1,700/kW.

Regarding offshore wind power, with the issuance of offshore wind power development plans by various provinces and cities, offshore wind project construction has steadily progressed. Since 2023, the bidding prices for offshore wind turbines (incl. towers) have been declining, with an average price of approximately RMB3,700/kW. We expect further cost reductions for offshore wind power in the future, leading to an increased IRR for offshore wind power projects. However, we believe that it will still take some time for offshore wind power to fully realize grid parity.

The decline in upstream costs for wind power has driven a continued increase in the IRR of onshore wind projects. For example, assuming that the average on-grid electricity price (incl-tax) for new wind power projects is RMB0.45/kWh, if the construction cost of a 100 MW onshore wind power project decreases from RMB4,500/kW to RMB4,000/kW, the project's IRR will increase from 11% to 14.3%. Furthermore, if the construction cost further decreases to RMB3,800/kW, the IRR will increase to 15.5%. Despite a slight rebound in wind turbine prices in the recent period, the market's lowest bidding price remains around RMB1,400/kW. We believe a reasonable price level is around RMB1,600-1,800/kW. Nevertheless, we maintain an optimistic outlook on the overall profitability, and expect the IRR of the new energy project to remain at a relatively favorable level.

Looking ahead to 2024, we anticipate wind turbine prices to stabilize within the range of RMB1,400-1,700/kW (ex-tower) and see a significant rebound in prices as unlikely. Considering the new energy installation goals outlined in the 14th Five-Year Plan and the attractive IRR, coupled with the scaling up of wind turbines and technological advancements, we expect steady growth in wind power installations. We project a newly-added capacity of 77 GW in 2024, bringing accumulated wind power capacity to 509 GW.

Figure 6: Sensitivity analysis of onshore wind power projects' IRR (assuming solar power utilization hours of 2,000)

		capital cost (RMB/watt)				
		3.5	4.0	4.5	5.0	5.5
Tariff (RMB, Incl. VAT)	0.35	9%	7%	4%	2%	1%
	0.40	14%	11%	8%	6%	4%
	0.45	18%	14%	**11%**	9%	7%
	0.50	22%	18%	15%	12%	10%
	0.55	26%	21%	18%	15%	13%

Source: NEA, Wind, CMBIGM estimates

In the first three quarters of 2023, there was a significant increase in solar power installations, thanks to the drop in upstream solar module prices. This resulted in an improved IRR for new solar projects, and has opened up opportunities for future growth in solar power installations.

Regarding solar projects, with the ongoing decrease in upstream costs, we expect the IRR of the projects to further improve. In 2023, solar cells used rapidly shifted from P-type to N-type, with the proportion of N-type cells increasing quickly. As the costs of N-type cells continue to decline, the prices of P-type products have also decreased. Additionally, there is an oversupply of solar modules, and there has been an increase in overseas module inventory. As a result, solar module prices have seen a significant fall in 2023, from around RMB1.8/W to approximately RMB1.15-1.2/W. Since Jul 2023, the lowest solar module price has reached a historical low of RMB1.18/W. In a recent bidding process for the procurement of 9 GW of PV modules by China Huadian Corporation, an astonishingly low price of RMB0.993/W was achieved, breaking the RMB1/W threshold.

Consequently, the fall in solar module prices has led to reduced costs for downstream solar power plants, and thus improving the investment returns of solar power projects. Furthermore, this strengthens the power operators' solar power installation willingness, boosting solar power installations in 2023. The profitability of projects also depends on the changes in non-technical costs linked with local governments and fluctuations in on-grid electricity prices.

Looking ahead to 2024, we anticipate that solar module prices will remain relatively low, as it will take time to clear the excess production capacity. The continued affordability of solar modules is expected to drive further solar power installations. We estimate that the newly-added solar power capacity in 2024 will reach 139 GW, bringing the cumulative installed capacity to 652 GW.

Figure 7: Sensitivity analysis of solar power projects' IRR (assuming utilization hours of 1,300)

		capital cost (RMB/watt)				
		2.5	3.0	3.5	4.0	4.5
Tariff (RMB, ex. VAT)	0.50	26%	20%	16%	13%	10%
	0.45	21%	16%	12%	9%	7%
	0.40	16%	11%	**8%**	6%	3%
	0.35	10%	7%	4%	1%	-1%
	0.30	5%	1%	-2%	-4%	-7%

Source: NEA, Wind, CMBIGM estimates

3. Wind power efficiency to benefit from “substitution of large for small”, implying promising growth potential

In Jun 2023, China's NEA issued the "Administrative Measures for Retrofitting, Upgrading, and Retirement of Wind Farms." The measures encourage the upgrading of wind farms that have entered grid-parity for over 15 years or have a capacity of less than 1.5 MW per unit. Wind farms that have reached their intended service life should be retired, but those that pass safety assessments and meet operating conditions can continue to operate.

The policy of "Substitution of large for small" creates growth opportunities for wind power operators. According to estimates by the Chinese Wind Energy Association, approximately 980 units with a total capacity of 546,000 kW would be retired by 2023 (onshore wind turbines typically have a 20-year lifespan). By 2025, the number is expected to exceed 1,800 units with a capacity of 1.25mn kW. By 2030, it is projected to surpass 34,000 units with a capacity of around 45,000 MW.

After recognizing impairment losses in 2022, wind power operators with longer operating lifetimes can expect incremental opportunities from 2024 to 2026 due to the policy of "substitution of large for small."

4. Increased proportion of electricity trading; green electricity and green certificate trading tend to be mature

According to statistics from the China Electricity Council (CEC), the total electricity trading volume of China's power trading centers increased by 8.1% YoY to 4.2trn kWh in Jan-Sep 2023, which accounted for 61.3% of China's total electricity consumption, showing a 1.4% YoY increase. In particular, long-term direct electricity transactions in the Chinese power market also saw a 6.7% YoY increase, reaching 3.31trn kWh.

In terms of electricity prices, the average price for annual long-term contracts in Guangdong electricity market reached around RMB554/MWh recently, nearly reaching the upper limit of annual contract electricity prices. This represents a 20% increase compared to the benchmark price for coal-fired power generation. Long-term contracts in various regions have recorded price premiums and exceeded market expectations.

Regarding electricity spot market trading, electricity spot markets have currently been established in a few regions such as Guangdong, Shandong, and Gansu. In mid-2023, China introduced new regulations to promote spot trading of renewable energy electricity, aiming to improve power consumption and ensure stable power supply during peak periods.

In 2023, the green electricity and green certificate market in China continued to expand. By the end of Oct 2023, the cumulative volume of green electricity transactions had reached 87.8bn kWh, with 148mn green certificates issued.

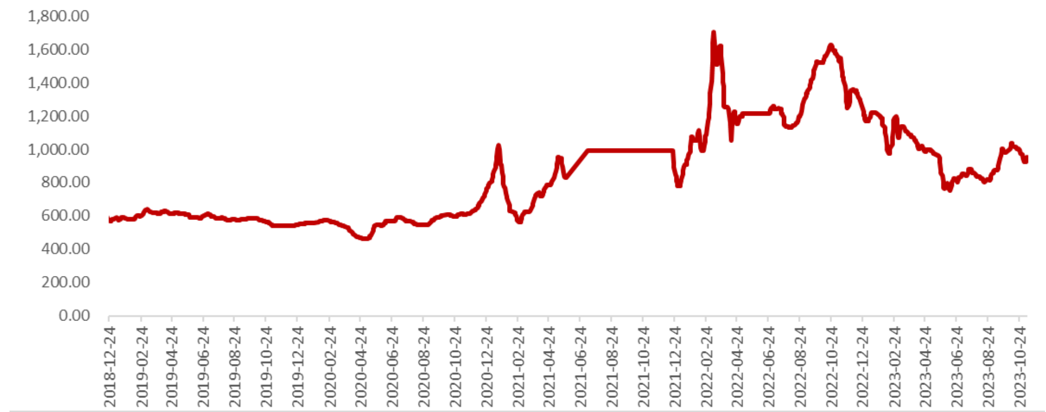
Looking ahead to 2024, with an increasing share of clean energy generation in China, the scale of China's green electricity and green certificate trading should continue expanding, in our view. Green certificates have achieved full coverage of renewable energy electricity trading, and with the accelerated development of a new power system and power sector reform, we believe green certificates will play a more vital role in China’s power market.

5. The decline in cost of thermal coal enhance profitability, and introduction of "capacity payment" favorable for sector revaluation

(1) Benefiting from the decline in the cost of thermal coal, the profitability of the thermal power sector improves.

The increase in the price of thermal coal in 2022 led to widespread losses among thermal power operators. With the downward movement of thermal coal prices in 2023, the profitability of the thermal power sector significantly increased. As of Nov 9, 2023, the closing price of Qinhuangdao thermal coal (Q5500) had declined from around RMB1,200/ton at the beginning of 2023 to around RMB950/ton, reaching a low of about RMB750/ton in June. Although there was a slight rebound in the third quarter, the overall cost of thermal coal for thermal power generation decreased significantly, and the long-term coal price moved downward. With the increase in long-term contract fulfillment rate, we expect the earnings performance of thermal power operators to improve in 2023.

Figure 8: Qinhuangdao thermal coal Q5500 exit price movement (RMB/ton)



Source: Wind, CMBIGM

Although there has been a slight rebound in the short-term price of thermal coal, it has not reached the high level seen last year. Against the backdrop of declining coal prices in 2023, the profitability of major thermal power operators has significantly recovered. Additionally, there were concerns in the market that the continuous decline in the cost of thermal coal might lead to adjustments in the on-grid electricity pricing policy for thermal power, resulting in a decrease in the benchmark on-grid coal price. However, such adjustments did not occur in 2023. Previously, the National Development and Reform Commission (NDRC) stated in 2022 that the reasonable range for the long-term trading price of thermal coal (5,500 kcal) should be between RMB570 and RMB770 per ton (incl-tax). Based on this reference, we believe that there is no significant pressure for a substantial adjustment of the benchmark electricity price in the electricity pricing policy by the end of 2023 and in 2024.

Thermal power still plays a crucial role in China's power supply structure. From Jan to Oct 2023, the proportion of thermal power generation in total power generation reached about 70%. We believe that in 2024, thermal power will continue to play a role in ensuring power supply and peak load regulation. While there may be a slight increase in the on-grid electricity price for thermal power, the overall trend should be stable, in our view.

(2) Implementation of "capacity payment", leading thermal power's value reassess

As new energy installations continue to grow, the utilization hours of thermal power generation are decreasing during the medium- to long-term transition of the power structure. Consequently, some thermal power plants are facing challenges in recovering their fixed costs through energy market revenues. To address this, implementing "capacity payment" can assist these plants in achieving cost recovery. Furthermore, in 2023, auxiliary service revenue for thermal power companies has started to show promising growth, accounting for approximately 2% of their overall revenue. This additional income contributes to improving the profitability of thermal power generation.

China's electricity market trading in the thermal power sector takes two forms: medium- to long-term power transactions and spot power transactions. However, neither of these methods has effectively enabled the recovery of fixed costs for thermal power plants. In medium- to long-term power transactions, prices are subject to certain limits, fluctuating within 20% above or below the benchmark price. Consequently, when fuel prices are excessively high, it becomes challenging for thermal power plants to recover their fuel and fixed costs through medium- to long-term power transactions, while spot power trading is still in its early stage.

To address the issue of recovering fixed costs, "capacity payment" has been introduced. Initially, the policy was only piloted in a few provinces such as Shandong and Yunnan. However, in Nov 2023, the NDRC and NEA issued a notice regarding the establishment of a coal-fired "capacity payment" mechanism. This notice outlines that compliant operating public coal-fired units will determine "capacity payment" electricity prices based on a certain proportion of the shareholder costs associated with recovering coal-fired units. It also requires localities to achieve a recovery ratio of no less than 50% by 2026.

Looking ahead to 2024, we expect thermal power to continue playing a vital role in ensuring reliable power supply and assisting with peak load regulation. The overall electricity supply and demand is anticipated to tighten slightly, leading to relatively stable electricity quantity and prices for thermal power generation. The implementation of the "capacity payment" policy is also likely to help thermal power operators improve earnings performance, enhance power supply certainty, deliver steady cash flow, and raise potential dividends.

6. Positive outlook for thermal power and renewable energy operators

Looking ahead to 2024, we have a positive outlook for downstream wind and solar power operators. We expect wind turbine prices to stabilize at RMB1,600-1,800/kW (excl- towers), and the prices of solar modules to remain relatively low due to excess capacity, which will help improve the profitability of newly-added wind and solar projects. Also, we believe the increasing trading of green electricity and green certificates, along with the rapid pace of wind and solar installations, are poised to continue driving a rerating of new energy power operators.

For new energy power operators, our top pick is **China Longyuan (916 HK/001289 CH)** who has higher enterprise quality and profitability than peers. The reasons are as follows. Firstly, China Longyuan (CLY) has significant growth potential in solar power installations, with the latest average procurement price for solar modules dropping to RMB1.3/W. This reduction in costs contributes to higher returns on solar power projects. Secondly, the company is actively involved in retrofitting old wind turbines. With almost 30 years of wind power project operation, CLY has around 70% of the turbines identified as outdated and below 1.5 MW. The company plans to take advantage of policy opportunities to upgrade eligible old turbines. Thirdly, CLY actively participates in the trading of green electricity and green certificates, which brings extra profits. Additionally, CLY released an announcement of a stock repurchase plan in Sep, showing management's confidence in the company's future development. Lastly, CLY's valuation is attractive.

We also recommend investors to focus on **CTGR (600905 CH),** as we see good growth potential in the stock from the following aspects. Firstly, we project CTGR will achieve a 42% YoY rise in newly-added installed capacity for solar and wind power, reaching 5,000 MW in 2023. The rapid development of new energy installations is driving the company's results growth. Secondly, CTGR has fared well in solar installations, and we anticipate further growth in solar installations in 2024. Thirdly, we expect cost reductions and technological advancement in the upstream wind and solar power sectors, which will lower the costs and increase the profitability of CTGR's newly-added new energy projects. Fourthly, we expect relatively stable on-grid electricity prices in 2023 and 2024. Lastly, CTGR has also announced a stock repurchase plan, which demonstrates the company's confidence in its future business.

China Suntien (956 HK) also has an attractive valuation and substantial growth potential. Key highlights are as follows: 1) China Suntien is supported by Hebei State-owned Assets Supervision and Administration Commission; 2) we anticipate an acceleration in its wind power installations in 2024; 3) gas sales and gas transmission performance look poised to improve as the economy further recovers; and 4) a stable dividend payout ratio.

Furthermore, we also have a positive outlook for thermal power operators with new energy business, given their fundamentals are expected to remain strong, and "capacity payment" is likely to drive a reassessment of the value of thermal power operators. Additionally, the anticipated economic growth in China in 2024 should continue driving an increase in electricity demand. We recommend **China Resources Power (836 HK)** for its accelerated expansion in new energy installations, the ongoing improvement in its thermal power business, and consistent track record of providing attractive dividends. We see its growth potential underpinned by the following:

1) CR Power actively secures long-term coal contracts, which is expected to enhance their fulfillment rates.

2) The optimization of electricity trading reform policies has led to higher electricity transaction prices in various regions, with a maximum fluctuation of 20% above the benchmark tariff.

3) The implementation of "capacity payment" should benefit CR Power's thermal power business.

4) In terms of new energy business, CR Power is experiencing rapid growth in installations, and the decreasing costs of upstream wind turbines and solar modules allow more newly-added projects to meet the company's IRR and construction standards, thus strengthening the company's willingness to accelerate new energy installations.

5) CR Power has announced its plan to spin-off and list the new energy business on the A-share market, which we think should help the company achieve its new energy installation target of 40 GW by 2025. This spin-off may unlock the potential value of the new energy business and contribute to an overall improved valuation.

6) Lastly, CR Power maintains stable dividend payouts.

Valuation

Figure 9: Peers table

Company	Ticker	Rating	12m TP (LC)	Price (LC)	Upside/ Downside	Mkt. Cap (HK$ mn)	P/E (x) FY24E	P/E (x) FY25E	P/B (x) FY24E	P/B (x) FY25E
New energy/thermal power operators (A/H)										
CHINA RES POWER	836 HK	BUY	22.5	15.30	48%	73,599	4.99	4.16	0.74	0.66
CHINA SUNTIEN-H	956 HK	BUY	4.16	2.62	59%	24,782	3.80	3.09	0.44	0.39
CHINA LONGYUAN-H	916 HK	BUY	10.4	6.16	69%	126,014	5.08	4.39	0.56	0.58
CHINA LONGYUAN-A	001289 CH	BUY	23.3	19.2	21%	115,754	17.97	15.13	1.94	1.74
CHINA THREE GO-A	600905 CH	BUY	6.24	4.61	35%	131,952	13.44	11.50	1.43	1.28
CGN NEW ENERGY H	1811 HK	N/A	N/A	1.93	N/A	8,281	3.44	2.92	N/A	N/A
CHINA POWER INTE	2380 HK	N/A	N/A	2.87	N/A	35,502	5.87	4.68	0.64	0.59
CHINA DATANG C-H	1798 HK	N/A	N/A	1.68	N/A	12,219	3.61	3.03	0.53	0.46
DATANG INTL PO-H	991 HK	N/A	N/A	1.19	N/A	40,873	4.05	3.42	0.29	0.26
HUANENG POWER-H	902 HK	N/A	N/A	3.82	N/A	106,551	3.84	3.17	0.54	0.46
HUADIAN POWER-H	1071 HK	N/A	N/A	3.13	N/A	51,420	4.11	3.51	0.50	0.44
CONCORD NE	182 HK	N/A	N/A	0.66	N/A	5,573	4.33	3.57	0.90	0.79
						Average	**6.2**	**5.2**	**0.8**	**0.7**

Source: Company data, Bloomberg, CMBIGM estimates
Note: Data as of 28 Nov 2023

China Energy-City Gas Operators — OUTPERFOM

Analyst: Megan Xia, CESGA – meganxia@cmbi.com.hk

Eye on gas demand and dollar margin improvement, accelerating new business expansion

In 2023, the general stock performance of city gas operators saw a brief drop, but it rebound in 2H23 amid the expectations for an economic recovery. A significant decline of stock prices in 1H23, was mainly due to the lower-than-expected industrial gas demand. In 3Q23, gas demand improved alongside China's economic uptrend, leading to a rebound in stock prices. Several factors influenced the stock performance in 2023: 1) the stability of international natural gas supply improved, causing a substantial drop in international gas prices; gas prices in Asia and China also experienced a downward trend. Overall, there has been a significant year-on-year improvement in the cost and availability of natural gas in China; 2) China's slower-than-expected economic recovery in 1H23 resulted in a weak overall demand for industrial gas, causing unfavorable imports and exports business ; 3) the gas connection business experienced a slowdown due to the slow pace of domestic real estate development; 4) China's slower-than-expected economic recovery put pressure on value-added and comprehensive energy businesses; and 5) mergers and acquisitions by city gas distributors were more cautious, in consideration of factors such as project returns and cash flow balance.

Looking ahead to 2024, we hold a slightly optimistic view for the city gas operators sector in China. In the global gas industry, an increase in Europe's natural gas imports in 2023 from countries like the US helped to maintain the high overall natural gas inventories in Europe. Coupled with the easing of natural gas consumption in Europe, the supply and demand of natural gas are moving towards a more balanced and stable state, which is expected to contribute to global gas price stabilization in 2023 and 2024, in our view. Asia and China are expected to become the main drivers of global natural gas demand growth. In China, with international gas prices returning to normal levels, an increase in China's LNG imports looks likely. Besides, further optimization of gas source supply in China in the upcoming future is anticipated, including increased domestic gas production, the implementation of long-term LNG import contracts, and growth in spot LNG imports and pipelined gas imports. From the gas demand perspective, China's natural gas demand is estimated to continue optimizing with the economic recovery. In terms of gas prices in China, based on the significant decline of gas prices in 2023 and the gradual recovery of overall demand, we expect gas prices to continue to decrease slightly but to remain stable overall in 2024.

Regarding Chinese city gas operators, we have a slightly optimistic view on their profitability:

1) Gas sales volume of city gas operators is expected to improve accordingly. Stable growth is anticipated in residential and commercial gas sales volumes for city gas companies, along with a gradual recovery in industrial gas sales volume, driven by China's economic recovery.

2) Dollar margins are expected to remain stable. The contract gas price that was signed with CNPC increased slightly year-on-year in 2023. Overall gas supply is expected to be relatively sufficient in 2024, helping maintain the gas price stability. Increased volumes of imported LNG and long-term LNG contracts are expected to partially offset the increase in contract gas prices that have been signed with CNPC, contributing to the optimization of gas costs.

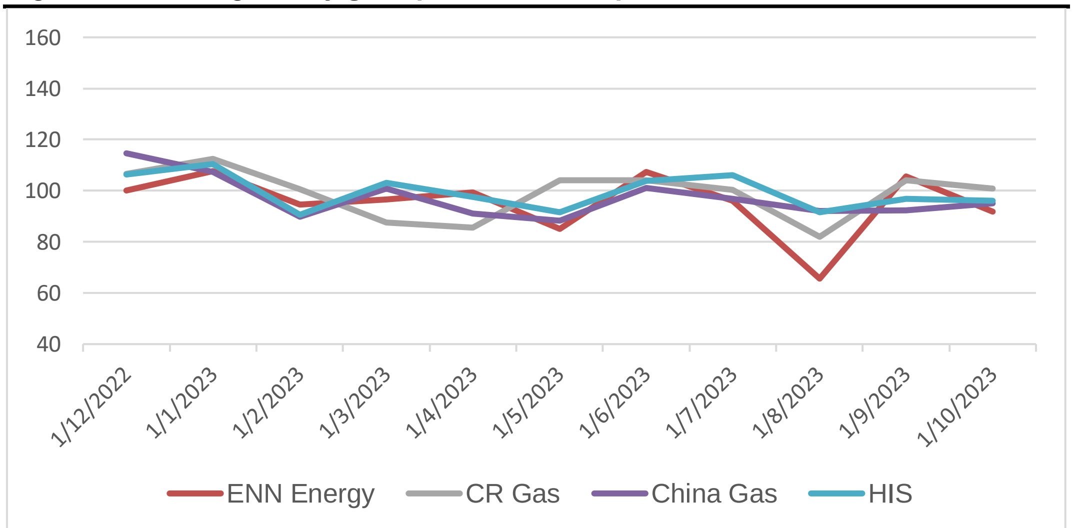
3) Cost-through policies. In 2023, the national residential cost-through policy continued to be implemented, and we expect that further measures will be taken to implement the cost-through mechanism in 2024.

4) The gas connection business is anticipated to continue slowing down due to a slower trend in new real estate project construction, and a cautious approach is maintained in line with market expectations.

5) Comprehensive energy business and value-added businesses are expected to develop rapidly and become the focus of new business growth for city gas operators, as they seek new growth drivers.

6) Mergers and acquisitions by city gas companies will be conducted cautiously. City gas companies with strong financial flexibility, project acquisition capabilities, and sufficient reserves of high-quality projects are expected to have a competitive advantage in future business development. The recovery of gas sales volume, gas source stability, steady signed gas prices with CNPC, diversification of gas sources, and progress in new business development are all factors to consider. Our top pick of city gas distributors is CR Gas (1193 HK), and we also suggest keeping an eye on Kunlun Energy (135 HK), ENN Energy (2688 HK), China Gas (384 HK), and Towngas Smart Energy(1083 HK)..

Figure 1: Focusing on city gas operators' stock performance

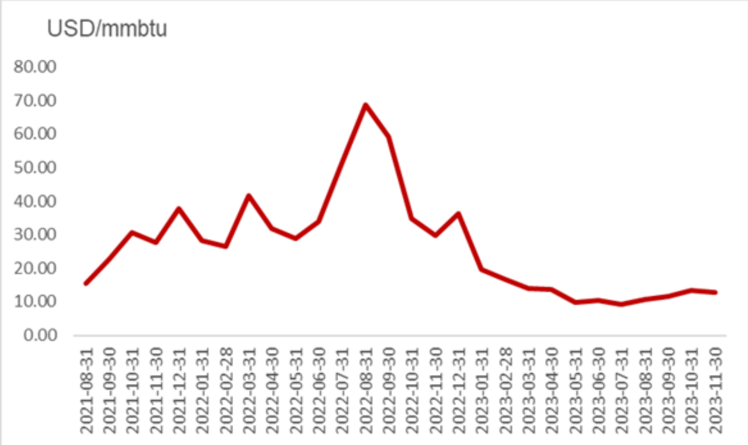


Source: Bloomberg, company data, CMBIGM estimates

1. Internationl gas prices experienced significant downtrend, leading to a drop in gas prices in Asia and China

In 2023, there was a significant decline in international natural gas prices. In 2022, due to the Russia-Ukraine conflict, natural gas prices in Europe and Asia reached historical highs. In Europe, the prices rose by nearly 350% YoY in August, reaching around US$70/MMBtu. However, in 2H22, as a result of increased natural gas imports to Europe and relatively high gas inventories in Europe, the TTF spot prices started to turn downward. Moving into 2023, there was a significant drag in the TTF spot prices. By Nov 2023, due to increased natural gas imports and higher gas inventories, the TTF spot price stood at US$12.77/MMBtu, representing a nearly 60% YoY decline. For 2024, we estimated TTF price will experience slightly rebound but remained at the price of US$10-20/MMBtu, the large fluctuation is not likely to happen again.

Figure 2: TTF spot price performance (2021-2023)



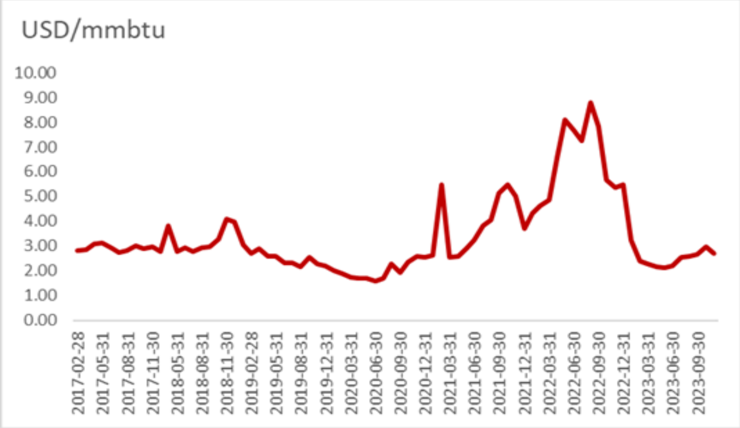
Source: Bloomberg, CMBIGM estimates

In terms of US natural gas price, in 2022, the Russia-Ukraine conflict caused a surge in US Henry Hub Natural Gas spot price. The surge was driven by increased demand for US natural gas exported to Europe. In May 2022, the US Henry Hub Natural Gas spot price reached its highest level since 2008, with an increase of 180%YoY, averaging around US$6.5/MMBtu. Despite this, US natural gas production remained relatively stable in the same year.

For 2023, global natural gas demand decreased, and the European demand for natural gas weakened. Additionally, Europe maintained high gas inventory levels resulting from increased gas imports from the US, normalizing gas import demand. Consequently, the US Henry Hub Natural Gas spot price experienced a fall. On average, the prices dropped by nearly 60% compared to the previous period.

For 2024, we believe US will continue export the natural gas to Europe and support Europe's gas inventory. Thus, we believe there is still upward possibility of US Henry natural gas price, but without any significant fluctuation.

Figure 3: US Henry Hub gas spot price (quarterly)



Source: Bloomberg, CMBIGM estimates

In terms of Asian gas prices and Chinese gas prices, in 2022, the surge in international gas prices raised the gas price in Asia. The average imported LNG price of China experienced significant growth, reaching US$32/MMBtu in 2022.

As for 2023, the spot prices of Asian gas started to decline due to the impact of international gas prices and weak gas demand resulting from a unfavourable economy. Consequently, the imported LNG prices in China experienced a substantial drop. From the beginning of 2023 until mid-November, the average price plummeted to US$12.81/MMBtu. However, there was a slight overall price rebound starting in October.

In 2024, we predicted the SHPGX will be stable and slightly drop as the gas source improvement.

Figure 4: China Imported LNG spot price (SHPGX)

Source: Bloomberg, SHPGX, CMBIGM estimates

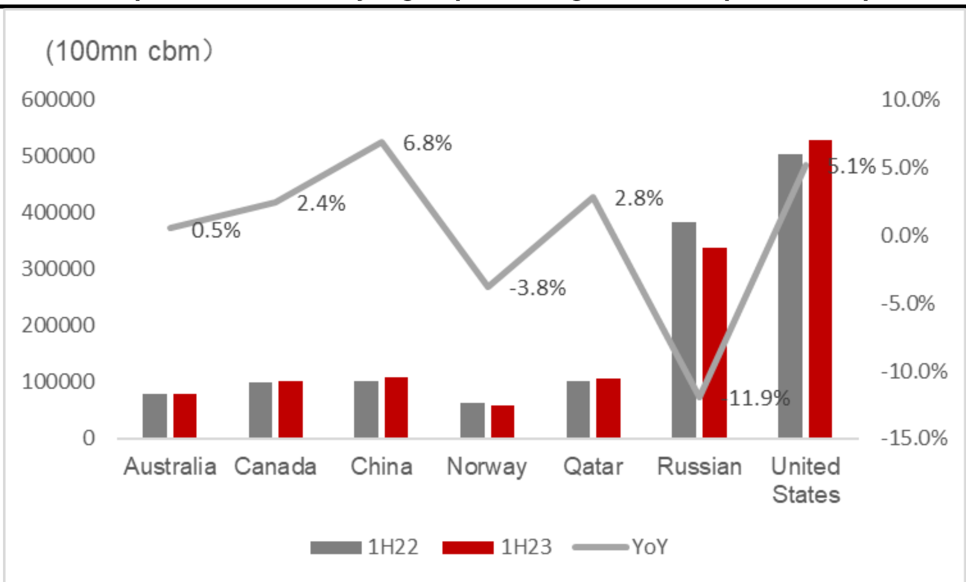
2. Global natural gas supply and demand tightness easing

1) Continuous growth in natural gas production from major gas-producing countries globally, supporting improved gas supply in Europe

From 2012 to 2022, global natural gas production increased from 3.29tn cbm to 4.01tn cbm, with a steady CAGR of approximately 2% over the decade. However, in 2022, global natural gas production experienced a slight decline of 0.2%YoY due to the Russia-Ukraine conflict and global economic weakness. The North American region had the highest natural gas production, with growth of 4.2% YoY. The US, Canada, and China were the countries with the highest growth in natural gas production, while Russia's gas production showed a decline.

Entering 1H23, major natural gas exporting countries such as the US, Australia, and Qatar continued to experience sustained growth in gas production. The US had a faster growth rate in natural gas production. China's natural gas production maintained stable growth, with an increase of nearly 7% YoY. However, Russia's gas production declined by 12% YoY.

Figure 5: Gas production of major gas-producing countries (1H22/1H23)



Source: Bloomberg, CMBIGM estimates

As for global LNG supply, the CAGR over the past decade was 5%, with LNG supply reaching 543.4bn cbm in 2022. This growth was primarily driven by LNG exports from the US, with the US LNG supply share increasing from 1% in 2016 to 19% in 2022, becoming a major driving force behind global LNG supply growth.

We anticipate that major gas-producing countries will have more stable production growth in 2024, supporting overall natural gas supply in Europe.

2) European natural gas supply and demand approaching balance as its gas consumption weakens and storage increases

In 2022, the European Union (EU) faced gas shortage challenges due to the Russia-Ukraine conflict, resulting in a significant increase in LNG imports and the strict requirement on the maintenance of high levels of LNG inventories. Afterwards, the EU went through a low-cost replenishment of gas storage during the off-season, and as of Oct 2011, the EU's natural gas inventories had risen to 98%. Based on its higher inventory levels, we anticipate that the demand for natural gas in the EU will remain weak in the near term.

According to data from the European Gas Infrastructure Association, as of November 13, 2023, gas storage across Europe reached 1,133 TWh, with a storage capacity utilization rate of 99.42%, nearing full capacity. Although there was a minor decrease of 0.07% compared to the previous day, the inventories remained stable at a high level.

Figure 6: European gas storage (by 13 Nov 2023)

Name	Gas in storage (TWh)	Full (%)	Trend (%)
EU	1133.37	99.42	-0.07
Austria	97.33	99.68	-0.19
Belgium	9.04	99.07	-0.12
Bulgaria	5.74	97.46	-0.21
Croatia	4.46	93.35	-0.43
Czech Republic	44.56	99.31	0
Denmark	9.84	97.2	-0.15
France	133.92	99.68	-0.01
Germany	255.29	100.11	-0.05
Hungary	68.63	97.94	-0.06
Ireland	0.00	0	0
Italy	194.53	98.77	-0.11
Latvia	21.61	95.62	-0.11
Netherlands	141.89	99.55	-0.02
Poland	37.33	99.52	0
Portugal	3.83	107.16	0
Romania	34.75	102.63	-0.2
Slovakia	36.28	98.41	-0.15
Spain	34.23	100.42	0
Sweden	0.10	95.33	0
United Kingdom (Pre-Brexit)	0.00	0	0
Non-EU	135.34	41	0.38
Serbia	0.00	0	0
Ukraine	125.27	39.12	0.37
United Kingdom (Post-Brexit)	10.07	102.08	0.58

Source: Bloomberg, Gas Infrastructure Europe, GIE, CMBIGM estimates

Moreover, the International Energy Agency (IEA) reported a 10% YoY decrease in natural gas consumption in OECD Europe countries during 1H23. This decline can be attributed to the EU's "REPowerEU" initiative, which aimed to reduce natural gas demand by 15% from Aug 1, 2022, to Mar 31, 2023, based on the average gas consumption over the previous five years. In March 2023, EU energy ministers agreed to extend the measures for another year until the end of March 2024, in order to ensure stable energy supply during the winter season.

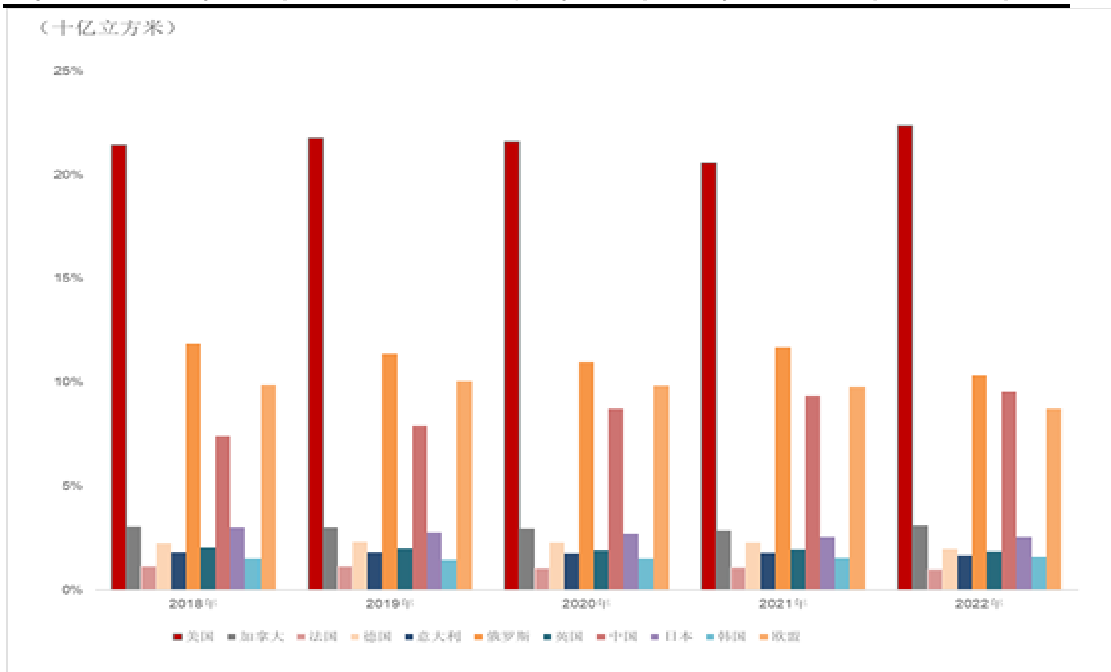
Looking ahead to 2024, European natural gas demand is likely to further decline, while the region may maintain relatively stable and high-level natural gas inventories. As a result, we believe the European natural gas supply and demand should move towards a more balanced state.

3) Stable growth in Asian natural gas demand, with China poised to drive global natural gas demand in the future

In 2022, factors such as rising international gas prices under the Russia-Ukraine conflict, and economic weakness significantly suppressed LNG import and gas consumption demand in the Asian region. Among Asian countries, China led in natural gas consumption, accounting for approximately 44% and serving as a major importer and consumer of natural gas. Under the guidance of carbon neutrality and carbon emissions peak, China's demand for clean energy, including natural gas, is steadily growing, making it an increasingly dominant driver of global natural gas consumption.

According to data from the International Energy Agency (IEA), Asia remained a major force in natural gas demand during 1H23. China's signed LNG purchase contracts over the past five years accounted for 30% of the total for Asian countries. In 1Q23, China's apparent natural gas demand increased by 6% YoY, with overall apparent demand showing positive performance and continuing to recover in the second and third quarters. With economic recovery, we anticipate that China's natural gas demand in 2024 will achieve a growth rate of 7-9% YoY, and it has the potential to become a primary driver of global natural gas demand growth.

Figure 7: Total gas export amount of major gas-exporting countries (2018-2022)



Source: Bloomberg, CMBIGM

4) Improved natural gas supply in China, overall gas demand recovery slower than expected

According to data from the General Administration of Customs of China, China's natural gas production in Sep 2023 increased by 10%YoY to 18bn cbm. Natural gas imports showed a slight slowdown, with import gas volume decreasing by 4%YoY to 5.69mn tons. From Jan to Sep, China produced 170.4bn cbm of natural gas, up by 6%YoY. Natural gas imports reached 51.13mn tons, up by 10% YoY. We expect China's natural gas supply to stabilize in the short to medium term.

In terms of natural gas consumption demand in China, actual national gas consumption increased by 1.5%YoY and 10.1% YoY in the first and second quarters of 2023, respectively. The growth rate in the second quarter accelerated significantly, mainly due to the low base caused by restrictions from the COVID-19 pandemic in the same period of 2022.

In Sep 2023, China's apparent natural gas consumption reached 29.6bn cbm, up by 6% YoY. From Jan to Sep 2023, the national apparent natural gas consumption reached 288.8bn cbm, an increase of 7% YoY. Overall, there has been a rebound in natural gas demand, but further improvement is still needed.

Looking ahead to 2024, we expect overall gas demand to continue to recover as economic stimulus measures are implemented and the economy continues to improve, driving overall gas demand. We estimate that China's natural gas demand will grow by 7-9% in 2024.

3. Review and outlook of city gas operators

In 2023, city gas companies faced challenges due to a relatively slow economic recovery, resulting in lower-than-expected industrial gas sales in 1H23. Despite this, the companies took proactive measures to address the situation.

Gas sales for city gas companies showed a partial recovery in 2H23, leading to sustained improvement in their gas sales business. In addition, their dollar margins improved due to lower upstream gas prices, optimization of the gas sales structure and proactive cost-through measures implemented by the companies. In the winter season, some city gas companies secured agreements with upstream suppliers at favorable prices, and the expected mild winter eased the pressure of rising gas costs. Increased heating demand during winter boosted gas consumption. Some city gas operators also improved their Capex and M&A management, resulting in better free cash flows.

Furthermore, city gas companies continue to develop new businesses. CR Gas, with its quality project resources, provides diversified clean energy solutions to users and actively expands the new energy market by accelerating the development of electric vehicle charging and hydrogen businesses. Towngas is actively promoting renewable energy businesses. ENN Energy maintains its leading position in comprehensive energy businesses. China Gas is actively developing and promoting value-added services.

Looking ahead to 2024, we maintain a neutral to optimistic outlook for the city gas operator sector.

1) In terms of gas demand, we expect the continued improvement of the Chinese economy to boost residential and commercial gas demand, as well as a recovery in industrial gas demand. This overall improvement will drive revenue and profit growth for city gas companies. We estimate that China's natural gas demand will achieve YoY growth of 7-9% in 2024.

2) In terms of gas supply, we expect overall gas supply in China to continue to improve in 2024. While domestic natural gas production steadily increases, we anticipate an increase in imported LNG spot and imported pipeline gas as international natural gas prices decline. Long-term LNG import agreements previously signed are expected to be fulfilled, resulting in better supply compared to the same period in 2023.

3) In terms of gas prices, we believe that as international gas prices decline, this trend will be transmitted to domestic gas prices. Currently, gas prices in China have returned to normal levels. We expect that gas prices will remain stable in 2024, but with increased supply and improved demand, there is a possibility of continued overall gas cost reduction with lower gas prices. The active cost-through policies implemented by city gas companies will also contribute to improved dollar margins and profits.

4) Regarding gas connection services, with the slowdown in real estate development, there is a consensus market expectation that new gas connections will continue to slow down. This has been partially reflected in the previous continuous decline in city gas stock prices. However, caution is still advised regarding connection businesses.

5) In terms of new business, we believe that city gas companies will continue to accelerate the development of its value-added business, comprehensive service business, and comprehensive energy business.

Currently, we believe that the “second phase” of large-scale expansion through mergers and acquisitions by city gas companies is nearing completion. Therefore, we expect that the merger and acquisition strategies of city gas companies in 2024 will be more cautious. Companies will potentially focus on projects with their own capabilities and leverage their financial flexibility to expand their businesses.

Based on the traditional gas business development scale and advantages of city gas operators, we lean towards CR Gas (1193 HK), which has high-quality project advantages and good financial flexibility. The advantages of CR Gas are attributable to: 1) a stable recovery in gas sales volume and continuous improvement in dollar margins; 2) outstanding project quality; 3) its capability of orderly advancing mergers and acquisitions of high-quality projects, and steadily expanding its scale, while being a state-owned enterprise provides advantages in upstream gas price agreements and downstream cost-through; 4) potential growth in value-added businesses and comprehensive energy services; 5) maintaining a stable dividend payout ratio; and 6) in terms of valuation, we believe the stock’s valuation is attractive compared to the industry's FY24E PE of approximately 8x.

We suggest investors take the following factors into consideration: 1) the recovery in gas sales growth for city gas companies; 2) improvement in dollar margin management capabilities; 3) city gas companies that have a faster pace of business transformation and rapid development of value-added services and new energy business; and 4) the industry's currently attractive valuation.

Consequently, our top recommendation for city gas distributors is CR Gas (1193 HK).

Additionally, we see Kunlun Energy (135 HK), ENN Energy (2688 HK), China Gas Holdings (384 HK), and Towngas Smart Energy(1083 HK) as worthy of attention.

Valutaion

Figure 8: Peers comparison table

Company	Ticker	Closing Price (HK$)	Mkt cap (HK$mn)	EPS 23E	EPS 24E	EPS 25E	23-25E CAGR	PER 23E	PER 24E	PER 25E	PBR 23E	PBR 24E	PBR 25E
CHINA RES GAS	1193 HK	25.4	58775.9	2.50	2.67	2.96	8.8%	10.16	10.16	8.60	1.36	1.25	1.16
CHINA GAS HOLDIN	384 HK	7.52	40875.5	1.14	1.05	1.17	1.2%	6.60	6.60	6.44	0.61	0.66	0.63
ENN ENERGY	2688 HK	57.05	64536.1	6.53	7.13	7.80	9.3%	8.03	7.35	6.72	1.34	1.19	1.06
TOWNGAS SMART E	1083 HK	3.36	11271.1	0.38	0.47	0.47	11.4%	8.82	8.82	7.06	0.50	0.48	0.46
KUNLUN ENERGY	135 HK	7.17	62083.6	0.76	0.82	0.88	7.4%	8.62	8.62	7.46	0.89	0.83	0.77
Average								**8.4**	**8.3**	**7.3**	**0.9**	**0.9**	**0.8**

Source: Bloomberg, CMBIGM estimates
Note: 28 Nov

Top Picks

- **China Internet & Software – Tencent (700 HK), Alibaba Group (BABA US)**
- **China Semiconductor – Innolight (300308 CH), Maxscend (300782 CH)**
- **China Technology – Xiaomi (1810 HK), BYDE (285 HK)**
- **China Healthcare – Innovent (1801 HK), Mindray (300760 HK)**
- **China Consumer Staples – Kweichow Moutai (600519 CH)**
- **China Consumer Discretionary – Vesync (2148 HK)**
- **China Auto – Li Auto Inc. (LI US), Geely Automobile (175 HK)**
- **China Property – Onewo (2602 HK)**
- **China Capital Goods – Weichai Power (2338 HK), Zhejiang Dingli (603338 CH)**
- **China Entertainment – Netflix (NFLX US), Kuaishou (1024 HK)**
- **China Energy: Power Operators – China Longyuan (916 HK/001289 CH)**
- **China Energy: City Gas Operators – CR Gas (1193 HK)**

18 Dec 2023

CMB International Global Markets | Equity Research | Company Update

Tencent (700 HK)

Focus on quality earnings growth

Tencent's competitive edge remains strong. We expect Tencent to deliver sustainable earnings growth amid macro uncertainty and intensifying competition. Looking into 2024, we expect: 1) higher-margin businesses like Video Account and Mini Games will bring incremental monetization opportunities and support GPM expansion; 2) the company will expand into new game genres such as causal games and content-driven games to drive steady growth of games business; 3) AI will empower business lines, elevate ad ROI, improve games business efficiency and create incremental revenue stream for cloud business. We forecast FY24/25 non-IFRS net income to grow by 18/9% YoY. The company's current valuation of 16x FY24E non-IFRS PE (or 12x FY24E PE if excluding strategic investment) offers attractive value. Our SOTP-derived TP is HK$465.0. BUY.

- **Operating leverage and business innovation to support quality growth.** Tencent's non-IFRS net income grew by 39% YoY to RMB44.9bn in 3Q23, beating consensus estimate by 12%, mainly due to the 5.2ppt GPM expansion. The record-high GPM since 2019 proved Tencent's operating leverage in its consumer internet business and its competitive edge. We expect further potential for improvement for the overall GPM, underpinned by the increasing revenue contribution from higher-margin businesses.

- **Expect FY24 non-IFRS net income to grow 18%.** We forecast FY24 total revenue to grow by 9% YoY in FY24: 1) games revenue to increase by 6% YoY, mainly driven by contribution from new titles like *Dream Stars*; 2) ad revenue to grow by 11% YoY, fueled by the revenue growth of Weixin ad properties (Video Account/mini programs/moment); 3) fintech and business services (FBS) revenue to grow by 12%, primarily due to solid growth of payment business and incremental revenue from Video Account e-commerce. Thanks to revenue mix shift to higher-margin business, we expect GPM to rise by 1 ppt YoY and non-IFRS net income to grow by 18% YoY in FY24.

- **Several catalysts to support fundamental and valuation.** 1) enhanced Video Account monetization supports better-than-expected revenue growth and GPM expansion of ad/FBS business; 2) new games like *Dream Stars* drive stronger-than-expected game revenue growth; 3) wealth management/consumer loan business expansion drives FBS business growth; 4) increasing share repurchase and dividend to enhance shareholder return.

- **Maintain BUY.** Our SOTP-derived target price is HK$465.0, comprising of HK$192.9/18.8/57.5/107.6/18.9 for games/SNS/ads/fintech/cloud businesses and HK$6.8/62.5 for net cash and strategic investment. Maintain BUY

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	560,118	554,552	611,875	664,724	716,952
Gross margin (%)	43.9	43.1	47.8	48.8	49.0
Adj. net income (RMB mn)	123,788	115,649	156,029	184,531	201,484
Adj. EPS (RMB)	12.99	12.13	16.11	19.05	20.81
Consensus EPS (RMB)	12.99	12.13	15.48	18.16	20.58
P/S (x)	4.8	4.8	4.4	4.0	3.7
ROE (%)	29.8	24.6	15.5	16.4	16.5

Source: Company data, Bloomberg, CMBIGM estimates

招銀国际 CMB INTERNATIONAL
招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

BUY (Maintain)

Target Price	**HK$465.00**
(Previous TP	HK$465.00)
Up/Downside	**+49.2%**
Current Price	**HK$311.60**

China Internet Sector

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Stock Data

Mkt Cap (HK$ mn)	2,962,791
Avg 3 mths t/o (HK$ mn)	5,012.9
52w High/Low (HK$)	415.00/283.00
Total Issued Shares (mn)	9466.5

Source: Bloomberg

Shareholding Structure

MIH TC	26.9%
Advance Data Services	8.4%

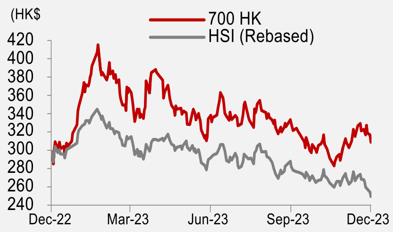
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-1.2%	8.7%
3-mth	-5.7%	6.5%
6-mth	-6.8%	9.1%

Source: Bloomberg

12-mth Price Performance



Source: Factset

Auditor: PwC

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**560,118**	**554,552**	**611,875**	**664,724**	**716,952**
VAS	291,572	287,565	301,884	318,537	333,689
Online advertising	88,666	82,729	99,836	110,976	122,172
Fintech & business services	172,195	177,064	204,400	229,455	255,336
Others	7,685	7,194	5,755	5,755	5,755
Cost of goods sold	**(314,174)**	**(315,806)**	**(319,173)**	**(340,424)**	**(365,557)**
Operating expenses	**(5,372)**	**(6,142)**	**(5,843)**	**(6,663)**	**(7,458)**
Selling expense	(3,798)	(3,973)	(4,056)	(4,606)	(5,124)
Admin expense	(514)	(652)	(696)	(828)	(965)
Others	156,117	132,885	16,727	19,187	21,145
Operating profit	**271,620**	**235,706**	**175,428**	**196,583**	**215,528**
Share of/profits of associates	(16,444)	(16,129)	4,200	4,200	4,200
Interest income	6,650	8,592	12,951	15,298	17,139
Interest expense	(7,114)	(9,352)	(11,808)	(11,899)	(2,691)
Pre-tax profit	**248,062**	**210,225**	**167,820**	**188,883**	**217,036**
Income tax	(20,252)	(21,516)	(44,472)	(37,777)	(41,547)
Minority interest	2,988	466	2,960	3,627	3,989
Net profit	**224,822**	**188,243**	**120,387**	**147,480**	**171,501**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**248,062**	**210,225**	**167,820**	**188,883**	**217,036**
Depreciation & amortization	56,818	60,230	55,298	67,927	78,711
Tax paid	(20,252)	(21,516)	(44,472)	(37,777)	(41,547)
Change in working capital	(2,844)	(28,405)	32,793	15,565	19,043
Others	(106,598)	(74,443)	0	0	(9,301)
Net cash from operations	**175,186**	**146,091**	**211,439**	**234,598**	**263,942**
Capital expenditure	(34,931)	(33,892)	(36,648)	(39,017)	(41,241)
Acquisition of investments	(117,642)	59,711	(22,691)	(60,344)	(43,945)
Net proceeds from disposal	0	0	0	0	0
Others	(25,976)	(130,690)	(64,914)	(69,110)	(73,050)
Net cash from investing	**(178,549)**	**(104,871)**	**(124,253)**	**(168,471)**	**(158,235)**
Net borrowings	45,239	31,982	7,743	12,004	12,363
Proceeds from share issues	0	0	0	0	0
Others	(23,619)	(91,935)	(969)	(11,686)	(12,782)
Net cash from financing	**21,620**	**(59,953)**	**6,774**	**318**	**(419)**
Net change in cash	**18,257**	**(18,733)**	**93,960**	**66,445**	**105,288**
Cash at the beginning	152,798	167,966	156,739	250,699	317,144
Exchange difference	(3,089)	7,506	0	0	0
Cash at the end of the year	**167,966**	**156,739**	**250,699**	**317,144**	**422,431**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**1,127,552**	**1,012,142**	**1,056,760**	**1,129,342**	**1,175,105**
PP&E	61,914	53,978	71,734	85,644	96,909
Investment in JVs & assos	323,188	252,715	264,094	275,842	287,948
Financial assets at FVTPL	192,184	206,085	206,085	206,085	206,085
Other non-current assets	550,266	499,364	514,847	561,771	584,163
Current assets	**484,812**	**565,989**	**540,584**	**641,874**	**787,213**
Cash & equivalents	167,966	156,739	250,699	317,144	422,431
Account receivables	49,331	45,467	48,469	51,076	53,436
Prepayment	65,390	76,685	78,410	82,627	86,446
ST bank deposits	83,813	104,776	127,294	154,105	185,913
Financial assets at FVTPL	10,573	27,963	29,361	30,829	32,371
Other current assets	107,739	154,359	6,351	6,093	6,616
Current liabilities	**403,098**	**434,204**	**318,870**	**343,090**	**370,534**
Short-term borrowings	19,003	22,026	17,099	18,237	19,584
Account payables	109,470	92,381	98,642	104,158	110,729
Tax payable	12,506	13,488	13,991	14,624	15,390
Other current liabilities	262,119	306,309	189,138	206,071	224,831
Non-current liabilities	**332,573**	**361,067**	**382,498**	**393,580**	**404,836**
Long-term borrowings	136,936	163,668	164,560	164,829	164,909
Bond payables	145,590	148,669	154,244	157,136	158,609
Deferred income	4,526	3,503	12,767	13,617	14,622
Other non-current liabilities	45,521	45,227	50,927	57,998	66,696
Minority interest	**70,394**	**61,469**	**64,429**	**68,056**	**72,044**
Total net asset	**876,693**	**782,860**	**895,976**	**1,034,546**	**1,186,948**
Total shareholders equity	**876,693**	**782,860**	**895,976**	**1,034,546**	**1,186,948**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
VAS	52.1	51.9	49.3	47.9	46.5
Online advertising	15.8	14.9	16.3	16.7	17.0
Fintech & business services	30.7	31.9	33.4	34.5	35.6
Others	1.4	1.3	0.9	0.9	0.8
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Profitability					
Gross profit margin	**43.9%**	**43.1%**	**47.8%**	**48.8%**	**49.0%**
Operating margin	48.5%	42.5%	28.7%	29.6%	30.1%
Adj. net profit margin	22.1%	20.9%	25.5%	27.8%	28.1%
Return on equity (ROE)	29.8%	24.6%	15.5%	16.4%	16.5%
Gearing/Liquidity					
Current ratio (x)	1.2	1.3	1.7	1.9	2.1
Receivable turnover days	32.1	29.9	28.9	28.0	27.2
Inventory turnover days	na	na	na	na	na
Payable turnover days	na	na	na	na	na
Valuation					
P/E	18.1	14.1	22.2	18.1	15.6
P/E (diluted)	18.4	14.3	22.5	18.4	15.8
P/B	5.0	3.7	3.2	2.8	2.4

Source: Company data, CMBIGM estimates

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Alibaba Group (BABA US)

Enhancing shareholder return in a holistic way

Although Alibaba's domestic business's GMV and revenue growth are still weighed by competitive pressure and relatively low consumption sentiment, leveraging "user first" strategy, Alibaba is on track to secure long-term revenue and earnings growth prospects to be in line with industry trend. Although the decision not to proceed with a full spin-off for Cloud Intelligence Group (CIG) has disappointed market expectation in the near term, it should benefit from long-term business development for both CIG and Alibaba. Moreover, management guided to adopt a holistic approach to enhance shareholder return. Looking into 2024, we expect the recovery in macro to drive a recovery for Alibaba's revenue growth, while the loss reduction of non-core asset is likely to continue to drive an improvement for margins. Leveraging an improving profitability, Alibaba is able to increase shareholder return, which may drive a valuation rerating, in our view. The current valuation of 7.6x FY24E non-GAAP PE is not demanding, in our view. Maintain SOTP-based target price of US$148.3 and BUY rating.

- **Fundamentals on improving trend.** Alibaba is continuously enhancing value for quality product supply, and enhancing its content ecosystem, which in turn drove better advertising willingness, and an improvement of monetization rate, which is likely to sustain in 2024 in our view. We forecast FY24 Taobao and Tmall Group GMV/customer management revenue growth of 3/5% YoY. Also, management aims to drive for profitability improvement of non-core business, which likely propels a further improvement in margins. We forecast Alibaba's adjusted EBITA to increase 21% in FY24, and adjusted EBITA margin to improve to 18.7% (FY23: 17.0%).
- **Cloud business could have more support at group-level to drive long-term growth.** Despite macro uncertainties, the management's increasing focus on driving quality growth has dampened revenue growth recovery of Alibaba Cloud, but the margin expansion is still on track, and potential incremental revenue generation from generative AI business could propel long-term revenue and earnings growth. The decision not to proceed with a full spin-off for Cloud Intelligence Group (CIG) likely benefits long-term development of both CIG and Alibaba, in our view, and CIG revenue growth could recover along with the recovery in macro. We forecast CIG's revenue growth of 3/12% YoY in FY24/25E.
- **Enhancing shareholder return based on a holistic view.** Although the decision not to proceed with a full spin-off for CIG has disappointed market expectation in the short term, it should benefit long-term business development, in our view. Also, management guided to enhance shareholder return through a holistic approach: 1) annual dividend (the US$2.5bn annual dividend has accounted for c.1.2% of mkt cap); 2) share buy-back (TTM buy-back of c. 4.8% outstanding shares as of 3Q23); and 3) investment in strategic important areas to drive for long-term shareholder return. Alibaba targeted to improve group level ROIC ratio to double digit range through driving for profitability improvement and monetization of non-core assets. Maintain SOTP-based target price of US$148.3 and BUY rating.

Earnings Summary

(YE 31 Mar)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	853,062	868,687	955,381	1,063,919	1,153,834
YoY growth (%)	18.9	1.8	10.0	11.4	8.5
Net income (RMB mn)	61,959.0	72,509.0	125,091.3	154,445.9	169,198.2
Adj. NI (RMB mn)	143,515.0	143,991.0	169,055.8	186,363.5	203,813.3
YoY growth (%)	53.26	54.91	66.32	73.04	79.80
Consensus EPS (RMB)			65.47	72.10	81.89
P/E (x)	46.5	23.0	10.5	8.5	7.8
ROE (%)	6.5	7.4	11.0	11.3	10.9

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**US$148.3**
(Previous TP	US$148.3)
Upside	**+104.9%**
Current Price	**US$72.38**

China Internet Sector

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Stock Data

Mkt Cap (US$ mn)	185,680.1
Avg 3 mths t/o (US$ mn)	738.9
52w High/Low (US$)	120.57/72.38
Total Issued Shares (mn)	2565.4

Source: Factset

Shareholding Structure

Softbank	13.9%

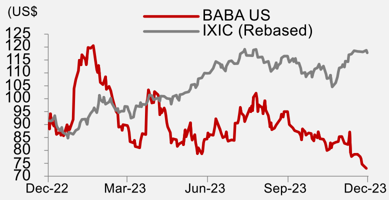
Source: HKex

Share Performance

	Absolute	Relative
1-mth	-15.2%	-19.2%
3-mth	-23.4%	-25.1%
6-mth	-16.5%	-21.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	**853,062**	**868,687**	**955,381**	**1,063,919**	**1,153,834**
Cost of goods sold	(539,450)	(549,695)	(594,247)	(662,822)	(718,839)
Gross profit	**313,612**	**318,992**	**361,134**	**401,098**	**434,995**
Operating expenses	**(243,974)**	**(218,641)**	**(213,165)**	**(231,934)**	**(248,074)**
S&M expenses	(119,799)	(103,496)	(109,869)	(121,287)	(130,383)
G&A expenses	(31,922)	(42,183)	(41,081)	(44,685)	(47,307)
Others	(92,253)	(72,962)	(62,214)	(65,963)	(70,384)
Operating profit	**69,638**	**100,351**	**147,969**	**169,163**	**186,921**
Gain/loss on financial assets at FVTPL	0	0	0	0	0
Interest income	(15,702)	(11,071)	0	2,128	2,077
Interest expense	(4,909)	(5,918)	(7,165)	(6,171)	(6,923)
Other operating expenses	10,523	5,823	5,732	5,852	6,346
Pre-tax profit	**59,550**	**89,185**	**146,536**	**170,972**	**188,421**
Income tax	(26,815)	(15,549)	(23,446)	(32,485)	(37,684)
Others	14,344	(8,063)	(2,866)	9,575	10,385
Minority interest	(15,170)	(7,210)	(4,777)	(6,384)	(8,077)
Net profit	**62,249**	**72,783**	**125,001**	**154,446**	**169,198**
Adjusted net profit	**143,515.0**	**143,991.0**	**169,055.8**	**186,363.5**	**203,813.3**

Cash flow summary

YE 31 Dec (RMB mn)	FY22	FY23	FY24E	FY25E	FY26E
Profit before taxation	**59,550**	**89,185**	**146,536**	**170,972**	**188,421**
Depreciation & Amortization	48,065	46,938	9,554	10,639	11,538
Tax Paid	(26,815)	(15,549)	(23,446)	(32,485)	(37,684)
Change in Working Capital	(18,150)	13,482	60,230	(8,856)	24,849
Others	80,109	65,696	23,595	25,068	26,172
Net Cash from Operations	**142,759**	**199,752**	**216,469**	**165,338**	**213,297**
Capital Expenditure	(53,309)	(34,330)	(47,769)	(48,940)	(50,769)
Acquisition of Subsidiaries/ Investments	(15)	(22)	(31,154)	(31,154)	(31,154)
Net proceeds from disposal of short-term investment	(106,984)	(61,086)	0	0	0
Others	(38,284)	(40,068)	12,262	12,262	12,262
Net cash from Investing	**(198,592)**	**(135,506)**	**(66,661)**	**(67,832)**	**(69,661)**
Net borrowings	0	0	0	0	0
Proceeds from Share Issues	109	11	0	0	0
Others	(64,558)	(65,630)	605	94	761
Net cash from financing	**(64,449)**	**(65,619)**	**605**	**94**	**761**
Net change in cash	**(120,282)**	**(1,373)**	**150,413**	**97,600**	**144,397**
Cash at the beginning of the year	356,469	227,353	229,510	379,923	477,523
Exchange difference	(8,834)	3,530	0	0	0
Cash at the end of the year	**227,353**	**229,510**	**379,923**	**477,523**	**621,920**

Balance sheet

YE 31 Dec (RMB mn)	FY22	FY23	FY24E	FY25E	FY26E
Non-current assets	**1,057,01**	**1,055,07**	**1,150,781**	**1,222,151**	**1,293,745**
PP&E	171,806	176,031	266,557	315,498	366,266
Investment in JVs & assos	219,642	207,380	192,252	189,565	187,688
Financial assets at FVTPL	223,611	245,737	245,737	245,737	245,737
Other non-current assets	441,959	425,930	446,234	471,351	494,054
Current assets	**638,535**	**697,966**	**892,949**	**1,005,98**	**1,162,80**
Cash & equivalents	189,898	193,086	379,923	477,523	621,920
Prepayment	145,995	137,072	145,218	160,652	173,075
Financial assets at FVTPL	265,187	331,384	331,384	331,384	331,384
Other current assets	37,455	36,424	36,424	36,424	36,424
Current liabilities	**383,784**	**385,351**	**423,641**	**431,193**	**468,590**
Short-term borrowings	8,841	7,466	8,071	9,002	9,763
Tax payable	21,753	12,543	20,632	27,612	30,901
Other current liabilities	353,190	365,342	394,938	394,579	427,926
Non-current liabilities	**229,576**	**244,772**	**221,433**	**228,943**	**235,763**
Long-term borrowings	38,244	52,023	52,023	51,186	51,186
Deferred income	3,490	3,560	3,849	4,293	4,655
Other non-current liabilities	187,842	189,189	165,561	173,465	179,922
Minority Interest	124,059	123,406	118,629	112,246	104,169
Total net asset	**958,134**	**999,515**	**1,280,027**	**1,455,751**	**1,648,026**
Total shareholders equity	**1,082,193**	**1,122,921**	**1,398,656**	**1,567,997**	**1,752,195**

Key ratios

YE 31 Dec	FY22	FY23	FY24E	FY25E	FY26E
P&L ratios (%)					
Gross margin	37%	37%	38%	38%	38%
Operating margin	8%	12%	15%	16%	16%
Adjusted net margin	17%	17%	18%	18%	18%
ROE	15%	15%	15%	14%	13%
Balance sheet ratios					
Current ratio (x)	1.7	1.8	2.1	2.3	2.5
PE	20.8	18.2	10.3	8.3	7.6
Non-GAAP PE	9.0	9.2	7.6	6.9	6.3

Source: Company data, CMBIGM estimates

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Innolight (300308 CH)

Continue to ride the AI tailwind in 2024

Innolight is a leading optical transceiver module manufacturer that supplies to Cloud Service Providers (CSPs) globally. Since early 2023, the Company has seen its share price surge to record high attributed to the enduring AI momentum, propelled by large models, such as ChatGPT by OpenAI. We identify Innolight as a genuine beneficiary within the domestic AI value chain, a sector we deem crucial for investors to focus on in 2024 or even beyond. **We maintain BUY on Innolight with TP of RMB109.3.**

- **The momentum in the AI sector has established itself as a sustained trend, driving an increased demand for computing power, thereby benefitting Innolight.** In 3Q23, we observed a notable rebound in capital expenditures by major CSPs (Amazon, Microsoft, and Google) & Meta, particularly in AI infrastructure. This resurgence validates our view that the AI momentum is enduring with a more prolonged impact than initially anticipated. Orders for Innolight's optical transceiver products extending into early-2024 further reinforces our positive forecast for the Company's financial performance in 2024.

- **AMD forecasted a US$45bn market size (prev. at US$30bn in Jun 2023) for its datacenter AI processors in 2023 as it launched a new generation of AI chips on 6 Dec.** (link) With the rapid market growth and effective AI monetization strategies, cloud computing power remains a key focus for investors to watch for in 2024, while also boosting demand for Innolight's high-performance optical transceivers

- **We advise investors to concentrate on true beneficiaries in the AI value chain, such as Innolight, which leads globally in producing high-speed optical transceiver modules.** The Company's robust performance in 3Q23 highlighted its solid position in the competitive AI infrastructure market. Given the easing of supply constraints and steady demand from data center operators, we remain bullish about the company's future earnings. **Maintain BUY on Innolight with TP of RMB109.3**

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	7,695	9,642	11,386	14,819	15,690
YoY growth (%)	9.2	25.3	18.1	30.2	5.9
Gross margin (%)	25.6	29.3	31.3	31.8	31.7
Net profit (RMB mn)	877.0	1,224.0	1,707.8	2,321.2	2,500.8
YoY growth (%)	1.3	39.6	39.5	35.9	7.7
EPS (RMB)	1.21	1.54	2.13	2.90	3.12
P/E (x)	32.6	20.6	56.4	41.5	38.5
ROE (%)	7.6%	10.2%	12.6%	14.8%	13.9%

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**RMB109.3**
(Previous TP	RMB109.3)
Up/Downside	**N/A**
Current Price	**RMB120.15**

China Semiconductor Sector

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Stock Data

Mkt Cap (HK$ mn)	96,456.4
Avg 3 mths t/o (HK$ mn)	3,220.0
52w High/Low (HK$)	170.00/26.33
Total Issued Shares (mn)	802.8

Source: FactSet

Shareholding Structure

Shandong Zhongji Investment Holdings Co.	11.3%
Wang Weixiu	6.2%

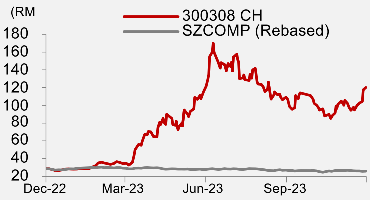
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	18.3%	20.8%
3-mth	10.0%	15.2%
6-mth	4.3%	11.4%

Source: FactSet

12-mth Price Performance



Source: FactSet

Related Reports

1. "Innolight (300308 CH) – Strong 3Q results on accelerating AI revenue" – 24 Oct 2023 (link)
2. "Innolight (300308 CH) – Expect higher contribution from AI revenue in 3Q; Upgrade to Buy" – 20 Oct 2023 (link)
3. "Innolight (300308 CH) – Investors focusing on 800G transceivers ramp-up after 1H23 results" – 28 Aug 2023 (link)

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**7,695**	**9,642**	**11,386**	**14,819**	**15,690**
Cost of sales	(5,727)	(6,816)	(7,821)	(10,112	(10,711
Gross profit	**1,968**	**2,826**	**3,565**	**4,707**	**4,980**
Selling exp	(73)	(91)	(117)	(146)	(158)
Admin exp	(434)	(507)	(506)	(659)	(697)
R&D exp	(541)	(767)	(921)	(1,184)	(1,238)
Finance costs	(84)	22	(2)	19	56
Other operating exp.	2,137	2,841	3,168	4,053	4,181
Operating profit	**963**	**1,327**	**1,943**	**2,624**	**2,836**
Other non-oper exp.	(3)	24	2	20	12
Pre-tax profit	**960**	**1,352**	**1,945**	**2,644**	**2,848**
Income tax expense	(73)	(118)	(171)	(233)	(251)
Minority interests	10	10	66	90	97
Net profit to shareholders	**877**	**1,224**	**1,708**	**2,321**	**2,501**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Net profit	886	1,234	1,774	2,411	2,597
Depreciation/amortization	321	361	420	491	579
Change in working capital	(587)	291	(175)	(1,074)	401
Others	193	563	122	311	261
Net cash from operating	**813**	**2,449**	**2,141**	**2,138**	**3,839**
Capex	(840)	(792)	(1,068)	(1,391)	(1,472)
Other	(379)	(761)	25	29	31
Net cash from investing	**(1,219)**	**(1,553)**	**(1,043)**	**(1,362)**	**(1,441)**
Share issuance	2,665	33	0	0	0
Dividend paid	(168)	(233)	(253)	(323)	(408)
Other	(233)	(1,441)	157	384	144
Net cash from financing	**2,264**	**(1,641)**	**(96)**	**61**	**(265)**
Net change in cash	**1,859**	**(745)**	**1,001**	**838**	**2,134**
Cash at beginning of the year	1,648	3,489	2,809	3,874	4,776
Exchange difference	(17)	64	64	64	64
Cash at the end of the year	**3,489**	**2,809**	**3,874**	**4,776**	**6,974**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Current assets	**10,022**	**9,587**	**11,232**	**13,895**	**14,929**
Cash & equivalents	3,515	2,831	3,898	4,799	6,998
Account receivables	1,997	1,509	1,424	2,394	1,648
Inventory	3,799	3,888	3,826	5,039	4,057
Prepayment	72	64	82	106	113
Other current assets	638	1,295	2,002	1,557	2,113
Non-current assets	**6,543**	**6,970**	**7,497**	**8,265**	**9,010**
PPE	3,152	3,217	3,579	4,102	4,657
Deferred tax assets	46	48	57	66	72
Other non-current assets	3,345	3,704	3,861	4,097	4,281
Total assets	**16,565**	**16,557**	**18,729**	**22,160**	**23,939**
Current liabilities	**3,166**	**3,264**	**2,857**	**3,910**	**2,915**
ST borrowings	794	385	456	703	347
Account payables	1,205	1,136	878	1,338	1,010
Tax payable	68	93	89	115	119
Other current liabilities	1,098	1,650	1,434	1,754	1,440
Non-current liabilities	**1,796**	**1,224**	**2,138**	**2,276**	**2,701**
LT borrowings	1,262	696	1,568	1,585	1,964
Deferred tax liability	277	264	283	344	367
Other non-current liabilities	258	264	286	346	370
Total liabilities	**4,962**	**4,488**	**4,994**	**6,185**	**5,616**
Share capital	800	801	801	801	801
Reserve	7,799	7,932	7,932	7,932	7,932
Retained earnings	2,861	3,893	5,420	7,489	9,657
Other	29	(680)	(608)	(527)	(443)
Minority interest	114	124	190	279	376
Total equity	**11,603**	**12,069**	**13,734**	**15,974**	**18,323**
Total liabilities and equity	**16,565**	**16,557**	**18,729**	**22,160**	**23,939**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue mix					
Optical module	7,261	9,413	11,200	14,668	15,568
Optical components	327	229	186	150	122
High-end equipment	107	0	0	0	0
Growth (%)					
Revenue	9.2%	25.3%	18.1%	30.2%	5.9%
Gross profit	9.8%	43.6%	26.1%	32.0%	5.8%
Operating profit	-2.7%	37.9%	46.4%	35.0%	8.1%
Net profit	1.3%	39.6%	39.5%	35.9%	7.7%
Profit & loss ratio (%)					
Gross margin	25.6%	29.3%	31.3%	31.8%	31.7%
Operating margin	12.5%	13.8%	17.1%	17.7%	18.1%
Net profit margin	11.4%	12.7%	15.0%	15.7%	15.9%
Balance sheet ratio					
Net debt/total equity (%)	Net	Net	Net	Net	Net
Current ratio (x)	3.2	2.9	3.9	3.6	5.1
Receivable turnover days	83	66	47	47	47
Inventory turnover days	(241)	(206)	(180)	(160)	(155)
Payable turnover days	(82)	(63)	(47)	(40)	(40)
Profitability (%)					
ROE	7.6%	10.2%	12.6%	14.8%	13.9%
ROA	5.3%	7.4%	9.1%	10.5%	10.4%
Per share data (RMB)					
EPS	1.21	1.54	2.13	2.90	3.12
DPS	0.22	0.20	0.27	0.37	0.40
BPS	15.85	14.91	16.91	19.60	22.41

Source: Company data, CMBIGM estimates

Maxscend (300782 CH)

Steady and resilient; Ready for 2024

Maxscend is a leading RF (Radio Frequency) frontend manufacturer with end customers spanning across multiple industries, including smartphones, telecom, automobile etc. The Company boasts strong R&D capabilities particularly represented in the development of DiFEM, L-DiFEM, and GPS modules. We are optimistic on the Company's future outlook as it continues to enhance its edge and strengthen its barrier. With the Company's inventory returning to a healthier level, we hold positive prospects on the Company's outlook and **maintain BUY on Maxscend with TP of RMB174.**

- **Steady production with strong R&D ability:** the Company delivered over 160mn units of DiFEM, L-DiFEM, and GPS modules, among others, integrated with its proprietary SAW filters in 1H23, signifying its ability of achieving stable mass production as well as a gradual increase in client uptake. Additionally, the Company has successfully begun mass production of its duplexers & quadplexers products with several key clients since early-2023. Consequently, the Company has seen growing revenue contributed by its RF module in the past few years, increasing from 9.93% in 2020 to 31.98% in 1H23.
- **Semiconductor domestic substitution to accelerate propelled by supply chain localization.** Driven by events like the release of multiple high-end Android smartphones and heightened US exports ban on tech products to China in 2H23, localization of China's semi supply chain has accelerated notably on both geopolitical complications and Chinese tech companies progressing towards self-reliance while achieving substantial breakthroughs.
- Looking ahead to 2024, amidst recovering consumer electronics demand and new product launches like L-PAMiD, the Company is poised for continued growth, with an expected 31% and 32% YoY increase in 2024/25E. This optimism extends to the broader Chinese semiconductor sector, as local tech companies advance towards self-reliance. **Maintain BUY with TP of RMB174.**

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	4,634	3,677	4,476	5,865	7,745
YoY growth (%)	66.0%	-20.6%	21.7%	31.0%	32.0%
Gross margin (%)	57.7%	52.9%	46.3%	45.4%	45.5%
Net profit (RMB mn)	2,135	1,069	1,194	1,554	2,209
YoY growth (%)	99.0%	-49.9%	11.7%	30.1%	42.1%
EPS (RMB)	4.01	2.00	2.24	2.91	4.14
PE (x)	37.6	75.3	67.3	51.8	36.4
ROE (%)	27.9%	12.3%	12.2%	13.8%	16.5%

Source: Company data, Bloomberg, CMBIGM estimates

招銀国际
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A Wholly Owned Subsidiary Of China Merchants Bank

BUY (Maintain)

Target Price	**RMB174.0**
(Previous TP	RMB174.0)
Up/Downside	**+27.2%**
Current Price	**RMB136.8**

China Semiconductor Sector

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Stock Data

Mkt Cap (RMBmn)	73,034.5
Avg 3 mths t/o (RMBmn)	788.2
52w High/Low (RMBmn)	150.70/88.64
Total Issued Shares (mn)	533.8

Source: FactSet

Shareholding Structure

WX HUIZHI UNITED INV	11.5%
Feng Chenhui	7.6%

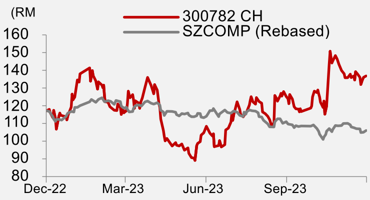
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-4.6%	-2.6%
3-mth	9.3%	14.4%
6-mth	30.7%	39.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

Related Reports

4. "Maxscend (300782 CH) – Impressive 3Q results; Maintain BUY" – 1 Nov 2023 (link)

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**4,634**	**3,677**	**4,476**	**5,865**	**7,745**
Cost of sales	(1,959)	(1,732)	(2,404)	(3,202)	(4,222)
Gross profit	**2,675**	**1,946**	**2,072**	**2,663**	**3,523**
Selling exp	(45)	(30)	(32)	(42)	(55)
Admin exp	(53)	(109)	(155)	(174)	(207)
R&D exp	(304)	(449)	(561)	(630)	(715)
Other operating exp.	8	6	0	0	0
Operating profit	**2,281**	**1,363**	**1,324**	**1,818**	**2,546**
Finance costs	(12)	35	34	37	58
Other non-oper exp.	146	(309)	(116)	(96)	(105)
Pre-tax profit	**2,415**	**1,089**	**1,242**	**1,758**	**2,500**
Income tax expense	(280)	(11)	(50)	(206)	(293)
Net profit	**2,135**	**1,078**	**1,193**	**1,552**	**2,206**
Minority interests	(0)	9	(2)	(2)	(3)
Net profit to shareholders	**2,135**	**1,069**	**1,194**	**1,554**	**2,209**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Net profit	2,135	1,078	1,193	1,552	2,206
Depreciation	47	90	175	272	358
Amortization of Intangibles	3	9	(4)	(29)	(70)
Change in working capital	(1,086)	(518)	227	338	(378)
Others	51	283	(735)	(353)	(435)
Net cash from operating	**1,150**	**942**	**857**	**1,781**	**1,680**
Capex	(2,858)	(1,711)	(1,033)	(942)	(846)
Other	(497)	92	(91)	(70)	(35)
Net cash from investing	**(3,356)**	**(1,619)**	**(1,125)**	**(1,012)**	**(881)**
Dividend paid	(185)	(234)	(93)	(104)	(136)
Other	2,965	1	11	12	13
Net cash from financing	**2,780**	**(233)**	**(82)**	**(93)**	**(123)**
Net change in cash	**574**	**(910)**	**(350)**	**676**	**676**
Cash at beginning of the year	1,475	2,020	1,214	879	1,569
Exchange difference	(29)	104	15	15	15
Cash at the end of the year	**2,020**	**1,214**	**879**	**1,569**	**2,260**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Current assets	**4,980**	**3,588**	**3,475**	**3,977**	**5,451**
Cash & equivalents	2,661	1,277	967	1,657	2,348
Account receivables	572	400	532	561	712
Inventory	1,476	1,720	1,705	1,453	2,017
Other current assets	271	191	272	305	375
Non-current assets	**3,468**	**5,915**	**7,402**	**8,383**	**9,319**
PPE	246	2,043	3,110	3,939	4,546
Construction In Progress-	766	2,496	2,196	1,919	1,643
Deferred tax assets	23	69	104	118	141
Other non-current assets	2,433	1,308	1,992	2,407	2,989
Total assets	**8,448**	**9,504**	**10,877**	**12,359**	**14,770**
Current liabilities	**752**	**721**	**841**	**818**	**1,082**
ST borrowings	0	0	-2	1	5
Account payables	376	476	643	585	803
Tax payable	298	136	85	96	115
Other current liabilities	78	109	114	136	159
Non-current liabilities	**62**	**98**	**227**	**258**	**308**
LT borrowings	0	0	0	0	0
Deferred tax liability	60	67	95	108	129
Other non-current liabilities	1	31	132	150	179
Total liabilities	**813**	**819**	**1,068**	**1,076**	**1,390**
Share capital	334	534	534	534	534
Reserve	3,689	3,523	3,523	3,523	3,523
Retained earnings	3,428	4,334	5,438	6,891	8,969
Other	191	291	314	336	359
Minority interest	-8	3	1	-1	-5
Total equity	**7,634**	**8,685**	**9,810**	**11,283**	**13,380**
Total liabilities and equity	**8,448**	**9,504**	**10,877**	**12,359**	**14,770**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue mix					
RFFE discrete	72.3%	67.7%	63.1%	55.6%	48.3%
RFFE module	25.9%	30.4%	35.3%	42.9%	50.3%
Other	1.7%	1.6%	1.6%	1.5%	1.4%
Growth (%)					
Revenue	66.0%	-20.6%	21.7%	31.0%	32.0%
Gross profit	82.1%	-27.3%	6.5%	28.5%	32.3%
Net profit	99.0%	-49.9%	11.7%	30.1%	42.1%
Profit & loss ratio (%)					
Gross margin	57.7%	52.9%	46.3%	45.4%	45.5%
Net profit margin	46.1%	29.1%	26.7%	26.5%	28.5%
Balance sheet ratio					
Net debt/total equity (%)	Net	Net	Net	Net	Net
Current ratio (x)	6.6	5.0	4.1	4.9	5.0
Receivable turnover days	36	48	38	34	30
Inventory turnover days	196	337	260	180	150
Payable turnover days	56	90	85	70	60
Profitability (%)					
ROE	27.9%	12.3%	12.2%	13.8%	16.5%
ROA	25.3%	11.3%	11.0%	12.6%	15.0%
Per share data (RMB)					
EPS	4.01	2.00	2.24	2.91	4.14
Adj. EPS	6.42	2.00	2.24	2.91	4.14
DPS	0.70	0.17	0.17	0.17	0.17
BPS	22.97	16.26	18.38	21.14	25.08

Source: Company data, CMBIGM estimates

Xiaomi (1810 HK)

Accelerated progress on premiumization, all eyes on EV launch in 1H24E

We maintain our positive view on Xiaomi given continued earnings recovery, strong GPM on smartphone/AIoT, resilient smartphone and recovery in advertising/overseas internet business. We believe market concerns over channel destocking, Huawei's comeback and uncertainties in India are overdone. We expect Xiaomi's premiumization strategy and overseas expansion to drive its smartphone business into new growth phase with further market share gain. We are also optimistic about Xiaomi's established smart hardware ecosystem that will become key competitive edge for its upcoming smart EV product. Reiterate BUY with TP of HK$ 20.25, based on 24x FY24E P/E.

- **Smartphone recovery better-than-expected, positive on global share gain.** Xiaomi's shipment increased 2% YoY in 3Q23 (vs. -1% YoY for industry) with market share of 14% (No. 1 among Chinese brands), based on Canalys. Xiaomi's strong smartphone shipment was mainly boosted by share gain in emerging markets and stabilizing demand in India. The ASP decline of 5.8% YoY was mainly due to higher sales of lower-ASP models in emerging markets, partially offset by better ASP in China. Looking into 4Q23E, we are positive on seasonal demand pull-in, outstanding sales from Xiaomi 14 and double-11 sales events. We expect Xiaomi's shipment to decline 4% YoY to 143.8mn in FY23E and rebound 8%/3% YoY to 155mn/160mn in FY24/25E.
- **Positive on 1H24 EV launch and AIoT smart ecosystem outlook.** Xiaomi is set to officially launch its EV product in 1H24E. We believe Xiaomi is well positioned to capture this growth opportunity given its strength in supply chain, established hardware ecosystem, strong branding and auto intelligent system technologies. We think the distinct AIoT ecosystem will serve as a key competitive edge for Xiaomi's EV product backed by "human-vehicle-home" fully connected smart life experience.
- **Reiterate BUY; Eye on EV launch and further global smartphone share gain.** We believe Xiaomi is on track to launch smart EV product in 1H24E, which will become the major catalyst in coming months. Our TP of HK$ 20.25 is based on the same 24x FY24E P/E (5-year hist. avg.). Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	328,309	280,044	269,916	304,862	338,621
YoY growth (%)	33.5	(14.7)	(3.6)	12.9	11.1
Net income (RMB mn)	22,039	8,518	17,954	19,170	20,717
EPS (RMB)	0.88	0.34	0.72	0.77	0.83
YoY growth (%)	63.1	(61.2)	110.8	6.8	8.1
Consensus EPS (RMB)	N/A	N/A	0.69	0.67	0.75
P/E (x)	26.8	30.7	18.3	17.1	15.9
P/B (x)	3.8	1.8	2.1	1.9	1.7
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	14.8	1.8	10.6	9.4	9.4
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$20.25**
(Previous TP	HK$20.25)
Up/Downside	**+36.1%**
Current Price	**HK$14.88**

China Technology Sector

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Stock Data

Mkt Cap (HK$ mn)	329,134
Avg 3 mths t/o (HK$ mn)	1,303.3
52w High/Low (HK$)	16.80/9.34
Total Issued Shares (mn)	20342.0

Source: Bloomberg

Shareholding Structure

Lin Bin	8.7%
Smart Mobile Holdings Ltd	8.7%
Vanguard	2.9%

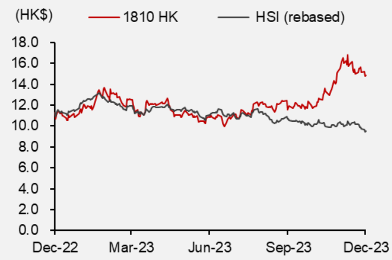
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-4.2%	4.5%
3-mth	26.5%	41.8%
6-mth	37.0%	59.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

5. Xiaomi (1810 HK): 3Q23 beat on GPM and resilient smartphone; Reiterate BUY on EV upside in FY24E-21 Nov 2023 (link)
6. Xiaomi (1810 HK): 3Q23E preview: Resilient smartphone sales with margin expansion; maintain BUY – 3 Nov 2023 (link)

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	328,309	280,044	269,916	304,862	338,621
COGS	(270,048	(232,467	(212,419	(241,708	(268,375
Gross Profit	58,261	47,577	57,286	63,155	70,246
Selling expense	(20,981)	(21,323)	(19,003)	(22,255)	(24,719)
Admin expense	(4,739)	(5,114)	(5,083)	(5,792)	(6,095)
R&D expense	(13,167)	(16,028)	(18,745)	(20,426)	(22,688)
Other income	6,654	(2,295)	4,214	4,214	4,214
EBIT	26,029	2,816	18,669	18,895	20,958
Net Interest income	(1,612)	1,117	1,525	1,525	1,525
Others					
Pre-tax profit	24,417	3,934	20,194	20,420	22,482
Income tax	(5,134)	(1,431)	(4,533)	(5,105)	(5,621)
Minority interest	(56)	29	(48)	175	192
Net profit	19,339	2,474	15,709	15,140	16,670
Adjusted net profit	22,039	8,518	17,954	19,170	20,717

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	24,417	3,934	20,194	20,420	22,482
Depreciation& amortization	3,062	2,182	2,745	3,381	4,087
Change in working capital	(15,725	(15,675	7,030	(8,354)	6,954
Others	(1,968)	5,169	(4,533)	(5,105)	(5,621)
Net cash from operations	9,785	(4,390)	25,436	10,342	27,903
Capital expenditure	(7,134)	(5,782)	(5,398)	(6,097)	(6,772)
Others	(37,874	21,331			
Net cash from investing	(45,008	15,549	(5,398)	(6,097)	(6,772)
Net borrowings	9,227	(2,791)			
Dividend payout					
Others	(4,729)	(5,063)			
Net cash from financing	4,499	(7,855)			
Net change in cash	(30,724	3,304	20,037	4,245	21,131
Cash at the beginning of	55,580	24,339	27,607	47,645	51,889
Exchange difference	(517)	791			
Cash at the end of year	24,339	27,607	47,645	51,889	73,020

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**107,040**	**113,092**	**115,746**	**118,462**	**121,148**
PP&E	6,965	9,138	11,792	14,508	17,194
Deferred income tax	1,662	2,278	2,278	2,278	2,278
Intangibles	5,579	4,630	4,630	4,630	4,630
Other non-current	92,835	97,046	97,046	97,046	97,046
Current assets	**185,851**	**160,415**	**177,386**	**201,208**	**217,990**
Cash & equivalents	23,512	27,607	47,645	51,889	73,020
Account receivables	17,986	11,795	15,197	15,290	18,572
Inventories	52,398	50,438	43,971	63,455	55,823
ST bank deposits	31,041	29,875	29,875	29,875	29,875
Other current assets	60,915	40,700	40,700	40,700	40,700
Current liabilities	**115,727**	**89,628**	**93,592**	**104,815**	**107,421**
Short-term borrowings	5,527	2,151	2,151	2,151	2,151
Account payables	74,643	53,094	57,058	68,281	70,887
Tax payable	2,335	1,384	1,384	1,384	1,384
Other current liabilities	33,222	32,999	32,999	32,999	32,999
Non-current liabilities	**39,732**	**39,957**	**39,957**	**39,957**	**39,957**
Long-term borrowings	20,720	21,493	21,493	21,493	21,493
Deferred tax liabilities	1,203	983	983	983	983
Other non-current	17,809	17,480	17,480	17,480	17,480
Minority interest	**220**	**265**	**216**	**391**	**583**
Total equity	**137,432**	**143,923**	**159,584**	**174,899**	**191,761**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue mix (%)					
Smartphone	64	60	57	57	57
AIoT	26	28	30	31	31
Internet	9	10	11	10	10
Others	2	2	1	1	2
P&L ratios（%)					
Gross margin	17.7	17.0	21.2	20.7	20.7
Operating margin	7.9	1.0	6.9	6.2	6.2
Net margin	5.9	0.9	5.8	5.0	4.9
Growth（%)					
Revenue	33.5	(14.7)	(3.6)	12.9	11.1
Gross profit	58.5	(18.3)	20.4	10.2	11.2
Operating profit	8.3	(89.2)	562.8	1.2	10.9
Adjusted net profit	69.5	(61.4)	110.8	6.8	8.1
Returns（%)					
ROE	16.0	5.9	11.3	11.0	10.8
ROA	6.6	0.9	5.4	4.7	4.9
Per Share (RMB)					
EPS (RMB)	0.88	0.34	0.72	0.77	0.83
DPS (RMB)	-	-	-	-	-

Source: Company data, CMBIGM estimates

BYDE (285 HK)

Android recovery; NEV business to accelerate growth

SUMMARY. BYDE's strong 3Q23 result is driven by fast-growing NEV/new intelligent products business, Android recovery, Apple share gain and product upgrade. Looking forward, we are positive on Android upside, NEV and new intelligent products, overseas customers expansion and synergy effect from Jabil's mobile biz acquisition to drive growth in FY24/25E. The stock now trades at 17.3x/13.8x FY23/24E P/E, which is attractive in our view. Reiterate BUY.

- **9M23 in-line; Jabil's mobile biz acquisition on track.** BYDE's 9M23 NP growth of 146% YoY is in-line with expectations and 3Q GPM improved 1.7ppts to 9.7% thanks to better product mix, rising sales of high-margin segments such as energy storage and NEV, and improving UTR given high-end Android order recovery. In addition, acquisition of Jabil's mobile business is well on track and we expect significant sales contribution to component biz.
- **Positive on Android recovery, Jabil's mobile biz acquisition to boost component sales and NEV biz fast growth.** We expect flattish revenue in 4Q23E due to seasonality effect. Looking into 2024, we are positive on casing ASP hike on Android titanium adoption and we expect steady recovery on Android assembly given high order visibility in 2024. In addition, we are positive on Jabil's mobile biz acquisition to create synergies with current component biz and we expect continuous share gain across Apple's product categories. Given sales potential in high-end Apple smartphone, we expect the acquisition will boost component biz sales outlook once the acquisition is completed. As for NEV biz, we are positive on high-level computing-powered ADAS, active suspension products and parentco orders to drive fast growth.
- **Catalysts: rising assembly UTR, NEV new products and Jabil's mobile biz capacity ramp-up.** BYDE's current assembly capacity is tight and we expect UTR will improve going forward. Given BYDE's large R&D investment in its automotive biz, we are positive on NEV new products roadmap and rising penetration of new NEV products in external customers. In addition, we expect production efficiency improvement for Jabil's mobile biz and strong customer orders will drive capacity ramp-up.
- **Valuation/Key risks.** We expect 4Q revenue/NP to grow 4%/49% YoY which is normalized given high base in 4Q22. We are positive on Android biz upside and NEV biz growth to accelerate. The stock now trades at 17.3x/13.8x FY23/24E P/E, which is attractive in our view. Reiterate BUY.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	89,057	107,186	129,576	151,936	179,241
YoY growth (%)	21.8	20.4	20.9	17.3	18.0
Net income (RMB mn)	2,309.9	1,857.6	3,968.1	4,971.1	6,493.3
EPS (RMB)	1.03	0.82	1.76	2.21	2.88
Consensus EPS (RMB)	na	0.00	1.59	2.10	2.74
P/E (x)	32.2	22.1	16.7	13.3	10.2
P/B (x)	3.1	1.6	2.2	1.9	1.7
Yield (%)	0.3	0.9	0.3	0.8	1.0
ROE (%)	10.0	7.5	14.4	15.6	17.6
Net gearing (%)	0.0	0.0	0.0	0.0	0.0

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$44.23**
(Previous TP	HK$44.23)
Up/Downside	**+38.2%**
Current Price	**HK$32.00**

China Technology Sector

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Stock Data

Mkt Cap (HK$ mn)	72,102.5
Avg 3 mths t/o (HK$ mn)	204.2
52w High/Low (HK$)	39.95/20.20
Total Issued Shares (mn)	2253.2

Source: Bloomberg

Shareholding Structure

Golden Link Worldwide Ltd	65.8%
Gold Dragonfly Ltd	5.0%

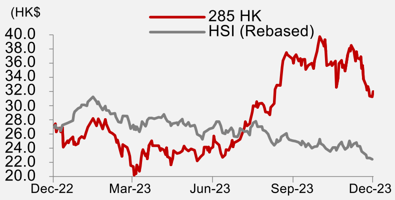
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-8.3%	-3.7%
3-mth	-11.1%	-2.1%
6-mth	32.5%	57.0%

Source: Bloomberg

12-mth Price Performance



Source: Factset

Financial Summary

Income statement

	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**89,057**	**107,18**	**129,57**	**151,93**	**179,24**
COGS	(83,028	(100,83	(119,12	(139,15	(163,23
Gross profit	**6,029**	**6,350**	**10,455**	**12,782**	**16,010**
Selling and marketing	(275)	(535)	(657)	(760)	(896)
Administrative	(1,041)	(1,235)	(1,291)	(1,519)	(1,792)
R&D	(3,308)	(3,969)	(5,321)	(6,001)	(7,080)
Operating profit	**1,405**	**611**	**3,185**	**4,502**	**6,241**
Other income/(losses)	1,104	1,386	1,272	1,272	1,272
Pre-tax profit	**2,465**	**1,939**	**4,365**	**5,681**	**7,421**
Tax	(155)	(81)	(397)	(710)	(928)
Minority interest	0	0	0	0	0
Net profit	**2,310**	**1,858**	**3,968**	**4,971**	**6,493**

Cash flow summary

	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**2,465**	**1,939**	**4,365**	**5,681**	**7,421**
D&A	1,717	1,987	2,314	2,697	3,148
Change in working capital	(2,228)	2,568	(5,673)	19	(4,091)
Others	(187)	(124)	(304)	(618)	(835)
Net cash from operating	**1,768**	**6,370**	**701**	**7,779**	**5,644**
Capex	(3,206)	(3,859)	(4,665)	(5,470)	(6,453)
Other	0	0	0	0	0
Net cash from investing	**(3,206)**	**(3,859)**	**(4,665)**	**(5,470)**	**(6,453)**
Dividend paid	(232)	(372)	(198)	(497)	(649)
Other	(43)	(59)	(93)	(93)	(93)
Net cash from financing	**(275)**	**(430)**	**(291)**	**(590)**	**(742)**
Cash at beginning of the year	3,466	2,825	6,258	2,003	3,723
Exchange difference	1,072	1,352	0	0	0
Cash at the end of the year	**2,825**	**6,258**	**2,003**	**3,723**	**2,172**

Balance sheet

	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**12,314**	**15,006**	**17,244**	**19,765**	**22,769**
PPE	11,182	12,941	15,404	18,177	21,481
Deferred income tax	201	481	481	481	481
Other non-current assets	931	1,583	1,359	1,107	807
Current assets	**27,630**	**40,488**	**37,624**	**46,732**	**49,273**
Cash & equivalents	2,825	6,244	2,003	3,723	2,172
Account receivables	9,240	10,471	13,304	17,083	18,765
Inventories	10,567	17,046	15,590	19,199	21,609
Other current assets	0	0	0	0	0
Current liabilities	**16,220**	**30,143**	**25,845**	**33,252**	**33,254**
Borrowing	0	0	0	0	0
Financing lease payable	11,724	22,002	17,705	25,112	25,113
Account payables	184	363	363	363	363
Other payables	4,312	7,777	7,777	7,777	7,777
Non-current liabilities	**928**	**1,216**	**1,216**	**1,216**	**1,216**
Deferred income	150	231	231	231	231
Others	404	395	395	395	395
Minority interest	0	0	0	0	0
Net asset	**22,272**	**24,027**	**25,635**	**29,531**	**34,005**
Shareholders' equity	**22,272**	**24,027**	**25,635**	**29,531**	**34,005**

Key ratios

	FY21A	FY22A	FY23E	FY24E	FY25E
Profit & loss ratio					
Gross margin	6.8	5.9	8.1	8.4	8.9
Operating margin	1.6	0.6	2.5	2.8	3.3
Net profit margin	2.6	1.7	3.1	3.1	3.4
Effective tax rate	28.5	26.5	28.6	28.7	28.1
Balance sheet ratio					
Current ratio (x)	1.7	1.3	1.5	1.4	1.5
Quick ratio (x)					
Receivable turnover days	48	34	33	37	37
Inventory turnover days	38	50	50	46	46
Payable turnover days	44	61	61	56	56
Profitability (%)					
ROE	9.6	7.2	13.4	13.8	15.6
ROA	5.6	3.3	7.0	6.8	8.3
Per share data(RMB)					
EPS(RMB)	1.03	0.82	1.76	2.07	2.72
Dividend per share(RMB)	0.10	0.17	0.09	0.21	0.27
BPS (RMB)	10.66	11.38	13.11	14.97	17.42

Source: Company data, CMBIGM estimates

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Innovent (1801 HK)

Leader in China GLP-1 market

- **Strong sales growth momentum with improving operating efficiency**. In 3Q23, Innovent's product sales increased 45%+ YoY to over RMB1.6bn. The product sales in 9M23 reached RMB4.1bn, +29% YoY. According to Eli Lilly, in 3Q23, sales of sintilimab grew strongly by 11% QoQ or 50% YoY, amid a challenging operating environment in China, which was mainly thanks to the broad NRDL coverage and wide hospital channel penetration. Innovent's gross margin increased by 2.2ppt to 80.8% in 1H23. Innovent further improved its operating efficiency in 1H23, with the SG&A ratio decreasing to 64.6% in 1H23 (vs 80.8% in 1H22).
- **Mazdutide to become BIC GLP-1 drug for obesity in China**. Innovent released Ph2 48-week results of mazdutide (9mg) in Chinese obesity patients (link). After 48 weeks of treatment, the placebo-adjusted mean percent change in body weight was -18.6% (-17.8kg). Recall that at week 24, mazdutide (9mg) met the primary endpoint of its Ph2 trial, showing 15.4% placebo-adjusted weight loss (vs 12.0% for tirzepatide 15mg and 8.0% for semaglutide, in cross-trial comparison, CMBI report link). Mazdutide showed global BIC efficacy potential with the highest placebo-adjusted weight loss among GLP-1 drugs in Chinese subjects. Tirzepatide realized 17.4% (15mg) and 11.5% (10mg) placebo-adjusted weight loss at week 48 in its China Ph3 trial (link) and semaglutide showed 9.9% weight loss in its Asian Ph3 trial (link) at week 44. Mazdutide was overall well-tolerated, with no AE-led drop-out, or SAE observed at week 48 in the Ph2 trial. Meanwhile, in tirzepatide and semaglutide's China/Asian trials, 2.9% (tirzepatide 10mg), 7.0% (tirzepatide 15mg) and 2.8% (semaglutide) discontinued due to AE, and the rates of SAE were 4.3%, 11.3% and 5.2%, respectively. The heart rate increase in mazdutide group was similar to placebo after 24 weeks of treatment, with no further increase till week 48.
- **Front-runner in China GLP-1 market with NDA submission shortly**. Innovent expects to submit the NDA of mazdutide (6mg) for obesity to NMPA in late 2023 or early 2024, and to initiate a Ph3 obesity study (9mg) by end-2023. Additionally, mazdutide demonstrated significant improvement in multiple cardiometabolic indicators (i.e. blood pressure, liver enzyme, LDL-C, triglyceride, and serum uric acid, etc). After 24-week treatment, mazdutide reduced subjects' liver fat content by 73.3% (vs -6.5% in placebo). Innovent will initiate a trial of mazdutide for NASH with the IND already approved.
- **Maintain BUY**. We see large commercial potential in mazdutide. Our DCF-based TP is HK$57.35 (WACC: 9.6%, terminal growth rate: 4.0%).

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	4,270	4,556	5,620	6,558	9,435
YoY growth (%)	11.1	6.7	23.3	16.7	43.9
Net profit (RMB mn)	(2,729)	(2,179)	(1,656)	(1,003)	(221)
EPS (Reported) (RMB)	(1.87)	(1.43)	(1.08)	(0.65)	(0.14)
R&D expenses (RMB mn)	(2,323)	(2,871)	(2,200)	(2,295)	(2,831)
CAPEX (RMB mn)	(1,066)	(897)	(500)	(400)	(300)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$57.35**
Up/Downside	**+26.6%**
Current Price	**HK$45.3**

China Healthcare Sector

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Stock Data

Mkt Cap (HK$ mn)	69,821.6
Avg 3 mths t/o (HK$ mn)	471.4
52w High/Low (HK$)	48.45/27.60
Total Issued Shares (mn)	1534.5

Source: Bloomberg

Shareholding Structure

Temasek Holdings	7.9%
Yu De-Chao Michael	6.9%

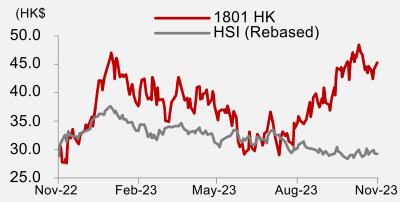
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	1.1%	1.4%
3-mth	30.9%	36.8%
6-mth	20.5%	28.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte
Website: www.innoventbio.com

Financial Summary

Income statement

YE 31 Dec (RMB mn)	2021A	2022A	2023E	2024E	2025E
Revenue	**4,270**	**4,556**	**5,620**	**6,558**	**9,435**
Cost of goods sold	(505)	(931)	(1,068)	(1,213)	(1,698)
Gross profit	**3,764**	**3,625**	**4,552**	**5,345**	**7,737**
Operating expenses	**(6,406)**	**(5,796)**	**(6,208)**	**(6,348)**	**(7,958)**
Selling expense	(2,620)	(2,591)	(2,810)	(2,754)	(3,397)
Admin expense	(806)	(835)	(787)	(853)	(1,132)
R&D expense	(2,323)	(2,871)	(2,200)	(2,295)	(2,831)
Others	(657)	502	(411)	(446)	(599)
Pre-tax profit	**(2,642)**	**(2,170)**	**(1,656)**	**(1,003)**	**(221)**
Income tax	(87)	(9)	0	0	0
Minority interest	0	0	0	0	0
Net profit	**(2,729)**	**(2,179)**	**(1,656)**	**(1,003)**	**(221)**

Cash flow summary

YE 31 Dec (RMB mn)	2021A	2022A	2023E	2024E	2025E
Operating					
Profit before taxation	**(2,555)**	**(2,162)**	**(1,656)**	**(1,003)**	**(221)**
Depreciation & amortization	165	245	262	271	273
Tax paid	(87)	(9)	0	0	0
Change in working capital	(90)	295	(68)	157	16
Others	951	(327)	1,036	1,147	1,250
Net cash from operations	**(1,616)**	**(1,958)**	**(425)**	**573**	**1,318**
Investing					
Capital expenditure	(1,066)	(897)	(500)	(400)	(300)
Acquisition of subsidiaries/ investments	(38)	(79)	0	0	0
Net proceeds from disposal of short-term investments	(12,121)	(10,603)	0	0	0
Others	10,527	10,143	166	160	172
Net cash from investing	**(2,698)**	**(1,435)**	**(334)**	**(240)**	**(128)**
Financing					
Dividend paid	0	0	0	0	0
Net borrowings	1,208	715	0	0	0
Proceeds from share	3,951	2,131	0	0	0
Others	(155)	46	(115)	(115)	(116)
Net cash from financing	**5,003**	**2,892**	**(115)**	**(115)**	**(116)**
Net change in cash					
Cash at beginning of year	7,764	8,377	9,163	8,288	8,505
Exchange difference	(197)	119	0	0	0
Cash at end of year	**8,377**	**9,163**	**8,288**	**8,505**	**9,580**

Balance sheet

YE 31 Dec (RMB mn)	2021A	2022A	2023E	2024E	2025E
Current assets	**11,551**	**11,507**	**10,673**	**10,773**	**11,968**
Cash & equivalents	8,377	9,163	8,288	8,505	9,580
Account receivables	968	575	875	931	1,211
Inventories	1,347	1,429	1,170	997	838
Financial assets at FVTPL	645	3	3	3	3
Other current assets	213	337	337	337	337
Non-current assets	**4,693**	**6,082**	**6,288**	**6,385**	**6,380**
PP&E	2,693	3,411	3,649	3,778	3,805
Intangibles	772	1,198	1,198	1,198	1,198
Other non-current assets	1,228	1,472	1,441	1,409	1,377
Total assets	**16,244**	**17,589**	**16,961**	**17,159**	**18,348**
Current liabilities	**3,050**	**3,499**	**3,472**	**3,513**	**3,648**
Short-term borrowings	365	888	888	888	888
Account payables	195	326	299	339	475
Tax payable	61	3	3	3	3
Other current liabilities	2,429	2,282	2,282	2,282	2,282
Non-current liabilities	**2,863**	**3,360**	**3,371**	**3,381**	**3,392**
Long-term borrowings	2,023	2,215	2,215	2,215	2,215
Obligations under finance	86	99	110	120	131
Other non-current liabilities	754	1,046	1,046	1,046	1,046
Total liabilities	**5,913**	**6,859**	**6,843**	**6,894**	**7,041**
Share capital	0	0	0	0	0
Other reserves	10,330	10,730	10,119	10,264	11,307
Total shareholders equity	**10,330**	**10,730**	**10,119**	**10,264**	**11,307**
Minority interest	0	0	0	0	0
Total equity and liabilities	**16,244**	**17,589**	**16,961**	**17,159**	**18,348**

Key ratios

YE 31 Dec	2021A	2022A	2023E	2024E	2025E
Profit & loss ratios (%)					
Gross margin	88	80	81	82	82
EBITDA margin	(59)	(39)	(25)	(11)	0
Net margin	(64)	(48)	(29)	(15)	(2)
Effective tax rate (%)	(3)	(0)	0	0	0
Balance sheet ratios					
Current ratio (x)	4	3	3	3	3
Trade receivables turnover	62	62	57	52	47
Trade payables turnover	114	102	102	102	102
Total debt to asset ratio (%)	36	39	40	40	38
Returns (%)					
ROE	(26)	(20)	(16)	(10)	(2)
ROA	(17)	(12)	(10)	(6)	(1)
Per share data					
EPS (RMB)	(1.9)	(1.4)	(1.1)	(0.7)	(0.1)
DPS (RMB)	0.0	0.0	0.0	0.0	0.0
BVPS (RMB)	7.1	7.0	6.6	6.7	7.4

Source: Company data, CMBIGM estimates

Mindray (300760 HK)

Establishing global commercial network

As a leader in China's medical device industry, Mindray has demonstrated business resilience amid the fluctuated operating environment. Since this August, the bidding process at China public hospitals has been delayed, resulting in a decrease in the purchase of medical equipment. However, Mindray still achieved solid growth in 3Q. In 9M23, Mindray's revenue/ attributable net profit were RMB27.3/ 9.8bn, up 17.2%/ 21.4% YoY, respectively.

- **Provincial VBPs to boost Mindray's market share gain in China's IVD industry.** In November 2023, Anhui Province led the VBP of CLIA and molecular test reagents across 25 provinces. According to the tender rules, any product/set entered with a 50%+ price discount will win the tender. Previous provincial IVD VBPs such as the VBP of CLIA reagents in Anhui and the VBP of biochemical reagents for liver function in 23 provinces alliance all enabled Mindray to gain market share. Therefore, we expect the upcoming IVD VBPs will further speed up Mindray's penetration into Class III hospitals and drive the long-term growth of revenue from IVD segment.
- **M&As to accelerate breakthroughs in high-end products.** Mindray actively seeks M&A opportunities to strengthen its R&D capabilities and overseas sales and service network. For example, Mindray acquired ZONARE in 2013 and reinforced its high-end ultrasound R&D capability. In 2023, Mindray launched the first domestic ultra-high-end ultrasound, Resona A20. The acquisition of HyTest in 2021 bolstered Mindray's capability to develop cutting-edge IVD reagents and narrowed the technology gap between Mindray and MNCs. In 2023, Mindray launched the high-sensitivity troponin I (hs-cTnI) and NT-proBNP cardiac biomarkers, which expanded its portfolio for CVDs diagnosis. The enhanced high-end product lines will accelerate Mindray's penetration into high-end customers, in our view. Mindray agreed to acquire DiaSys in 2023, which is expected to effectively improve the Company's overseas supply chain platform and to drive the breakthrough in key overseas customers such as laboratories with medium/ large sample volumes.
- **Rapid overseas revenue growth.** The overseas revenue increased by 14.2% YoY to RMB10.2bn in 9M23 and logged 23.0% YoY growth and over 20% QoQ growth for 3Q23. With improving overseas supply platform and enhanced brand recognition, we expect Mindray's overseas business to maintain strong growth momentum.
- **Maintain BUY.** We see solid earnings growth for Mindray in the long term. We derived our DCF-based TP as RMB383.43 (WACC: 9.0%, terminal growth rate: 3.0).

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	25,270	30,366	35,654	42,817	51,366
YoY Growth (%)	20.2	20.2	17.4	20.1	20.0
Net profit (RMB mn)	8,004.0	9,610.7	11,615.5	13,869.4	16,585.5
YoY Growth (%)	20.2	20.1	20.9	19.4	19.6
P/E (x)	40.4	33.5	27.8	23.2	19.4
P/B (x)	12.0	10.1	8.7	7.5	6.5
Net gearing (%)	(57.0)	(72.5)	(71.0)	(72.0)	(73.2)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	RMB383.43
(Previous TP	RMB380.03)
Up/Downside	+35.4%
Current Price	RMB283.20

China Healthcare Sector

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Stock Data

Mkt Cap (HK$ mn)	339,229
Avg 3 mths t/o (HK$ mn)	1,143.78
52w High/Low (HK$)	353.00/ 253.48
Total Issued Shares (mn)	1,212

Source: Bloomberg

Shareholding Structure

ABC	22.9%
DEF	22.4%
GHIJ	8.0%

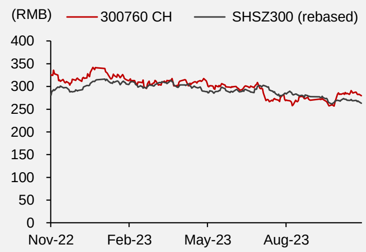
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	10.3%	9.5%
3-mth	1.9%	6.8%
6-mth	-10.8%	-2.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Financial Summary

Income statement

YE Dec 31 (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**25,270**	**30,366**	**35,654**	**42,817**	**51,366**
PMS	11,153	13,401	15,893	18,357	21,110
IVD	8,449	10,256	12,366	15,457	19,321
Medical Imaging	5,426	6,464	7,157	8,660	10,435
Other Products	230	233	203	304	456
Others	12	12	35	39	42
Cost of sales	-8,843	-10,885	-12,188	-14,670	-17,644
Gross profit	**16,427**	**19,480**	**23,466**	**28,147**	**33,722**
Business taxes	-282	-348	-409	-491	-589
Selling & distribution	-3,999	-4,802	-5,526	-6,637	-7,936
Administrative expenses	-1,106	-1,320	-1,604	-1,905	-2,260
R&D expenses	-2,524	-2,923	-3,494	-4,196	-5,034
Finance costs, net	86	451	484	560	662
Other gains and losses,	464	452	320	320	320
Operating profit	**9,066**	**10,991**	**13,236**	**15,798**	**18,884**
Non-operating income	23	35	35	35	35
Non-operating expenses	-72	-72	-72	-72	-72
Pre-tax profit	**9,017**	**10,954**	**13,199**	**15,761**	**18,847**
Income tax	-1,013	-1,343	-1,584	-1,891	-2,262
Minority interests	-2	-4	-4	-5	-6
Attributable net profit	**8,002**	**9,607**	**11,611**	**13,864**	**16,579**

Cash flow summary

YE Dec 31 (Rmb mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total net profit	**8,004**	**9,611**	**11,616**	**13,869**	**16,586**
D&A	717	911	978	1,115	1,239
Change in working capital	328	1,524	-225	-933	-1,115
Investment loss (gain)	-15	20	20	20	20
Other operating activities	-36	75	-244	-320	-422
Net cash fr. operating act.	**8,999**	**12,141**	**12,145**	**13,751**	**16,308**
Capex	-1,402	-1,916	-2,000	-2,000	-2,000
Purchase of investment	0	-37	-1,200	0	0
Other investing activities	-3,410	-1,268	265	265	265
Net cash fr. investing act.	**-4,812**	**-3,220**	**-2,935**	**-1,735**	**-1,735**
Net proceeds from shares	0	0	0	0	0
Bank borrowing	-441	0	0	0	0
Dividends and interests paid	-3,039	-4,233	-6,168	-7,452	-9,002
Other financing activities	-1,125	-961	0	0	0
Net cash fr. financing act.	**-4,605**	**-5,194**	**-6,168**	**-7,452**	**-9,002**
FX changes	-171	114	0	0	0
Net change in cash	-590	3,841	3,042	4,565	5,570
Cash at beginning of the year	15,723	15,133	23,186	26,228	30,792
Cash at the end of the year	**15,133**	**18,974**	**26,228**	**30,792**	**36,362**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**16,768**	**16,139**	**17,836**	**18,195**	**18,431**
Fixed asset	3,772	4,261	5,696	6,994	8,169
Intangible assets	2,061	1,977	1,628	1,280	932
Construction in progress	1,126	1,803	1,803	1,803	1,803
Goodwill	4,218	4,403	4,403	4,403	4,403
Other non-current assets	5,591	3,696	4,305	3,715	3,125
Current assets	**21,335**	**30,606**	**34,142**	**40,160**	**47,470**
Cash	15,361	23,186	26,228	30,792	36,362
Inventories	3,565	4,025	4,249	5,115	6,151
Trade and bills receivables	1,790	2,661	2,930	3,519	4,222
Prepayments, deposits and	238	289	289	289	289
Other current assets	380	445	445	445	445
Current liabilities	**8,629**	**11,770**	**12,039**	**12,560**	**13,184**
Borrowings	0	0	0	0	0
Trade and other payables	2,281	2,291	2,559	3,081	3,705
Other current liabilities	6,348	9,479	9,479	9,479	9,479
Non-current liabilities	**2,506**	**2,976**	**2,976**	**2,976**	**2,976**
Borrowings	0	0	0	0	0
Other non-current liabilities	2,506	2,976	2,976	2,976	2,976
Total net assets	**26,968**	**31,999**	**36,962**	**42,820**	**49,741**
Minority interest	15	18	23	28	34
Shareholders' equity	**26,953**	**31,981**	**36,940**	**42,792**	**49,707**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
PMS	44	44	45	43	41
IVD	33	34	35	36	38
Medical Imaging	21	21	20	20	20
Other Products	1	1	1	1	1
Others	0	0	0	0	0
Profit & loss ratios (%)					
Gross margin	65	64	66	66	66
EBITDA margin	38	38	38	38	38
Pre-tax margin	36	36	37	37	37
Net margin	32	32	33	32	32
Effective tax rate	11	12	12	12	12
Balance sheet ratios					
Current ratio (x)	2	3	3	3	4
Trade receivables turnover	24	27	30	30	30
Trade payables turnover days	78	77	77	77	77
Net debt to total equity ratio	Net	Net	Net	Net	Net
Returns (%)					
ROE	30	30	31	32	33
ROA	21	21	22	24	25
Per share					
EPS (RMB)	6.59	7.94	9.58	11.44	13.67

Source: Company data, CMBIGM estimates

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Kweichow Moutai (600519 CH)

Our 2024 top pick among F&B names

BUY (Maintain)

Target Price	**RMB2,219.0**
(Previous TP	RMB2,219.0)
Up/Downside	**+26.4%**
Current Price	**RMB1,751**

China Consumer

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We view Moutai's recent price hike positively, as it not only represents a supportive stance from policy-maker to foster a more balanced profits distribution along the value chain, but also a renewed driver to rejuvenate growth to the company itself when that of Series wine alone might not be able to sustain. Compared to the last price hike in 2018 that led to an 11%+ retail price surge, the latter has only gone up by 0.7% this time, according to our survey, and we believe the timing of the adjustment (amid slow season) and migration of direct sales channel, explained our observation. Given the fact that retail price for Feitian (~RMB2,900) has been well above the ex-factory price (~RMB969), the initiative unlikely comes in a total surprise to the market, and is likely very welcomed by the investment community. We are positive on Moutai and believe the initiative enables the company to deliver high-teen revenue/net profits growth for 2024 that comes in above its peer average. We are Buy-rated.

- **Moutai's price hike is the blockbuster.** Sector-wise, we think the move could break the price ceiling faced by mid-end brands and pave way for brand upgrade among tiers. Before that happens, however, we believe mid-end brands would have to eliminate excess channel inventory to ensure an effective pass-through. Of note, other bellwethers like Wuliangye and Liaojiao have already followed suits, and levied a 10-20%/4-5% price increase on "Wuliangye 8th Generation"/ "60th Edition Tequ", respectively.
- **Special dividend as a sweetener.** Moutai also announced a special dividend of RMB19.11 per share, equivalent to 37.7% of our 2023E EPS. Together with its final dividend, we estimate that Moutai will pay out 76.1% of its 2023E earnings to reward investors and align shareholders' interest.
- **Earnings change.** To reflect the price hike, we raise our 2024/25E revenue and net profits by 5% and 7% respectively.
- **Valuation.** Our TP is based on an updated 38.0x (from 39.0x) 2023E P/E that still represents 5-year average since 2018.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	109,464	127,554	147,435	179,647	201,129
YoY growth (%)	11.7	16.5	15.6	21.8	12.0
Net income (RMB mn)	52,460.1	62,716.2	73,346.8	90,831.7	102,362.2
EPS (RMB)	41.76	49.93	58.39	72.31	81.49
YoY growth (%)	12.3	19.6	17.0	23.8	12.7
Consensus EPS (RMB)	na	na	59.05	70.36	81.65
P/E (x)	47.2	36.0	30.1	24.3	21.6
P/B (x)	13.1	11.4	10.3	8.3	6.8
Yield (%)	1.1	1.2	1.4	1.8	2.0
ROE (%)	29.9	32.4	35.6	37.7	34.7
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

Stock Data

Mkt Cap (RMB bn)	2,199
Avg 3 mths t/o (RMB mn)	NA
52w High/Low (RMB)	1912.9/1628.9
Total Issued Shares (mn)	1,256.2

Source: FactSet

Shareholding Structure

China Kweichow Moutai Winery Group	54.1%
HKSC	6.9%
Guizhou State Own Capital	4.5%

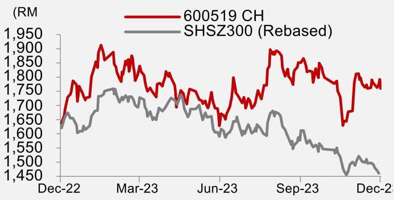
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-1.2%	1.3%
3-mth	-4.9	5.1
6-mth	7.6	17.6

Source: FactSet

12-mth Price Performance



Source: FactSet

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Financial Summary

Income Statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revnue	**109,464**	**127,554**	**147,435**	**179,647**	**201,129**
COGS	(9,157)	(10,199)	(10,875)	(11,750)	(12,714)
Gross profit	**100,307**	**117,355**	**136,560**	**167,897**	**188,415**
Operating expenses	(26,569)	(30,956)	(35,532)	(43,296)	(48,473)
Selling expenses	(18,042)	(21,794)	(25,507)	(31,080)	(34,796)
Administrative	(8,512)	(9,147)	(10,026)	(12,216)	(13,677)
Others	(15)	(15)	-	-	-
EBITDA	**75,217**	**88,010**	**102,643**	**126,554**	**142,263**
Depreciation and Amortisation	(1,345)	(1,444)	(1,615)	(1,952)	(2,321)
Others	(135)	(168)	-	-	-
EBIT	**73,738**	**86,399**	**101,028**	**124,602**	**139,942**
Interest income	945	1,475	1,377	1,490	1,863
Interest expense	(14)	(12)	-	-	-
Other income/expense	(141)	(161)	(229)	(232)	(236)
Pre-tax profit	**74,528**	**87,701**	**102,176**	**125,859**	**141,568**
Income tax	(18,808)	(22,326)	(26,011)	(32,040)	(36,039)
Minority interest	(3,260)	(2,659)	(2,818)	(2,987)	(3,167)
Net Profit	**52,460**	**62,716**	**73,347**	**90,832**	**102,362**

Cash flow summary

YE 31 Dec (RMB	FY21A	FY22A	FY23E	FY24E	FY25E
Pre-tax profit	**74,528**	**87,701**	**102,176**	**125,859**	**141,568**
Depreciation & amortization	1,480	1,611	1,615	1,952	2,321
Tax paid	(18,808)	(22,326)	(26,011)	(32,040)	(36,039)
Change in working capital	7,860	(29,127)	(477)	(672)	(624)
Others	(1,032)	(1,163)	-	-	-
Net cash from operations	**64,029**	**36,699**	**77,303**	**95,099**	**107,226**
Capital	(3,409)	(5,307)	(6,134)	(7,474)	(8,367)
Acquisition of	2	0	-	-	-
Net proceeds from	(2,150)	(210)	-	-	-
Others	(6)	(21)	(1,031)	(1,031)	(1,031)
Net cash from investing	**(26,564)**	**(57,425)**	**(31,842)**	**(39,433)**	**(44,439)**
Proceeds from	-	-	-	-	-
Dividend paid	(27,228)	(27,227)	(31,842)	(39,433)	(44,439)
Others	664	(30,197)	-	-	-
Net cash from financing	**(26,564)**	**(57,425)**	**(31,842)**	**(39,433)**	**(44,439)**
Cash at the	146,741	178,641	152,379	166,675	213,837
Exchange	(2)	1	-	-	-
Others	31,900	(26,262)	14,296	47,162	53,389
Cash at the end of the year	**178,639**	**152,380**	**166,675**	**213,837**	**267,226**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Current assets	**220,766**	**216,611**	**233,644**	**284,404**	**341,641**
Cash & equivalents	186,878	174,447	188,743	235,905	289,294
Account receivables	422	1,056	1,220	1,487	1,664
Inventories	33,394	38,824	41,396	44,728	48,398
Other current assets	72	2,284	2,284	2,284	2,284
Non-current assets	**34,403**	**37,753**	**43,303**	**49,855**	**56,932**
PP&E	19,794	21,951	26,469	31,991	38,037
Intangibles	6,208	7,083	8,114	9,145	10,176
Other non-current	8,400	8,719	8,719	8,719	8,719
Total assets	**255,168**	**254,365**	**276,947**	**334,259**	**398,573**
Current liabilities	**57,914**	**49,066**	**51,325**	**54,251**	**57,475**
Short-term	-	-	-	-	-
Account payables	34,510	34,103	36,362	39,289	42,512
Other current	23,404	14,963	14,963	14,963	14,963
Non-current	**296**	**334**	**334**	**334**	**334**
Long-term borrowings	296	334	334	334	334
Total liabilities	**58,211**	**49,400**	**51,659**	**54,586**	**57,809**
Total shareholders equity	**189,539**	**197,507**	**215,011**	**266,410**	**324,334**
Minority Interest	7,418	7,458	10,276	13,264	16,430
Total equity and liabilities	**255,168**	**254,365**	**276,947**	**334,259**	**398,573**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Growth (%)					
Revenue	11.71	16.53	15.59	21.85	11.96
Gross profit	11.79	17.00	16.37	22.95	12.22
EBITDA	11.11	17.01	16.63	23.30	12.41
EBIT	11.08	17.17	16.93	23.33	12.31
Net profit	12.34	19.55	16.95	23.84	12.69
P&L ratios (%)					
Gross margin	91.63	92.00	92.62	93.46	93.68
EBITDA margin	68.71	69.00	69.62	70.45	70.73
ROE	29.90	32.41	35.56	37.73	34.66
Balance sheet					
Current ratio (x)	3.8	4.4	4.6	5.2	5.9
Net receivable	1.4	3.0	3.0	3.0	3.0
Inventory days	1,331	1,389	1,389	1,389	1,389
Net payable days	1,376	1,220	1,220	1,220	1,220
Per share					
EPS	42	50	58	72	81
BPS	151	157	171	212	258
DPS	22	22	25	31	35

Source: Company data, CMBIGM estimates

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Vesync (2148 HK)

An all-round beat and a bullish outlook

Vesync's 1H23 results were far more than good, with industry-leading sales and net profit growth, plus a declining inventory. And we do think the turnaround is not just here but solid. With an undemanding valuation of 11x FY23E P/E, backed by a 20% sales CAGR during FY22-25E, we maintain BUY on the stock.

- **1H23 results beat expectations.** Vesync's sales grew by 24% YoY to US$277mn, in line with CMBI est., and its net profit surged by 111% YoY to US$33mn, beating CMBI est. by 15% and reaching the high-end of its pre-announced profit alert (around 70% to 120%) for 1H23. We believe the speedy sales growth was driven by: 1) strong performance of its new products (e.g. tower-shaped and mega-sized air purifiers, humidifiers, pressure cookers and rice cookers), 2) rapid offline, EU and Japan expansion, and 3) resumption of growth for Etekcity. And the jump in NP margin to ~12%, which was far better than the company's guidance of 10%+, was a mixture of: 1) decent GP margin expansion, on favourable transportation and raw material costs, ASP hike, and more value engineering, etc., 2) better-than-expected government grants and effective tax rate, but 3) higher-than-expected opex (including A&P expenses and professional fees associated with product recalls).
- **The robust FY23E guidance was reiterated but we continue to stay conservative.** Management maintained its FY23E guidance (20%+ sales growth and 10%+ NP margin) and in fact, they are foreseeing potentially faster growth in 2H23E and even in FY24E, thanks to: 1) a prosperous new products pipeline (e.g. new-generation air purifiers and air fryers, more smart products, as well as new categories such as the pet care products), 2) more upgrades to its APP and addition of new smart functions, 3) further expansion in other countries in the EU and Japan, and 4) more cross-selling of products and brands to retailers in the offline channel. Margin wise, we also believe the GP margin and even NP margin should further expand, as: 1) cheaper shipping costs kick in, 2) CNY depreciation continues, 3) more value engineering are placed to enhance the product margins. Since we are more cautious about the potential resumption of import tariffs, we are forecasting a decline in GP margin and just a mild NP margin increase in FY24E (vs FY23E).
- **Maintain BUY and TP of HK$6.71 after the significant jump on earnings.** We raise our FY23E/24E/25E net profit forecasts by 43%/39%/37% to factor in: 1) the boost from those successful new products, 2) a better-than-expected GP margin, and 3) higher government grants and better tax rate. Considering the robust growth (17% sales and 28% net profit CAGR during FY21-25E), its current valuation of 11x is extremely attractive. Our TP is based on 14x FY23E P/E (unchanged, vs 3-year average of 12x).

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	454	490	603	727,	839,165
YoY growth (%)	30.2	8.0	22.9	20.7	15.4
Net income (RMB mn)	42	-16	72	89	112
EPS (RMB)	0.036	(0.014)	0.062	0.077	0.096
YoY growth (%)	(25.3)	(138.6)	(541.5)	23.8	25.3
Consensus EPS (RMB)	NA	NA	0.056	0.069	0.084
P/E (x)	18.4	(47.6)	10.8	8.8	7.0
P/B (x)	2.5	2.8	2.2	1.8	1.4
Yield (%)	2.4	0.0	2.3	2.9	3.6
ROE (%)	14.5	(5.5)	23.0	22.6	22.6
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$ 6.71**
(Previous TP	HK$ 6.71)
Up/Downside	**+29.1%**
Current Price	**HK$5.20**

China Catering Sector

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Stock Data

Mkt Cap (HK$ mn)	6,024
Avg 3 mths t/o (HK$ mn)	1.40
52w High/Low (HK$)	5.36/2.09
Total Issued Shares (mn)	1,165.1

Source: Bloomberg

Shareholding Structure

Ms. Yang Lin	36.15%
Mr. Yang Yuzheng	32.74%
Mr. Yang Hai	0.72%
Hill House	1.43%
Share Award Trust	3.04%
Free Float	25.92%

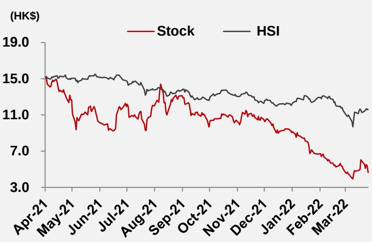
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-13.9%	-12.8%
3-mth	-51.1%	-48.1%
6-mth	-58.4%	-53.6%
12-mth	-68.2%	-58.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Financial Summary

Income statement

YE 31 Dec (USD k)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	**454,250**	**490,378**	**602,523**	**727,094**	**839,165**
North America	358,060	366,182	423,251	485,077	536,644
Europe	81,041	107,946	156,522	211,304	264,130
Asia	15,149	16,250	22,750	30,713	38,391
Cost of goods sold	**(278,143)**	**(348,089)**	**(344,411)**	**(422,360)**	**(486,720)**
Gross profit	**176,107**	**142,289**	**258,112**	**304,734**	**352,445**
Other income	**712**	**3,267**	**9,640**	**1,454**	**1,678**
Operating expenses	**(125,540)**	**(166,862)**	**(192,103)**	**(204,106)**	**(225,119)**
A & P	(21,165)	(35,993)	(45,189)	(53,078)	(59,581)
Commission to platform	(12,839)	(2,409)	(2,031)	(2,057)	(2,082)
Staff costs	(31,851)	(45,854)	(45,451)	(47,445)	(50,346)
R & D	(17,308)	(29,954)	(33,139)	(36,355)	(39,441)
Other opex	(42,377)	(52,652)	(66,292)	(65,171)	(73,670)
EBIT	**51,279**	**(21,306)**	**75,650**	**102,082**	**129,004**
Finance costs, net	(98)	(916)	181	457	994
JVs & associates	-	-	-	-	-
Exceptional	(172)	381	-	-	-
Pre-tax profit	**51,009**	**-21,841**	**75,830**	**102,538**	**129,998**
Income tax	(9,421)	5,524	(3,792)	(13,330)	(18,200)
Less: Minority interests	0	0	0	0	0
Net profit	**41,588**	**(16,317)**	**72,039**	**89,208**	**111,798**

Cash flow summary

YE 31 Dec (USD k)	FY20A	FY21A	FY22E	FY23E	FY24E
EBIT	**51,279**	**(21,306)**	**75,650**	**102,082**	**129,004**
D & A	1,403	1,730	1,248	1,115	1,017
Change in working capital	(113,402)	(8,109)	67,886	(136,120)	78,672
Income tax paid	(7,822)	(18,400)	(3,792)	(13,330)	(18,200)
Others	21,863	47,380	2,268	2,652	3,290
Net cash from operating	**(46,680)**	**1,295**	**143,260**	**(43,601)**	**193,783**
Capex & investments	(16,547)	(5,728)	(3,638)	(4,390)	(5,067)
Associated companies	-	-	-	-	-
Interest received	225	857	-	-	-
Others	(30,000)	27,128	-	-	-
Net cash from investing	**(46,322)**	**22,257**	**(3,638)**	**(4,390)**	**(5,067)**
Equity raised	28,875	(2,050)	-	-	-
Net change in bank loans	684	4,764	-	-	-
Dividend paid	(18,561)	(18,943)	-	18	22
Others	(4,334)	(5,936)	(1,537)	(1,703)	(1,852)
Net cash from financing	**6,664**	**(22,165)**	**(1,537)**	**(1,685)**	**(1,830)**
Net change in cash	(86,338)	1,387	138,085	(49,677)	186,886
Beginning cash balance	**183,450**	**126,659**	**123,798**	**261,883**	**212,206**
Exchange difference	29,547	(4,248)	-	0	0
Cash at the end of the year	126,659	123,798	261,883	212,206	399,092

Balance sheet

YE 31 Dec (USD k)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	**45,138**	**61,229**	**63,069**	**65,852**	**69,458**
Fixed asset	4,477	4,557	6,518	9,411	13,126
Intangible assets & goodwill	288	207	85	-24	-133
Prepaid lease payments	12,398	10,216	10,216	10,216	10,216
Interest in joint ventures	12,202	12,215	12,215	12,215	12,215
Other non-current assets	15,773	34,034	34,034	34,034	34,034
Current assets	**415,669**	**396,065**	**524,180**	**606,818**	**769,405**
Inventories	128,547	114,647	83,507	159,495	120,536
Trade and other receivables	106,019	149,217	164,389	214,055	222,721
Prepayments	21,721	26,225	32,222	38,884	44,878
Other current assets	32,723	12,375	12,375	12,375	12,375
Cash and cash equivalents	126,659	93,601	231,686	182,009	368,895
Current liabilities	**132,816**	**168,252**	**226,168**	**222,362**	**276,735**
Bank loans	34,900	8,495	8,495	8,495	8,495
Trade payables	37,739	60,751	109,730	95,998	141,440
Accruals & other payables	36,945	39,078	48,015	57,942	66,873
Tax payables	17,084	5,561	5,561	5,561	5,561
Others	6,148	54,367	54,367	54,367	54,367
Non-current liabilities	**13,353**	**11,585**	**11,585**	**11,585**	**11,585**
Bank loans	-	741	741	741	741
Deferred income	-	-	-	0	0
Deferred tax	-	-	-	0	0
Others	13,353	10,844	10,844	10,844	10,844
Minority Interest	**0**	**0**	**0**	**0**	**0**
Total net assets	**314,638**	**277,457**	**349,496**	**438,722**	**550,542**
Shareholders' equity	**314,638**	**277,457**	**349,496**	**438,722**	**550,542**

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
North America	79	75	70	67	64
Europe	18	22	26	29	31
Asia	3	3	4	4	5
		0	0	0	0
Total	100	100	100	100	100
P&L ratios (%)					
Gross margin	11.3	(4.3)	12.6	14.0	15.4
Operating margin	11.2	(4.5)	12.6	14.1	15.5
Pre-tax margin	9.2	(3.3)	12.0	12.3	13.3
Net margin	18.5	25.3	5.0	13.0	14.0
Effective tax rate	38.8	29.0	42.8	41.9	42.0
	9.2	(3.3)	12.0	12.3	13.3
Balance sheet ratios					
Current ratio (x)	3.1	2.4	2.3	2.7	2.8
Quick ratio (x)	2.2	1.7	1.9	2.0	2.3
Cash ratio (x)	1.0	0.6	1.0	0.8	1.3
Inventory turnover days	147	128	105	105	105
Trade receivables days	57	95	95	95	95
Trade payables days	55	52	52	52	52
Total debt / total equity ratio (%)	12	5	4	3	2
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	13.2	(5.9)	20.6	20.3	20.3
ROA	9.0	(3.6)	12.3	13.3	13.3
Per share					
EPS (USD)	0.04	-0.01	0.06	0.08	0.1
DPS (USD)	0.02	0.00	0.02	0.02	0.0
BVPS (USD)	0.27	0.24	0.30	0.38	0.5

Source: Company data, CMBIGM estimates

Li Auto Inc. (LI US)

Best positioned among NEV start-ups

We believe Li Auto's superior product design capabilities, along with reasonable investment priorities, have made it enter a virtuous cycle. Its healthy balance sheet could help it withstand the prolonged price war and catch up in the autonomous driving (AD) technologies.

- **Strong balance sheet and margins to withstand the competition.** Although China's highly complex industry dynamics makes more survival room for different automakers, we still believe NEV start-ups are better positioned in terms of technological advancement and brand marketing. The NEV competition is likely to become even stiffer with more involvement of Huawei and the entry of Xiaomi (1810 HK, BUY), which makes cash reserves and product positioning even more important, in our view.

  As the only profitable Chinese NEV start-up, Li Auto has the highest net cash position and gross margin. We have not seen clear signs for Xpeng (XPEV US, HOLD) and NIO (NIO US, HOLD) to turn profitable yet, given their single-digit gross margins.

- ***MEGA* once again showcases Li Auto's product design capabilities.** Li Auto's high margins come from its superior product design capabilities, in our view. Its first BEV model, the *MEGA*, is another example, which should reduce investors' previous worries about the sales cannibalization between its BEVs and EREVs, as well as its BEV's profitability. The *L6* EREV could be another sales driver in FY24E.

- **Still has a chance to catch up in AD.** We are of the view that Li Auto still has a chance to catch up in the AD technologies, as it starts to accelerate R&D spending, leveraged by its healthy balance sheet. We think growing parts suppliers and still evolving AD roadmap also provide such an opportunity.

- **Earnings/Valuation.** We project Li Auto's to surge 65% YoY to 0.61mn units and net profit to rise 61% YoY to RMB 14.5bn in FY24E, accounting for rising R&D investments and possible margin dent from the heightening competition. Our target price of US$ 50.00 is based on 25x our FY24E P/E. We think such multiple is justified by its fast sales growth and potential earnings upside surprise, especially with lowered expectation after a share-price correction. Key risks to our rating and target price include shower AD development, lower sales and or/gross margin than our expectation, as well as a sector de-rating.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	27,010	45,287	123,147	196,350	264,450
YoY growth (%)	186	68	172	59	35
Net income (RMB mn)	-321	-2,012	9,045	14,514	20,796
EPS (RMB)	(0.17)	(1.04)	4.61	7.34	10.41
YoY growth (%)	N/A	N/A	N/A	60.5	43.3
P/S (x)	8.1	5.5	2.1	1.4	1.0
P/E (x)	N/A	N/A	29.2	18.3	12.9
P/B (x)	5.3	5.5	4.8	3.8	2.9
ROE (%)	(0.9)	(4.7)	18.1	23.1	25.5
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**US$ 50.00**
(Previous TP	US$ 50.00
Up/Downside	**+37.7%**
Current Price	**US$ 36.30**

China Auto Sector

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Stock Data

Mkt Cap (US$ mn)	38,520
Avg 3 mths t/o (US$ mn)	194
52w High/Low (US$)	47.33/17.90
Total Issued Shares (mn)	2,085

Source: Bloomberg

Shareholding Structure

Li Xiang	21.9%
Wang Xing	18.1%
Others	60.0%

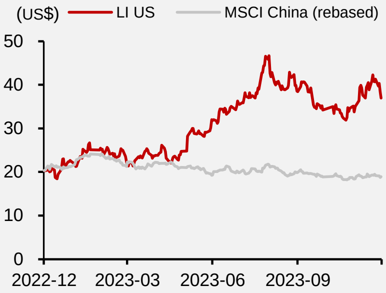
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	5.6%	4.9%
3-mth	-7.4%	-2.2%
6-mth	22.8%	26.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers Zhong Tian

Related Report

7. "Li Auto Inc. – Mega could be a positive catalyst" – 10 Nov 2023

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**27,010**	**45,287**	**123,147**	**196,350**	**264,450**
Cost of sales	(21,248)	(36,496)	(96,739)	(153,699)	(209,752)
Gross profit	**5,761**	**8,790**	**26,408**	**42,651**	**54,698**
R&D exp.	(3,286)	(6,780)	(10,311)	(16,514)	(19,074)
SG&A exp.	(3,492)	(5,665)	(9,374)	(13,448)	(15,993)
Operating profit	**(1,017)**	**(3,655)**	**7,083**	**13,189**	**20,231**
Net finance costs	150	494	677	932	1,437
Investment income	527	376	980	1,484	1,588
Other non-oper exp.	187	626	915	815	820
Pre-tax profit	**(153)**	**(2,159)**	**9,654**	**16,420**	**24,075**
Tax	(169)	127	(579)	(1,806)	(3,130)
Discontinued operations	-	-	-	-	-
Accr. on preferred shares	-	-	-	-	-
Net profit	**(321)**	**(2,012)**	**9,045**	**14,514**	**20,796**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**(153)**	**(2,159)**	**9,654**	**16,420**	**24,075**
Depreciation/amortization	590	1,214	2,393	4,042	5,825
Change in working capital	6,565	5,035	28,849	16,475	27,861
Others	1,338	3,290	915	(620)	(2,029)
Net cash from operating	**8,340**	**7,380**	**41,811**	**36,317**	**55,732**
Capex	(3,445)	(5,128)	(9,650)	(11,200)	(12,200)
Others	(813)	763	(26,000)	(4,600)	(8,600)
Net cash from investing	**(4,257)**	**(4,365)**	**(35,650)**	**(15,800)**	**(20,800)**
Share issuance	11,006	2,469	9	12	15
Net borrowings	170	3,080	(2,276)	(890)	(757)
Others	5,533	90	-	-	-
Net cash from financing	**16,710**	**5,639**	**(2,267)**	**(878)**	**(742)**
Net change in cash	**20,793**	**8,655**	**3,895**	**19,639**	**34,190**
Cash at beginning of the year	10,173	30,493	40,418	44,313	63,952
FX & discontinued operations	(472)	1,270	-	-	-
Cash at the end of the year	**30,493**	**40,418**	**44,313**	**63,952**	**98,142**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Current assets	**52,380**	**66,992**	**99,712**	**130,332**	**175,894**
Cash & equivalents	27,854	38,478	41,813	60,952	94,642
Account receivables	121	48	675	1,076	1,449
Inventories	1,618	6,805	9,276	14,738	17,240
Other current assets	22,788	21,661	47,948	53,566	62,563
Non-current assets	**9,468**	**19,545**	**30,097**	**41,486**	**50,020**
PP&E	4,498	11,188	18,247	25,121	31,173
Intangibles	751	833	951	1,102	1,234
Right-of-use assets	2,061	3,539	4,784	7,065	6,822
Other non-current assets	2,157	3,986	6,114	8,199	10,791
Total assets	**61,849**	**86,538**	**129,809**	**171,818**	**225,913**
Current liabilities	**12,108**	**27,373**	**59,663**	**81,848**	**110,535**
Bank borrowings	37	391	848	734	-
Account payables	9,376	20,024	47,707	63,164	86,199
Current deferred revenue	305	569	1,203	2,205	3,554
Other current liabilities	2,390	6,388	9,905	15,745	20,782
Non-current liabilities	**8,676**	**13,979**	**14,654**	**18,896**	**22,468**
Bank borrowings	563	3,317	669	(65)	(65)
Lease liabilities	1,370	1,946	2,779	4,445	4,426
Other non-current liabilities	6,744	8,716	11,207	14,517	18,107
Total liabilities	**20,785**	**41,352**	**74,317**	**100,744**	**133,003**
Mezzanine equity	-	-	-	-	-
Share capital	1	1	1	1	1
Reserves	41,063	44,857	55,133	70,615	92,302
Shareholders' equity	**41,064**	**44,859**	**55,134**	**70,617**	**92,303**
Total equity and liabilities	**61,849**	**86,538**	**129,809**	**171,818**	**225,913**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Vehicle sales	96.7	97.4	97.3	96.9	96.8
Other sales & services	3.3	2.6	2.7	3.1	3.2
Growth (%)					
Revenue	185.6	67.7	171.9	59.4	34.7
Gross profit	271.9	52.6	200.4	61.5	28.2
Operating profit	N/A	N/A	N/A	86.2	53.4
Net profit	N/A	N/A	N/A	60.5	43.3
Profit & loss ratio (%)					
Gross margin	21.3	19.4	21.4	21.7	20.7
Operating margin	(3.8)	(8.1)	5.8	6.7	7.7
Net profit margin	(1.2)	(4.4)	7.3	7.4	7.9
Balance sheet ratio					
Net cash (debt)/total equity (x)	1.1	1.1	1.4	1.5	1.6
Current ratio (x)	4.3	2.4	1.7	1.6	1.6
Receivable turnover days	2	0	2	2	2
Inventory turnover days	28	68	35	35	30
Payable turnover days	161	200	180	150	150
Profitability (%)					
ROE	(0.9)	(4.7)	18.1	23.1	25.5
ROA	(0.7)	(2.7)	8.4	9.6	10.5
Per share data (RMB)					
EPS	(0.17)	(1.04)	4.61	7.34	10.41
DPS	N/A	N/A	N/A	N/A	N/A

Source: Company data, CMBIGM estimates

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Geely Automobile (175 HK)

Could be undervalued compared with peers

Geely's share price has been lagging vs. its peers and Hang Seng Index in 2023, despite its stronger-than-expected sales volume. We attribute this partially to its previous multi-brand strategy, making it difficult to build brand image. That could be improved when Geely Galaxy ramps up in 2024.

- **Zeekr is one of the few premium NEV brands under traditional automakers.** After attempting different brands for electrification, now Zeekr and Geely Galaxy become the key NEV drivers. We expect Zeekr's sales volume to surge 50% YoY to 180,000 units in FY24E. The Zeekr *007* would be the most important model for 2024, as the new medium-size SUV is likely to be rolled out in 4Q24 with little sales contribution in 2024. Although Zeekr is still catching up in the premium NEV market, it is still better positioned than most of its traditional OEM peers.
- **New models to lift Galaxy's sales in FY24E.** We are of the view that Galaxy had a good start in FY23 and we expect its sales volume to more than double in FY24E to 250,000 units, with BEV models and lower-priced new PHEV models. We believe the market still has low expectations for Galaxy's sales.
- **Jiyue as a positive surprise?** Although the joint venture between Baidu (BIDU US, BUY) and Geely is at Geely's parent company, the listed company could still potentially benefit from such partnership, should Jiyue's development exceed expectation. We believe little has been priced in from this partnership so far.
- **Earnings/Valuation.** We revise up Geely's FY23E net profit by 15%, as we believe its 2H23E earnings could beat, given its peers' stronger-than-expected 3Q23 earnings. We raise our FY24E net profit by 22% amid greater economies of scale, especially for NEVs. We now value Zeekr at 1.5x (previously 2.0x) FY24E core revenue (excluding Virid's battery pack sales and R&D services), which would result in HK$ 70bn for 100% Zeekr's valuation. We think such valuation is conservative, as it is lower than its previous round of financing. We value Geely's all other businesses excluding Zeekr at 13x (prior 15x) our FY24E P/E. We maintain our BUY rating and target price of HK$ 14.00. Key risks to our rating and target price include lower sales volume, especially NEVs, than we expect and a sector de-rating.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	101,611	147,965	178,525	206,290	225,440
YoY growth (%)	10.3	45.6	20.7	15.6	9.3
Net income (RMB mn)	4,847	5,260	4,142	6,013	7,629
EPS (RMB)	0.48	0.50	0.40	0.57	0.73
YoY growth (%)	(12.4)	8.5	(21.3)	45.1	26.9
P/E (x)	13.9	14.2	19.1	13.0	10.3
P/B (x)	1.0	1.0	1.0	0.9	0.9
Yield (%)	0.9	1.6	1.1	1.6	2.0
ROE (%)	7.3	7.3	5.4	7.4	8.9
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$ 14.00**
(Previous TP	HK$ 14.00)
Up/Downside	**+70.3%**
Current Price	**HK$ 8.22**

China Auto Sector

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Stock Data

Mkt Cap (HK$ mn)	82,668
Avg 3 mths t/o (HK$ mn)	304
52w High/Low (HK$)	13.50/8.18
Total Issued Shares (mn)	10,057

Source: Bloomberg

Shareholding Structure

Li Shufu	43.2%
Others	56.8%

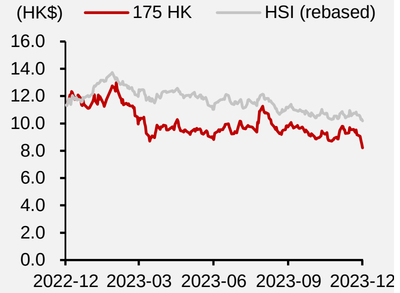
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-7.1%	-5.5%
3-mth	-15.6%	-7.2%
6-mth	-6.7%	0.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: GrantThornton

Related Report

8. "Geely Automobile – 1H23 GPM beat for both ICE and NEV" – 23 Aug 2023

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**101,611**	**147,965**	**178,525**	**206,290**	**225,440**
Cost of sales	(84,199)	(127,069)	(153,563)	(178,636)	(193,777)
Gross profit	**17,412**	**20,896**	**24,962**	**27,654**	**31,663**
Selling exp.	(6,323)	(8,228)	(10,872)	(11,227)	(11,689)
Admin exp.	(8,036)	(10,435	(11,439)	(13,360)	(15,261)
Other income	1,339	1,157	1,100	1,050	1,000
Operating profit	**4,393**	**3,389**	**3,751**	**4,118**	**5,713**
Share-based payments	(1,213)	(1,489)	(975)	(600)	(75)
Net finance costs	280	380	332	355	424
Profit share of asso.&JVs	1,205	651	188	1,538	1,442
Other non-oper exp.	-	1,750	20	-	-
Pre-tax profit	**4,665**	**4,682**	**3,317**	**5,411**	**7,504**
Tax	(312)	(32)	(469)	(581)	(909)
Minority interests	494	611	1,295	1,182	1,034
Net profit	**4,847**	**5,260**	**4,142**	**6,013**	**7,629**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**4,665**	**4,682**	**3,317**	**5,411**	**7,504**
Depreciation/amortization	6,893	8,318	8,926	10,171	11,420
Change in working capital	3,964	3,590	3,678	4,749	(910)
Others	(174)	(571)	686	(1,045)	(1,530)
Net cash from operating	**15,348**	**16,018**	**16,607**	**19,286**	**16,484**
Capex	(6,100)	(10,337	(13,338	(12,851	(11,969
Others	(1,059)	(1,793)	(342)	1,465	1,464
Net cash from investing	**(7,159)**	**(12,130**	**(13,679**	**(11,386**	**(10,505**
Share issuance	31	9	1	35	-
Dividend paid	(1,677)	(1,833)	(1,907)	(1,480)	(2,134)
Others	2,562	3,149	(2,260)	1,273	(757)
Net cash from financing	**916**	**1,325**	**(4,166)**	**(172)**	**(2,891)**
Net change in cash	**9,105**	**5,213**	**(1,239)**	**7,728**	**3,087**
Cash at beginning of the year	18,977	28,014	33,341	32,102	39,830
Exchange difference	(68)	114	-	-	-
Cash at the end of the year	**28,014**	**33,341**	**32,102**	**39,830**	**42,917**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Current assets	**65,296**	**79,064**	**86,669**	**101,914**	**110,087**
Cash & equivalents	28,014	33,341	32,102	39,830	42,917
Account receivables	31,549	34,392	42,699	49,340	53,920
Inventories	5,522	10,822	11,359	12,235	12,742
Other current assets	211	508	508	508	508
Non-current assets	**69,046**	**78,762**	**84,229**	**87,885**	**89,337**
PP&E	30,859	32,201	32,292	31,364	29,356
Intangibles	20,959	22,609	26,523	29,805	32,015
Deferred income tax	2,435	4,573	4,573	4,573	4,573
Other non-current assets	14,793	19,379	20,841	22,142	23,393
Total assets	**134,341**	**157,826**	**170,898**	**189,798**	**199,424**
Current liabilities	**60,351**	**68,953**	**79,748**	**92,539**	**97,662**
Bank borrowings	1,907	-	-	-	-
Account payables	57,393	65,481	78,338	91,129	96,252
Tax payable	853	773	773	773	773
Other current liabilities	198	2,699	637	637	637
Non-current liabilities	**3,770**	**12,677**	**13,174**	**13,435**	**13,540**
Bank borrowings	-	2,758	3,258	3,258	3,258
Long-term payables	2,863	7,602	7,599	7,860	7,964
Other non-current liabilities	907	2,317	2,317	2,317	2,317
Total liabilities	**64,120**	**81,631**	**92,922**	**105,974**	**111,201**
Share capital	183	184	184	185	185
Reserves	65,010	71,534	74,648	79,708	85,171
Non-controlling interests	1,615	1,065	(269)	518	(546)
Shareholders' equity	**68,606**	**75,130**	**78,245**	**83,306**	**88,769**
Total equity and liabilities	**134,341**	**157,826**	**170,898**	**189,798**	**199,424**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Automobile	84.6	68.3	64.9	61.1	59.0
Auto parts	8.7	5.9	5.6	5.3	5.3
IP licensing & R&D support	6.8	25.8	29.5	33.5	35.6
Growth (%)					
Revenue	10.3	45.6	20.7	15.6	9.3
Gross profit	18.2	20.0	19.5	10.8	14.5
Operating profit	(11.6)	(22.8)	10.7	9.8	38.7
Net profit	(12.4)	8.5	(21.3)	45.1	26.9
Profit & loss ratio (%)					
Gross margin	17.1	14.1	14.0	13.4	14.0
Operating margin	4.3	2.3	2.1	2.0	2.5
Net profit margin	4.8	3.6	2.3	2.9	3.4
Balance sheet ratio					
Net cash/total equity (x)	0.3	0.3	0.3	0.4	0.4
Current ratio (x)	1.1	1.1	1.1	1.1	1.1
Receivable turnover days	117	89	90	90	90
Inventory turnover days	24	31	27	25	24
Payable turnover days	254	193	190	190	185
Profitability (%)					
ROE	7.3	7.3	5.4	7.4	8.9
ROA	4.0	3.6	2.5	3.3	3.9
Per share data (RMB)					
EPS	0.48	0.50	0.40	0.57	0.73
DPS	0.18	0.19	0.14	0.21	0.26

Source: Company data, CMBIGM estimates

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Onewo (2602 HK)

Exploration on existing market yields results

As a pioneer exploring the existing market, Onewo adopted the "Onewo Town " strategy to achieve high project density and efficiency improvement. The strategy delivered quantifiable results in 1H23 that not only lifted GP margins (GPM) but also boosted the efficiency of value-added services (VAS). The company's tendency to involve capital investment in bidding project has sparked market controversies. However, our analysis suggests that the move is advantageous in multiple aspects. We forecast 18% YoY growth in revenue and 27% YoY growth in EBITDA for 2023E. Maintain BUY with TP unchanged at HK$ 44.1, reflecting a 20x 2023E P/E. Catalyst: inclusion in the Stock Connect.

- **"Onewo Town" strategy yields results.** By 1H23, the Company has 601 Onewo Towns, up by 17 from 2022. Among them, renovation was completed for 102, up by 64 from 2022. The Company plans to complete renovation for 150 Onewo Towns by the end of 2023 meaning 48 more to do in 2H23. The strategy keeps showing results including 1) Onewo Towns that completed renovation have saved costs of ~RMB 104mn in 1H23, lifting GPM of residential PM to 12.6%, up 2.1 ppt from 1H22 and 2.9 ppt from FY22. 2) Community VAS gained more business opportunities within Onewo Towns with revenue grew 22% YoY and GPM went up 1.8ppt to 36.5% in 1H23. By Sep 2023, partial decoration business "Yan Xuan Jia" saw YTD contract volume increased 150% YoY.
- **Bidding with capital investment is a win-win strategy.** The Company's strategy of involving capital input when bidding PM contract was criticized for disrupting market competition and unwelcomed by investors as it makes company's assets heavier. However, upon detailed analysis, we think this move outweighs its drawbacks:1) participating in bidding with capital investment significantly enhances competitiveness. 2) On the contrary to the common practice of using capital to solve leftover problems, company's capital input is to align with "Onewo Town" strategy and carry out related renovation. This can be proved by the fact that the Company does not set up co-mgmt. account with property owners committee. 3) Upon winning the bid, the Company integrates project into "Onewo Town" which gains more cost advantages thereby providing more competitive pricing in the bidding process. 4) Consider capital input from the perspective of acquisition of PM companies, valuation of these projects is at avg. of ~0.26x P/S and ~5x P/E, significantly lower than 10x P/E in M&A market. Besides, there will be no goodwill impairment issue in the future and the funds will be used on the project other than paid to sellers.
- **Estimate 19%/27% YoY revenue/EBITDA growth in 2023E** based on continued GPM % SG&A fee improvement. Dividend payout ratio was lifted to 20% of EBITDA (from 10% in FY22) in 1H23 and will be maintained. We remain positive on the Company due to its 1) absolute competitiveness in existing market and growth space for VAS secured by "Onewo Town" strategy, 2) dominant advantage on commercial PM under the brand – Cushman & Wakefield Vanke, 3) low dependency on parentco. and low parentco. Risk, and 4) management's confidence highlighted by announcement of HK$ 632mn share buyback on 31 Oct. Maintain BUY with TP unchanged at HK$ 44.1, reflecting 20x 2023E P/E. Catalyst: H-share full circulation was

BUY (Maintain)

Target Price	**HK$44.1**
Up/Downside	**+90.9%**
Current Price	**HK$23.1**

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Stock Data

Mkt Cap (HK$ mn)	27,223
Avg 3 mths t/o (HK$ mn)	12.2
52w High/Low (HK$)	56.15/20.95
Total Issued Shares (mn)	1178.5

Source: Bloomberg

Shareholding Structure

China Vanke	50.9%
Radiant Sunbeam Ltd.	15.3%

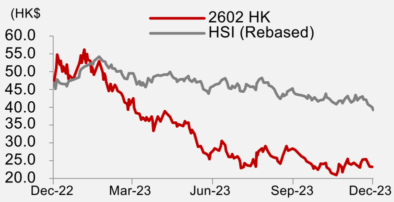
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-9.4%	-0.3%
3-mth	-18.8%	-8.3%
6-mth	-15.7%	-1.4%

Source: Bloomberg

12-mth Price Performance



Source: FactSet

Auditor: KPMG

completed on 24 Oct which increases possibility to be included in Stock Connect next year.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	23,705	30,106	35,789	42,205	49,507
YoY growth (%)	30.6	27.0	18.9	17.9	17.3
Net income (RMB mn)	1,667.6	1,510.5	2,076.4	2,539.6	3,062.2
EPS (RMB)	1.65	1.40	1.92	2.35	2.83
YoY growth (%)	12.4	(15.2)	37.5	22.3	20.6
Consensus EPS (RMB)	na	na	1.85	2.33	2.79
P/E (x)	na	28.1	11.0	9.0	7.5
P/B (x)	na	5.0	2.1	1.7	1.4
Yield (%)	na	0.7	3.2	3.7	4.3
ROE (%)	30.6	27.0	18.9	17.9	17.3
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

Income statement

YE Dec 31 (Rmb mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**23,705**	**30,106**	**35,789**	**42,205**	**49,507**
Residential PM	11,363	14,811	17,748	21,179	25,068
Commercial PM	5,288	7,545	9,229	10,857	12,511
Community VAS	1,798	1,772	2,199	2,748	3,456
VAS for developers	3,065	2,935	2,935	2,935	2,935
Urban space services	340	664	764	863	967
AIoT and BPaaS solution	1,850	2,378	2,914	3,623	4,569
Cost of sales	(19,685)	(25,875)	(30,347)	(35,672)	(41,738)
Gross profit	**4,020**	**4,231**	**5,442**	**6,533**	**7,769**
Other income	**394**	**571**	**308**	**314**	**321**
Selling expenses	(257)	(450)	(501)	(591)	(693)
Administrative expenses	(1,792)	(2,153)	(2,290)	(2,701)	(3,168)
Other expenses	(69)	(156)	(180)	(180)	(180)
Operating profit	**2,297**	**2,042**	**2,778**	**3,375**	**4,049**
Share from JCE	34	(10)	10	10	10
Finance cost	(10)	(11)	(10)	(10)	(9)
Pre-tax profit	**2,320**	**2,021**	**2,777**	**3,375**	**4,049**
Income tax	(606)	(435)	(625)	(759)	(911)
Profit for the year	**1,714**	**1,586**	**2,152**	**2,616**	**3,138**
Non-controlling interest	(47)	(76)	(76)	(76)	(76)
Net profit to shareholders	**1,668**	**1,510**	**2,076**	**2,540**	**3,062**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Net income	**2,320**	**2,021**	**2,777**	**3,375**	**4,049**
D&A	395	855	895	945	985
Change in working capital	784	588	(391)	147	256
Income tax paid	(496)	(535)	(625)	(759)	(911)
Others	(170)	(171)	116	109	101
Net cash fr. operating act.	**2,834**	**2,756**	**2,772**	**3,816**	**4,480**
Capex & investments	(285)	(543)	(643)	(743)	(843)
Others	804	506	322	329	336
Net cash fr. investing act.	**519**	**(36)**	**(321)**	**(414)**	**(507)**
Equity raised	-	5,728	-	-	-
Change of Debts	(18)	(16)	-	-	-
Dividend paid	(2,243)	(1,294)	(724)	(852)	(993)
Others	(58)	(235)	(10)	(10)	(9)
Net cash fr. financing act.	**(2,319)**	**4,183**	**(734)**	**(862)**	**(1,002)**
Net change in cash	**1,033**	**6,903**	**1,717**	**2,540**	**2,971**
Cash at the beginning of the	5,398	6,431	13,345	15,062	17,603
Exchange difference	(0)	12	-	-	-
Cash at the end of the	**6,431**	**13,345**	**15,062**	**17,603**	**20,574**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**15,016**	**15,121**	**15,681**	**16,290**	**16,960**
Fixed asset	501	666	842	1,017	1,203
Goodwill	3,700	3,700	3,700	3,700	3,700
Other intangible assets	4,544	4,807	5,120	5,483	5,895
Prepayments	1,992	2,389	2,389	2,389	2,389
Others	4,279	3,559	3,630	3,701	3,772
Current assets	**13,708**	**21,789**	**24,040**	**27,392**	**31,199**
Cash	6,431	13,345	15,062	17,603	20,574
Account receivable	4,514	6,278	6,800	7,597	8,416
Prepayments	1,698	1,698	1,698	1,698	1,698
Other current assets	1,066	468	480	494	511
Total Assets	**28,724**	**36,910**	**39,721**	**43,682**	**48,158**
Current liabilities	**16,282**	**17,714**	**17,856**	**18,815**	**19,907**
Account payables	3,243	5,320	5,463	6,421	7,513
Contract liabilities	4,168	4,515	4,515	4,515	4,515
Other	8,871	7,879	7,879	7,879	7,879
Non-current liabilities	**2,130**	**2,195**	**2,195**	**2,195**	**2,195**
Borrowings	4	4	-	-	-
Deferred tax liabilities	1,088	990	990	990	990
Others	1,038	1,201	1,205	1,205	1,205
Total Liabilities	**18,412**	**19,909**	**20,052**	**21,010**	**22,102**
Shareholders' equity	**9,893**	**16,460**	**19,052**	**21,979**	**25,287**
Non-controlling interests	419	541	617	693	769
Total Equity	**10,313**	**17,001**	**19,669**	**22,672**	**26,056**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Residential PM	47.9	49.2	49.6	50.2	50.6
Commercial PM	22.3	25.1	25.8	25.7	25.3
Community VAS	7.6	5.9	6.1	6.5	7.0
VAS to developers	12.9	9.7	8.2	7.0	5.9
Urban space services	1.4	2.2	2.1	2.0	2.0
AIoT and BPaaS solution	7.8	7.9	8.1	8.6	9.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
P&L ratios (%)					
Gross margin	17.0	14.1	15.2	15.5	15.7
Operating margin	9.7	6.8	7.8	8.0	8.2
Net margin	7.0	5.0	5.8	6.0	6.2
Effective tax rate	26.1	21.5	22.5	22.5	22.5
Growth (%)					
Revenue	30.6	27.0	18.9	17.9	17.3
Gross profit	19.5	5.2	28.6	20.1	18.9
Net profit	13.9	-9.4	37.5	22.3	20.6
Balance sheet ratios					
Current ratio (x)	0.8	1.2	1.3	1.5	1.6
Receivable turnover days	70	76	69	66	62
Returns (%)					
ROE	16.9	9.2	10.9	11.6	12.1
ROA	5.8	4.1	5.2	5.8	6.4
Per share					
EPS (RMB)	1.65	1.40	1.92	2.35	2.83
DPS (RMB)	3.49	0.26	0.67	0.79	0.92
BVPS (RMB)	2.04	7.85	10.02	12.46	15.21

Source: Company data, CMBIGM estimates

18 Dec 2023

CMB International Global Markets | Equity Research | Company Update

Weichai Power-H (2338 HK)

A major beneficiary of the upcycle of HDT sector

Weichai is a major beneficiary of the HDT upcycle. Most importantly, Weichai is well positioned to capture the rising demand for gas HDTs given its >60% market share in the HDT gas engine segment. Besides, we also like Weichai's on-track diversification of product portfolio, including (1) fast-growing large-bore engines, (2) the consolidation of LOVOL Heavy and the increase in installation of CVT engines for LOVOL, and (3) continuous investment in hydrogen fuel cell. Our SOTP-based TP is HK$19.4. Reiterate **BUY**. Weichai-H is our sector top pick.

- **We expect sales volume in HDT industry to grow 15% YoY in 2024E.** (1) The fleet size of HDTs is highly correlated with China's GDP growth. We expect moderate economic growth in 2024E (CMBI estimate: 4.8%) to boost the HDT fleet size by a similar rate. We estimate this, together with recovery of replacement demand, will translate to ~14% YoY increase in domestic sales volume; (2) We expect a solid export growth rate of 18% in 2024E. In terms of product mix, we expect natural gas HDTs to continue to account for 25-30% of total sales.
- **Weichai Power delivered 71% YoY growth of multi-cylinder diesel engine sales volume in Oct**, according to CICEIA, the highest growth rate since Apr. The growth is also higher than the industry sales volume growth of multi-cylinder engine for commercial vehicles (+52% YoY). Based on our calculation, Weichai's market share in multi-cylinder diesel engine reached 22.1% in Oct, up from 19.3% in Sep and 16.1% in Oct 2022.
- **Risk factors:** 1) weakness in engine export; 2) increase in component cost; and 3) weaker-than-expected new business growth

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	203,548	175,158	206,901	228,433	242,376
YoY growth (%)	3.1	(13.9)	18.1	10.4	6.1
Net income (RMB mn)	9,255	4,906	8,595	10,172	10,908
EPS (RMB)	1.06	0.56	0.98	1.17	1.25
YoY growth (%)	(8.6)	(47.0)	75.2	18.4	7.2
Consensus EPS (RMB)	n/a	n/a	0.98	1.19	1.33
P/E (x)	11.2	21.1	12.7	10.7	10.0
EV / EBITDA (x)	4.7	6.8	4.8	4.3	4.1
P/B (x)	1.5	1.4	1.4	1.3	1.2
Yield (%)	3.0	2.1	2.8	3.3	3.5
ROE (%)	15.2	6.8	11.3	12.2	12.1
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$19.4**
(Previous TP	HK$19.4)
Up/Downside	**+42%**
Current Price	**HK$13.60**

China Capital Goods

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Stock Data

Mkt Cap (HK$ mn)	118,855.7
Avg 3 mths t/o (HK$ mn)	113.5
52w High/Low (HK$)	14.58/9.49
Total Issued Shares (mn)	8,726.6

Source: Bloomberg

Shareholding Structure

Weichai Holdings Group	16.3%
Weifang Investment Group	3.4%

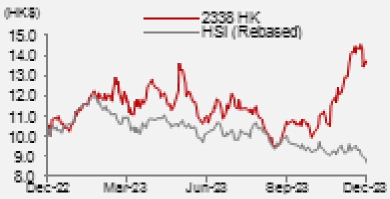
Source: HKEx, Company data

Share Performance

	Absolute	Relative
1-mth	12.0%	23.2%
3-mth	28.0%	44.6%
6-mth	27.3%	48.9%

Source: Bloomberg

12-mth Price Performance



Source: Factset

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**203,548**	**175,158**	**206,901**	**228,433**	**242,376**
Cost of sales	-163,947	-144,011	-164,693	-182,289	-193,416
Gross profit	**39,601**	**31,147**	**42,208**	**46,143**	**48,960**
Operating expenses	-26,038	-25,664	-29,855	-31,510	-33,587
EBIT	**13,563**	**5,482**	**12,352**	**14,634**	**15,373**
Other expenses	-145	-162	-248	-274	-291
Net finance cost	450	909	337	578	963
Finance income and others	1,724	2,359	2,058	2,315	2,704
Finance expenses	-1,274	-1,450	-1,721	-1,737	-1,741
profit of JV & associates	187	-144	188	191	177
Pretax profit	**14,055**	**6,086**	**12,630**	**15,129**	**16,223**
Income tax	-2,493	-403	-2,084	-2,723	-2,920
After tax profit	**11,562**	**5,683**	**10,546**	**12,405**	**13,303**
MI	-2,307	-778	-1,951	-2,233	-2,394
Net profit	**9,255**	**4,906**	**8,595**	**10,172**	**10,908**
D&A	10,597	11,148	11,279	11,902	12,533
EBITDA	**24,160**	**16,630**	**23,632**	**26,535**	**27,906**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Pretax profit	14,055	6,086	12,630	15,129	16,223
Finance cost	1,274	1,450	1,721	1,737	1,741
Interest income	-1,724	-2,359	-2,058	-2,315	-2,704
Share of profit or loss of associates	-187	144	-188	-191	-177
Depreciation	8,473	8,950	8,719	9,324	9,984
Amortization of intangible assets	2,065	2,114	2,475	2,493	2,464
Income tax paid	-2,493	-403	-2,084	-2,723	-2,920
Change in working capital	-8,767	-20,324	-6,590	-1,455	-566
Others	1,963	1,992	2,143	2,400	2,789
Cash flow from operation	**14,658**	**-2,350**	**16,768**	**24,398**	**26,834**
Net capex on PP&E	-3,610	-5,242	-8,400	-6,900	-6,900
Investment in JV/associates	-3,082	-150	0	0	0
Investment in subsidiaries	-496	-159	0	0	0
Dividend received	143	160	107	109	101
Others	1,636	-3,155	0	0	0
Cash flow from investing	**-5,409**	**-8,545**	**-8,293**	**-6,791**	**-6,799**
Proceeds from equity financing	14,050	1,676	0	0	0
Net bank borrowings	-5,913	12,842	800	100	100
Dividend paid	-4,715	-3,930	-2,203	-3,008	-3,560
Interest paid	0	0	-1,721	-1,737	-1,741
Others	-298	-5,736	0	0	0
Cash flow from financing	**3,123**	**4,852**	**-3,124**	**-4,645**	**-5,201**
Change in cash	12,372	-6,043	5,351	12,962	14,834

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**116,406**	**125,182**	**122,468**	**117,634**	**112,162**
PP&E	33,188	37,892	36,173	32,349	27,865
Investment in JV/associates	6,713	5,341	5,422	5,504	5,580
Goodwill	22,847	24,019	24,019	24,019	24,019
Long term receivables	9,522	10,173	10,173	10,173	10,173
Intangible assets	20,908	22,760	21,684	20,592	19,527
Others	23,228	24,998	24,998	24,998	24,998
Current assets	**160,638**	**168,484**	**186,683**	**204,087**	**222,853**
Prepayments	1,570	1,473	1,388	1,303	1,218
Inventories	31,585	33,374	41,528	43,374	46,710
Trade receivables	18,191	21,419	26,197	28,877	29,559
Notes receivables	16,562	16,575	16,575	16,575	16,575
Others	17,688	24,803	24,803	24,803	24,803
Cash	75,043	70,842	76,193	89,155	103,989
Current liabilities	**115,382**	**119,743**	**126,885**	**130,057**	**133,609**
Trade and bills payables	39,596	45,560	51,902	54,974	58,426
Notes payable	27,797	22,025	22,025	22,025	22,025
Bank borrowings	12,982	15,824	16,624	16,724	16,824
Others	35,006	36,334	36,334	36,334	36,334
Non-current liabilities	**58,700**	**69,813**	**69,813**	**69,813**	**69,813**
Bank borrowings	18,839	28,839	28,839	28,839	28,839
Long term payables	18,427	14,879	14,879	14,879	14,879
Others	21,435	26,094	26,094	26,094	26,094
Equity	**102,962**	**104,111**	**112,454**	**121,851**	**131,593**
Shareholders' equity	70,907	73,184	79,576	86,741	94,089
MI	32,055	30,926	32,877	35,110	37,505

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Diesel engines	31.7	22.4	28.2	29.6	29.7
Automobiles and major components	36.5	26.7	28.9	28.1	27.6
Forklift trucks & supply chain solution	38.6	45.1	39.7	38.1	38.1
Agricultural machinery	-	10.1	9.0	9.0	8.9
Intersegment sales	(6.8)	(4.3)	(5.8)	(4.8)	(4.3)
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratio (%)					
Gross margin	19.5	17.8	20.4	20.2	20.2
EBIT margin	6.7	3.1	6.0	6.4	6.3
After tax profit margin	5.7	3.2	5.1	5.4	5.5
Growth (%)					
Revenue	3.1	(13.9)	18.1	10.4	6.1
Gross profit	3.8	(21.3)	35.5	9.3	6.1
EBIT	5.5	(59.6)	125.3	18.5	5.1
Net profit	0.5	(47.0)	75.2	18.4	7.2
Balance sheet ratio					
Current ratio (x)	1.4	1.4	1.5	1.6	1.7
Receivable turnover days	30	41	42	44	44
Inventory turnover days	70	82	83	85	85
Payable turnover days	95	108	108	107	107
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	4.2	2.0	3.5	3.9	4.1
ROE	15.2	6.8	11.3	12.2	12.1
Per share data					
EPS (RMB)	1.06	0.56	0.98	1.17	1.25
BVPS (RMB)	8.13	8.39	9.12	9.94	10.78
DPS (RMB)	0.35	0.25	0.34	0.41	0.44

Source: Company data, CMBIGM estimates

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Zhejiang Dingli - A (603338 CH)

Clear strategy on overseas expansion

Driven by strong infrastructure spending, manufacturing capex and machinery replacement demand, the demand for AWP will stay robust over the coming years, in our view. We believe a wide range of product offerings, together with clear strategies in overseas including the penetration into tier-one leasing companies in the US and the expansion to emerging countries, will help Dingli differentiate itself from peers. We maintain our **BUY** rating with TP of RMB70 (based on 18x 2024E P/E which is 1SD below the historical average of 31x). We see the risk/reward profile is highly attractive.

- **Dingli offers a full range of AWP products.** The main products cover (1) boom lifts, (2) scissor lifts and (3) vertical lifts, with a total of >200 models. Boom lifts series includes telescopic booms and articulating booms, powered by electric, hybrid and diesel. The maximum working height is 44 meters and the maximum capacity is 454kg. Scissor lifts series has a maximum working height of 32 meters and a maximum capacity of 1,000kg. These products are widely used in construction engineering, building maintenance, warehouse and logistics, petrochemical, shipyards production and maintenance, as well as special working conditions, such as power grids, nuclear power plants, high-speed rails, airports and tunnels.
- **Boom lift remains the key growth driver.** Boom lift revenue surged 1.9x YoY to RMB730mn in 3Q23. This is the first time that revenue from boom lift exceeded that of scissor lift (RMB700mn in 3Q23). For boom lift, overseas sales ratio in 9M23 increased to 45% (previously 30%). Dingli expects the overseas sales ratio will exceed 50% in 2024E. Furthermore, given that boom lift in overseas carries higher gross margin (>40%) compared with China's market, higher overseas sales will boost gross margin going forward.
- **Resilient gross margin helped by decline in input cost.** We expect Dingli's gross margin to stay high given the sharp decline in global freight rate and lower steel cost.
- **Risks:** (1) intensified competition in China's AWP market; (2) higher-than-expected EU's anti-dumping duties; and (3) sharp rebound of RMB rate.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	4,939	5,445	6,267	7,508	8,646
YoY growth (%)	67.1	10.2	15.1	19.8	15.2
Net income (RMB mn)	884	1,257	1,693	1,963	2,229
EPS (RMB)	1.82	2.48	3.34	3.88	4.40
YoY growth (%)	33.2	36.3	34.7	16.0	13.6
Consensus EPS (RMB)	n/a	n/a	3.26	3.78	4.39
EV/EBITDA (x)	19.7	17.8	11.7	9.7	8.6
P/E (x)	26.2	19.2	14.3	12.3	10.8
P/B (x)	4.0	3.4	2.8	2.4	2.0
Yield (%)	0.7	1.0	1.4	1.6	1.8
ROE (%)	18.2	19.3	21.7	21.1	20.2
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**RMB70**
(Previous TP	RMB70)
Up/Downside	**46%**
Current Price	**RMB47.73**

China Capital Goods

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Stock Data

Mkt Cap (RMB mn)	24,165.7
Avg 3 mths t/o (RMB mn)	182.0
52w High/Low (RMB)	61.65/43.58
Total Issued Shares (mn)	506.3

Source: Bloomberg

Shareholding Structure

XU Shugen	45.5%
Deqing Zhongding Equity Investment Management	11.6%
CCASS (Hong Kong)	11.1%

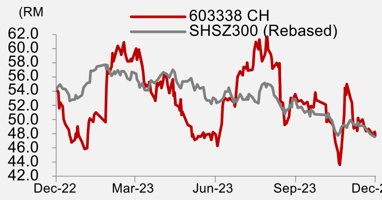
Source: Shanghai Stock Exchange

Share Performance

	Absolute	Relative
1-mth	-13.0%	-9.9%
3-mth	-10.9%	-1.6%
6-mth	-0.3%	10.7%

Source: Bloomberg

12-mth Price Performance



Source: Factset

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	**4,939**	**5,445**	**6,267**	**7,508**	**8,646**
Cost of sales	-3,490	-3,755	-3,912	-4,686	-5,454
Gross profit	**1,449**	**1,690**	**2,355**	**2,822**	**3,192**
Surcharge	-15	-12	-13	-15	-17
S&D expenses	-111	-158	-182	-218	-251
Administrative expenses	-88	-123	-138	-161	-182
R&D expense	-155	-202	-219	-263	-303
Asset impairment	-32	-51	-50	-45	-52
EBIT	**1,048**	**1,143**	**1,753**	**2,120**	**2,388**
Net finance income/(cost)	-69	233	104	61	89
Finance income	16	250	150	105	130
Finance expenses	-85	-17	-46	-44	-41
Other gains/(losses)	40	64	69	75	86
Profit of JV & associates	1	20	43	27	29
Pretax profit	**1,021**	**1,460**	**1,969**	**2,283**	**2,592**
Income tax	-137	-203	-276	-320	-363
After tax profit	**884**	**1,257**	**1,693**	**1,963**	**2,229**
MI	0	0	0	0	0
Net profit	**884**	**1,257**	**1,693**	**1,963**	**2,229**
D&A	77	101	138	165	192
EBITDA	**1,125**	**1,245**	**1,892**	**2,286**	**2,581**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Pretax profit	1,021	1,460	1,969	2,283	2,592
Finance cost	85	17	46	44	41
Interest income	58	-234	-150	-105	-130
Profit / loss of associates	-1	-20	-43	-27	-29
Depreciation and amortization	77	101	138	165	192
Income tax paid	-164	-260	-276	-320	-363
Change in working capital	-687	-211	68	-44	-432
Others	-15	83	0	0	0
Cash flow from operation	**374**	**937**	**1,753**	**1,998**	**1,872**
Net capex on PP&E	-340	-819	-500	-300	-300
Interest received	-58	234	150	105	130
Others	409	-464	0	0	0
Cash flow from investing	**-69**	**-1,222**	**-350**	**-195**	**-170**
Proceeds from equity	1,482	0	0	0	0
Net bank borrowings	746	266	-50	-100	-100
Dividend paid	-126	-172	-253	-339	-393
Interest paid	-30	-46	-46	-44	-41
Others	-3	-3	0	0	0
Cash flow from financing	**2,069**	**45**	**-349**	**-483**	**-533**
Change in cash	2,374	-240	1,054	1,320	1,168

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**2,181**	**2,980**	**3,555**	**3,777**	**4,048**
PP&E	828	947	1,317	1,460	1,576
JV/associates	108	121	164	190	219
LT trade receivables	584	602	772	833	968
Intangible assets	234	396	388	379	371
AFS investments	0	0	0	0	0
Others	415	885	885	885	885
Deferred tax assets	12	30	30	30	30
Current assets	**7,394**	**8,821**	**9,312**	**11,818**	**12,951**
Inventories	1,387	1,795	1,377	1,961	1,685
Trade and bill receivables	2,293	3,094	2,949	3,551	3,792
Prepayment	42	9	9	9	9
Others	157	401	401	401	401
Cash	3,514	3,522	4,576	5,896	7,064
Current liabilities	**3,144**	**3,753**	**3,378**	**4,531**	**4,149**
Trade and bill payables	1,868	2,381	2,056	3,259	2,927
Bank borrowings	873	777	727	677	627
Tax payable	165	225	225	225	225
Advance from customers	18	29	29	29	29
Others	220	341	341	341	341
Non-current liabilities	**452**	**984**	**984**	**934**	**884**
Bank borrowings	302	740	740	690	640
Deferred tax liabilities	0	0	0	0	0
Deferred income	108	183	183	183	183
Others	42	61	61	61	61
Equity	**5,978**	**7,065**	**8,505**	**10,129**	**11,966**
Shareholders' equity	5,978	7,065	8,505	10,129	11,966
MI	0	0	0	0	0

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue mix (%)					
Boom lifts	33	27	26	30	33
Scissor lifts	58	61	62	59	56
Vertical lifts	5	9	9	8	8
Others	4	4	3	3	2
Total	100	100	100	100	100
Profit & loss ratio (%)					
Gross margin	29.3	31.0	37.6	37.6	36.9
EBITDA margin	22.8	22.9	30.2	30.4	29.8
EBIT margin	21.2	21.0	28.0	28.2	27.6
Net profit margin	17.9	23.1	27.0	26.1	25.8
Growth (%)					
Revenue	67.1	10.2	15.1	19.8	15.2
Gross profit	40.4	16.7	39.3	19.8	13.1
EBITDA	39.9	10.6	52.0	20.8	12.9
EBIT	37.2	9.1	53.4	20.9	12.6
Net profit	33.2	42.1	34.7	16.0	13.6
Balance sheet ratio					
Current ratio (x)	2.4	2.4	2.8	2.6	3.1
Receivable turnover days	131	181	176	158	155
Inventory turnover days	122	155	148	130	122
Payable turnover days	162	207	207	207	207
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	11.5	11.8	13.7	13.8	13.7
ROE	18.2	19.3	21.7	21.1	20.2
Per share data					
EPS (RMB)	1.82	2.48	3.34	3.88	4.40
BVPS (RMB)	11.81	13.95	16.80	20.00	23.63
DPS (RMB)	0.34	0.50	0.67	0.78	0.88

Source: Company data, CMBIGM estimates

18 Dec 2023

CMB International Global Markets | Equity Research | Company Update

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招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

Netflix (NFLX US)

Entering the AVOD space

We remain positive on Netflix's long-term subs trend, AVOD expansion, paid-sharing rollout and margin expansion, backed by its vibrant original content pipeline and efficient investment. After its better-than-feared 3Q23, Netflix demonstrated strong net adds, resilient margin guidance (22%-23% OPM in FY24E, +2~3ppts YoY) and increasing FCF (guiding US$6.5bn), partly alleviating market concerns about content spending and competition. Looking ahead, we forecast Netflix to deliver 11%/24% rev/earnings CAGR during FY23-25E, with 7.6% subs CAGR (driven by international market expansion, AVODs and paid-sharing penetration). With competition to pull back and strikes to settle, we think it is a good time to accumulate the stock. Maintain BUY with TP of US$512.

- **Global streaming leader on clear growth trajectory.** Netflix is a global leading online video platform, with 247mn subs in >190 countries (by 3Q23). Backed by its sizable subs, vibrant original content and exclusive IP reserve, we forecast Netflix to deliver 24% earnings CAGR in FY23-25E.
- **Leveraging original content edge for share gains and price hikes.** Netflix prides itself on exclusive high-quality original content (e.g. suspense & survival categories), backed by stepped-up investment and rational industrial production system with top-tier studios and producers. Such content edge enhances its leadership and supports its continuous price hike (seven times in 2011-23, forecasting ARM at 3.4% CAGR in FY23-25E). With competition to pull back and strikes to settle, we expect its share gain to continue.
- **Bearing fruit from AVOD expansion and paid-sharing initiatives.** We are bullish on Netflix's AVOD expansion, and expect positive impact on both net adds and ARPU. With a lower-priced package, AVOD can help Netflix spread its global reach and tap into price-sensitive users (forecasting TAM of 380mn subs worldwide). Netflix has signed up >5mn ad-supported subs in May 2023, and the US "Standard with Ads" Plan accounted for 30% of new sign-ups in Sep 2023. Looking ahead, we expect Netflix's AVOD subs to rise to 32mn in FY25E (11% subs mix), at 51% CAGR. Moreover, we expect paid-sharing initiatives (launched on 23 May) to transfer more users into add-on subs (>100mn password-sharing users in Netflix). We forecast ~30mn extra subs from paid initiatives by 2025E (6% rev mix), implying ~30% conversion rate.
- **Maintain BUY.** We set our DCF-based TP at **US$512** (implying **33x** FY24E P/E)**,** 15% below historical multiple but largely above industry average. Key catalysts: 1) Content pipeline to pick up after strikes; 2) resilient net adds; and 3) higher UE and ARPU ahead to drive margin improvement.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (US$ mn)	29,698	31,616	33,580	37,981	41,488
YoY change (%)	19%	6%	6%	13%	9%
Adj. net income (US$)	5,116	4,492	5,397	6,825	8,351
Adj. EPS (US$)	11.24	9.94	12.00	15.45	19.15
YoY growth (%)	NA	NA	21%	29%	24%
Consensus EPS (US$)	NA	NA	12.22	15.96	19.41
P/E (x)	NA	NA	34.3	26.7	21.5
P/S (x)	NA	NA	5.4	4.7	4.3
ROE (%)	38.02	24.53	25.00	27.84	28.27

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**US$512**
(Previous TP	US$512)
Up/Downside	**+12.0%**
Current Price	**US$455.2**

Global Entertainment

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Stock Data

Mkt Cap (US$ mn)	199,210
Avg 3 mths t/o (US$ mn)	2,165
52w High/Low (US$)	485/273
Total Issued Shares (mn)	438

Source: Bloomberg

Shareholding Structure

Vanguard	8.28%
Capital Group	7.24%
BlackRock	6.85%

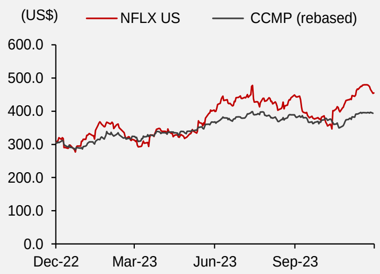
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	5.3%	-0.3%
3-mth	1.4%	0.0%
6-mth	12.8%	4.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: ERNST & YOUNG

Financial Summary

Income statement

YE 31 Dec (US$ mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**29,698**	**31,616**	**33,580**	**37,981**	**41,488**
Streaming	29,515	31,470	33,497	37,981	41,488
DVD	182	146	83	-	-
COGS	(17,333)	(19,168)	(20,010)	(21,858)	(23,335)
Gross profit	**12,365**	**12,447**	**13,570**	**16,123**	**18,153**
S&M	(2,545)	(2,531)	(2,496)	(2,765)	(2,874)
Admin.Exp.	(1,352)	(1,573)	(1,758)	(1,882)	(1,973)
Technology & Development	(2,274)	(2,711)	(2,698)	(2,957)	(3,116)
Others	-	(15)	-	(0)	(0)
Operating profit	**6,195**	**5,633**	**6,617**	**8,520**	**10,190**
Financial income	(766)	(706)	(698)	(675)	(611)
Other income	411	337	179	184	246
Pre-tax Income	**5,840**	**5,264**	**6,099**	**8,029**	**9,825**
Income Tax	724	772	702	1,204	1,474
MI	-	-	-	-	-
Share of equity investment	-	-	-	-	-
Net profit	**5,116**	**4,492**	**5,397**	**6,825**	**8,351**

Cash flow summary

YE 31 Dec (US$ mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Net income	**(130)**	**102**	**88**	**118**	**155**
D&A	208	337	372	421	431
Change in WC	(242)	(758)	(764)	(477)	(317)
Others	556	2,346	7,160	6,400	8,645
Operating CF	**393**	**2,026**	**6,855**	**6,462**	**8,913**
Capex	(525)	(408)	(406)	(456)	(479)
Acquisitions	(788)	(757)	-	-	-
Others	(27)	(911)	397	-	-
Investing CF	**(1,340)**	**(2,076)**	**(9)**	**(456)**	**(479)**
Proceeds from debt	(500)	(678)	61	(400)	(1,808)
Repurchases of common stock	(600)	-	(4,295)	(3,000)	(3,000)
Others	(50)	14	(14)	-	-
Financing CF	**(1,150)**	**(664)**	**(4,249)**	**(3,400)**	**(4,808)**
Net change in cash	**(2,178)**	**(881)**	**2,561**	**2,606**	**3,627**
Cash (beg of yr)	8,206	6,028	5,147	7,708	10,314

Balance sheet

YE 31 Dec (US$ mn)	FY21A	FY22E	FY23E	FY24E	FY25E
Non-current assets	**36,515**	**39,328**	**38,362**	**40,757**	**42,073**
Fixed asset	1,323	1,398	1,535	1,571	1,618
Content library, net	30,920	32,737	31,179	32,701	33,396
Others	4,272	5,193	5,648	6,485	7,059
Current assets	**8,070**	**9,266**	**11,481**	**14,458**	**18,407**
Cash	6,028	5,147	7,708	10,314	13,942
Content library, net	-	-	-	-	-
Others	2,042	4,119	3,773	4,144	4,465
Current liabilities	**8,489**	**7,931**	**7,895**	**8,751**	**9,499**
Current content liabilities	4,293	4,480	4,333	4,827	5,254
Account payable	837	672	607	633	663
Deferred revenue	1,209	1,265	1,217	1,476	1,607
Accrued expenses	1,449	1,515	1,738	1,815	1,976
Non-current liabilities	**20,246**	**19,886**	**19,151**	**19,428**	**18,145**
Convertible debt	14,693	14,353	13,901	13,501	11,693
Non-current content liabilities	3,094	3,081	2,715	3,024	3,292
Others	2,459	2,452	2,536	2,904	3,161
Total net assets	15,849	20,777	22,797	27,036	32,835
Shareholders' equity	**15,849**	**20,777**	**22,398**	**26,637**	**32,436**

Key ratios

YE 31 Dec	FY21A	FY22E	FY23E	FY24E	FY25E
Sales mix (%)					
Streaming	99.4	99.5	99.8	100.0	100.0
DVD	0.6	0.5	0.2	0.0	0.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth rate (%)					
Revenue	18.8	6.5	6.2	13.1	9.2
Gross profit	27.2	0.7	9.0	18.8	12.6
EBIT	NA	NA	NA	28.7	19.6
Net profit	85.3	(12.2)	20.2	26.4	22.4
P&L ratios (%)					
Operating margin	20.9	17.8	19.7	22.4	24.6
Pre-tax margin	19.7	16.6	18.2	21.1	23.7
Adj. net margin	17.2	14.2	16.1	18.0	20.1
Effective tax rate					
Returns (%)					
ROE	38.0	24.5	25.0	27.8	28.3
ROA	12.2	9.6	11.0	13.0	14.4
Per share					
EPS (US$)	11.2	9.9	12.0	15.5	19.1
DPS (US$)	0.0	0.0	0.0	0.0	0.0
BVPS (US$)	34.8	46.0	49.8	60.3	74.4

Source: Company data, CMBIGM estimates

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Kuaishou (1024 HK)

Upbeat margin to continue

Kuaishou (KS) delivered upbeat margins and in-line revenue in 3Q23. Looking into 4Q23E, we expect the resilient momentum to continue. We forecast 4Q23E revenue +15% YoY (largely in line), and bottom line at RMB2.8bn (9% above consensus). We are positive on its long-term ecommerce upside, boosted by deeper MAC penetration, higher traffic efficiency, and shelf-based mall expansion. Thanks to 11.11 outperformance (the highest GMV growth among key platforms), we expect its ecommerce GMV/others revenue +29.5%/40% YoY in 4Q23E. Ads would see above-industry growth in 4Q23E (forecasting +20% YoY). We raise FY23-25E earnings by 7%-10%, and keep TP unchanged at HK$97.

- **3Q23 beat on earnings.** KS delivered upbeat 3Q23 results, with revenue +21% YoY to RMB27.9bn (1%/1% above consensus/our estimates), and adj. net profit at RMB3.2bn (19%/15% above consensus/our estimates, adj. NPM at 11.4%). By segment, ecommerce GMV/revenue rose 30%/37% YoY, supported by extensive brand participation and shelf-based e-commerce. In 3Q23, shopping mall GMV showed sequential growth and shelf-based GMV accounted for nearly 20% of total GMV. Ads revenue grew 27% YoY (in line), attributable to external ads recovery (e.g. media info, education and training) and robust internal ads. Adj. NP beat on higher GPM, better opex control and other income.
- **Better margin outlook in 4Q23E, with resilient ads & ecommerce.** We expect KS to see a solid 4Q23E (forecasting revenue +15% YoY), backed by strong ecommerce, resilient ads and better profit. KS delivered the highest GMV growth in 11.11 promotion among key platforms. We expect its ecommerce GMV/others revenue +29.5%/40% YoY in 4Q23E, boosted by deeper MAC penetration and shelf-based mall contribution. There is still ample room for shelf-based mall GMV expansion (vs. ~30% mix of Douyin), with supply chain enrichment and higher purchase frequency. Ads would see above-industry growth in 4Q23E (forecasting +20% YoY), with internal ads to contribute around 50% of ads revenue. We expect external ads recovery to continue, driven by resilient media (e.g. bite-sized shows), mini game, healthcare and education verticals. Given business adjustment, we forecast livestreaming revenue to stay flat YoY in 4Q23E. We forecast adj. NP at RMB2.8bn in 4Q23E (9% above consensus, with adj. NPM at 9%), with domestic OP to be stable QoQ.
- **Maintain BUY.** We lift our earnings forecast by 7-10% in FY23-25E, with an unchanged SOTP-based TP at HK$97. Catalysts: 1) a solid 4Q23E; 2) shelf-based mall expansion; and 3) earnings upside.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	**81,082**	**94,183**	**113,527**	**129,143**	**145,562**
YoY growth (%)	37.9	16.2	20.5	13.8	12.7
Adjusted net profit (RMB mn)	**(18,852)**	**(5,751)**	**8,752**	**13,566**	**21,538**
Diluted EPS (RMB cents)	**(4.7)**	**(1.3)**	**1.9**	**2.9**	**4.6**
YoY growth (%)	NA	NA	NA	55	59
Consensus EPS (RMB)	NA	NA	1.7	3.2	4.8
P/S (x)	**2.9**	**2.5**	**2.0**	**1.8**	**1.6**
P/E (x)	**NA**	**NA**	**26**	**17**	**11**
ROE (%)	NA	(32.2)	7.7	13.5	20.8

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**HK$97.0**
(Previous TP	HK$97)
Up/Downside	**+76.0%**
Current Price	**HK$55.1**

China Entertainment

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Stock Data

Mkt Cap (HK$ mn)	240,263
Avg 3 mths t/o (HK$ mn)	1,036.46
52w High/Low (HK$)	80.85/47.45
Total Issued Shares (mn)	3,592

Source: Bloomberg

Shareholding Structure

Tencent	18.9%
Morningside	15.7%
DCM	4.9%

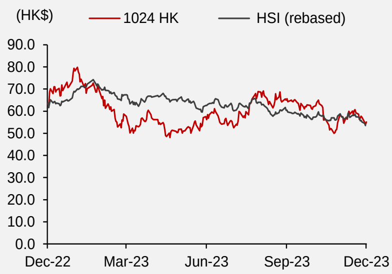
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-1.6%	6.5%
3-mth	-17.0%	-6.2%
6-mth	-6.2%	9.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**81,082**	**94,183**	**113,527**	**129,143**	**145,562**
Live streaming	30,995	35,388	39,054	40,616	41,632
Online marketing services	42,665	49,042	60,227	70,540	82,057
Other services	7,421	9,753	14,246	17,987	21,874
COGS	**(47,052)**	**(52,051)**	**(56,863)**	**(61,711)**	**(66,781)**
Gross profit	**34,030**	**42,131**	**56,664**	**67,432**	**78,781**
S&M	(44,176)	(37,121)	(37,171)	(40,218)	(42,142)
Admin.Exp.	(3,400)	(3,921)	(3,803)	(4,293)	(4,500)
R&D	(14,956)	(13,784)	(12,652)	(14,252)	(15,175)
Other gains	801	137	600	500	500
Operating profit	**(27,701)**	**(12,558)**	**3,637**	**9,169**	**17,464**
Other income/(exp), net	(51,314)	166	97	153	247
Pre-tax Income	**(79,102)**	**(12,531)**	**3,722**	**9,318**	**17,711**
Income Tax	1,025	(1,158)	(380)	(2,133)	(3,422)
Net profit	(78,077)	(13,689)	3,342	7,186	14,289
Adj. net profit	**(18,852)**	**(5,751)**	**8,752**	**13,566**	**21,538**

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Net income	**(78,077)**	**(13,689)**	**3,342**	**7,186**	**14,289**
D&A	6,885	6,306	7,105	8,195	8,910
Change in WC	2,444	(2,631)	1,955	2,110	2,205
Others	63,229	12,203	3,870	4,900	5,100
Operating CF	**(5,519)**	**2,189**	**16,272**	**22,390**	**30,504**
Capex	(5,789)	(9,181)	(11,210)	(10,802)	(13,227)
Purchase of investments	-	-	-	-	-
Others	(12,572)	(8,367)	47	47	47
Investing CF	**(18,361)**	**(17,548)**	**(11,163)**	**(10,755)**	**(13,179)**
Equity raised	39,386	-	-	-	-
Change of Debts	-	-	-	-	-
Cash from CB raised	-	-	-	-	-
Others	(2,885)	(4,482)	-	-	-
Financing CF	**36,500**	**(4,482)**	**-**	**-**	**-**
Net change in cash	**12,620**	**(19,841)**	**5,109**	**11,636**	**17,325**
Cash (beg of yr)	20,392	32,612	13,274	18,878	31,008
FX	(399)	494	494	494	494
Cash (end of yr)	**32,612**	**13,274**	**18,878**	**31,008**	**48,827**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**39,505**	**43,449**	**48,859**	**50,924**	**54,699**
Property and equipment	11,051	13,215	11,728	14,759	19,774
Right-of-use assets	12,562	10,806	18,700	18,199	17,425
Intangible assets	1,172	1,123	1,336	1,413	1,489
Others	14,720	18,305	17,094	16,553	16,011
Current assets	**53,011**	**45,859**	**52,407**	**65,962**	**85,277**
Cash	32,612	13,274	18,878	31,008	48,827
Prepayments	3,278	4,106	4,486	4,868	5,268
Financial assets at fair value	8,842	13,087	13,087	13,087	13,087
Trade receivables	4,450	6,288	7,579	8,622	9,718
Others	3,828	9,103	8,377	8,377	8,377
Current liabilities	**37,256**	**40,710**	**44,336**	**47,871**	**51,571**
Accounts payables	20,021	22,868	24,982	27,113	29,340
Other payables and accruals	9,123	10,190	11,132	12,081	13,073
Advances from customers	3,503	3,240	3,810	4,266	4,747
Others	4,608	4,411	4,411	4,411	4,411
Non-current liabilities	**10,108**	**8,744**	**8,744**	**8,744**	**8,760**
Convertible redeemable	-	-	-	-	-
Others	10,108	8,744	8,744	8,744	8,760
MI	-	-	-	-	-
Total Equity	45,096	39,838	47,050	59,136	78,525
Shareholders' equity	**45,096**	**39,838**	**47,050**	**59,136**	**78,525**

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Live streaming	38.2	37.6	34.4	31.5	28.6
Online marketing services	52.6	52.1	53.1	54.6	56.4
Other services	9.2	10.4	12.5	13.9	15.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth rate (%)					
Revenue	37.9	16.2	20.5	13.8	12.7
Gross profit	42.9	23.8	34.5	19.0	16.8
EBIT	NA	NA	NA	NA	NA
Adj. net profit	NA	NA	NA	55.0	58.8
P&L ratios (%)					
Operating margin	(34.2)	(13.3)	3.2	7.1	12.0
Pre-tax margin	(97.6)	(13.3)	3.3	7.2	12.2
Adj. net margin	(23.3)	(6.1)	7.7	10.5	14.8
Effective tax rate	(1.3)	9.2	(10.2)	15.0	15.0
Returns (%)					
ROE	NA	NA	NA	25.6	31.3
ROA	NA	NA	NA	12.4	16.8
Per share					
EPS (RMB)	(4.66)	(1.29)	1.92	2.93	4.56
DPS (RMB)	0.00	0.00	0.00	0.00	0.00
BVPS (RMB)	11.15	8.92	10.34	12.76	16.62

Source: Company data, CMBIGM estimates

China Longyuan (916 HK)

Speeding up new energy installation with enhanced generation efficiency; attractive valuation

China Longyuan (CLY) is the frontrunner of the new energy power industry in China. We see broad potential in its new energy installed capacity, and view its current valuation as attractive. CLY achieved stable power generation in Jan-Oct 2023. For new energy installation, due to lower upstream costs, the IRR of newly-added new energy power projects improved and stimulated CLY's installation willingness. CLY showed strong confidence in achieving its full-year newly-added new energy installed capacity target of 5,500 MW. Additionally, it actively refurbished old wind turbines, in line with the "substitution of large for small" policy, bringing great potential for its wind power efficiency. Besides, CLY announced the approval of its H-share repurchase plan, implying confidence in its own business. We maintain CLY-H's TP unchanged at HK$10.09, and CLY-A's TP unchanged at RMB23.98; reiterate BUY.

- **CLY had stable operating data, and its approval to implement share buyback shows strong confidence in the company's business.** In Nov 2023, CLY repurchased 3.58mn H-shares (accounting for 0.0427% of total issued shares) at a price range of HK$6.07-6.43/share, totaling HK$22.5mn. CLY plans to continue with the share buyback to show its confidence in company operations, at a time when it deems the H-share as undervalued. Additionally, its operating data in Jan-Oct 2023 was relatively stable. In terms of installations, CLY still has confidence to achieve its target of newly added new energy installed capacity at 5,500 MW.
- **We recommend CLY for its high operating quality and expectable profit improvement.** The detailed reasons are as follows: 1) stable operating data; 2) active development of green power trading and green certificate trading to obtain decent profits; 3) rapid solar power installations with lower upstream costs and a higher IRR for solar projects; 4) seizing the "substitution of large for small" window to upgrade qualified old wind turbines and enhance total wind power generation efficiency; 5) active implementation of share buyback plans showing confidence in business; and 6) CLY as the pioneer of renewable power operator in China benefiting from China-US collaboration in tripling renewable energy capacity by 2030 under the Sunnylands Statement.
- **Multiple factors support CLY's earnings improvement with attractive valuation.** CLY's stock price dropped significantly in 2022 due to losses from the provision for impairment on "substitution of large for small" and weak Ukrainian business. For 2023, with the impact of these provisions fading and the recovery of business operations, CLY's 1H23 results notably improved. At present, CLY-H is trading at 4x FY24E PE, close to the 3-year historical low. Considering CLY's steady power generation, strong confidence in achieving the new energy installation goal, mature green power and green certificate trading, and higher operation efficiency of old wind turbines, we expect CLY's results to further improve in 2023. Based on better results expectation, we regard CLY-H's current valuation as attractive.
- **We maintain our TP for CLY-H at HK$10.09, and our TP for CLY-A at RMB23.98; maintain a BUY rating .** We expect the results of CLY to improve continually, with rapid new energy installations and higher generation

BUY (Maintain)

Target Price	**HK$ 10.09**
(Previous TP	HK$ 10.09)
Up/Downside	**+78%**
Current Price	**HK$5.68**

China Energy

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Stock Data

Mkt Cap (HK$ mn)	126,730
Avg 3 mths t/o (HK$ mn)	91.27
52w High/Low (HK$)	11.54/5.87
Total Issued Shares (mn)	8,382

Source: FactSet

Shareholding Structure

Blackrock	9.0%
Citigroup Inc.	8.2%

Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-13.1%	-11.0%
3-mth	-4.2%	4.2%
6-mth	-32.7%	-26.5%

Source: FactSet

12-mth Price Performance

Source: FactSet

efficiency. Maintain CLY-H target price of HK$10.09, based on 10x FY24E PE (close to 3-year avg. PE). Reiterate BUY.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	39,893	39,863	42,097	46,268	51,027
YoY growth (%)	38.5	(0.1)	5.6	9.9	10.3
Gross margin (%)	36.5	34.4	35.1	36.7	36.9
Net profit (RMB mn)	7,423.8	5,112.2	7,866.0	9,101.3	9,953.7
YoY growth (%)	49.2	(31.1)	53.9	15.7	9.4
EPS (Reported) (RMB)	0.92	0.61	0.94	1.09	1.19
P/E (x)	12.3	19.0	6.0	5.2	4.7
ROE (%)	11.7	7.4	10.9	11.5	11.4

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**39,893**	**39,863**	**42,097**	**46,268**	**51,027**
Power Generation	30,611	31,875	35,283	40,214	45,318
Others	8,856	7,578	6,956	6,624	6,308
Cost of goods sold	(25,348	(26,139	(27,304	(29,274	(32,191
Gross profit	**14,545**	**13,724**	**14,793**	**16,994**	**18,836**
Operating expenses	**366**	**246**	**1,870**	**(79)**	**(48)**
Selling expense	3	0	0	0	0
Admin expense	363	398	301	379	416
Others	0	(152)	1,568	(458)	(465)
Operating profit	**13,965**	**11,492**	**14,490**	**16,622**	**18,360**
Other expense	3,998	3,806	3,250	3,517	3,825
Other gains/(losses)	49	(49)	0	0	0
Pre-tax profit	**10,016**	**7,638**	**11,240**	**13,106**	**14,534**
Income tax	1,599	1,542	2,247	2,685	3,051
After tax profit	**8,417**	**6,096**	**8,993**	**10,420**	**11,484**
Minority interest	993	983	1,127	1,319	1,530
Net profit	**7,424**	**5,112**	**7,866**	**9,101**	**9,954**

Cash flow statement

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**10,016**	**7,638**	**11,240**	**13,106**	**14,534**
Depreciation & amortization	8,187	10,158	12,409	13,839	15,666
Tax paid	1,599	1,542	2,247	2,685	3,051
Change in working capital	(2,875)	2,915	508	(73)	407
Net cash from operations	**18,120**	**29,606**	**25,134**	**27,653**	**31,332**
Capital expenditure	(18,273	(22,255	(29,701	(40,067	(45,256
-	0	0	0	0	0
Others	(737)	3,246	0	0	0
Net cash from investing	**(19,010**	**(19,009**	**(29,701**	**(40,067**	**(45,256**
Dividend paid	(3,399)	(4,501)	(4,231)	(5,027)	(5,573)
Net borrowings	17,006	8,261	(196)	19,704	14,704
Proceeds from share issues	2,055	0	0	0	0
Others	(17,000	(712)	(515)	(593)	(593)
Net cash from financing	**(1,339)**	**3,048**	**(4,942)**	**14,084**	**8,538**
Cash at the beginning of	5,225	3,536	17,961	9,243	11,704
FX exchange	-	-	-	-	-
Cash at the end of the year	**3,004**	**17,170**	**8,452**	**10,913**	**6,319**
Restricted cash	-	-	-	-	-

Balance sheet

YE 31 Dec(mn RMB)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**165,01**	**169,60**	**187,51**	**214,38**	**244,61**
PP&E	125,72	134,64	145,42	162,60	185,80
Deferred income tax	286	506	506	506	506
Intangibles	13,757	13,132	13,441	13,667	13,808
Other non-current assets	25,243	21,330	28,139	37,609	44,505
Current assets	**40,136**	**53,286**	**44,975**	**49,164**	**46,495**
Cash & equivalents	4,175	20,493	11,775	14,236	9,642
Account receivables	1,094	1,362	1,244	1,388	1,553
Inventories	765	750	740	794	874
Other current assets	34,101	30,682	31,216	32,745	34,426
Current liabilities	**63,533**	**74,711**	**75,720**	**77,374**	**79,707**
Short-term borrowings	19,893	18,524	18,624	18,624	18,624
Account payables	11,764	11,100	11,670	12,592	13,846
Other account payable	723	795	906	971	1,068
Tax payable	31,153	44,292	44,521	45,188	46,170
Non-current liabilities	**63,191**	**68,105**	**67,888**	**87,591**	**102,29**
Long-term borrowings	46,373	55,548	55,252	74,956	89,660
Other non-current liabilities	16,818	12,557	12,636	12,636	12,636
Share capital	8,036	8,382	8,382	8,382	8,382
Other reserves	54,778	55,867	62,751	70,342	78,548
Total shareholders	**68,499**	**68,807**	**75,691**	**83,282**	**91,488**
Total equity and	**205,14**	**222,89**	**232,48**	**263,54**	**291,11**

Key ratios

YE 31 Dec(mn RMB)	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Power generation	77.6	80.8	83.5	85.9	87.8
Others	22.4	19.2	16.5	14.1	12.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth					
Gross margin	36.46	34.43	35.43	37.33	37.33
Pre-tax new profit rate	32.64	26.24	32.05	33.71	33.43
Net profit rate	18.61	12.82	19.02	20.22	19.91
Gearing					
Current ratio (x)	0.6	0.7	0.5	0.6	0.5
Quick ratio (x)	0.6	0.7	0.5	0.6	0.5
Receivable turnover days	3.0	5.1	5.1	5.1	5.1
Inventory turnover days	10.8	10.6	10.0	10.0	10.0
Dividend payout ratio	15.9%	19.2%	19.2%	19.2%	19.2%
Profitability (%)					
ROE	10.84	7.43	10.68	11.38	11.21
ROA	3.62	2.29	3.48	3.61	3.54
Per share data(RMB)					
EPS (RMB)	0.92	0.61	0.94	1.09	1.19
DPS(RMB)	0.147	0.117	0.186	0.219	0.237

Company data, CMBIGM estimates

18 Dec 2023

China Longyuan (001289 CH)

Speeding up new energy installation with generation efficiency upgrade; attractive valuation

China Longyuan (CLY) is the frontrunner of the new energy power industry in China. We see broad growth potential in its new energy installed capacity and view its current valuation as attractive. CLY achieved stable power generation in Jan-Oct 2023. For new energy installation, due to lower upstream costs, the IRR of newly-added new energy power projects improved and stimulated CLY's installation willingness. CLY showed strong confidence in achieving its full-year newly-added new energy installed capacity target of 5,500 MW. Additionally, it actively refurbished old wind turbines, in line with the "substitution of large for small" policy, bringing great potential for its wind power efficiency. Besides, CLY announced the approval of its H-share repurchase plan, implying confidence in its own business. We maintain CLY-H's TP unchanged at HK$10.9, and CLY-A's TP unchanged at RMB23.98; reiterate BUY.

- **CLY had stable operating data, and its approval to implement share buyback shows strong confidence in the company's business.** In Nov 2023, CLY repurchased 3.58mn H-shares (accounting for 0.0427% of total issued shares) at a price range of HK$6.07-6.43/share, totaling HK$22.5mn. CLY plans to continue with the share buyback to show its confidence in company operations, at a time when it deems the H-share as undervalued. Additionally, its operating data in Jan-Oct 2023 was relatively stable. In terms of installations, CLY still has confidence to achieve its target of newly-added new energy installed capacity at 5,500 MW.

- **We recommend CLY for its high operating quality and expectable profit improvement.** The detailed reasons are as follows: 1) stable operating data; 2) active development of green power trading and green certificate trading to obtain decent profits; 3) rapid solar power installations with lower upstream costs and a higher IRR for solar projects; 4) seizing the "substitution of large for small" window to upgrade qualified old wind turbines and enhance total wind power generation efficiency; 5) active implementation of share buyback plans showing confidence in business; and 6) CLY as the pioneer of renewable power operator in China benefiting from China-US collaboration in tripling renewable energy capacity by 2030 under the Sunnylands Statement .

- **Multiple factors support CLY's earnings improvement with attractive valuation.** CLY's stock price dropped significantly in 2022 due to losses from the provision for impairment on "substitution of large for small" and weak Ukrainian business. For 2023, with the impact of these provisions fading and the recovery of business operations, CLY's 1H23 results notably improved. At present, CLY-H is trading at 4x FY24E PE, close to the 3-year historical low. Considering CLY's steady power generation, strong confidence in achieving the new energy installation goal, mature green power and green certificate trading, and higher operation efficiency of old wind turbines, we expect CLY's results to further improve in 2023. Based on better results expectation, we regard CLY-H's current valuation as attractive.

- **We maintain our TP for CLY-H at HK$10.09, and our TP for CLY-A at RMB23.98; maintain a BUY rating.** We expect the results of CLY to improve continually, with rapid new energy installations and higher generation

BUY (Maintain)

Target Price	**RMB 23.98**
(Previous TP	RMB 23.98)
Up/Downside	**+23.2%**
Current Price	**RMB19.47**

China Energy

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Stock Data

Mkt Cap (HK$ mn)	115,764
Avg 3 mths t/o (HK$ mn)	46.83
52w High/Low (HK$)	22.46/16.9
Total Issued Shares (mn)	8,382

Source: FactSet

Shareholding Structure

China Energy Investment	54.91%

Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-4.1%	-2.1%
3-mth	-0.3%	8.4%
6-mth	-4.7%	4.8%

Source: FactSet

12-mth Price Performance

Source: FactSet

efficiency. Maintain CLY-A target price of RMB23.98, based on 22x FY24E PE (close to 3-year avg. PE).

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	39,893	39,863	42,097	46,268	51,027
YoY growth (%)	38.5	(0.1)	5.6	9.9	10.3
Gross margin (%)	36.5	34.4	35.1	36.7	36.9
Net profit (RMB mn)	7,423.8	5,112.2	7,866.0	9,101.3	9,953.7
YoY growth (%)	49.2	(31.1)	53.9	15.7	9.4
EPS (Reported) (RMB)	0.92	0.61	0.94	1.09	1.19
P/E (x)	12.3	19.0	6.0	5.2	4.7
ROE (%)	11.7	7.4	10.9	11.5	11.4

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**39,893**	**39,863**	**42,097**	**46,268**	**51,027**
Power Generation	30,611	31,875	35,283	40,214	45,318
Others	8,856	7,578	6,956	6,624	6,308
Cost of goods sold	(25,348	(26,139	(27,304	(29,274	(32,191
Gross profit	**14,545**	**13,724**	**14,793**	**16,994**	**18,836**
Operating expenses	**366**	**246**	**1,870**	**(79)**	**(48)**
Selling expense	3	0	0	0	0
Admin expense	363	398	301	379	416
Others	0	(152)	1,568	(458)	(465)
Operating profit	**13,965**	**11,492**	**14,490**	**16,622**	**18,360**
Other expense	3,998	3,806	3,250	3,517	3,825
Other gains/(losses)	49	(49)	0	0	0
Pre-tax profit	**10,016**	**7,638**	**11,240**	**13,106**	**14,534**
Income tax	1,599	1,542	2,247	2,685	3,051
After tax profit	**8,417**	**6,096**	**8,993**	**10,420**	**11,484**
Minority interest	993	983	1,127	1,319	1,530
Net profit	**7,424**	**5,112**	**7,866**	**9,101**	**9,954**

Cash flow statement

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**10,016**	**7,638**	**11,240**	**13,106**	**14,534**
Depreciation & amortization	8,187	10,158	12,409	13,839	15,666
Tax paid	1,599	1,542	2,247	2,685	3,051
Change in working capital	(2,875)	2,915	508	(73)	407
Net cash from operations	**18,120**	**29,606**	**25,134**	**27,653**	**31,332**
Capital expenditure	(18,273)	(22,255)	(29,701)	(40,067)	(45,256)
-	0	0	0	0	0
Others	(737)	3,246	0	0	0
Net cash from investing	**(19,010)**	**(19,009)**	**(29,701)**	**(40,067)**	**(45,256)**
Dividend paid	(3,399)	(4,501)	(4,231)	(5,027)	(5,573)
Net borrowings	17,006	8,261	(196)	19,704	14,704
Proceeds from share issues	2,055	0	0	0	0
Others	(17,000)	(712)	(515)	(593)	(593)
Net cash from financing	**(1,339)**	**3,048**	**(4,942)**	**14,084**	**8,538**
Cash at the beginning of	5,225	3,536	17,961	9,243	11,704
FX exchange	-	-	-	-	-
Cash at the end of the year	**3,004**	**17,170**	**8,452**	**10,913**	**6,319**
Restricted cash	-	-	-	-	-

Balance sheet

YE 31 Dec(mn RMB)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	**165,01**	**169,60**	**187,51**	**214,38**	**244,61**
PP&E	125,72	134,64	145,42	162,60	185,80
Deferred income tax	286	506	506	506	506
Intangibles	13,757	13,132	13,441	13,667	13,808
Other non-current assets	25,243	21,330	28,139	37,609	44,505
Current assets	**40,136**	**53,286**	**44,975**	**49,164**	**46,495**
Cash & equivalents	4,175	20,493	11,775	14,236	9,642
Account receivables	1,094	1,362	1,244	1,388	1,553
Inventories	765	750	740	794	874
Other current assets	34,101	30,682	31,216	32,745	34,426
Current liabilities	**63,533**	**74,711**	**75,720**	**77,374**	**79,707**
Short-term borrowings	19,893	18,524	18,624	18,624	18,624
Account payables	11,764	11,100	11,670	12,592	13,846
Other account payable	723	795	906	971	1,068
Tax payable	31,153	44,292	44,521	45,188	46,170
Non-current liabilities	**63,191**	**68,105**	**67,888**	**87,591**	**102,29**
Long-term borrowings	46,373	55,548	55,252	74,956	89,660
Other non-current liabilities	16,818	12,557	12,636	12,636	12,636
Share capital	8,036	8,382	8,382	8,382	8,382
Other reserves	54,778	55,867	62,751	70,342	78,548
Total shareholders	**68,499**	**68,807**	**75,691**	**83,282**	**91,488**
Total equity and	**205,14**	**222,89**	**232,48**	**263,54**	**291,11**

Key ratios

YE 31 Dec(mn RMB)	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Power generation	77.6	80.8	83.5	85.9	87.8
Others	22.4	19.2	16.5	14.1	12.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth					
Gross margin	36.46	34.43	35.43	37.33	37.33
Pre-tax new profit rate	32.64	26.24	32.05	33.71	33.43
Net profit rate	18.61	12.82	19.02	20.22	19.91
Gearing					
Current ratio (x)	0.6	0.7	0.5	0.6	0.5
Quick ratio (x)	0.6	0.7	0.5	0.6	0.5
Receivable turnover days	3.0	5.1	5.1	5.1	5.1
Inventory turnover days	10.8	10.6	10.0	10.0	10.0
Dividend payout ratio	15.9%	19.2%	19.2%	19.2%	19.2%
Profitability (%)					
ROE	10.84	7.43	10.68	11.38	11.21
ROA	3.62	2.29	3.48	3.61	3.54
Per share data(RMB)					
EPS (RMB)	0.92	0.61	0.97	1.14	1.24
DPS(RMB)	0.147	0.117	0.186	0.219	0.237

Company data, CMBIGM estimates

18 Dec 2023

CMB International Global Markets | Equity Research | Company Update

CR Gas (1193 HK)

Stable gas sales, resilient financial flexibility and high-quality projects

CR Gas achieved sound gas sales volume during Jan-Oct 2023, and its dollar margin improved to RMB0.45-0.55/cbm. We expect CR Gas to achieve its full-year dollar margin goal of RMB0.5/cbm. In addition, we project CR Gas's newly-added residential users to reach 3-3.5mn, and its comprehensive service business (CSB) to maintain rapid growth in 2023. Despite the lower-than-expected industrial gas sales in 1Q-3Q23, CR Gas achieved stable YoY growth in its industrial gas sales, even outperforming its peers with double-digit growth in 2H23; its dollar margin also significantly improved. As a city gas company with M&A activities in 2022, CR Gas has a strong foundation for stable sales growth, and has demonstrated robust financial resilience, cash flow, M&A capabilities and project quality. **We maintain a BUY rating and a TP at HK$34.13.**

- **CR Gas's gas sales in Jan-Oct 2023 rose by 10.7% YoY; operating data performed well in Oct 2023; and we expect its full-year gas sales growth target of 8% YoY to be met.** From Jan to Oct 2023, CR Gas's retail gas sales saw a 7.6% YoY increase. Residential gas sales grew steadily by 11% YoY, while industrial/commercial sales up by over 6.7%/8.3%YoY, respectively. In Oct 2023, its residential/industrial/commercial gas sales expanded by 12%/11%/18.5% YoY, respectively. The growth was driven by recovering gas demands and a lower base in 2H22, leading to an optimized gas sales structure. CR Gas has provided guidance of 8% YoY growth in retail gas sales volume for 2023. Based on Oct 2023 gas sales data and improving gas demand, along with higher winter gas consumption, and the low base in 2H22, we expect CR Gas to achieve its target, with increased profitability from a higher proportion of commercial gas usage.

- **CR Gas has achieved continued improvement in dollar margin and secured stable gas supply through a long-term cooperation agreement with CNPC.** CR Gas's dollar margin from Jan to Oct 2023 ranged from RMB0.54 to RMB0.55 per cbm (~RMB0.53-0.54/cbm for Jan-Sep), with Oct margin at RMB0.62/cbm (~RMB0.6/cbm in Sep). This positive trend is attributed to CR Gas's proactive cost pass-through measures and optimized gas sales structure, with over 60% of residential cost pass-through measures implemented as of Oct 2023. Despite potential pressure on dollar margin due to winter gas cost increases, CR Gas is expected to achieve its dollar margin target of over RMB0.5/cbm by passing the costs to end users in various regions. Furthermore, CR Gas has established a strategic partnership with CNPC, ensuring long-term gas supply of 4bn cbm over 10 years.

- **CR Gas aims to develop 3-3.5mn newly-added residential users for full-year 2023.** Its CSB continues to experience rapid growth. However, the pace of new residential gas user additions is likely to slow down as new real estate development project growth falls. We estimate 3.2mn new residential users in 2023. Additionally, we forecast the CSB to maintain an annual revenue growth rate of over 18%.

- **We maintain our TP unchanged at HK$34.13 and reiterate BUY rating.** CR Gas is trading at 8x FY24E PE, lower than its 3-year avg. PE +1SD (~10x PE). We believe the valuation is attractive. We maintain our TP at HK$34.13, based on11x FY24E PE. We remain optimistic about CR Gas's stable gas sales

BUY (Maintain)

Target Price	**HK$ 34.13**
(Previous TP	HK$ 34.13)
Up/Downside	**+38%**
Current Price	**HK$24.75**

China Energy

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Stock Data

Mkt Cap (HK$ mn)	57,272.0
Avg 3 mths t/o (HK$ mn)	67.3
52w High/Low (HK$)	35.35/20.85
Total Issued Shares (mn)	100.0

Source: FactSet

Shareholding Structure

Blackrock	61.5%
Citigroup Inc.	5.0%

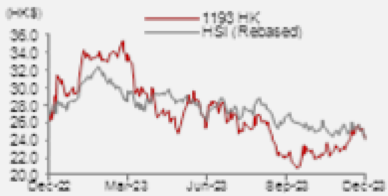
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	6.2%	7.9%
3-mth	9.3%	22.4%
6-mth	-9.1%	-1.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

growth, dollar margin improvement, rapid growth of CSB, and resilient financial flexibility. Reiterate BUY.

Earnings summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	78,175	94,338	95,314	98,485	104,321
Net profit (RMB mn)	6,395.1	4,733.5	6,067.4	7,234.9	7,713.6
EPS (Reported) (RMB)	2.82	2.09	2.67	3.19	3.40
EPS (Reported) (change%)	-	-26	18	19	7
Consensus (RMB)	na	2.77	3.03	3.39	3.61
PE (x)	15.5	15.2	9.0	7.6	7.1
PX (x)	2.4	1.8	1.3	1.2	1.1
ROE (%)	12.7	8.9	11.0	12.0	11.6

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

Income Statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	**78,175**	**94,338**	**95,314**	**98,485**	**104,32**
Cost of goods sold	59,880	76,256	76,905	78,384	83,480
Gross profit	**18,295**	**18,082**	**18,408**	**20,101**	**20,841**
Operating expenses	**(9,594)**	**(10,189**	**(9,439)**	**(9,162)**	**(9,079)**
Selling expense	(5,758)	(6,303)	(5,719)	(5,417)	(5,216)
Admin expense	(3,825)	(3,883)	(3,717)	(3,742)	(3,860)
Others	(11)	(3)	(3)	(3)	(3)
Operating profit	**8,701**	**7,892**	**8,969**	**10,939**	**11,762**
Other expense	1,774	771	1,430	1,477	1,565
EBITDA	**13,144**	**11,359**	**12,722**	**14,380**	**15,443**
Depreciation	2,592	2,598	2,216	1,861	2,017
Other amortization	77	99	108	103	98
EBIT	**10,475**	**8,663**	**10,399**	**12,417**	**13,327**
Dividend	(382)	(557)	(563)	(582)	(616)
Others	1,091	510	669	691	732
Pre-tax newt profit	**11,183**	**8,616**	**10,505**	**12,526**	**13,443**
taxation	(2,744)	(2,307)	(2,574)	(3,069)	(3,294)
After tax profit	8,440	6,309	7,931	9,457	10,149
Minority interest	(2,044)	(1,575)	(1,864)	(2,222)	(2,436)
Net profit	**6,395**	**4,733**	**6,067**	**7,235**	**7,714**

Cash flows statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Profit before taxation	**8,440**	**6,309**	**7,931**	**9,457**	**10,149**
Depreciation & amortization	2,669	2,696	2,323	1,964	2,116
Change in working capital	221	(2,592)	3,931	275	1,426
Others	(4,214)	3,124	(258)	(840)	(1,546)
Net cash from operations	**7,115**	**9,537**	**13,928**	**10,856**	**12,145**
Investing					
Capital expenditure	(5,978)	(6,258)	(6,323)	(6,533)	(6,921)
Net cash from investing	**(5,978)**	**(6,258)**	**(6,323)**	**(6,533)**	**(6,921)**
Financing					
Dividend paid	(2,347)	(2,382)	(3,053)	(3,640)	(3,881)
Others	(30)	(2,022)	(26)	(85)	(156)
Net cash from financing	**(2,377)**	**(4,404)**	**(3,079)**	**(3,725)**	**(4,037)**
Net change in cash					
Cash at the beginning of the	13,4	7,56	6,43	10,9	11,5
Others	(5,879)	(1,125)	4,526	598	1,188
Cash at the end of the year	**7,563**	**6,438**	**10,963**	**11,561**	**12,749**

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Current assets	**30,565**	**28,073**	**30,184**	**31,440**	**33,798**
Cash & equivalents	7,563	6,437	10,963	11,561	12,749
Account receivables	15,705	17,042	17,219	17,792	18,846
Inventories	1,142	1,307	(1,318)	(1,343)	(1,430)
Account payable	0	0	0	0	0
Other current asset	0	0	0	0	0
Non-current assets	**75,571**	**83,979**	**88,290**	**93,873**	**100,54**
PP&E	47,349	48,109	51,829	56,119	60,627
Deferred income tax	463	509	514	531	563
Associated	12,992	17,073	17,250	17,824	18,880
Intangible	3,254	3,188	3,572	3,952	4,344
Good will	1,274	2,540	2,566	2,652	2,809
Assets at fair value throu	165	2,226	2,249	2,324	2,462
Other non-current asset	6,820	7,146	6,737	6,519	6,513
Total asset	**106,13**	**112,05**	**118,47**	**125,31**	**134,34**
Current liabilities	**48,698**	**46,234**	**47,751**	**48,684**	**51,281**
short-term debt	616	7,696	7,696	7,696	7,696
Account-receivable	26,18	27,04	28,44	28,99	30,87
Tax account payable	969	880	889	918	973
Other current liabilities	5,620	22	22	23	24
Non-current assets	**3,401**	**13,277**	**13,304**	**13,392**	**13,555**
Long term debt	296	10,021	10,021	10,021	10,021
Deferred Tax	1,317	1,566	1,582	1,634	1,731
Other non-current asset	1,788	1,691	1,702	1,737	1,803
Total debt	**52,099**	**59,511**	**61,055**	**62,077**	**64,836**
Share capital	41,257	39,335	42,349	45,944	49,777
Share capital	**54,038**	**52,540**	**57,419**	**63,236**	**69,504**
Minority interest	12,781	13,206	15,070	17,292	19,728
Total equity and	**106,13**	**112,05**	**118,47**	**125,31**	**134,34**

Main ratio

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Sales Mix (%)					
Gas sales	78.4	79.6	82.9	81.4	82.1
Gas connection	15.3	12.9	8.6	9.9	9.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Profitability					
Gross profit margin	23.4	19.2	19.3	20.4	20.0
Operating margin	11.1	8.4%	9.4%	11.1	11.3
EBITDA ratio	16.8	12.0	13.3	14.6	14.8
ROE	12.7	8.9%	11.0	12.0	11.6
Gearing					
Current ratio （x）	0.6	0.6	0.6	0.6	0.7
Receivable turnover days	73.3	65.9	65.9	65.9	65.9
Inventory turnover days	7.0	6.3	6.3	6.3	6.3
Account payable days	159.	129.	135.	135.	135.
Return (%)					
ROA	14.2	15.5	12.0	14.3	15.7
Data pershare (RMB)					
EPS (RMB)	2.82	2.09	2.67	3.19	3.40
DPS (RMB)	1.03	1.05	1.35	1.60	1.71
BPS (RMB)					

Source: Company data, CMBIGM estimates

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