

Strategy Report

HSI constituent candidates in half-yearly review

The HSI Company will announce results of the 2021 Q2 review of the Hang Seng Family of Indexes after market close on 20 Aug 2021. In addition to potential changes to HSI, HSCEI & HSTECH constituents, this review will also determine changes in HSCI constituents and in turn eligible Southbound stocks. We expect five stocks will be added to the HSI to bring the number of constituents to 63.

- **Expect five stocks added to the HSI.** Since the HSI Company implemented enhancements to the HSI earlier this year, this will be the second index review. In order to meet the target to bring the number of HSI constituents to 80 by mid-2022, we expect to see five new constituents in this review.
- **Consumer sector to enjoy more additions to the HSI.** According to the simulated portfolio by the HSI Company, Consumer, Healthcare and IT would enjoy the biggest increase in number of constituents. In terms of market cap coverage, currently Consumer and Healthcare are the most under-represented. Considering there are more liquid large-caps in Consumer than Healthcare sector among non-HSI stocks, we expect to see more new constituents coming from Consumer sector.
- **Potential new HSI constituents: JD Health (6618 HK)** from Healthcare industry, **JD.com (9618 HK)** from IT industry, **Smooer (6969 HK)**, **CR Beer (291 HK)** and **Li Ning (2331 HK)** from Consumer industry.
- **Changes in Southbound eligible stocks.** We shortlisted 11 stocks that might become Southbound eligible stocks through inclusion into the HSCI, and on the other hand 7 stocks that risk being removed from Stock Connect. It is worth noting that while HK\$5 bn is the minimum market cap required to be Southbound eligible, the actual threshold has increased to above HK\$8 bn (to be included into the HSCI), per our estimates.

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Market Data

Hang Seng Index	26,181
52-week High / Low	31,183/23,124
3-month avg. daily t/o	HK\$162.6bn

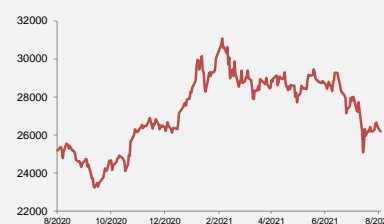
Source: Bloomberg

Indices Performance

	HSI	HSCEI	HSTECH
1-month	-6.5%	-8.7%	-15.7%
3-month	-6.6%	-11.0%	-15.1%
6-month	-14.8%	-23.0%	-40.0%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

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Which stocks will become new constituents of the HSI?

Recall that on 1 Mar 2021, the Hang Seng Indexes Company (HSI Company) announced the Consultation Results & Conclusions on the proposal to enhance the HSI. The enhancements have been implemented since the previous index review in May 2021. Key enhancements include:

1. Number of constituents is targeted to reach 80 by mid-2022, and ultimately fix at 100;
2. Select constituents by Seven Industry Groups;
3. Listing History requirement shortened to three months (counting up to the index review meeting date);
4. 8% weighting cap on every constituent, including WVR and secondary-listed ones;
5. Maintain 20-25 constituents classified as Hong Kong Companies.

Predicting the outcome of these several HSI reviews is arguably more difficult than ever, since the increase in number of constituents is unprecedented, and it is unclear how the HSI Company will prioritise the factors in considering new inclusions (e.g. how does a mega-cap stock in a well-represented industry compare to a large-cap stock in an under-represented industry). In the index review in May 2021, the inclusion of **Xinyi Solar (968 HK)** and **Country Garden Services (6098 HK)** surprised many.

Anyway, we try to predict which stocks will be included into the HSI and which into the Stock Connect.

Expect at least five new constituents in each quarter

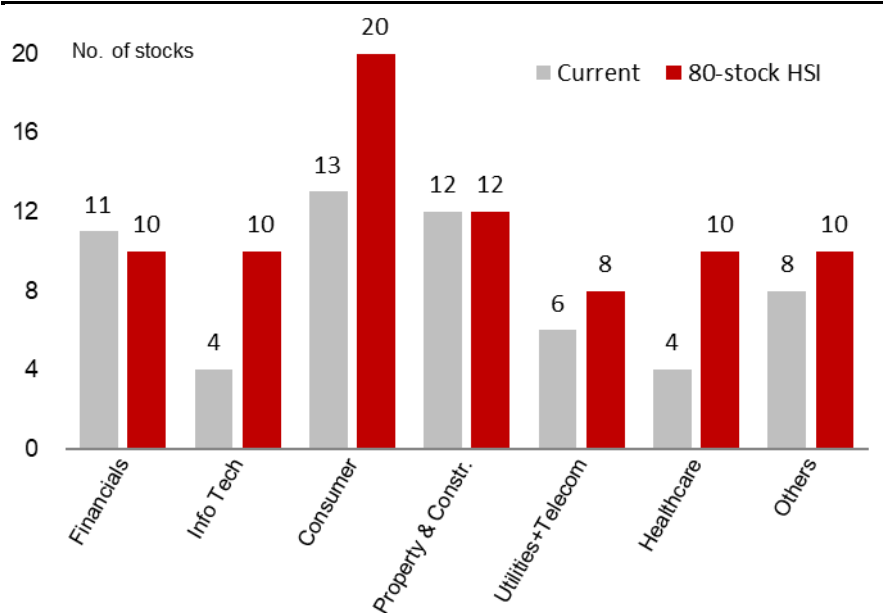
In the quarterly review in May 2021, three stocks were added to the HSI, bringing the number of constituents to 58. Since the number of HSI constituents is “targeted to reach 80 by mid-2022”, and there will be four quarterly index reviews between now and Jun 2022, we expect **5-6 new constituents (net) in each of the upcoming four reviews.**

Consumer & Healthcare should contribute to most additions

According to the simulated portfolio by the HSI Company in Feb 2021, **Consumer, Healthcare and IT would enjoy the biggest increase in number of constituents** (7, 6 and 6 respectively), when the total number of constituents reaches 80 (Fig. 1).

In terms of market cap coverage, the HSI is targeted to cover at least 50% of market cap for each industry group, and currently **Consumer, Healthcare and Properties & Construction are under-represented.**

Taking these two points into consideration, **we expect to see more new constituents coming from Consumer and Healthcare in the next 12 months.**

Figure 1: No. of HSI constituents by industry (simulated results)


Source: HSI Company, CMBIS

Potential inclusion: JD Health, JD.com, Smoore, CR Beer, Li Ning

In assessing potential HSI constituents, the HSI Company considers 1) Market value (MV) and turnover rank, 2) industry representation, and 3) financial performance. We rank candidates by their market value in Fig. 2.

In this quarterly review we expect the HSI to include five new constituents, namely **JD Health (6618 HK)** from Healthcare industry, **JD.com (9618 HK)** from IT industry, **Smoore (6969 HK)**, **CR Beer (291 HK)** and **Li Ning (2331 HK)** from Consumer industry.

Other “dark horses” include **Kuaishou (1024 HK)**, **Baidu (9888 HK)**, **NetEase (9999 HK)**, **Nongfu Spring (9633 HK)**, **China Feihe (6186 HK)**, **SMIC (981 HK)** and **Innovent Bio (1801 HK)**.

We expect no removals of constituents from the HSI in this review.

Figure 2: Top 25 non-HSI stocks by market value

Company	Ticker	Market Value* (HK\$ bn)	6-m avg. daily Turnover (HK\$ mn)
Kuaishou	1024 HK	835	2,096
JD Health	6618 HK	406	703
Baidu	9888 HK	363	N/A
Evergrande Vehicle	708 HK	333	429
NetEase	9999 HK	322	718
Smooore	6969 HK	295	1,129
China Merchants Bank	3968 HK	240	936
Nongfu Spring	9633 HK	223	420
Hansoh Pharma	3692 HK	216	131
Beigene	6160 HK	214	84
JD.com	9618 HK	207	1,632
CR Beer	291 HK	194	591
China Feihe	6186 HK	171	609
Trip.com	9961 HK	170	N/A
Bilibili	9626 HK	157	N/A
SMIC	981 HK	141	1,818
China Gas	384 HK	141	426
Swire Properties	1972 HK	130	69
ENN Energy	2688 HK	128	285
Li Ning	2331 HK	125	1,092
Zhongsheng	881 HK	124	270
Chow Tai Fook	1929 HK	112	151
Innovent Bio	1801 HK	103	571
Postal Savings Bank	1658 HK	94	378
CR Gas	1193 HK	92	121

Source: Bloomberg, CMBIS

*Month-end average from Jul 2020-Jun 2021; for secondary-listed stocks, only showing HK-registered shares

Which stocks will become eligible Southbound stocks?

This index review is also a half-yearly review on the Hang Seng Composite Index (HSCI), which will determine most of the changes in Southbound eligible stocks too, because to be eligible for Southbound trading, a stock has to be:

1. **Constituent of the HSCI, with 12-month average market cap over HK\$5 bn**, or
2. H-shares of A-H dual listed companies.

In Fig. 3, we listed some stocks that may become eligible Southbound stocks effective from 6 Sep 2021. These include:

1. Potential new HSCI constituents, in which most were IPOs in 1H 2021;
2. Weighted voting rights (WVR) stocks which have met the listing history requirement of 6 months plus 20 trading days [**Kuaishou (1024 HK)**]. While some other WVR stocks such as **Linklogis (9959 HK)** and **XPENG (9868 HK)** would have to wait for the next half-yearly review since they have not met listing history requirement.

Figure 3: Potential ADDITIONS into Southbound trading

Company	Ticker	Sector	Market Cap (HK\$ mn)*
Kuaishou -W	1024 HK	Internet	835,214
Angelalign	6699 HK	Healthcare	66,422
Nayuki	2150 HK	Consumer staples	29,363
Youran Dairy	9858 HK	Consumer staples	23,494
CARsgen -B	2171 HK	Healthcare	17,276
CStone Pharma -B	2616 HK	Healthcare	12,602
Cheerwin	6601 HK	Consumer staples	11,353
Kintor Pharma -B	9939 HK	Healthcare	10,370
SciClone Pharma	6600 HK	Healthcare	10,331
HK Tech Venture	1137 HK	Internet	10,284
China Nonferrous Mining	1258 HK	Materials	8,916

Source: Bloomberg, CMBIS

*Month-end average from Jul 2020-Jun 2021

In Fig. 4, we listed some stocks that might be removed from Stock Connect due to potential removals from the HSCI, as they have dropped out of the top 96% of the cumulative market value in HKEX, per our estimates.

Figure 4: Potential REMOVALS from Southbound trading

Company	Ticker	Sector	Market Cap (HK\$ mn)*
Mulsanne Group	1817 HK	Consumer discretionary	5,430
China Re	1508 HK	Financial	5,394
iDreamSky	1119 HK	Internet	5,368
Colour Life	1778 HK	Property management	5,198
China VAST	6166 HK	Property	5,111
Smartone Tele	315 HK	Telecom	4,864
Suncity Group	1383 HK	Consumer	4,459

Source: Bloomberg, CMBIS

* Month-end average from Jul 2020-Jun 2021

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