Dim Sum Express

A-Share Market

F&B: Volume and price growth in China’s bakery industry to continue

We believe the bakery industry in China is going through a phase of strong volume and price growth similar to what was seen during the 1970s-1980s in Japan. Similar to their Japanese counterparts back then, leading bakers in China have now developed advantageous regional presence and are seeking national business expansion. The bakery industry should continue to see both sales volume and prices rising on the back of changes in the younger generation’s consumer habits, product structure upgrade and consumption upgrade. We are positive on the "centralized plant production and wholesaling" business model.

Hong Kong Market

Investment Strategy: When China macro headwinds meet global uncertainties

Over the weekend, FAI, retail sales and industrial output all showed different degrees of slowdown in Apr, further confirming that the strong Mar data was short lived. We expect further market pressure this week. In fact, we expect sentiment to remain weak for the rest of 2Q16, as headwinds remain strong in the weeks ahead since decisions will be made on the US interest rate hike (Jun FOMC), the UK’s EU referendum, A-share inclusion in the MSCI, and possibly the Shenzhen Hong Kong Stock Connect. We remain conservative and recommend traditionally defensive sectors and high-yield stocks.

Macro: China’s policy focus to shift from stimulus to structural reform

According to comments made by an “authoritative person” in the People’s Daily, the Chinese government does not intend to launch stimulus measures in the short term. Policy focus will shift to structural reform, and the main aim of reform should be capacity reduction, destocking, deleveraging and cost reduction. Recent data also show the same idea, overall showing that the economy lost momentum in Apr after a short rebound in Mar. On the other hand, headline inflation remained unchanged at 2.3% for the third consecutive month, something which also makes it harder for the PBoC to ease monetary policy.

Property: Update on Chinese developers’ overseas projects

Eyeing overseas markets as a new revenue driver, Chinese developers have been accelerating overseas expansion. We believe this is to cope with overseas demand from Chinese buyers, to get relatively low-cost land banks in overseas markets, for business diversification, and to learn best practice from local developers. We expect overseas markets to account for 15-20% of some Chinese developers’ revenue in the next 3-5 years, which will improve their gross margins. Regarding 4M16 contract sales, COGO’s rose 12% YoY, COLI’s were up 20%, Yuexiu Property saw a rise of 100% for the next 3-5 years, which will improve their gross margins. Regarding 4M16 contract sales, COGO’s rose 12% YoY, COLI’s were up 20%, Yuexiu Property saw a rise of 100% YoY and Shenzhen Investment’s increased 300% YoY.

Alex Fan, CFA, Head of Research, SFC CE No. ADJ672 alexfan@gfgroup.com.hk +852 3719 1047
Gao Yedong, Editor, SFC CE No. BAI002 yedonggao@gfgroup.com.hk +852 3719 1026
F&B: Volume and price growth in China’s bakery industry to continue

Bakery industry to maintain 10% market growth The bakery industry in China grew at a CAGR of 18.6% during 1999-2013 before the number dropped to 11% in 2014, and the size of the market amounted to Rmb100bn in 2015. The industry has seen increases in both sales volume and prices since 2008, with per capita bakery consumption of 6.31kg and bread consumption of 1.53kg in 2015 representing 2-3x growth upside compared with levels in Japan and Hong Kong. We believe changes in the dietary habits of the younger generation will drive bread sales volume growth and penetration rate going forward; meanwhile, upgrades in consumer habits and product structure also point to substantial upside for price growth. We calculate that the industry is likely to maintain growth above 10% in the foreseeable future.

Rising industry concentration a key trend We believe the bakery industry in China is going through a phase of strong volume and price growth similar to what was seen during the 1970s-1980s in Japan. Just as Japan’s industry leader Yamazaki Baking was aggressively building production plants and expanding its business relying on convenient stores, leading bakeries in China have developed advantageous regional presence and are seeking national business expansion. Industry concentration is set to pick up, with some national market leaders to emerge. Leading player Toly Bread (603866 CH) has started its national expansion and is likely to maintain rapid but steady growth over the next five years and beyond.

Centralized model more sustainable than chain store model The “centralized plant production and wholesaling” model for the bakery business is highly efficient as it involves unified production and delivery, while the chain store model involves both plant production and in-store preparation. The centralized model relies on supermarkets and convenient stores as its main sales channels and is set to benefit from the rapid development of convenient stores going forward, while the chain store model requires relatively high channel costs. In addition, the centralized model is spreading to an enlarging scope of areas and is likely to create leaders with national presence, whereas big brands under the chain store model often find themselves competing with each other within the same regions. The centralized model also offers a higher net profit margin than the chain store model, as its slightly lower gross profit margin caused by its cheaper product prices is more than offset by its even lower channel costs. Lastly, the cheaper product prices and lower channel costs of the centralized model also make it more suitable for a path towards nationwide penetration through lower-tier cities.

Positive on Toly Bread despite high ST valuation The bakery industry should continue to see both sales volume and prices rising on the back of changes in the younger generation’s consumer habits, product structure upgrade and consumption upgrade. We are positive on the “centralized plant production and wholesaling” business model. In particular, industry leader Toly Bread will resume its cross-regional business expansion in 2016. We expect the company to maintain revenue growth of 20%-30% during 2016-2018, with net profit growth of 35%, 24% and 25% for each of the three years, and EPS of Rmb1.04, 1.29 and 1.62, representing P/E of 41x, 33x and 26x. Its valuation is slightly expensive for a newly listed stock, but we remain positive on the company given its steady long-term expansion and high earnings growth visibility.

Investment Strategy: When China macro headwinds meet global uncertainties

Market recap The old saying “sell in May” continued to play out over the past two weeks, with the HSI/HSCC down 6.4%/7.1% MTD, largely driven by worse-than-expected macro data for Apr and the “authoritative” comments on China’s economic policy on the front page of the People’s Daily last Monday. Indeed after the post-CNY rebound in Mar, macro data including PMI, exports and loan growth returned to weakness in Apr, denting investors’ hopes for a V-shaped rebound after seeing green shoots in Mar. Away from China, weaker-than-expected non-farm payrolls and PMI in the US also cast doubt on the sustainability of US economic growth. A rebound in the US dollar and a weakening of the Rmb added further pressure to the Hong Kong market. Over the past month, defensive sectors have outperformed commodity and macro-related sectors (except oil, which has been driven by higher oil prices).

Nowhere to hide, but turnover is dissipating The market decline has been quite comprehensively across the board, with even typically defensive sectors like consumer staples, telecoms and healthcare recording negative returns, albeit better than the market and many other sectors. There have only been a handful of stocks able to defy gravity and record positive share price performance. However, the selling pressure has not been strong, the market has declined slowly and quietly, and
average daily turnover declined consistently from HK$81.7bn in Jan down to HK$59.7bn in May MTD, indicating investors are losing interest but sentiment is far from being at crisis stage.

**Headwind remains after weak data points** Over the weekend, FAI, retail sales and industrial output all showed different degrees of slowdown in Apr, further confirming that the strong Mar data was short lived. We expect further market pressure this week. In fact, we expect sentiment to remain weak for the rest of 2Q16, as headwinds remain strong in the weeks ahead since decisions will be made on the US interest rate hike (Jun FOMC), the UK’s EU referendum, A-share inclusion in the MSCI, and possibly the Shenzhen Hong Kong Stock Connect. On top of the divided opinion poll on a Brexit and A-shares’ critical accessibility issues, uncertainties in the timing of the US interest rate hike and the launch of the stock connect could add to market volatility. In the extreme scenario of negative surprises from most of these events, the previous market floor in mid-Feb (~18,200 for the HSI) may not be a strong support level. In fact as we have argued before, during the last five major crisis periods since 1994, the Hong Kong market suffered 13 months of market decline (from peak to trough) on average, with a maximum index loss of around 52% on average. Counting from the previous high in May 2015 (HSI at 28,524 on May 26), the HSI downside could be 13,691 by the end of Jun, although this is not our base case scenario.

**Safety first** Given the macro headwinds, we remain conservative and recommend traditionally defensive sectors such as consumer staples, telecoms and healthcare, as well as high-yield stocks as the US interest rate cycle is tempered by a sluggish growth outlook.

(Alex Fan, CFA, Head of Research, SFC CE No. ADJ672, alexfan@qfgroup.com.hk +852 3719 1047)

**Macro: China’s policy focus to shift from stimulus to structural reform**

**Strong retail sales confirm 1Q16 slowdown was transitory** Last week, the US released several consumption related data points, which showed that personal consumption rebounded strongly in 2Q16. Headline retail sales grew 1.3% MoM during Apr, the strongest gain in one year. The main driver was car sales, which increased by a sharp 3.2%, a pullback from the 3.2% decline recorded in Mar. In addition, the consumer sentiment index jumped to 95.8 in Apr from 89 in Mar, the largest increase since Dec 2013. The broad increases in the consumption sector showed that the 1Q16 slowdown was just transitory. We expect GDP growth to rebound to 3% or even higher in 2Q16, following the two-year low of 0.5% in 1Q16. However, the strong retail sales data may not be enough to cause a Jun rate hike. First, Apr’s labor report was a big disappointment for the Fed given that “maximum employment” is one of its mandates. Second, the UK’s EU referendum will be held on Jun 23, one week after the FOMC meeting. The Fed is therefore likely to remain in “wait and see” mode to avoid market turbulence. In short, we believe the rate hike decision may be delayed until the second half of the year.

**UK’s EU referendum the next market focus** The Bank of England (BoE) maintained its benchmark rate at 0.5% and kept its asset purchase programme size at £375bn as expected last week. In its statement, the BoE mentioned the EU referendum risk three times. UK GDP grew by just 0.4% QoQ in 1Q16, much lower than the 0.6% growth seen in 4Q15, partly as companies may postpone investment decisions and households may defer consumption. GDP growth is generally expected to decline further in 2016. After the policy meeting, BoE governor Mark Carney warned that if the referendum results in the UK leaving the EU, the country may slide into a technical recession, which would mean two consecutive quarters of negative GDP growth. Mr Carney said that a Brexit may have several economic effects, including a plunge in the currency and higher unemployment, and could result in lower growth and higher inflation. The spillover effect should not be underestimated either. The turbulence in financial markets may also result in uncertainties for stock markets and tighter financial conditions in other countries. The referendum will therefore be the main focus in the coming months.

**Chinese government does not intend to launch stimulus measures in the short term** Last week, an un-named “authoritative person” shared his views on China’s economy and future policy direction on the front page of the People’s Daily. Several key points from this are worth noting. First, the recent economic rebound was investment-driven, but not by new growth engines, so the rebound may not be sustainable. China’s economy is therefore following an “L-shape”, but not a “V-shape” or “U-shape”. Second, too many stimulus policies may result in a bigger crisis in the future, which could include a housing bubble, bad loans, local government debt and excess capacity. The government should therefore not stimulate the economy by leveraging. Third, supply-side reform will continue to be the main policy direction going forward. According to the article, the Chinese government does not intend to launch stimulus measures in the short term. Policy focus will shift to
structural reform, and the main aim of reform should be capacity reduction, destocking, deleveraging and cost reduction. Recent data also show the same idea. New credit recorded a sharp fall in Apr. New bank loans narrowed to Rmb555.6m in Apr from Rmb1.37trn in Mar. M2 money supply growth slowed to 12.8%, the lowest level in ten months. Undoubtedly, the extremely easy credit seen in 1Q16 was unlikely to continue. Since the amount of new credit has dropped significantly, economic activity has also seen a broad slowdown. Industrial production growth fell to 6% in Apr from 6.8% in Mar, missing estimates of 6.5%. Retail sales growth declined to 10.1%, missing our forecast. Fixed asset investment growth dropped to 10.5%, less than our forecast of 11%. Overall, the data showed that the economy lost momentum in Apr after a short rebound in Mar. On the other hand, headline inflation remained unchanged at 2.3% for the third consecutive month in Apr, driven by extremely high pork prices (+33.5% YoY). The relatively high inflation also makes it harder for the PBoC to ease monetary policy. Therefore, we do not expect the PBoC to cut the RRR or interest rates in the coming months, even with the economic slowdown. In short, we believe the rebound in Mar may be just temporary. China’s economic growth is likely to slow in the second half of this year, and policy focus will shift to structural reform.

(Alex Fan, CFA, Head of Research, SFC CE No. ADJ672, alexfan@gfgroup.com.hk +852 3719 1047)
(Frankie Wan, Research Analyst, SFC CE No. AVK969, frankiewan@gfgroup.com.hk +852 3719 1052)

Property: Update on Chinese developers’ overseas projects

Vanke launches its ninth property project in the US Vanke (2202 HK, Buy) recently announced that it will co-develop a 43-story apartment building in Seattle in cooperation with US developer Laconia Development. This is Vanke’s ninth project in the US, having previously announced it would co-develop eight property projects in San Francisco and New York. In 2015, Vanke had projects in five international cities: New York, San Francisco, London, Singapore and Hong Kong, and its international business achieved revenue of Rmb2.9bn and booked GFA of 28,000 sqm.

Country Garden plans to co-invest Rmb250bn in its Forest City project in Malaysia Country Garden (2007 HK, Hold) launched presales for some of the apartments at its Forest City project in March, at an ASP of Rmb20,000 per sqm. The project is located in southern Malaysia’s Johor state (near Singapore), and has a total area of 14 square kilometers. The company will develop apartments, villas, schools, hospitals, an exhibition center, and a financial special administrative region at the project. It plans to co-invest Rmb250bn over the next 20 years in this mega-project. Management has stated that its overseas investment will comprise 10% of its annual total investment budget going forward. We see the project as a big bet for the company and expect it to significantly influence its future results.

Greenland Group has expanded to 13 international cities Greenland Group (a leading developer in China and a Fortune 500 company; not-listed) announced it has expanded to 13 cities in nine countries (USA, Australia, UK, Canada, etc), with overseas revenue of around Rmb30bn in 2015. Its projects in the US include Los Angeles Greenland Center and New York Atlantic Plaza; its projects in Australia include Sydney Greenland Center and Melbourne Flemington Life.

Gemadele Corporation plans to develop 20-30 projects in the US Gemadele Corporation’s (600383 CH) management has said the company prefers to develop residential and commercial property projects in selected cities in the US such as San Francisco, Los Angeles, Boston and Seattle. The company plans to develop 20-30 projects in the US in the future.

Overseas markets a new revenue driver for Chinese developers We believe Chinese developers are accelerating their overseas expansion for the following reasons: 1) to cope with overseas demand from Chinese buyers; 2) to get relatively low-cost land banks in overseas markets and to achieve higher gross margins; 3) business diversification, and; 4) to learn best practice from local developers. We expect overseas markets to account for 15-20% of some Chinese developers’ revenue in the next 3-5 years, which will improve their gross margins.

4M16 contract sales update
- COLI sales up 20% YoY; property disposal gains of HK$1.46bn COLI’s (688 HK, Buy) 4M16 sales rose 20% YoY to HK$54.9bn. GFA sold rose 13% YoY to 3.6m sqm. It recently sold an office building in Hong Kong for HK$4.9bn, which management expects to increase 2016 net earnings by HK$1.46bn.
- COGO sales increased 12% YoY COGO’s (81 HK, NR) contract sales rose 12% YoY to HK$5.5bn. GFA sold rose 22% YoY to 0.65m sqm.
- **Shenzhen Investment sales rose 300% YoY** Shenzhen Investment’s (604 HK, Buy) contract sales rose 300% YoY to Rmb8.4bn, 45% of its 2016 contract sales target. GFA sold increased by 91% YoY to 0.37m sqm, at an ASP of Rmb22,309 per sqm.

- **Yuexiu Property sales up 100% YoY** Yuexiu Property’s (123 HK, NR) contract sales rose 100% YoY to Rmb11.4bn, 44% of its 2016 contract sales target of Rmb25.8bn. GFA sold increased by 107% YoY to 1.09m sqm.

(Dennis Yao, Research Analyst, SFC CE No. ALK994, dennisyao@gtgroup.com.hk +852 3719 1065)
Rating Definitions

Benchmark: Hong Kong Hang Seng Index
Time horizon: 12 months

<table>
<thead>
<tr>
<th>Company ratings</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Stock expected to outperform benchmark by more than 15%</td>
</tr>
<tr>
<td>Accumulate</td>
<td>Stock expected to outperform benchmark by more than 5% but not more than 15%</td>
</tr>
<tr>
<td>Hold</td>
<td>Expected stock relative performance ranges between -5% and 5%</td>
</tr>
<tr>
<td>Underperform</td>
<td>Stock expected to underperform benchmark by more than 5%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sector ratings</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive</td>
<td>Sector expected to outperform benchmark by more than 10%</td>
</tr>
<tr>
<td>Neutral</td>
<td>Expected sector relative performance ranges between -10% and 10%</td>
</tr>
<tr>
<td>Cautious</td>
<td>Sector expected to underperform benchmark by more than 10%</td>
</tr>
</tbody>
</table>

Analyst Certification

The research analyst(s) primarily responsible for the content of this research report, in whole or in part, certifies that with respect to the company or relevant securities that the analyst(s) covered in this report: (1) all of the views expressed accurately reflect his or her personal views on the company or relevant securities mentioned herein; and (2) no part of his or her remuneration was, is, or will be, directly or indirectly, in connection with his or her specific recommendations or views expressed in this research report.

Disclosure of Interests

(1) The proprietary trading division of GF Securities (Hong Kong) Brokerage Limited (“GF Securities (Hong Kong)”) and/or its affiliated or associated companies do not hold any shares of the securities mentioned in this research report.
(2) GF Securities (Hong Kong) and/or its affiliated or associated companies do not have any investment banking relationship with the companies mentioned in this research report in the past 12 months.
(3) Neither the analyst(s) preparing this report nor his/her associate(s) serves as an officer of the company mentioned in this report and has any financial interests or hold any shares of the securities mentioned in this report.

Disclaimer

This report is prepared by GF Securities (Hong Kong). It is published solely for information purpose and does not constitute an offer to buy or sell any securities or a solicitation of an offer to buy, or recommendation for investment in, any securities. The research report is intended solely for use of the clients of GF Securities (Hong Kong). The securities mentioned in the research report may not be allowed to be sold in certain jurisdictions. No action has been taken to permit the distribution of the research reports to any person in any jurisdiction that the circulation or distribution of such research report is unlawful. No representation or warranty, either express or implied, is made by GF Securities (Hong Kong) as to the accuracy and completeness of the information contained in the research report. GF Securities (Hong Kong) accepts no liability for all loss arising from the use of the materials presented in the research report, unless it is expressly prohibited by applicable laws or regulations. Please be aware of the fact that investments involve risks and the price of securities may be fluctuated and therefore return may be varied, past results do not guarantee future performance. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. The report is not to be taken in substitution for the exercise of judgment by respective recipients of the report, where necessary, recipients should obtain professional advice before making investment decisions.

GF Securities (Hong Kong) may have issued, and may in the future issue, other communications that are inconsistent with, and present opposite points of view to their clients and the proprietary trading division with respect to market commentary or dealing strategy either in writing or verbally. The proprietary trading division of GF Securities (Hong Kong) may have different investment decision which may be contrary to the opinions expressed in the research report. GF Securities (Hong Kong) or its affiliates or respective directors, officers, analysts and employees may have rights and interests in securities mentioned in the research report. Recipients should be aware of relevant disclosure of interest (if any) when reading the report.

Copyright © GF Securities (Hong Kong) Brokerage Limited.
Without the prior written consent obtained from GF Securities (Hong Kong) Brokerage Limited, any part of the materials contained herein should not (i) in any forms be copied or reproduced or (ii) be re-disseminated.

© GF Securities (Hong Kong) Brokerage Limited. All rights reserved.
29-30/F, Li Po Chun Chambers, 189 Des Voeux Road Central, Hong Kong
Tel: +852 3719 1111  Fax: +852 2907 6176  Website: http://www.gfgroup.com.hk