

Investment Opportunities of Shenzhen-Hong Kong Stock Connect (I)

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CHINA | STRATEGY | MARKET REPORT

Introduction

The launch time of Shenzhen-Hong Kong Stock Connect is approaching and how the market will be affected by this launch? How can investors make money? In this regard, we will issue serial reports of "Investment Opportunities of Shenzhen-Hong Kong Stock Connect". This report will focus on the main points concerning the investment in Shenzhen-Hong Kong Stock Connect, and presents special introductions and guidelines about mainland market of Northbound Shenzhen Trading Link.

When will Shenzhen-Hong Kong Stock Connect be officially launched?

On August 16, Premier Li Keqiang made it clear at the executive meeting of State Council that "the State Council has approved the Implementation Program of Shenzhen-Hong Kong Stock Connect".

On the same day, the China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission signed the Joint Announcement about Shenzhen-Hong Kong Stock Connect, indicating that the preparations for the launch of Shenzhen-Hong Kong Stock Connect kicked off. Given that the existing Shanghai-Hong Kong Stock Connect has been launched for more than one year, it only takes 3 to 4 months for Shenzhen-Hong Kong Stock Connect from approval to final implementation. And it is in all likelihood that Shenzhen-Hong Kong Stock Connect will be launched before the end of 2016.

What are the thresholds of including listed companies into Shenzhen-Hong Kong Stock Connect?

For the northbound market, the scope of eligible shares of Northbound Shenzhen Trading Link under Shenzhen-Hong Kong Stock Connect are constituents of the Shenzhen Component Index and Shenzhen Small/Mid Cap Innovation Index with a market value of RMB6 billion and above, as well as the stocks of Shenzhen-listed companies with both A and H shares.

For the southbound market, the scope of eligible shares of Southbound Hong Kong Trading Link are all the constituents of the Hang Seng Composite Large Cap Index and Hang Seng Composite Madcap Index, constituents of Hang Seng Composite Small Cap Index with a market value of HKD5 billion and shares of all companies listed on SEHK.

What are the differences between Shenzhen-Hong Kong Stock and Shanghai-Hong Kong Stock Connect?

1) The scope of eligible shares will be broader. There are 881 shares eligible to be traded through the Northbound Shenzhen Trading Link under Shenzhen-Hong Kong Stock Connect, more than the 568 shares eligible to be traded through the Northbound Shanghai Trading Link under Shanghai-Hong Kong Stock Connect. There are 417 shares eligible to be traded through the Southbound Hong Kong Trading Link under Shenzhen-Hong Kong Stock Connect, 99 shares more than those eligible to be traded through the Southbound Hong Kong Trading Link under Shanghai-Hong Kong Stock Connect.

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2) Compared with the aggregate quotas of RMB300 billion/RMB250 billion of Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect will not set aggregate quota, but the daily quotas of RMB13 billion/RMB10.5 billion will be maintained. However, in view that Northbound Trading Link uses less than half of the aggregate quota, we believe this measure is little significance to Northbound Shenzhen Trading Link, but will facilitate the inflow of funds to Hong Kong stocks and benefits Southbound Hong Kong Trading Link.

Comparison of Stock Markets in Shenzhen and Hong Kong

Investors: A-share market is dominated by individual investors. Nearly 50% of the account market value and balance is less than RMB100,000 on A-share market with more frequent trading and better stock liquidity. By contrast, Hong Kong stock market is dominated by institutional investors, especially by overseas investors. Except some major stocks, the daily trading of small and medium-sized stocks is not heavy with poor liquidity.

Shenzhen-Hong Kong total market cap by industry RMB: yuan

sector	行业	总市值
Bio-medicine	医药生物	1,680,351,829,532.8
Computer	计算机	1,521,388,079,166.5
Electronic	电子	1,209,583,382,803.0
Media	传媒	1,201,137,630,830.7
Real Estate	房地产	1,053,454,171,436.0
Chemical	化工	986,122,495,796.1
Non bank finance	非银金融	753,196,995,815.4
Machinery	机械设备	708,408,796,504.6
Automobile	汽车	671,236,452,073.8
Electrical equipment	电气设备	659,502,911,103.8
Household appliances	家用电器	638,381,760,522.2
Food & Drink	食品饮料	575,656,374,997.3
Utility	公用事业	527,513,657,698.0
Construction	建筑装饰	504,350,796,075.4
Tele-communication	通信	490,800,240,854.4
Agriculture	农林牧渔	479,679,365,750.9
Metal	有色金属	462,726,627,100.5
Commercial Trade	商业贸易	395,205,823,879.0
Light industry	轻工制造	346,898,969,272.8
Textiles & Garments	纺织服装	249,198,436,921.5
Steel	钢铁	219,136,043,686.8
Bank	银行	217,212,058,156.6
National defence	国防军工	174,782,599,853.3
Transportation	交通运输	148,744,599,551.5
Coal	采掘	127,916,506,734.5
others	综合	99,850,359,907.2
tourism	休闲服务	90,852,982,869.3

Source: Wind, Phillip Securities Hong Kong Research

Shenzhen-Hong Kong average market cap by industry RMB: yuan

sector	行业	平均市值
Bank	银行	100,606,049,070.3
Non bank finance	非银金融	57,938,230,447.3
Real Estate	房地产	28,471,724,363.1
Food & Drink	食品饮料	27,412,208,383.2
Household appliances	家用电器	26,599,240,021.8
National defence	国防军工	24,968,942,836.2
Agriculture	农林牧渔	23,983,968,287.5
Media	传媒	23,728,474,645.0
Steel	钢铁	21,913,604,368.7
Automobile	汽车	21,652,788,776.6
others	综合	19,970,079,981.4
Commercial Trade	商业贸易	18,819,324,946.6
Bio-medicine	医药生物	18,068,331,500.4
Electronic	电子	17,413,288,956.8
Computer	计算机	16,937,645,280.7
Tele-communication	通信	15,832,265,834.0
Chemical	化工	15,652,738,028.5
tourism	休闲服务	15,142,163,811.5
Utility	公用事业	15,071,818,791.4
Metal	有色金属	14,460,207,096.9
Electrical equipment	电气设备	13,739,643,981.3
Transportation	交通运输	13,522,236,322.9
Construction	建筑装饰	13,273,440,423.0
Coal	采掘	12,791,650,672.5
Machinery	机械设备	12,659,157,080.4
Light industry	轻工制造	12,589,248,902.6
Textiles & Garments	纺织服装	11,866,592,234.4

Source: Wind, Phillip Securities Hong Kong Research

Investment preferences/appetites: The investment preferences/appetites of individual investors and institutional investors are completely different, which also builds a platform for some stocks with medium and small market value on the Shenzhen Stock Exchange, whose prospects are bright but with greater risk. This also provides a source of funding for a number of conceptual growth stocks, especially small-cap stocks.

Valuation system: Compared with HKEx, the average market value of listed companies on Shenzhen Stock Exchange is small, but the proportion of emerging industries is high and the valuation is obviously high, where the average P/E ratio of GEM is 73 times. Additionally, cross-market sale is forbidden on both Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, and cross-market arbitrage cannot be conducted.

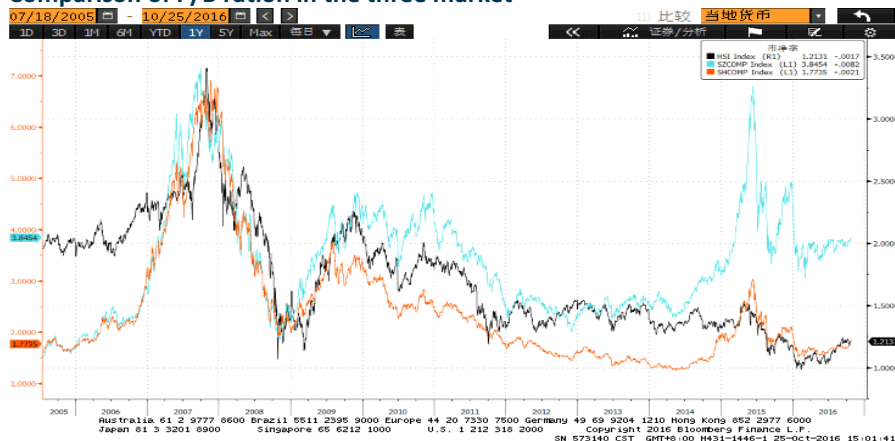
Among the 881 shares under Northbound Shenzhen Trading Link, the market value of the top ten stocks accounted for 9.7% of the total market value, and that of the top twenty stocks represented 16% of the total market value. As is shown below, in case of ranking according to the proportion of overall market value of industry, the top five industries of Northbound Shenzhen Trading Link are bio-medicine, computers, electronics, media and real estate. Nevertheless, in case of ranking according to average market value, the top five industries of Northbound Shenzhen Trading Link are banking and finance, real estate, food and beverage, household appliances and national defense and military industry. The companies of emerging industry on Northbound Shenzhen Trading Link are featured by "small size and large number".

Comparison of P/E ration in the three market



Source: Bloomberg, Phillip Securities Hong Kong Research

Comparison of P/B ration in the three market



Source: Bloomberg, Phillip Securities Hong Kong Research

What are the beneficiaries of launching Shenzhen-Hong Kong Stock Connect?

Firstly, Northbound Shenzhen Trading Link expands the channels for overseas funds to invest in domestic A shares, and provides the corresponding investment objectives for active funds characterized by proactive styles.

Secondly, in respect of short-term expectations, the southbound funds will be greater than the northbound funds, which will significantly benefit the local securities companies and bourses of the Hong Kong market.

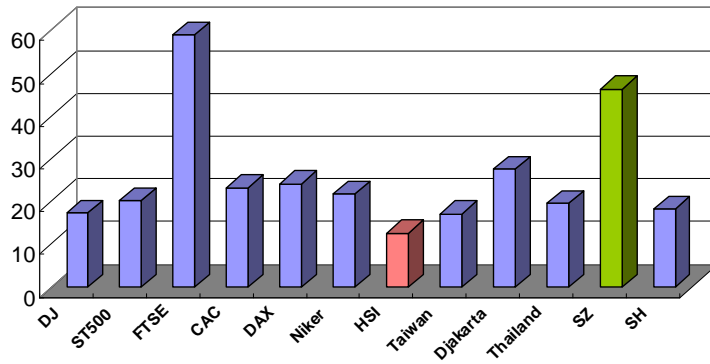
Secondly, in respect of short-term expectations, the southbound funds will be greater than the northbound funds, which will significantly benefit the local securities companies and bourses of the Hong Kong market. Although the characteristics of Shenzhen stock market considerably differ from those of the Shanghai stock market, we can get a rough idea of Shenzhen-Hong Kong Stock Connect. The diagram below sets out the (potential) leading stocks in all industries on Shenzhen-Hong Kong Stock Connect for investors' reference.

Views of Shenzhen-Hong Kong's leading company industry RMB: yuan

Name	Ticker	Market Cap	行业	Sector
西山煤电	000983	31,165,368,000	采掘	Coal
乐视网	300104	88,977,437,702	传媒	Media
分众传媒	002027	134,721,972,570	传媒	Media
金风科技	002202	41,205,843,690	电气设备	Electrical equipment
京东方A	000725	87,757,332,030	电子	Electronic
东旭光电	000413	71,338,519,398	电子	Electronic
蓝思科技	300433	54,780,045,605	电子	Electronic
招商蛇口	001979	135,950,394,818	房地产	Real Estate
万科A	000002	273,836,256,629	房地产	Real Estate
跨境通	002640	29,625,457,991	纺织服装	Textiles & Garments
国信证券	002736	136,694,000,000	非银金融	Non bank fiance
广发证券	000776	124,665,797,296	非银金融	Non bank fiance
申万宏源	000166	128,161,710,538	非银金融	Non bank fiance
沙钢股份	002075	35,573,160,965	钢铁	Steel
碧水源	300070	57,782,935,687	公用事业	Utility
中航飞机	000768	61,353,174,773	国防军工	National defence
传化股份	002010	65,319,184,294	化工	Chemical
机器人	300024	37,664,184,354	机械设备	Machinery
海康威视	002415	152,578,959,475	计算机	Computer
紫光股份	000938	66,082,020,471	计算机	Computer
格力电器	000651	131,022,618,523	家用电器	Household appliances
美的集团	000333	167,947,781,530	家用电器	Household appliances
东方园林	002310	42,063,288,182	建筑装饰	Construction
怡亚通	002183	27,334,502,134	交通运输	Transportation
温氏股份	300498	158,785,835,244	农林牧渔	Agriculture
长安汽车	000625	71,670,885,497	汽车	Automobile
比亚迪	002594	144,151,541,994	汽车	Automobile
索菲亚	002572	26,409,992,466	轻工制造	Light industry
苏宁云商	002024	104,551,745,326	商业贸易	Commercial Trade
双汇发展	000895	78,991,425,319	食品饮料	Food & Drink
泸州老窖	000568	44,830,011,658	食品饮料	Food & Drink
五粮液	000858	128,303,675,136	食品饮料	Food & Drink
洋河股份	002304	103,680,774,400	食品饮料	Food & Drink
中兴通讯	000063	57,782,025,575	通信	Tele-communication
网宿科技	300017	49,453,326,243	通信	Tele-communication
宋城演艺	300144	35,981,238,302	休闲服务	tourism
云南白药	000538	72,096,102,477	医药生物	Bio-medicine
上海莱士	002252	110,686,690,340	医药生物	Bio-medicine
宁波银行	002142	61,304,762,953	银行	Bank
平安银行	000001	155,907,335,203	银行	Bank
天齐锂业	002466	40,562,481,538	有色金属	Metal

Source: Wind, Phillip Securities Hong Kong Research

Comparison of P/E ratio in the main markets of the world



Source: Bloomberg, Phillip Securities Hong Kong Research

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Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

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