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Report Review of October 2019

Hong Kong | INVESTNOTES REPORTS REVIEW

Sectors:

Air, Automobiles (Zhang Jing)
Pharmaceuticals, Technology & Environment (Leon Duan)
Retail, Manufacturing (Tracy Ku)

Automobile & Air (Zhang Jing)

This month I released 3 updated reports of BYD (1211.HK), Minth (425.HK) and Dongfeng (489.HK), which got success by their unique Competitive edge. Among them, we recommend Dongfeng first.
According to the total sales volume, the market share of the Company in H1 was approximately 11.2%, up by 0.5 ppts yoy. The market share of passenger vehicles and commercial vehicles increased by 0.3 and 0.8 ppts, respectively. In H1, the Company sold approximately 1,374,400 vehicles, down approximately 9% yoy, lower than the industry average by approximately 3.4 ppts. Specially, 1.134 million passenger vehicles were sold, down 11.3% yoy, better than the industry average by approximately 2.7 ppts. In terms of sales in Q3, Japanese brands remained strong, while DFL continued to rise against the trend but its growth rate narrowed, with sales volume up 5% yoy to 377,000 vehicles; Dongfeng Honda surged 21.7% to 212,000 vehicles. It is expected that the strong Japanese brands and steady growth of commercial vehicles in the future will support the company to maintain steady growth.

Pharmaceuticals, Technology & Environment (Leon Duan)

I released four reports on CR Pharma (3320.HK), CN Energy Eng(3996.HK), CMS(867.HK) and SinoPharm Accord (000028.SZ). We highly recommend CMS. For the six months ended June 30, 2019, the company recorded operating income of RMB 2.964 billion, an increase of 11.7% YoY; if excluding the effect of the “two-invoice system” revenue was RMB 3.402 billion, an increase of 14.4% YoY, mainly because of an increase in sales volume. Gross profit was RMB 2.218 billion, a YoY increase of 17.7%; excluding the effect of the “two-invoice system”, gross profit was RMB 2.023 billion, a YoY increase of 16.0%, mainly reflecting the increase in turnover. Gross profit margin was 74.8%, up 3.9ppt YoY; excluding the effect of the “two-invoice system”, gross profit margin was 59.5%, an increase of 0.8ppt YoY, mainly due to decreases in import duty rate and value-added tax rate. The profit for the period was RMB 1.168 billion, a YoY increase of 22.2%, mainly due to the continuous growth in turnover and an increase in other gains. As of June 30, 2019, the company acquired four innovative products with sufficient competitive advantages to meet the clinical needs in Chinese market. Among them, two have been launched in the United States, the European Union and other regions, and the other two are in the clinical stage. The company's innovative products have expanded to 13 products in various fields, including ophthalmology, dermatology, nervous system, anti-tumor, immune system, digestive system. anti-infection and endocrine system. For1H2019, the company's promotion network covers more than 57,000 hospitals and medical institutions across the country, covering all provincial administrative regions and most prefecture-level administrative regions, and also China's tertiary hospitals, secondary hospitals and the main departments of the tertiary hospital.

Retail & Manufacturing (Tracy Ku)

This month I released the report of Xtep(1368) and Mengniu(2319). Xtep is placed as a brand management company with a clear brand image focusing on professional running that distinguishes it from the industry. Transforming from a fashion sportswear company to a Chinese runners' favorite brand, Xtep continued to rank first among all domestic brands and fourth among all global sports brands in international class marathons held in Beijing, Shanghai, Guangzhou and Xiamen, with the market share ranging from 10% to 20% in 2018.

Xtep's interim revenue increased by23%,mainly driven by sales volume, ASP increased by 3% to 5%. It is expected that with the upgrading of products, ASP will grow by 3 to 5% every year in the future. From July to August, retail sales growth followed the trend of the 1H. It slowed down slightly in September. The management team believe that it was due to the warm weather. As the weather turns cooler, sales will pick up. It still maintains the annual core brand revenue growth target of 20%, next year is a double digit. After the announcement of the interim results, Xtep's share price dropped, mainly due to the RMB100 million expenses incurred by the K-Swiss and Palladium acquisition projects, which will be reflected in 2H. In fact, RMB40 million is for the relevant administrative, legal and auditing costs involved in the acquisition, and the rest is the one-off expenses for the employee's contingency expenses and inventory impairment which will be involved in the termination of the loss business.

Although Xtep's multi-brand strategy will increase the operating expenses in the short term, it will put pressure on the profit margin. However, in the long run, sources of income can be diversified. Xtep currently focuses on the second- and third-tier cities or below. The new brands business can help the company to open up high-end first-tier market. The new brand K-Swiss business still record a loss. It is expected to take 18 to 24 months to consolidate and will be re-launched to the market in 202. Most of this business is wholesale business, and Xtep will increase apparel business' percentage share to the total revenue, and improve product quality. Palladium has distributors and stores in China and the company plans to continue this model.

For Saucony and Memell, which are operated through joint venture, will expand network through distributors after two to three years. Merrell will have new stores being opened in the second half of next year, and Saucony in the second quarter of 2020. The two brands will retain 30% of their original design products. 70% will be the products that are redesigned for the China market.

Fig 1. Performance of Recommended Stocks

Time	Ticker	Company	Analyst	Rating	Price on Recommendation Date	Target Price	Expected Return	Last Month Closing Price	Month Return	Closing Price 2M ago	1M Price Chg
14/10/2019	1211.HK	BYD	ZJ	Accumulate	38.1	44	15.49%	36.9	-3.15%	39.15	-5.75%
21/10/2019	425.HK	Minth	ZJ	Accumulate	27.35	32	17.00%	27.8	1.65%	26.55	4.71%
28/10/2019	489.HK	Dongfeng	ZJ	Buy	7.43	9	21.13%	7.88	6.06%	7.45	5.77%
02/10/2019	3320.HK	CR Pharma	LD	Buy	7.37	11.22	52.24%	7.25	-1.63%	7.35	-1.36%
09/10/2019	3996.HK	CN Energy Eng	LD	Buy	0.79	1.02	29.11%	0.79	0.00%	0.78	1.28%
22/10/2019	867.HK	CMS	LD	Accumulate	10.06	11.34	12.72%	10.66	5.96%	9.32	14.38%
29/10/2019	000028.SZ	SinoPharm Accord	LD	Buy	43.9	54.9	25.06%	46.58	6.10%	43.49	7.11%
09/10/2019	1368.HK	XTEP	TK	Buy	4.38	6.15	40.50%	4.56	4.11%	4.24	7.55%
21/10/2019	2319/HK	Mengiu	TK	Accumulate	31.2	34.6	10.80%	31.35	0.48%	29.35	6.81%

A stock is calculated by RMB yuan.
Source: Company, Phillip Securities Research

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

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 ± 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

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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