

# Investment Opportunities of Shenzhen-Hong Kong Stock Connect (II)

## Pharmaceuticals & TMT

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China | Pharmaceutical | Company report

**No Rating**

### Northbound Shenzhen Trading Link: Pharmaceuticals

The Shenzhen-Hong Kong Stock Connect program will be launched soon. The A-shares that will concern overseas investors mainly include: pharmaceuticals, finance, food and beverage and other reasonably valued blue chips, based on past experiences of Shanghai-Hong Kong Stock Connect and QFII investment. High-value sectors in the A-share market make up a lion's share, while some stand out due to their scarcity, rapid growth and strong attraction to investors, such as pharmaceuticals.

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According to estimates, the pharmaceuticals theme will make up the largest share in Shenzhen trading link by market cap. Compared with other sectors, outlook of pharmaceuticals appears certain: 1) domestic pharmaceutical industries account for only 5-6% of China's GDP, which is far lower than developed countries like the United States and Japan. 2) China's ageing population is growing, with the number of people over 60 increasing from 200 million in 2012 to 300 million in 2025. And as country is ageing, people will spend more money on health care, in particular those over 60. Furthermore, the sector has stable cash flow, high profitability, and low leverage. Since the 21st century, the sector's asset-liability ratio has dropped by 20 percentage points to only around 41%.

### Sectors Overview under the Northbound Shenzhen Trading Link

Sectors	No.	Market value(RMB bn)	Annualized ROE	Liability Ratio	PBR
Health care	93	1675.6	12.30%	29.57%	6.24
Computer	90	1530.5	6.90%	27.39%	7.13
Electronic	74	1296.9	8.64%	38.17%	5.41
Media	54	1283.9	12.58%	33.97%	7.38
Real Estate	38	1055.8	8.66%	69.06%	3.54
Chemical	63	1004.3	9.24%	42.06%	4.54
Non bank finance	13	766.6	8.20%	70.08%	2.84
Automobile	31	682.9	10.20%	42.76%	4.95
Food & Drink	21	589.9	9.22%	31.73%	5.39
Public Utilities	35	525.2	10.02%	50.20%	3.53
Tele-communication	31	490.1	8.62%	36.66%	6.59
Non-ferrous Metals	32	468.4	6.26%	42.27%	4.39
Bank	2	221.3	17.16%	93.63%	1.08
National Defence	7	174.3	4.36%	36.47%	6.26
Total	881	16468.2	8.58%	40.69%	5.30

Source: Wind, Phillip Securities (HK) Research

Meanwhile, since 2H 2015, many pharmaceutical policies have been made, including self-examining clinical trial data for drugs, consistency assessment of generic drugs, two-vote system, grading diagnosis and treatment, etc. We believe, in addition to a bright outlook, such policies will optimize the structure of the sector in Mainland China, which means enterprises with innovation power and a wide range of products and channels will be more competitive, thus increasing the concentration ratio of the sector. Therefore, we pay close attention to Huadong Medicine (000963 CH), Shenzhen Salubris(002294 CH), China Resources Sanjiu Medical & Pharmaceutical(000999 CH), Harbin Gloria Pharmaceutical(002437 CH), Shijiazhuang Yiling Pharmaceutical(002603 CH), Renhe Pharmacy(000650 CH), etc.

It is worth noting that, the traditional Chinese medicine (TCM) sector is China-featured, so companies such as Dong-E-E-Jiao (000423 CH) and Yunnan Baiyao(000538 CH) hold scarce resources to some degree. Moreover, currently, since TCM enterprises have low liability ratio and their stocks are undervalued, coupled with clear policy support, the outlook is optimistic.

### Pharmaceuticals Overview under the Northbound Shenzhen Trading Link

Subsectors	No.	Market value(RMB bn)	Annualized ROE	Liability Ratio	PBR
Pharmaceutical chemical	32	515.9	12.24%	33.65%	5.02
biologicals	15	352.5	9.78%	23.40%	8.35
medical instruments	18	301.9	13.34%	27.64%	9.01
Medical Commerce	5	105.2	17.60%	55.76%	4.64
Traditional Chinese Medicine	23	400.2	12.06%	23.75%	4.74
Pharmaceuticals	93	1675.6	12.30%	29.57%	6.24

Source: Wind, Phillip Securities (HK) Research

### Pharmaceuticals Stocks Overview under the Northbound Shenzhen Trading Link

Stock Code	Company	Close price	PE(TTM)	PB	ROE(3Q 16,%)	Liability Ratio(3Q 16,%)	Net profit Growth(3Q 16,%)	Revenue Growth(3Q 16,%)
000963.CH	Huadong Medicine	73.60	26.75	5.09	18.53	48.15	28.89	17.11
002294.CH	Shenzhen Salubris	30.20	23.29	6.32	21.84	17.31	12.28	10.19
000999.CH	China Resources Sanjiu Medical	26.88	24.50	3.17	10.90	41.81	4.93	11.84
002437.CH	Harbin Gloria Pharmaceutical	8.53	28.57	4.93	15.45	53.87	11.77	7.46
002603.CH	Shijiazhuang Yiling Pharmaceutical	16.42	34.34	3.60	8.62	17.31	31.59	17.63
000650.CH	Renhe Pharmacy	7.42	24.96	3.46	10.72	15.53	2.09	44.38
000423.CH	Dong-E-E-Jiao	56.00	23.47	4.75	16.66	14.25	8.51	5.28
000538.CH	Yunnan Baiyao	69.23	25.64	4.75	16.35	33.16	10.16	10.89

Source: Wind, Phillip Securities (HK) Research

## Northbound Shenzhen Trading Link: TMT

The scope of eligible stocks of 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. Therefore, investment opportunities in the TMT Sector are more abundant with nearly 250 companies, the total market value of which account for up to 28% of the total market value of Shenzhen Trading Link, and is several times that of its counterpart in Shanghai Trading Link.

TMT will be one of the core drives of the new economy in the context of supply-side structural reforms and the Internet+, with the most promising growth prospects. Nevertheless, in light of the general high valuation of the sector, we take a positive attitude to companies with core competitiveness, great potential for long-term development and a high safety pad.

First of all, based on the experience of Shanghai Trading Link, constituents of Shenzhen Stock 100 and Shenzhen Stock 300 have the highest certainty among the initial pilot stocks, including Iflytek(002230 CH), Guangdong Advertising(002400 CH), Beijing Ultrapower Software(300002 CH), Goertek(002241 CH), etc.

Secondly, there is a lack of investment opportunity in themes like state-owned enterprise reforms and national defence military industry in current Hong Kong-listed stocks. Therefore, relevant names are worthy of note, including Shenzhen SDG Information (000070 CH), Westone Information Industry (002268 CH), Hwacreate(300045 CH), Guangzhou Haige Communications(002465 CH), Beijing Watertek Information Technology(300324 CH), Wisisoft(002253 CH), etc.

Furthermore, to some extent, QFII positions reflect the preferences of overseas investors. We believe White Horse shares which have high market value and dividends will be favoured, including Hikvision(002415 CH), EyeSmart Technology(002236 CH) and other leading security giants and leading semiconductor giants like Tianshui Huatian Technology(002185 CH).

**TMT Stocks Overview under the Northbound Shenzhen Trading Link**

Stock Code	Company	Sector	Close price	PE(TTM)	PB	ROE(3Q16, %)	Liability Ratio(3Q16, %)	Net profit Growth(3 Q16,%)	Revenue Growth(3 Q16,%)
002400.CH	Guangdong	Media	13.18	29.64	3.52	14.88	45.79	20.36	9.72
002241.CH	Goertek	Electronic	30.72	34.84	4.56	10.50	55.72	21.34	38.57
002185.CH	Tianshui Hua	Electronic	12.68	48.22	2.81	6.12	25.77	11.79	40.71
002230.CH	Iflytek	Computer	29.98	145.15	6.02	4.31	28.34	24.51	27.90
300002.CH	Shenzhen SD	Computer	10.65	77.84	4.21	6.79	25.91	95.57	17.24
002268.CH	Westone Inf	Computer	35.06	124.84	11.39	0.38	56.62	5.80	56.20
300045.CH	Hwacreate	Computer	16.04	303.27	9.66	2.61	20.99	14.74	2.83
300324.CH	Beijing Wate	Computer	22.80	84.97	14.91	13.92	32.12	486.22	89.73
002253.CH	Wise Soft	Computer	29.80	216.18	5.31	1.62	12.25	5.98	55.20
002415.CH	Hikvision	Computer	24.54	22.39	6.97	23.69	40.71	28.65	26.74
002236.CH	EyeSmart Te	Computer	14.62	25.65	5.67	15.35	40.66	40.51	36.68
000070.CH	SDG Informa	Tele-commu	29.82	61.32	5.60	7.72	59.95	135.08	91.10
002465.CH	Haige Comm	Tele-commu	12.55	53.10	4.21	3.88	29.97	10.75	17.33

Source: Wind, Phillip Securities (HK) 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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