NOMURA

China Investor Forum 2014

EQUITY: ASIA EX-JAPAN PRODUCT MANAGEMENT

The real Shanghai connect (Day One)

On the ground in the new China

Global Markets Research

3 September 2014

On the ball

China has probably never fascinated the investment community more than it has done this year, initiating a period of structural adjustment with a determination that the world is only just starting to believe. No wonder that the hall was packed for the morning's presentation by Prof Zheng Yongnian on the motivations and methods of President Xi Jinping. But there was much more than the anti-corruption drive to exercise the minds of investors who turned up for the China Investor Forum 2014 at the Pudong Shangri-La in Shanghai. An all-star line-up of keynotes and panel discussions went through everything from the health of the global financial system to the opportunities offered by the Shanghai Free Trade Zone to the state of the property market and China's stake and role in the gas boom. If you were unable to attend, the following pages should help you feel some of the vibe!

Fig. 1: He said, Xi said… Dr Zhu, Prof Zheng and our own Wendy Liu discuss the regime's motivations and methods (see page 3)

Source: Nomura

On the money

It was certainly not all about the big picture, with 70 of China's leading companies on the ground along with ten of Japan's top enterprises. Our analysts and sales people took copious notes at the public presentations and we have packed them for your reference inside this report.

On the way

The conference continues tomorrow – check the agenda inside – and we will bring the action ringside again. Also keep an eye on your inbox for company and sector notes from our analysts over the next couple of days.

Special thanks to all the analysts and sales persons on the ground who contributed to this report… now on to Day Two!

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Presentation: China under Xi Jinping

The changing landscape of elite politics and reforms

The changing face of China under Xi Jinping is probably the single most fascinating topic for international investors, and Professor Zheng Yongnian, Director of East Asian Institute, National University of Singapore, led this discussion at our China Investor Forum today.

According to Prof Zheng, President Xi likes to refer himself as the third generation [of leadership] after Mao ZeDong (first generation) and Deng Xiaoping (second generation). It is no surprise that President Xi wants his legacy to last for 30 years, well beyond his 10-year term, and he wants to show greater leadership over Li Keqiang, which is very different from the relationship adopted by Hu Jintao and Wen Jiabao, which was more of an equal partnership.

Understanding the anti-corruption campaign

Discussing the background of the anti-corruption campaign, Prof Zheng believes that corruption is unfortunately a part of normal politics. If there is no corruption, there will be no political survival. But what is worrisome is that corruption weakens the governing capacity of the Chinese Communist Party (CCP), causing social distrust over the ruling party, which in turn leads to a deep fear of a revolution from the bottom.

This essentially explains President Xi's populist move against elite corruption, fighting both 'tigers' (vice-ministerial-level-and-above officials) and "flies" (mid-ranked officials). The officials above the level of bureau chief are constantly afraid that they might be the next one being prosecuted. Hence, no one wants to make any bold moves, including executing bold reforms. Many corruption cases in Shanxi province are cases in point and there inaction became a crime.

President Xi relies heavily on Wang QiShan, a banking veteran who now heads the CCP Central Commission for Discipline Inspection, to fight corruption. Nicknamed 'fire chief', Wang is famous for his boldness in quelling crisis and has sent dozens of anti-corruption inspection teams to key party and government bodies.

Practical implications

Privatisation of SOEs is not easy. The heads of SOEs are appointed by the party which remains influential to date, and private sector enterprises are not as free-willed as in other countries. The financial sector has also been controlled by various vested interest groups. According to Li Keqiang, the possibility of halving the list of the negatives caused by vested interest groups in the financial sector would be a dream come true. That said, institutional reforms are more important than anti-corruption campaigns. After all, the objective of the anti-corruption campaign is to engage meaningful reforms.

For the fourth plenum agenda, there doesn't seem to be any mention of social safety while there were two items on the third plenum that addressed this. This could be a bit worrisome as social safety remains an important issue in order to smooth out the pains associated with these reforms, and Japan offers a good model to follow in this regard.

Q&A session

- **Q: Can you elaborate on social reforms?**

A: Government cannot control everything in social safety development (social enterprises), and needs to step back and get the involvement of the private sector. It has partially worked before in the Guangdong province. As seen in Japan, the government doesn't intervene much and it worked well. And so, the Chinese government only needs to provide legal framework for the development of social enterprises.

- **Q: How about Bismarck's approach?**

A: In Europe, many social institutions (schools, etc) were established before democracy was introduced. This is a good lesson for China, and we need to have these institutions in place first.

Speaker:
Prof Zheng Yongnian
Director of East Asian Institute, National University of Singapore

Moderator:
Dr Zhu Wen Hui
Senior Research Fellow, Bauhinia Foundation

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- **Q. Some Asian countries have been demanding more democratic processes recently. Any thoughts?**

A. Western scholars naively believe that democracy will bring economic prosperity. Sri Lanka, the Philippines, and Myanmar all introduced constitutional democracy but it didn't lead those countries to an economic success. On the other hand, Singapore teaches us that economics should come before politics. If you are well off, political demonstration will not lead to violence. Also, when Hong Kong citizens protest on the street, there is no violence because they are not economically deprived, and this does not apply to China. I believe that when you have a strong economy with a middle class representing 80% of the population, you do not need to worry about violence.

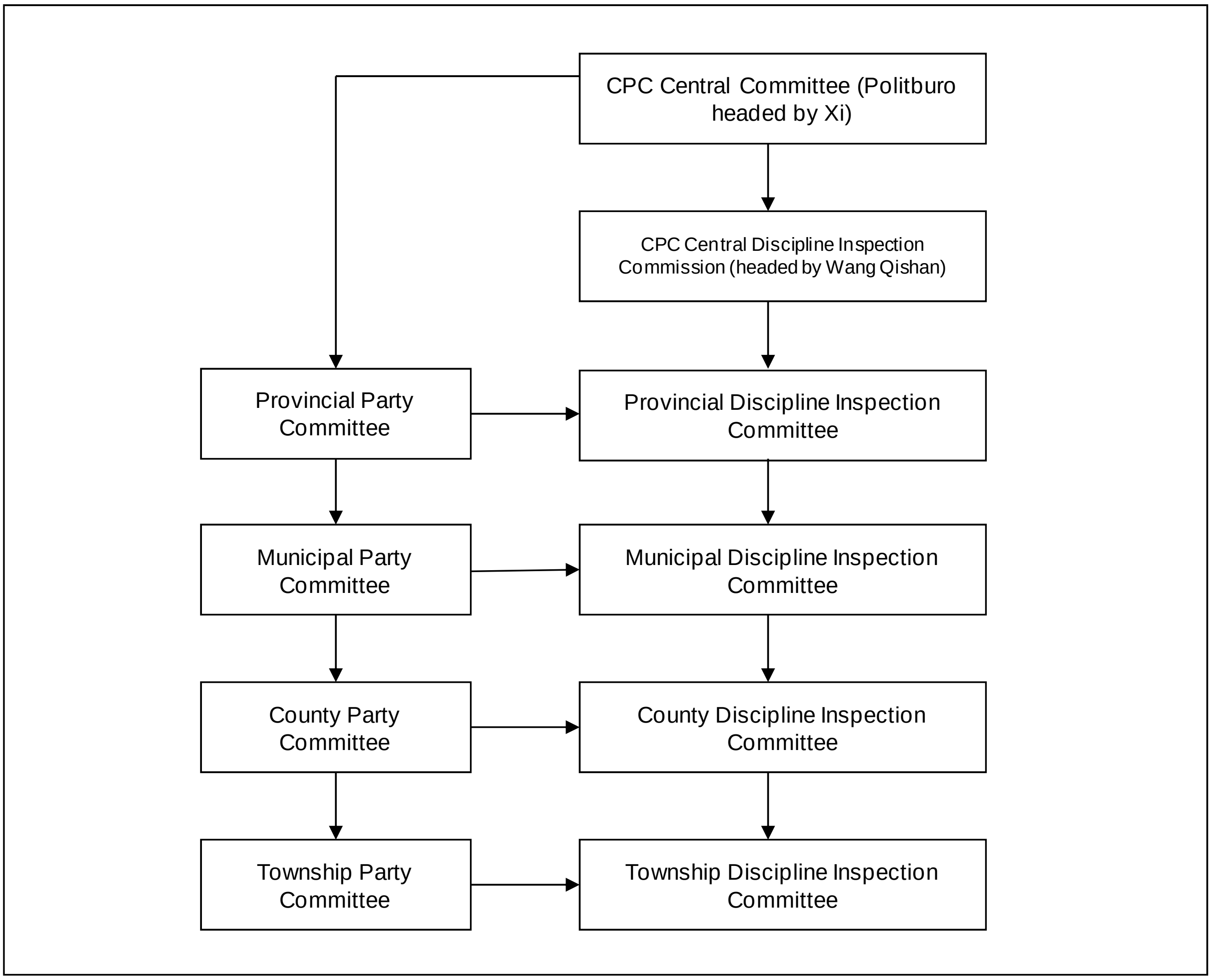
- **Q: How about India?**

A: Mao's eradication of the traditional social structure has helped capitalism take root in China. India didn't have that, and it still remains a very traditional country. Hong Kong has also had a 'good dictatorship' but the country has an independent judiciary system which helped boost the prosperity and rule of law. It is crucial that China has an independent judiciary system and not have its judicial system influenced by a single powerful figure like Zhou Yongkang.

- **Q: Is Ukraine an issue to China?**

A: No doubt ISIS needs to be watched, especially given its connections with Islamic factions in China's western and southern provinces.

Fig. 2: China's discipline inspection apparatus



Source: Prof Zheng Yongnian

Keynote: Financial innovation and development of Shanghai Pilot Free Trade Zone

Speaker:

Li Jun
China (Shanghai) Pilot Free Trade Zone Administration Deputy Secretary-General

Moderator:

Shen Hong
Shanghai Bureau Chief, The Wall Street Journal and Dow Jones Newswires

Mr Li Jun, Shanghai Pilot Free Trade Zone Administration Deputy Secretary-General, kicked off the set-list for the first day of the China Investor Forum 2014 with a comprehensive update on the progress and prospects of the high-profile FTZ.

Since the initiative was announced a year ago, all kinds of cornerstone entities have started building their presence in the FTZ, such as shipping and financial companies, cultural bodies, hospitals, law firms, etc. Mr Li argued that Shanghai has natural advantages to be a major trading hub – a good port, prime location, etc, and the administration is encouraging multinationals not just to operate out of the FTZ but set up headquarters there. Boeing has already set up an engine operation, as a major example.

There have been three important props to this progress:

- Legal: After the basic components of the legal framework were put in place about a year ago, 31 additional measures were introduced to expand the scope and strengthen the rules, including special laws to deal with land usage.
- Facilitation: The Customs Department has revised their regulations to make customs clearance more efficient. International practices in trade logistics have been adopted to enhance efficiency.
- Finance: Six key components: 1) risk management; 2) funds transfer; 3) promotion of RMB use; 4) liberalisation of FX transactions; 5) information sharing and transparency; 6) supervision of government performance.

Looking ahead, Mr Li highlighted the FTZ's strong interest in attracting enterprises involved in financial innovation. A total of 84 financial license holders are already in the FTZ, including a Nomura joint venture. About 100 private equity funds have set up operations in the FTZ, both domestic and local. In this context, future plans include:

- Promoting cross-border use of RMB. Companies in the FTZ are unwilling to borrow from offshore, so the idea is to make it easier and usage has grown this year.
- The FTZ currently supports only RMB but other major currencies will soon be supported.
- Other exchanges will be launched soon, for example the Shanghai gold and energy trading centre, Shanghai clearing house, Shanghai insurance trading centre (similar to Lloyd's), and a trading centre for leased assets.
- Strong risk management, with regular stress tests.
- Recent initiatives include giving international FX rates for the accounts in the FTZ. Interest rate and FX reforms are complicated processes, and the FTZ is working closely with the relevant authorities.

Keynote: Out of the balance sheet recession and into a QE 'trap'

Speaker:

Richard Koo

Chief Economist, Nomura Research Institute

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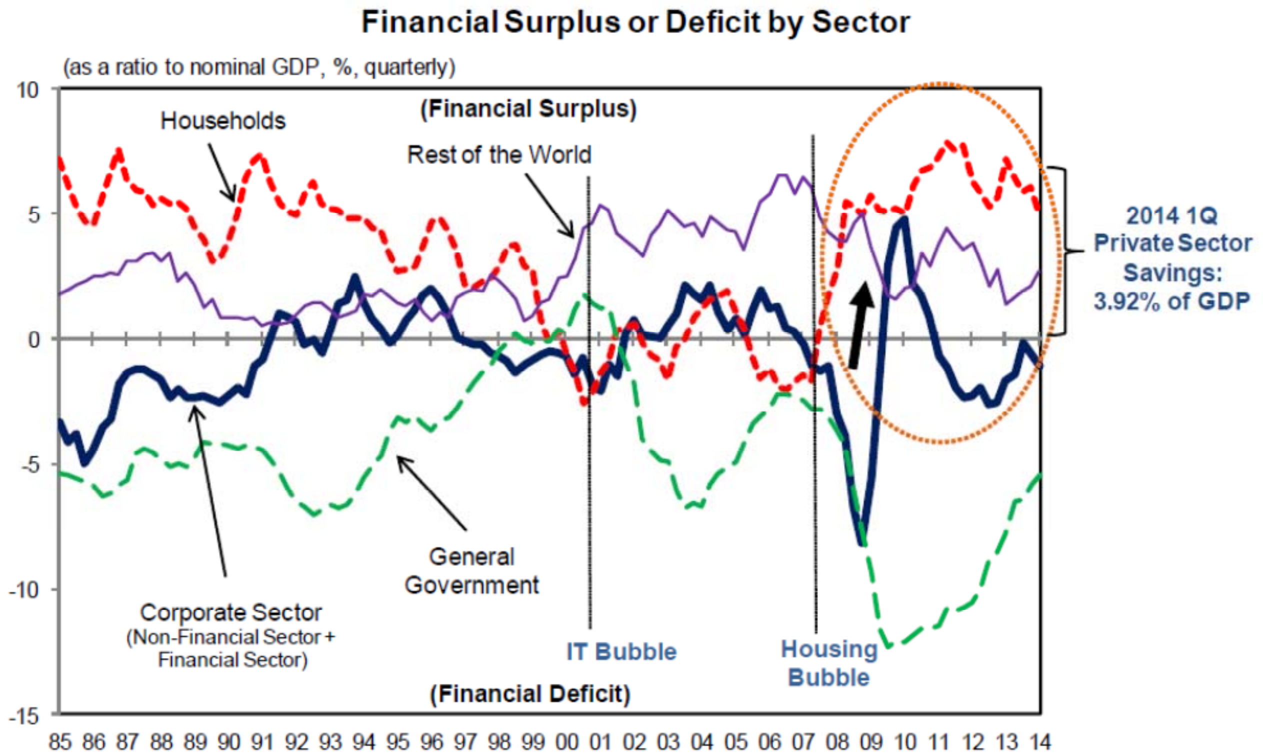
Richard Koo, Chief Economist, Nomura Research Institute, the man who added "balance sheet recession" to the financial world's vocabulary was in fine form, pulling the crowds as usual at our China Investment Forum in Shanghai. Once again, he regaled the audience with his prodigious recall of economic history, putting the challenges of the post-GFC world into the context of dilemmas past and leading from them to possible futures and the choices that lead to them.

To recap the world we are living in, massive liquidity was created after the global financial crisis. In normal times, excess reserve / required reserve ratio should be 1. After the GFC, however, the ratio is 20x. In the US, the monetary base went up 4.82x since the GFC, but the money supply only went up by 1.47x, and bank credit only 1.05x. As a result, inflation rate hasn't picked up. We see similar situations in Japan and the UK: bank lending actually even fell in the UK.

Why is this happening? Cash flow is being used to pay down debt from the high leverage days so there is no appetite for borrowing. Savings go up but get trapped in the system without being utilised. This is what happened during the Great Depression in the 1930s.

In Japan, the corporates borrowed heavily during the 80s, but they became net savers since the late 90s. This lack of spending was compensated by government spending and this kept the economy from shrinking. This continues to this date with the corporates still saving 7.35% of GDP. Why? Due to the psychological trauma of over-leverage. This has happened before; in the US, those who lived through the Great Depression never borrowed again. This is what balance sheet recession does.

Fig. 3: US in balance sheet recession



Note: All entries are four-quarter moving averages. For the latest figures, four-quarter averages ending with 1Q/'14 are used.

Source: FRB, US Department of Commerce

But hasn't quantitative easing staved off another balance sheet recession? Hasn't synchronised action by global central banks put the world on a slow but sure path to recovery? Mr Koo acknowledges that these unprecedented strategies have indeed pulled the global economy away from the brink of meltdown, but he points out that the job is not finished yet and complacence on the part of the financial leaders of the world may beget a “QE trap” that substitutes one crisis for another.

Abenomics shows an understanding of the deep issues Japan faces in pulling its economy out of long-term stagnation. The second arrow is particularly important in the short- to medium-term as the government must offset the net savings of 8% of GDP. For the third arrow to work well, structural reforms have to be of the right type. Former PM Koizumi’s attempt to privatise Japan Post was wrong because there was no private sector borrower. Abe’s structural reforms (the third arrow) are better focused. BOJ governor Kuroda shouldn’t push it too far. If more people believe in 2% inflation, JGB will be dumped, yield will go up and the government can’t fund the second arrow.

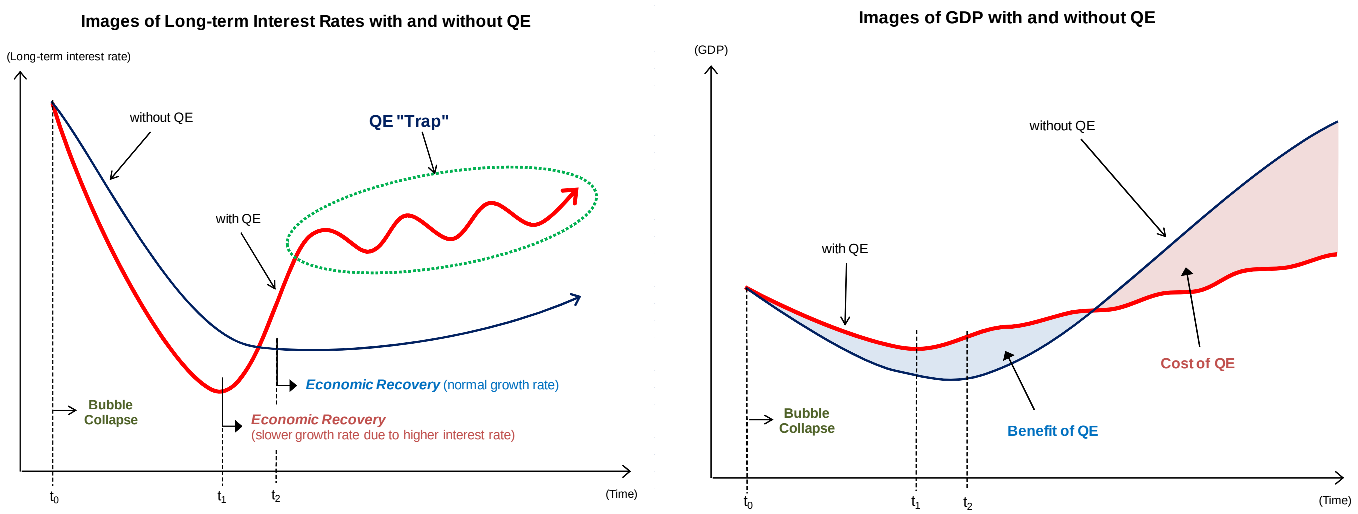
The US shouldn’t make a mistake by reducing government spending prematurely. The recovery there is still not complete.

In Europe, all troubled countries have seen savings rise since the GFC. There has been some buying of German bonds but this is not enough recycling. The Eurozone needs more structural reforms. He offers two modifications to Euro to resurrect the ailing Eurozone economies: allowing countries in balance sheet recessions to implement sufficient fiscal stimulus with blessings from the Troika and introducing different risk weights for holdings of domestic vs. foreign gov. bonds to keep domestic savings at home.

Starting QE is easy but unwinding it is more difficult. QE is the by-product of balance sheet recession based on the thinking that monetary policy can solve everything. However, there are costs involved in QE which will become more apparent once the economy starts to recover. The Fed says that, as part of its QE exit strategy, it will hold bonds until maturity but that won’t solve the problem. Treasury will have to issue redemption bonds to finance maturity payments but this won’t work as the private sector’s appetite for the bonds is uncertain and works against the Treasuries.

The Fed paying interest on reserves creates political challenges too as the estimated USD100bn interest payment will have to be made to the banks but this will cause a problem politically. A better solution would be to unwind QE before the economy recovers. Mr Koo reckons a USD500bn loss vs 15bn capital is likely if the Fed starts to sell bonds and push up the yield. Likewise, he sees a JPY36tn loss vs 6tn capital for the BOJ. To prevent this, private sector demand for bonds has to recover quickly.

Fig. 4: US in a QE trap?



Source: Nomura

Presentation: Demographic challenges in China – lessons from Abenomics

Key message: Be cautious on Chinese growth going forward, as China is at a critical turning point in terms of demographics - expect working population to peak at 1bn in 2010-2020, while the elderly population continues to rise and is expected to triple by 2040. Corporates will likely need to raise wages in order to keep the economy growing, but subsequently exports will suffer. As well, when similar cases happened (both in Japan and other countries globally), we also saw property market bubbles burst not long after.

Although Japan is also suffering from an overall population decline and surge in elderly population (in fact it is one of the first countries globally to experience this), the economy has remained very resilient, because:

- Japanese seniors tend to continue working well into retirement age, and are notorious for being big savers (estimated JPY30trn of savings, or 6% of GDP left behind by deceased elderly people annually)!
- Many industries are highly automated, with labour work mainly done by robots and machines. Total number of jobs in Japan has in fact remained extremely stable in the past 20 years, while productivity has progressively improved.

Also an interesting trend in Japan is that corporates are targeting the elderly population for business opportunities:

- Carmakers selling sports cars to seniors.
- 7-11 convenience stores offering healthy snacks in smaller and resealable packets, putting ATMs in every store.
- Uniqlo promoting "uni-generation" clothes.

Presenter:

Kosuke Motani
Chief Senior Economist, Economist Department, Japan Research Institute Ltd, and Senior Adviser, Regional Planning Department, The Development Bank of Japan Ltd

Panel discussion: China's Natural Gas transformation – winners and losers

Panel takeaways

- According to Mao, the priority for PetroChina is natural gas followed by tight gas and then, shale gas.
- While shale gas is not top priority for PetroChina, it is the first company to run a pilot test in Sichuan, gain technical knowhow and test if foreign equipment is suitable for China's conditions. The company has successfully lowered cost per well by 20-30%, and hopes to lower it by 50% next year.
- Jack discussed the overall oil market in China. Chinese Crude imports reached 282mn tons in 2013, accounting for 58% of China's total demand (487mn tons). And it is expected that this reliance on imports will only continue to increase.
- Crude oil price in China is regulated, which has created a situation where consumers, local refineries and oil majors - all are unhappy. While consumers find the prices expensive and think that oil majors are making all the money, the oil majors actually suffer from low margins and sometimes also suffer losses. And local refineries are actually struggling to make money as well. Due to unavailability of crude-oil, the import of which is subject to quota restrictions for non-SOEs, local refineries are forced to run at low utilisation levels, which is far below that of the oil majors.
- As per Jack, the solution is to liberalise crude oil market. Government should relax import crude oil quota (non-SOEs have import quota and they only account for 10% of imports now). This will encourage local refiners to be more efficient, will also ensure that resources are reasonably allocated, will lead to further improvement in the product mix and product quality besides also leading to discipline in capex and even the export of oil products. This will be good for China's oil storage and logistics industry too.

Moderator:

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Panelists:

Jack Fang
Director, Hans Energy

Zefeng Mao
Joint Company Secretary, PetroChina

Colin Shek
China editor for Interfax Energy and Shanghai bureau chief for Interfax

Panel discussion: Property outlook

Moderator:

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Panelists:

Liu Yuan
Vice President (Property Research), Centaline Group

Liqun Zhang
Senior Research Fellow of Macro Economic Research Department, DRC

Joe Zhou
Head of Research, Shanghai and East China, Residential Market, JLL

Overall market growth

All three panellists agreed that China property has passed the fast growth period in 2009 and we have entered a period of slower or even no growth in the future.

Short-term view

Dragged property sales in 1H do not mean the genuine housing demand has gone, but instead it is a process for accumulating demand. The property market should recover in 2H once the tight credit environment is loosened. Local governments will also support the market by adjusting their policies pro-actively.

Medium-term view

Mixed view by panellists on growth in Tier 1 and Tier 2/3 cities. Centaline believes emerging cities (excluding the top 50 cities) still have strong demand from returned workers and may become the support of the entire nation's property market in the future. However, Professor Zhang and JLL do not agree with this view. They believe high tier cities have large population inflows due to better education, job opportunities, social farewell, and infrastructure. Higher tier cities also cultivate large numbers of the middle class.

Long-term view

Property sales growth is linked to population growth and income growth. In higher tier cities, the proportion of the middle class group has increased, and they often have strong purchase power and upgrade demand in the future. The income growth of the people enhances their purchasing power and housing affordability, which is likely to be the major market supporting factor in the long run.

Fig. 5: Always room for debate on China property!

Source: Nomura

Panel discussion: Mobile gaming

Moderator:

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Panelists:

Tao Hong
Founder, Gamelook

Quanxin Sun
VP, Mokylin

Hang Zhen
Director of Strategic Analysis, Chukong Technologies Inc Co Ltd

At Nomura's China Investment Forum in Shanghai today, we hosted a panel discussion on mobile gaming. Panelists included Mr. Tao Hong, Founder of Gamelook, Mr. Quanxin Sun, VP, Mokylin and Mr. Hang Zeng, Director of Strategic Analysis, Chukong Technologies and discussed the gaming market and overall trends in China. We present below the major takeaways:

Growth in the mobile gaming world

Mobile gaming has been growing at >200% y-y from 3Q12 onwards till 4Q13, so market saturation should come earlier than expected and quicker than PC games. Seasonality also plays a part and 3Q traditionally should be stronger, given the summer holiday season. There is still some room to monetize mobile gaming in China as the penetration rate is still low in China vs. developed countries. It stands at CNY40/per user/year in China vs. CNY400 in Japan. In addition, Chinese players mostly play mobile gaming in WIFI environment but in Korea, mobile gaming usage is pretty much the same indoor and outdoor. Action and card games have been driving the mobile gaming sector since last year.

The big four segments of mobile gaming

- **Platform:** Apple (AAPL US, Buy), Google (GOOG US, Buy), Microsoft (MSFT US, Buy).
- **Mobile app distribution channels:** 360, Tencent (700 HK, Buy).
- **Publishers:** this segment is dying.
- **Developers:** There are three successful types of developers: those with a long R&D cycle but with one big #1 ranked product, those with a brand name (IP) building long product life cycles and the creative ones (which are first to bring to market the new 'sensation').

The panellists were of the view that the licensing model (like PC games) is unlikely to succeed in mobile games market and also that developers and channel will combine eventually.

Killer product missing still

Mobile gaming is turning more traditional non-gamers to paying-gamers but it still lacks killer product to release a potentially very deep pocket. Right now we're still in a 'trial & error' stage, where developers are spending money on developing different kinds of mobile games until a mainstream hit product segment is formed.

Tighter distribution channel control by Apple

Apple's control in distribution channel will become tighter to protect licensed games distribution. This is a negative to 91 Wireless (and now part of Baidu [BIDU US, Buy]) with iPhone 6 coming to the market in 4Q

Terminal/ web gamers versus Mobile gamers

Mobile gaming users are less sticky. So, simpler games, which are designed for gamers to play once every few hours and for a shorter period, would win vs. terminal/web games which have highly elaborated story-line based structure.

Fig. 6: Four off-line avatars

Source: Nomura

Company updates

Biostime: Competition and promotions will not ease

(1112 HK, Buy, target price: HKD60)

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Key message

We came away from a meeting with Lauren Tang (IR) of Biostime (1112 HK) that things are not set to improve in 2H14F after the company reported disappointing 1H14 numbers. To recall, 1H14 revenues only edged up 6.2% y-y while net profit was up even less, by 4.9% y-y due to a high teen % y-y drop in probiotic supplements and dried baby food. Since 1H14, the company has guided that sales momentum in July and Aug has not picked up. During the meeting, investors' questions were focused on: 1) the fierce competition, 2) margin compression and 3) e-commerce initiatives.

Forum takeaways

- **Competition.** The company continues to face intensifying competition with more domestic brands entering the high-end segment. Management also noted that there are many baby stores that are opening, which are taking traffic away from the supermarket channel.
- **Margin trend.** Biostime will launch mid-tier infant formula brand in an effort to capture growth in that segment, with 55% GPM (vs high-end at 62%), and guided that the level of promotion will remain high in the foreseeable future which together is likely to drag down Biostime's margins.
- **E-commerce.** Offsetting a slowdown in the supermarket channel, Biostime launched B2C initiatives with JD.com and introduced O2O initiatives too. However, the company guided that it is still too early to tell if these new sales channel efforts would be successful.

For more details, please see these notes:

Quick Note - Biostime International (1112 HK, Buy) - Online platform structure common in China
Quick Note - Biostime International (1112 HK, Buy) - Heavy discounts mainly online promotions

China Merchants Bank: NPL pressure to continue till next year; overall risk manageable

(3968 HK, Not Rated)

We hosted China Merchants Bank at Nomura's China Investment Forum today. Below we present the group meeting takeaways.

- **NPL pressure to continue till next year:** Investors' concerns were mainly focused on asset quality. Along with the sector trend, CMB's NPL continued to rise in 1H14. New NPLs mainly stemmed from manufacturing, wholesale & retail and steel/coal trades. From geographic perspective, new NPLs are mainly concentrated in Yangtze River Delta, but management also sees rising trends in Pearl River Delta, Bohai Rim region and some inner provinces like Shanxi and Inner Mongolia. Management believes pressure on NPLs would remain in 2H and next year, however the overall risk is manageable.
- **NPL ratios of some specific sectors:** Management also disclosed the NPL ratios of some specific sectors as at the end of 1H14. While NPL ratio of overcapacity sectors went down to 0.67% from 0.73% as at end-FY13 and NPL ratio of LGFV loans dropped to 0.01% from 0.02% at end-FY13, the NPL ratio of property development loans rose from 0.52% at end-FY13 to 0.67%. However, management is not too concerned about exposures to property sector. The percentage of real estate developer loans was only 5.5% of total loans, while the risk of mortgage loans is low, given a relatively low LTV ratio of under 50% on average.

- **As for loans to enterprises,** management didn't view the risks of loans to small and micro enterprises to be high as over 70% are secured by properties. The NPL ratio as at the end of 1H14 was 0.82%. The average loan amount of loans to small and micro enterprises is CNY1.5mn while lending rates are generally above benchmark.
- **NIM contraction attributed to strong deposit growth and strong growth in interbank business:** CMB's NIM in 1H14 narrowed by a larger magnitude than peers. Management attributed this to the bank's rapid deposit growth and relatively strong growth in interbank business which generated narrower spread. Management expects the downward trend to continue (which should be the same case sector-wise).
- **Interbank business:** CMB also conducted increasing interbank business but in a standardised way. For those "non-standard" products, CMB preserved sufficient provisions and capital according to the regulatory requirements and their risk appetite.

China Unicom: potential beneficiary of SOE reform

(762 HK, Buy, target price: **HKD13.50)**

Key message

Today, we met with China Unicom's management, Wan Xia (Deputy GM, Office of Board of Directors) during our China Investment Forum. Investors were surprised by the strong sector rally (+22% YTD) with China Mobile's (941 HK, Buy) share price punching above HKD100 levels for the first time since 2008.

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Leping Huang - NIHK

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Nomura analyst Leping Huang thinks the strong sector rally is driven by: 1) 4G growth, 2) SG&A reduction, and 3) mixed ownership. Interestingly, we also note that China Telecom's (728 HK, Neutral) Chairman and CEO Wang Xiao Chu will be kicking off his first US marketing in three years this coming Monday, 8 September 2014. This may also increase investors' confidence. We maintain our bullish stance on the overall sector, and reiterate our preference for China Mobile with the highest TP on the Street at HKD115, and our positive stance on China Unicom.

Forum takeaways

- 4G license driving data traffic growth. The company indicates the expansion of FD-LTE trial cities into 40 cities, which will help the company to drive the usage of mobile data service. The low-mid-end 4G handset model selection should also help lift the company's mobile ARPU.
- Similar percentage cut in SG&A. China Unicom confirmed that it will also cut similar percentage of sales and marketing expenses as China Mobile and China Telecom (~15%). Although not all of the cost reduction in handset subsidy will be translated into the bottom line as part of it is merely a 'change of use' of cost into monthly rate subsidy. However, this ensures earnings growth momentum for China Unicom.
- Reform on mixed ownership. KPI is currently decided by SASAC while the decision on salaries is controlled by central govt. If controlling interest is held by a private company, then there will be changes to the whole operating structure but this is unlikely to happen as China Unicom believes that government needs to decide the objective of these reforms first.

For more on China Unicom, please see our notes:

China Unicom (762 HK, Buy) - Results in line, maintain Buy
China Mobile (941 HK, Buy) - Raise TP by 28% to HKD115, reiterate Buy
China Telecom (728 HK, Neutral) - 1H14 review: not sweet enough

China South City: Enough landbank

(1668 HK, Not Rated)

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Key message

Management stated: 1) the company has sufficient landbank (8 projects with 26mn sqm) in T1 cities and provincial capitals, and will add one to two new projects per year; 2) recurring income is still small (HKD656mn in 2013, 5% of total revenues), but CSC targets to triple it in three years to HKD1.5-2bn; 3) gross margin is likely to remain high (49% in 2013), thanks to low land cost (4.4% of ASP); 4) cooperation with Tencent has huge potential, especially through tracking buyer behaviour, discovering demand and connecting SMEs to potential buyers.

Forum takeaways

Business model: Normally invited by local governments to build large-scale trading centres in city outskirts (usually 1.5 hours away from the city centre) and to relocate existing wholesale market tenants out of the city centre. A typical project consists of 50% trade centres, 20% residential, 15% logistics, and 15% other commercial facilities, and the company normally holds 50% of the project for long-term recurring income.

Landbank: Currently owns eight projects in T1 cities and provincial capitals, with total GFA of 26mn sqm, and another 52mn sqm for future acquisition. Of the 26mn sqm, 6.5mn sqm has been completed, 7.1mn sqm is under construction, and 19.4mn is for future development. The company plans to cautiously add one to two new projects each year in the next few years.

Margin: Gross margin is very high (49% in 2013), mainly thanks to the very low land cost, which only accounts for 4.4% of ASP. Management explains the company is able to get such low land cost mainly because the local governments need to leverage its expertise, and the company agrees to hold around 50% of the project.

Recurring income: Recurring income is still small (HKD656mn in 2013, 5% of total revenue) but the company targets to triple it in three years to HKD1.5-2bn. The significant growth will be supported by the increase of rentable GFA: currently only CSC Shenzhen is in full operation and the other projects should catch up in the next few years.

Co-operation with Tencent: CSC and Tencent target to seek co-operation opportunities in five areas to develop a leading integrated O2O business system, eg, using WeChat as a platform to track the behaviour of buyers who visit their trade centres, categorise and analyse their demand, and connect potential buyers with CSC’s SMEs clients.

Competition: According to management, competitors such as Wuzhou (1369 HK, Not rated) and Hydoo (1396 HK, Not rated) are mainly operating smaller-size projects and have higher land cost because local governments are only willing to grant large-size projects at cheaper prices to CSC given its strong track record and expertise.

Daqo New Energy: Waiting for the sun

(DQ US, Not Rated)

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Forum takeaways

DQ is a lower-cost but smaller-scale producer than GCL Poly (3800 HK, Reduce). Management says the local government is supportive, and indicated that once DQ doubled its capacity, they'd further lower the electricity cost charged to them, and the cost saving would directly go to profit. 1Q14 was the first time DQ recorded a profit. 2Q profit was roughly the same. 3Q volume is guided to be higher than in 2Q, but price slightly lower. Cost has been coming down year to date.

Management thinks poly demand and supply are roughly balanced. It also believes market expectations are for poly price to rise for the next two years, with a range of $15-25 over the next three years (the current cost is $14/kg not including depreciation). Nomura’s view is less upbeat, and we believe continued poly ASP strength in 3Q14F and likely into 4Q14F accompanied by new capacity starts/restarts will result in full production runs. Thus we do not see meaningful price upside for polysilicon producers.

Franshion Properties: Sales on target

(817 HK, Buy, target price: HKD 3.16)

Analyst:
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Key message

The key messages from investor meetings include: 1) the company is very confident about achieving sales of at least CNY24bn this year, representing 80% of the initial sales target of CNY30bn. Based on current project launch plans, management indicated that September sales are likely to reach CNY2bn, followed by very strong sales in October and November with over CNY4bn of sales each month (including the en-bloc office sale in Shanghai and primary land sales in Changsha); 2) in the rest of the year, the company may consider buying primary land parcels in Nanjing (with very favourable payment terms) and some small secondary land parcels in Qingdao and Chongqing; and 3) the company is cautious on cash flow management, targeting to break even on operating cash flow and bring down adjusted net gearing to around 50% by the end of 2014F (adjusting for the cash inflow from Jinmao spin-off).

We believe the recent weak share price performance is partially due to the company's weak sales performance so far this year. The significant sales pick-up in October and November as guided by management should improve investors' confidence.

Forum takeaways

- **Sales:** The company has only achieved contracted sales of CNY8.1bn in 7M14, representing 27% of its original full-year sales target of CNY30bn. According to the company, the lagging sales were mainly due to: 1) the delay in the Shanghai office en-bloc sale (CNY3bn), which is now likely to be sold in October-November; and 2) back-loaded saleable resources: total saleable resources of CNY47bn for 2014, including CNY3.7bn carried forward from 2013, CNY9.1bn in 1H14, CNY29bn in 2H14F, and CNY5.2bn from primary land sales.
- Based on current **project launch plans**, the company has indicated that September sales are likely to reach CNY2bn, followed by very strong October and November sales of over CNY4bn in each of the two months.
- **Pricing strategy:** The company was reluctant to cut prices in 1H14, which partially weakened sales. Management recently decided to trade ASP for sales volume. It also adjusted the project managers' KPIs to include contracted sales and cash collection performance. We believe these changes should help to boost the company's sales in the rest of the year.
- **Margin:** Management expects full year gross margin to be higher than the 39% recorded in 1H14. It expects to complete the selling and booking of the en-bloc office in Shanghai this year, which enjoys a high gross margin of over 50%.

For more on Franshion, please see our last report:

Franshion Properties (817 HK, Buy) - Execution is key for a turnaround

Geely Automobile: Cruise control

(175 HK, Buy, target price: HKD3.76)

Analyst:
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Key message

Daniel Dai, Geely's vice president, represented the company at Nomura's China Investor Forum. Generally speaking, Geely's message at the forum was similar to what it delivered in its interim results announcement two weeks ago, where the net profit decline of 20% y-y was better than our/consensus expectations (despite a 29% volume decline) thanks to cost control. While we are already projecting a 2H14F recovery on contribution from new models, Mr. Dai highlights two additional potential earnings upsides from 2015F onwards: 1) he believes gross margins (at 20% in 1H14) still have 3-4pp upside potential, thanks to improved capacity utilisation and the launch of the CMA platform from 2016F; and 2) improved selling expenses as percentage of revenue (at 5.5% in 1H14) following the revamping of its dealer network where Geely has already rid itself of 20% under-performing dealers in 1H14. We maintain our Buy rating.

Forum takeaways

- **2014F sales volume target** – in the interim results announcement, Geely has already cut its 2014F sales volume target from 580k units to 430k units (-22% y-y over FY13). This is broadly in line with our assumption (445k units). The new sales target implies that Geely expects the sales volume decline in 2H14F to moderate to -15% y-y. To reach the 430k target, the main uncertainty lies in the volatile exports markets.
- Geely believes the 2H14F sales volume will likely be driven by new EC7 ("Xindihao"; just launched in August) which offers improved performance and fuel efficiency but at the same price as the old version. It expects **monthly sales volumes** to reach 15-20k units (domestic sales at 10-12k, exports at 5-8k) towards the end of this year (versus average of 10.7k units per month in 1H14). EC7 is Geely's most important model (accounting of 35% of Geely's total sales volume in FY13).
- **Gross margin** improved somewhat from 19.2% in 1H13 to 20.3% in 1H14 thanks to lower component procurement costs. Geely believes there is further upside potential in the future from improved capacity utilisation (as the sales volume recovers) and the launch of the CMA platform. Currently, we expect largely flat margins.
- At end-June 2014, Geely's **sales network** in China comprised a total of 838 shops (representing a cut of 20% from 1,055 at the beginning of the year), including 723 4S stores and 115 exclusive franchisee stores. After eliminating under-performing dealers, Geely has been able to save dealer rebates, and hence when the sales volume starts to recover, selling expenses as percentage of revenue (at 5.5% in 1H14) should decline as well. Longer term, the company has indicated that it will add higher-quality dealers in lower-tier cities.

For more, see our note from the ground:

Quick Note - Geely Automobile (175 HK, Buy) - China Investor Forum 2014 takeaways

Gome: Industry outperformer

(493 HK, Not Rated)

Key message

David Li (Head of Corp Development & IR) and Anita Sun (Deputy Manager) shared a rosy outlook at Nomura's China Investor Forum today. At a time when industry growth is sluggish around 3-5% per annum, and industry margins are squeezed due to fierce competition, Gome is outperforming with revenue is growing at high teens while margins are actually expanding. Why is that? The company went through a rough investment cycle since 2009 to streamline its procurement, logistics and IT platform. Now, its business strategy is finally starting to bear fruits. Management is confident that Gome will continue to reap benefits and target to 'build another Gome' (double profits) by 2017.

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Forum takeaways

- **Transformation.** The company has launched a new 'differentiated products' scheme that has higher GPM of 21-27% (vs traditional products at 10-17%). These products include exclusive distribution rights in China for premium brands such as Sanyo. Furthermore, all stores and online channel now share the same logistics, inventory data and procurement.
- **Online channel.** This segment currently accounts for high-single-digit of total sales but management expects this segment to start picking up and believes that omni-channel is the key going forward. That is why the company is streamlining all of its online and offline offerings. Unlike pure online players, Gome has 1,605 stores available for pick up/return, in addition to its 428 warehouses. The company also offers three deliveries per day to 200 cities, and targets to offer up to 400 cities by 2016. Gome believes that their offline presence is will help their online channel succeed.
- **Another Gome.** With margin expansion (coming from selling higher GPM differentiated products, and streamlined supply chain, logistics, IT platform), aggressive expansion in lower tier cities, partnerships with offline super markets and department stores, management targets to create another Gome by 2017.

Longfor Properties: Conservative guidance

(960 HK, Buy, target price: HKD12.59)

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Key message

Key messages from the investor meetings include: 1) contracted sales may miss the company's full-year sales target of CNY57bn, but cash collection ratio is good at over 90% in 1H14 (the company has only achieved contracted sales of CNY24.1bn by July, implying 42% completion of its annual target); and 2) the company has three key focus areas this year – lowering the inventory level, improving cost control, and increasing the number of JV projects.

We believe management remains conservative by guiding slower growth for the sake of financial safety. We reaffirm our Buy on its slower but stable growth, with 27% potential upside to our TP of HKD12.59.

Forum takeaways

- **Inventory:** According to management, bringing down the inventory level is a key focus in 2014, mainly through: 1) destocking the inventory; and 2) slowing down new constructions to avoid adding new inventory for projects that are difficult to sell.
- **Cost control:** The company targets to reduce construction costs by 5-10% for the high-rises apartment products. It has hired some experts from COLI (688 HK) to enhance the company's cost management in several ways, including: 1) improving product designs and construction skills to reduce construction costs; and 2) reducing expenses due to inefficient operations, i.e. only spend on items/aspects that can transfer into higher ASPs.
- **Increase JV projects:** The company is seeking more JV opportunities to run a light-asset business model. Among the seven new land parcels acquired during 1H14, three were purchased through JV cooperation. Management explains that it will be very cautious in expanding JVs: 1) the company takes operational control on the projects; and 2) it would only be open to pure equity JVs with no guaranteed return to the project partners.
- **Investment properties:** Management prefers to develop the company's investment property portfolio slowly but with higher quality. The company targets an annual yield-on-cost at around 4-6% for the first three years, followed by higher return of 6-8% thereafter. Management believes real estate investment trusts would be the future trend for investment properties, and it has started making some preparations in this regard.

For more on Longfor, see our last note:

Longfor Properties (960 HK, Buy) - Slower growth to trade for safety

MGM China: Looking to Mass and Cotai to save the day

(2282 HK, Buy, target price: HKD35)

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Key message

Sidney Luk (AVP of IR) of MGM China (2282 HK, Buy) cited anti-corruption, visa restrictions and the macro slowdown as the key drivers for the overall slowdown in Macau this year. Amid GGR slowdown, MGM has two key initiatives to buck the industry trend: 1) shift focus from VIP to mass market; 2) new casino opening in Cotai.

Forum takeaways

- **Focusing more on mass market.** Shifted 29 tables for mass and this initiative is starting to work – in August, when overall mass market GGR grew 14.4%, MGM China saw their mass growing by 29% while VIP market dropped in line with the market. Higher than industry growth will be more obvious on the bottom line given ~4x margin that operators make on mass market. They are aiming to change VIP mass GGR contribution from 70:30, to 60:40 this year, and eventually to 50:50 – mainly driven by growth in mass.
- **New casino:** On track to open in Cotai in mid-2016. This will quadruple their current capacity. Not worried about oversupply during 2015-16 because rooms now are always

fully booked. However, the risk will be market risk given it is difficult to say what the environment will be like during 2016.

For more on MGM, please see our last report:

Macau Gaming - Another round of GGR cuts, now what?

NetEase: Game on

(NTES US, Not Rated)

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Key message
Cassia Curran, IR Manager of NetEase, a leading provider of online games in China, stated that the company remains upbeat on its growth prospects led by new growth areas in mobile games, e-commerce, new mobile applications overseas expansions and improvement in shareholder returns.

Forum takeaways
Online games (80% revenue). NetEase traditional strength is in PC games through: 1) in-house developed and licensed games from Blizzard Entertainment, and 2) successful marketing of PC games by using celebrity mascot sponsorship at offline events as well advertising on internet bars, Baidu, Weibo and other sites. The company has now successfully transitioned into mobile games in which a portion is developed in-house while others are licensed from Blizzard and other game developers. The company expects strong growth in mobile games, and guided that there will be a lot of new game launches soon.

Email, e-commerce and other mobile applications (7% revenues). Aggregately, these segments are growing rapidly through new product offerings such as:

- Yichat: tapping into its existing >100m users by offering differentiated products like free SMS, free international roaming, online payment services, etc.
- E-commerce: new growth from offering online lottery, insurance products, movie tickets and train ticket purchases.
- Online education: tapping into a large user base for its popular Youdao online dictionary by offering English and technical courses and exams online.

Overseas expansion. NetEase is looking to acquire good quality teams and products globally, and has recently started to market its online games in international markets like Korea and Taiwan. The company also set up offices in San Francisco and Seoul for M&A purposes.

Shareholder returns. Given its strong cash balance and cashflow, shareholders' returns remain the key area of focus for the company through various means including:

- Share buyback programme (USD100mn).
- Special dividend in 2013.
- Quarterly dividend from 2014 (payout ratio of 25%) .

PetroChina: Expect re-rating to continue

(857 HK, Buy, target price HKD12.20)

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Key message
We hosted PetroChina (857 HK, Buy) at Nomura's China Investment Forum today. The firm delivered an upbeat earnings outlook for 2H and 2015, given potential for more cost efficiencies together with pipeline asset disposal gains. The 18% natural gas price hike effective 1-Sep could lift E&P and pipeline profits, which should offset the slowdown in domestic refining during the third quarter. We maintain our Buy rating on PetroChina.

Forum takeaways
- **Focus more on profitability:** PetroChina is now focused more on profitability rather than production volume growth. The firm is one of the first SOEs to have established divisional profitability and cost cut targets and will reward employees according to a formula, depending on the outperformance vs. these specific targets. As a firm,

PetroChina aims to structurally improve the return on capital from 9% to about 12%. We believe this could extend the re-rating of the stock, which could overshoot our current HK12.20 TP.

- **To explore further business opportunities in Russia:** PetroChina will consider more oil and gas deals with Russia. The construction of the "Power of Siberia" gas pipeline has started this week and should complete on time in 2018. Meanwhile, PetroChina is evaluating another Russia gas deal, up to 30bcm annually, from Western Siberia, as domestic demand will continue to outstrip domestic gas production in the next 5 years amid the clean air campaign.
- **To invest more in domestic shale gas projects:** PetroChina is committed to investing more in domestic shale gas projects, setting aside CNY7bn annually to lift production from 100m cm this year to about 2bcm next year. This should help steady the share prices of Anton Oilfield Services (3337 HK, Buy) and SPT Energy Group Inc. (1251 HK, Buy) amid concerns of capex cuts.
- **E&P capex not materially affected:** PetroChina clarified today that the firm is unlikely to cut upstream capex. As upstream is the most profitable business, the downstream business like refining and chemicals will shoulder all the capex cuts in the next five years.

For more on PetroChina, please see our notes:

Quick Note - PetroChina (857 HK, Buy) - 1H: results in line
Quick Note - PetroChina (857 HK, Buy) - Key takeaways from investor lunch

Sa Sa International: Challenges come visiting

(178 HK, Buy, target price HKD7.60)

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Key message

Management is well aware that the slowdown in Mainland visitor growth is becoming more stressful as spending power is weakening with a changing visitor profile (more from lower-tier cities). Key strategies to counter this structural change include market share focus (at the expense of margins if needed), ramping up house brands in the product mix, reorienting store locations to reduce dependence on tourists and retraining staff to be more effective in a more price-sensitive environment.

Forum takeaways

At a well attended presentation, Tiffany Cheung, Sa Sa's Director of Corporate Communications and IR, walked investors through the key challenges facing the company and its response strategies.

Tourist arrivals to HK are still softening. After seeing a drop in June to single-digit growth for the first time in three years, management expects stabilisation and more normalised growth going forward. A new concern is that the spending profile of mainland tourists is changing, with more tourists coming from lower-tier cities and the bigger spenders going overseas, with Korea and Thailand seeing growth in Chinese visitor numbers in particular. These are markets where Sa Sa lacks a presence.

- **Top line and market share focus:** The Chairman has directed a focus on top line, aiming at better traffic and return business, and so short-term margin sacrifice to maintain market share is acceptable. Expect no margin growth in 2014/15F. The company's longer-term product strategy revolves around house brands: the aim is to have a 55% house brand mix to support a 50% gross margin in the long run, now at around 45%. Gross margins for private labels/house brands are much higher, up to 70% compared with only about 15% for parallel imports. However it takes longer to bring in products with exclusive distribution rights. This quarter, they had a lot of parallel imported Korean products so gross margin is likely to trend further down: already down 0.6% to 45.9% in 2H 13/14, the management expects to see another 1-2% drop next quarter. Some good news here is sales growth is strongest at 60% for Korean products.
- **Store strategy:** The company has adopted a more flexible store strategy and expanded along the railway line in northern Hong Kong, aiding double-digit SSS

growth; these new stores have seen the highest growth despite overall negative SSS growth. The company intends to reduce stores in tourist areas and add more in residential areas.

- **Staff retraining:** Given the increasing price sensitivity of customers, management has initiated training programmes for staff to dissuade them from pushing too hard for the expensive products.

What about competition from online companies in China? Management highlighted this is not a simplistic problem of price competition. In fact, comparing the top 10 selling products on Taobao, Sa Sa's pricing is actually cheaper. Sa Sa's weakness is its delivery lead time is much longer as delivery from HK as takes seven days whereas local online companies can manage one day. However, Sa Sa doesn't want to take legal risks as parallel import products are not allowed in China. Online companies without official distribution rights from the big brands and their business models might not be sustainable. Hong Kong is different as it is a free trade zone so big discounts are fine as long as the parallel products are real.

How can the company turn around the negative SSS in China? The company thinks it has finally found the right format and believes the boutique approach works best to increase profitability, with payback typically 12 months whereas the older, bigger stores took four to five years. Management aims to roll out more small stores and close the big stores by FY17. China has much lower foot traffic than Hong Kong so, although rent is low, productivity is also much lower. Southern China will be a key expansion focus as rents are attractive.

For more on Sa Sa, please refer to our notes:

Sa Sa International (178 HK, Buy) - Earnings growth has stabilized
Quick Note - Sa Sa International (178 HK, Buy) - SSSG likely to recover over 2Q-4QFY14/15F

Stella International: Beneficiary of US economic rebound

(1836 HK, Buy, target price HKD24)

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Key message

Olivia Wang, IR Director of Stella provides insight into Stella's background. The company is a family-run business founded in 1982 in Taiwan. In 1991, the company shifted to Mainland China to work with some of the global brands such as NineWest, and has also moved to ASEAN and started their first factory in Vietnam in 1998 given the relatively more stable labour force supply in Vietnam. In 2000, Stella started to cooperate with high-end brands like Louis Vuitton, and in 2006 started its retail operations to capture the mid-end consumption boom in China, with their own brand Stella Luna.

Stella Luna's ASPs are much higher than local shoe designers with its Asian fitting and focus on style and comfort. The company launched another brand "What for" in 2007, which is slightly less high-end, targeting teenagers and office ladies. The company opened its first store in Paris in 2012, and its performance in Europe remains much better than China. Later on in 2011, the company launched its third brand JKJY, and its fourth brand Pierre Balmain which are both higher-end. All of Stella's stores are self-operated and concession stores.

Forum takeaways

- **Manufacturing segment.** Given the pick-up in demand for the past two quarters (after being relatively unstable for the past few years), utilisation has been relatively stable at around 90% (vs historical 95-100%). ASP has been growing at 6% CAGR y-y for 1H14 and current capacity is at 58mn pairs. By year-end, the company plans to relocate half of its capacity to Mainland China, and the rest to Vietnam and Indonesia.
- **Retail business.** This segment contributes about 8% to Stella's top line with blended GPM around 70%. EBIT has been stable given less pension provisions this year. The company has closed 80 stores and saved a significant portion of SG&A expenses and

will close 5 to 8 more stores this year. The company has 300 stores now (90% concession stores at dept stores).

- **Shanghai flagship store.** Stella guides that its Shanghai store is still loss making, and has plans to hire new talents, and replace its previous General Manager to turn around this business. The company guided that the margin contraction is mainly due to capacity migration, and its EBITDA margin should return to 10% levels in two years time after the company fully ramps up its capacity, and when its handbag business starts to contribute to earnings.
- **Inventory days.** Lead time for shipping window has been shortened by 1-2 weeks, but Stella guides that the company needs at least a month to procure raw materials, in addition to the 2-3 weeks' production time which may add a bit of challenge to the company's manufacturing front. Inventory days are still good for manufacturing, but given the company has procured a little too much for its retail business in 2012, inventory turnover is more than a year.
- **E-commerce platform.** A platform mainly used to clear their past seasons' products. Stella takes 2% off its fully-priced products as write offs, effectively taking 20% of COGS. Its clearance sale has slowed due to the many closed stores this year, as the company targets to grow the store area rather than number of stores going forward.

For more details please see our report:

Quick Note - Stella International (1836 HK, Buy) - Beneficiary of US economic rebound

VIPShop: Execution on track

(VIPS US, Buy, target price USD267)

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Key message

We had VIPS' IR Director, Millicent Tu with us during our China Investor Forum in Shanghai. Our analyst, Wang Chao, foresees two key investment themes in 2014-15F, 1) continuous traffic shift to mobile; and 2) margin contraction risk from irrational competition. We prefer stocks that are likely to make a smooth transition to mobile and would avoid stocks that are likely to face stiff competition, and reiterate our Buy call on VIPS on 1) improving efficiency to support aggressive expansion, 2) increasing mobile revenue contribution to fuel growth, and 3) synergy with Lefeng will kick in during 2H14F.

Forum takeaways

- **Mass market business model.** Management confirmed that it will be shifting its business model to focus more on mass market, rather than luxury (2% of revenue). Although the luxury and international brands segment fetches lower margins (in the teens), VIPS will remain its exposure to that segment to increase its brand name recognition, and will be more focused on Tier 2-4 cities (Tier 1 cities represent 10% revenue).
- **Expansion into new product categories.** VIPS decided to expand its product offerings to include cosmetics, babycare, and mother products. Its recent acquisition of Lefeng will help strengthen its cosmetics business segment. The company will potentially look for more M&A opportunities in order to grow these three business segments.
- **Key competitor remains Jumei.** VIPS is currently at 70% of Jumei's gross merchandise value (GMV), and with the narrowing gap, VIPS looks likely to surpass. Jumei's growth is also slowing as the overall cosmetics market is currently facing a crackdown on counterfeit products. VIPS remains relatively unaffected as the company only sells legitimate products.

Key figures

- **Mobile:** This segment currently contributes 46% of GMV (vs 1Q14 of 36%).
- **Average spending per user:** Largely stable at USD30-35. Spending power by lower-tiered city consumers is growing, and hence unlikely to drag down the overall average.
- **Marketing expenditure:** Increased to 5% of revenue (vs 1Q14 of 4%), as the company spends more on mobile and TV advertisements.

- **Margins:** Blended average of 25%, with home goods (>30%), apparel (25%), and cosmetics (in the teens).
- **Capex:** Plans to spend USD200mn to build new warehouse (300k sqm)
- **Inventory turnover:** 30 days.
- **Fulfilment costs:** 10% of revenue, of which 50% are warehousing costs, and the other 50% consists of delivery costs (trucking + last mile). VIPS is actively looking to acquire stake in the regional last mile delivery companies to strengthen its foothold.

For more details: VIPSHOP (VIPS US, Buy) - Execution on track

ZTE: Double happiness on the doorstep

(763 HK, Buy, target price HKD25)

Analyst:

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Key message

According to Xu Yulong IR of ZTE, the company 1) has high expectations in its 4G business, 2) aims to stabilise its market share in its handset business and aims to focus on the enterprise market, and 3) expects to gain in market share in Europe.

Our analyst, Leping believes that there is a re-rating opportunity in ZTE's share price, driven by its earnings quality improvement. Although ZTE's share price has been de-rated since early 2012 after its continuous miss on consensus quarterly earnings expectations, Leping sees an improvement in ZTE's earnings quality and accuracy since 2013 after it adopted a profit-centric growth strategy in 2H12 to focus on quality clients (eg, China Mobile) and avoided low-margin overseas contracts.

Forum takeaways

- **4G demand.** The company expects the bulk of its 4G growth to kick-in in mid-2015, and finds that both China Mobile and China Telecom's 4G subscription targets are reasonable. Overall, ZTE expects the operators to continue its spending in 4G as revenue improves, especially with the extra savings from the handset subsidies cut.
- **Handset business.** ZTE does not have much expectations for its China handset business (10% margin), and aims only to stabilise its current market share in this business segment given the highly competitive landscape. The company looks to focus on the enterprise market, offering handsets with better security and encryption functions. China Telecom remains one of their biggest customers for handsets, and the recent government policy to make CDMA-compatibility mandatory for 4G handsets bodes well for ZTE's CDMA product volumes. Within China, network and information security a key focus, and will look to sell more high-end routers (high margin) while in overseas market, the company highlights that recent new contracts were all signed at good margins (30-40%).
- **Europe.** With the recent penetration into Deutsche Telekom in Germany, Europe remains the key bright spot for ZTE. Investments in Germany are finally bearing fruit after many years, as the company started off with orders only from small telcos. However, ZTE has proven itself with technology capabilities and now big telcos are approaching ZTE now. Many German telcos want to diversify away from Alcatel, so ZTE is gaining market share at their expense. Other European telcos likely to approach ZTE going forward, as German telcos usually set the standard in terms of equipment procurement, and European clients will prefer ZTE's experience with China Mobile's TD-LTE equipment. As TD-LTE is increasing in prevalence as a global standard, European players need to start procuring equipment compatible with TD-LTE
- **Elsewhere.** Africa will likely see projects announced in 2H14, given political talks between African countries and China. In the United States, there is now 5 operators, and the market is entering into a virtuous cycle (handset sales comprise 90%). In Asia, there have been a lot of discussions on potential projects but ZTE believes that it is unlikely to see anything finalised this year, while LatAm will remain flat y-y.

For more details: ZTE Corp (763 HK, Buy) - Double happiness on the doorstep

Agenda: Wednesday, 3 Sep, 2014

Agenda

*Open to media

Wednesday, September 3	Pudong Shangri-la, The River Wing, Shanghai	
8:15 AM	**Registration** (Breakfast will be served)	
8:50-9:00 AM	**Grand Ballroom, River Wing, Level 3** **Welcome Remarks *** Mr. Minoru SHINOHARA, CEO, Asia ex-Japan, Nomura	
9:00-09:50 AM	**Keynote: Financial Innovation and Development of Shanghai Pilot Free Trade Zone *** Mr. LI Jun, China (Shanghai) Pilot Free Trade Zone Administration Deputy Secretary-General *Moderator:* Mr. SHEN Hong, Shanghai Bureau Chief, The Wall Street Journal and Dow Jones Newswires	
10:00-10:50 AM	**Presentation: China under Xi Jinping: the changing landscape of elite politics and reforms** Professor ZHENG Yongnian, Professor and Director of East Asian Institute, National University of Singapore *Moderator:* Dr. ZHU Wen Hui, Senior research fellow, Bauhinia Foundation, Research Centre, Anchor and Commentator on Phoenix TV *Panelist:* Ms. Wendy LIU, Head of China Equity Research, Nomura	
10:50-11:00 AM	**Morning Refreshments**	
	Changan Room, River Wing, Level 3	**Suzhou Room, River Wing, Level 3**
11:00-11:50 AM	**Panel discussion: How do we soft land an asset bubble?** *Moderator:* Ms. Wendy LIU, Head of China Equity Research, Nomura *Panelists:* Mr. Jin CAI, Vice President ,China Federation Logistics & Purchasing Mr. Liqun ZHANG, Senior Research Fellow of Macro Economic Research Department, DRC Mr. Peng ZHANG, Senior Research Fellow, Ministry of Finance	**Panel discussion: China's natural gas transformation – winners & losers** *Moderator:* Mr. Gordon KWAN, Regional Head of Oil & Gas Research, Equity Research, Asia ex-Japan, Global Markets, Nomura *Panelists:* Mr. Jack FANG, Director, Hans Energy Mr. Zefeng MAO, Joint Company Secretary, PetroChina Company Limited Mr. Colin SHEK, China editor for Interfax Energy, and Shanghai bureau chief for Interfax
12:00-1:20 PM	**Grand Ballroom, River Wing, Level 3** **Lunch Keynote: Out of the Balance Sheet Recession and into a QE 'Trap' *** Mr. Richard KOO, Chief Economist, Nomura Research Institute	
	Changan Room, River Wing, Level 3	**Suzhou Room, River Wing, Level 3**
1:30-2:20 PM	**Presentation: Demographic challenges in China - Lessons from ABENOMICS** Mr. Kosuke MOTANI, Chief Senior Economist, Economist Department, Japan Research Institute, Ltd and Senior Advisor, Regional Planning Department, The Development Bank of Japan, Ltd	**Presentation: What China should do in the environmental industry from the experience in Japan on the road of environmental protection?** Mr. Shoji ONOGI, President, Japan-China Environment Service Center *Moderator:* Mr. Joseph LAM, Power, Utilities & Renewables Energy, Equity Research, Nomura
2:30-3:20 PM	**Panel discussion: China's aging society and its implications** *Moderator:* Ms. Emma LIU, Head of China Consumer Research, Asia ex-Japan / China, Hong Kong, Nomura *Panelists:* Mr. Yu ZHAO, Group Deputy General Manager, Fushouyan Mr. Di LU, The Board Office Senior Manager, Shanghai Pharmaceutical	**Panel discussion: Online education - a replacement or supplement to physical learning center?** *Moderator:* Mr. Chao WANG, China Media/Internet, Hong Kong, Nomura *Panelists:* Mr. Zhuoming HUANG, Education Expert, Ex-EDU Mr. Kingson LIU, Founder, enhance.cn Mr. Jack HUANG, Founder, Xuexibao
3:20-3:30 PM	**Afternoon Refreshments**	
3:30-4:20 PM	**Panel discussion: Outlook on China property sector - are we at a turning point?** *Moderator:* Mr. Jeffrey GAO, Head of China Property Research, Nomura *Panelists:* Mr. LIU Yuan , Vice President (Property Research), Centaline Group Mr. Liqun ZHANG, Senior Research Fellow of Macro Economic Research Department, DRC Mr. Joe ZHOU, Head of Research, Shanghai and East China, Residential Market, JLL	**Presentation: Home revolution – Opportunities in Eco-Smart Home** *Moderator:* Mr. Joseph LAM, Power, Utilities & Renewables Energy, Equity Research, Nomura *Panelists:* Mr. Alessandro BISAGNI, Founder & Managing Director, Bisagni Environmental Enterprise Mr. Shawn QU, CEO, Canadian Solar Mr. Xin Cong ZHU, Vice President, U-Home (Smart Home Unit of Haier Electronics)
4:30-5:20 PM	**Panel discussion: Mobile gaming - blue ocean or red sea?** *Moderator:* Mr. Chao WANG, China Media/Internet, Hong Kong, Equity Research, Nomura *Panelists:* Mr. Tao HONG, Founder, Gamelook	**Presentation: China and Semiconductors - Brave New World or Same Old Story?** Mr. Christopher THOMAS, Senior Advisor, Asia Leadership Team, McKinsey & Company *Moderator:* Mr. Leping HUANG, China Technology and
	Mr. Quanxin SUN, VP, Mokylin Mr. Hang ZENG, Director of Strategic Analysis, Chukong Technologies Inc. Co., Ltd, Author of Mobile Empire	Telecom Research, Asia ex-Japan, Nomura

* Session opens to media

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Agenda subject to change

Agenda: Thursday, 4 Sep, 2014

Thursday, September 4	Pudong Shangri-la, The River Wing, Shanghai	
8:30 AM	**Registration** (Breakfast will be served)	
09:00-9:50 AM	**Grand Ballroom, River Wing, Level 3**	
	Keynote Address: Thoughts on reforms of the Chinese financial system Mr. Xiqing GAO, Professor, School of Law, Tsinghua University and Former Vice-Chairman and President, China Investment Corporation *Moderator:* Mr. Michael KURTZ, Chief Asia Equity Strategist and Global Head of Equity Strategy, Nomura	
	Changan Room, River Wing, Level 3	**Suzhou Room, River Wing, Level 3**
10:00-10:50 AM	**Presentation: Challenges of Chinese retail market** Mr. Tomihiro SAEGUSA, Head of China Operations, Ito Yokado *Moderator:* Ms. Emma LIU, Head of China Consumer Research, Asia ex-Japan / China, Hong Kong, Nomura	**Presentation: The future of China's mobile carriers** Mr. Andy TAO, Vice Director, Senior Consultant for NRI, Telecom Team *Moderator:* Mr. Leping HUANG, China Technology and Telecom Research, Asia ex-Japan, Nomura
10:50-11:00 AM	**Morning Refreshments**	
11:00-11:50 AM	**Presentation: The bottlenecks in the development of electric vehicle and energy storage station in China** Professor Chengwei XIAO, Head of Electric Battery Material Taskforce, National 863 Project *Moderator:* Mr. Leping HUANG , China Technology and Telecom Research, Asia ex-Japan, Nomura	**Panel discussion: Innovative online marketing solution to target more precise audience** *Moderator:* Mr. Chao WANG, China Media/Internet, Hong Kong, Nomura *Panelists:* Mr. Simon WANG, VP, AdChina Mr. Eric WENG, Managing Director, Client Solutions, Carat
12:00-1:20 PM	**Grand Ballroom, River Wing, Level 3**	
	Lunch Keynote: Shanghai-Hong Kong Stock Connect Mr. James FOK, Chief of Staff, Head of Group Strategy, Hong Kong Exchanges and Clearing Limited Ms. Lisa YingYing LI, Manager, Global Business Development, Shanghai Stock Exchange *Moderator:* Ms. Wendy LIU, Head of China Equity Research, Nomura	
	Changan Room, River Wing, Level 3	**Suzhou Room, River Wing, Level 3**
1:30-2:20 PM	**Panel discussion: China's Changing Banking Landscape: Challenge and Opportunity** *Moderator:* Mr. Michael KURTZ, Chief Asia Equity Strategist and Global Head of Equity Strategy, Nomura *Panelists:* Ms. Jennifer QIN, Lead Partner, Deloitte Asia Pacific Investment Management industry practice and co-leader, Deloitte China Global Financial Services Industry banking and securities audit practice Mr. Simon RABINOVITCH, Asia Economics Editor, The Economist Dr. ZOU Xin, Deputy General Manager of Corporate Strategy and Investor Relations, ICBC	**Presentation: Online is the new Black - The impact of ecommerce on China's retail real estate sector** Mr. Michael KLIBANER, Regional Director, Head of Research – Greater China, JLL *Moderator:* Mr. Jeffrey GAO, Head of China Property Research, Nomura
2:30-3:20 PM	**Panel discussion: Future of industrials sector driven by automation** *Moderator:* Ms. Caren HUANG, Analyst, Machinery, Taiwan Equity Research, Nomura *Panelists:* Mr. Johnny HUANG, Analyst, Mechanical and Manufacturing Systems in Industrial Economics & Knowledge Centre (IEK), Industrial Technology Research Institute (ITRI) Mr. Wei WANG, Vice chief editor, Robot Technique and Application magazine	**Presentation: Auto demand outlook from a regional perspective and auto financing boom** Mr. John ZENG, Managing Director, LMC *Moderator:* Mr. Benjamin LO, Autos & Auto Parts, China, Research, Asia ex-Japan, Nomura

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Appendix A-1

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Biostime International	1112 HK	HKD 27.95	03-Sep-2014	Buy	Not Rated	26-May-2014	N/A
SPT Energy Group Inc	1251 HK	HKD 3.89	03-Sep-2014	Buy	Not Rated	29-May-2014	N/A
Geely Automobile	175 HK	HKD 2.99	03-Sep-2014	Buy	Neutral	09-Jul-2014	N/A
Sa Sa International	178 HK	HKD 6.28	03-Sep-2014	Buy	Not Rated	22-Jan-2013	N/A
Stella International	1836 HK	HKD 21.30	03-Sep-2014	Buy	Not Rated	22-Apr-2014	N/A
MGM China	2282 HK	HKD 24.95	03-Sep-2014	Buy	Not Rated	10-Feb-2014	N/A
Anton Oilfield Services	3337 HK	HKD 3.40	03-Sep-2014	Buy	Not Rated	25-Nov-2013	N/A
China Overseas Land & Inv	688 HK	HKD 22.95	03-Sep-2014	Buy	Not Rated	07-Jan-2014	N/A
Tencent Holdings	700 HK	HKD 129.30	03-Sep-2014	Buy	Not Rated	05-Mar-2014	N/A
China Telecom	728 HK	HKD 4.97	03-Sep-2014	Neutral	Buy	08-Jan-2014	N/A
China Unicom	762 HK	HKD 13.78	03-Sep-2014	Buy	Neutral	11-Feb-2010	N/A
ZTE Corp	763 HK	HKD 18.10	03-Sep-2014	Buy	Neutral	26-Oct-2012	N/A
Franshion Properties	817 HK	HKD 2.15	03-Sep-2014	Buy	Not Rated	18-Feb-2014	N/A
PetroChina	857 HK	HKD 11.50	03-Sep-2014	Buy	Rating Suspended	25-Sep-2013	N/A
China Mobile	941 HK	HKD 101.70	03-Sep-2014	Buy	Neutral	03-Jun-2014	N/A
Longfor Properties	960 HK	HKD 9.94	03-Sep-2014	Buy	Not Rated	07-Jan-2014	N/A
Apple, Inc.	AAPL US	USD 103.30	02-Sep-2014	Neutral	Not Rated	09-Oct-2012	Neutral
Baidu	BIDU US	USD 224.80	02-Sep-2014	Buy	Not Rated	05-Mar-2014	N/A
Google Inc.	GOOG US	USD 577.33	02-Sep-2014	Buy	Not Rated	14-Jan-2014	Not rated
Microsoft Corporation	MSFT US	USD 45.09	02-Sep-2014	Buy	Neutral	22-Aug-2013	Neutral
Qihoo	QIHU US	USD 88.76	02-Sep-2014	Buy	Not Rated	05-Mar-2014	N/A
VIPSHOP	VIPS US	USD 207.02	02-Sep-2014	Buy	Not Rated	05-Mar-2014	N/A

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STOCKS

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STOCKS

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