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Report Review of June. 2023

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Hong Kong | INVESTNOTES REPORTS REVIEW

Sectors:
Air & Automobiles (Zhang Jing),
TMT, Semiconductors, Consumer, Healthcare (Eric Li)
TMT, Food (Elvis Kwok)

Automobile & Air (ZhangJing)

This month I released updated reports of Sinotruk(3808.HK) and Tuopu (601689.CH).

Sinotruk sold 158 thousand heavy trucks in 2022, down 44% yoy, a decrease significantly less than the industry average of 52%. The Company occupied a share of 23.5% in China's heavy truck market, up 3.0 ppts over the same period last year, surpassing FAW Jiefang and ranking first. We think that the reasons for Sinotruk's increased market share despite headwinds are mainly as follows: 1) In the domestic market, the Company has made certain breakthroughs in the development of key segments and key customers. Dump trucks and mixer trucks continued to maintain their competitive edge. The market share of high-horsepower tractors, trucks and special vehicles has grown significantly. 2) With the help of Sinotruk International's network layout and strategic breakthroughs, the Company's export sales volume of heavy trucks reached a new high during the reporting period, increasing by 65% yoy to 89 thousand units, accounting for 56% of the Company's total sales volume of heavy trucks, and maintaining the first place in China for 18 consecutive years.

In recent years, the Company has been committed to improving product technology, extending the industrial chain, and broadening market channels, which has achieved obvious results. The Company has adjusted the product structure purely centered on heavy trucks to cover a variety of choices for products including heavy trucks, medium and light trucks, buses and special vehicles. Through in-depth cooperation with MAN and Weichai Power, the Company has become a heavy truck manufacturer with the most complete power and drive types in China, and has built its core competitiveness in both domestic and foreign markets.

In terms of the domestic economic situation, China needs to boost its economy after the pandemic. With the further implementation of the government's policies to stabilize the economy, infrastructure investment and logistics demand will maintain the momentum of rally, which will provide a foundation for the recovery of the heavy truck market. Secondly, since the implementation of the National VI emission standard in July 2021, the heavy truck industry has fallen into a downturn for one and a half year. While, the heavy trucks in the previous round of peak consumption have gradually entered the replacement period. In addition, the stricter emission regulations of the industry, the overload transportation governance, and the elimination of backward and old models will play a positive role in the recovery of the industry. We expect the Company to continue to benefit from the recovery of the domestic heavy truck industry and the growth trend of the export market.

A forward-looking layout has been made by Tuopu in new energy vehicles (NEVs). Especially, Tuopu's lightweight chassis and electronic business entered the harvesting period in 2022 and began to contribute to business performance. The year 2022 witnessed the global delivery of 1.31 million units of NEVs by the Group's largest customer, Tesla, up 40%yoy. Tesla's output was 1.37 million units, up 47% yoy. Additionally, the annual sales of new customers--NIO, AITO, Li Auto, and BYD-- up 34%,626%, 47%, and 153% yoy, respectively. The sales growth of both new and existing customers stimulated the Group's growth in revenue and profit.Meanwhile, thanks to the continuous practice of the Tier0.5 business model, the Group's matching amount of single vehicles increased constantly. The net profit margins in 2022Q1-Q4 were 9.56%, 9.65%, 10.98%, and 11.87%, respectively, indicating increasing profitability. The scale effect will hopefully promise continuous profitability growth. In the first quarter of 2023, the Company recorded a revenue of 4.47 billion yuan,+19.3% yoy, and a net profit attributable to the parent company of 450 million yuan, a yoy increase of 16.7%.In order to adapt to the new energy and intelligent trends, expand capacity, and ensure the ability to take orders, the Group has recently released its private placement plan. It intends to raise no more than RMB4 billion by issuing shares no higher than 30% of the total share capital. Previously, Tuopu Group raised RMB14.25 billion in total through private placement and the issue of convertible bonds in February 2021 and July 2022 to expand the lightweight chassis project. The ambitious capacity expansion plan demonstrates the Group's confidence in its future business development momentum and rapid order growth. In terms of overseas markets, the Group's plant in Poland has begun mass production and their counterparts in Mexico and the U.S. are being promoted, backing the global business expansion.

TMT, Semiconductors, Consumer, Healthcare (Eric Li)

This month I released reports of Baguio Green (1397.HK) & Xtep International (1368.HK). For the year ended 31 December 2022 (FY2022), Baguio's revenue was HK$1,793.1 million, representing an increase of 40.8% YoY. Profit attributable to equity shareholders amounted to HK$53.7 million (FY2021: HK$12.8 million), representing in a yoy increase of 3.2 times. EPS was HK12.9 cents (FY2021: HK3.1 cents). Final dividend for the FY2022 at HK3.8 cents (FY2021: HK0.9 cents) per ordinary share.

Gross profit increased by 38.5% to HK$151.0 million. However, the waste management and recycling segment was affected by the initial operation costs in new projects, its relevant income in short run may not be proportional to its expenditure. In addition, high service level demand in pest management services market with keen competition, together with the high energy price also affect the gross profit margin. The gross profit margin decreased by 0.2 percentage points to 8.4%.

Cleaning services, as Baguio's core business, recorded a considerable growth in 2022. Revenue of cleaning services increased by 61.2% to approximately HK$1.33 billion, accounting for 74.2% of the overall revenue during the Year. Company secured a number of service contracts worth approximately HK$1.99 billion in total for street cleansing services in Mong Kok, Sha Tin, Yuen Long, Western and Tai Po districts. Demand for cleaning services increased due to the pandemic enabled the Baguio to secure the cleaning services projects with high profit margin, which contributed to an increase in gross profit margin of cleaning business to 9.3% from 8.8% in FY2022.

In 2022, new contracts awarded amounted to a total of HK$3.08 billion. As a result, recorded a historical high for its contracts on hand of HK$3.59 billion, representing a surge of 67.3%. In addition, the company continued to maintain a high tender success rate at 43.7% in 2022 (2021: 39.5%).

Currently, ~80% of the Baguio's revenue was generated from contracts with government and quasi-government organizations, the amount of contracts on hand (generally with a term of 2–3 years) as of 31 December 2022, ~HK$1,795.1 million will be recognized by the end of 2023 (~HK$1,164.6 million will be recognized in 2024 and the rest of ~HK$629.8 million will be recognized in 2025 and beyond), while this value is higher than the revenue for the whole year of 2022 (HK$1,793.1 million). With potential new contracts to be obtained in 2023, despite the unsatisfactory in the global macroeconomic environment, it is expected that the company's business and revenue growth in FY2023 still has high certainty..

TMT, Food (Elvis Kwok)

This month I released one report, China Lit (772.HK)

China Lit (772.HK) is a comprehensive cultural industry group based on Chinese online literature and centered on IP cultivation and development as its core. Its subsidiaries include well-known brands in the industry such as QQ Reading, Qidian and New Classics Media (NCM). It has a lineup of writers and a rich reserve of literatures, covering more than 200 content categories, reaching hundreds of millions of users, and adapting a large number of web text IPs, such as Joy of Life, The King's Avatar and Soul Land, into animation, film and television and games and other products.
China Lit (772.HK) has announced the annual report ended December 31, 2022. The company's revenue amounted to RMB 7.6 billion, decreasing 12.0% YoY. Cost of revenue amounted to RMB 3.6 billion, decreasing 11.6% YoY. Gross profit amounted to RMB 4.0 billion, decreasing 12.4% YoY. Gross profit margin was 52.8%, slightly decreasing 0.3 percentage point YoY. Operating profit was RMB 0.6 billion, decreasing 71.1% YoY. Profit attributable to non-IFRS shareholders amounted to RMB 1.4 billion, increasing 9.6% YoY.
The Chinese literature market consists of three segments, including online literature, e-books and physical books. As the company is the leader of China's online literature platform, traffic and literature are particularly important to the company's development. If the company's platform has enough traffic, it can attract more authors to enter the platform and create more literatures, and the platform has more high-quality literatures could attract more traffic, it will form a good cycle between traffic and literatures. The company's platform can not only collect copyright fees, subscription fees, and advertising fees, but also adapt popular online literature into TV series, movies, and games to fully monetize popular IPs.
We believe that the company's series of anti-theft measures have achieved initial results and have a positive impact on the company's online literature business. However, since the piracy problem has deeply plagued the entire online literature market for many years, it is difficult to solve it. We suggest investors to continue pay attention to the subsequent impact of the anti-theft measure. As for the advertising business, as the mainland's anti-epidemic policies have been relaxed and economic activities have largely returned to normal, we expect a recovery in this segment. In terms of copyright operations, with the normalization of the approval of game licenses in the mainland, it is expected that the company will have more cooperation in converting popular IPs into games. In addition, the company will launch popular IP dramas such as Joy of Life 2 and My Heroic Husband 2 in 2023. We expect this part of the revenue to grow significantly.

We use SOTP method and set a target price of HK$36.2 (calculated at RMB/HKD exchange rate of 1.08), including: 1) In line with the average P/S of other online entertainment companies (2.73x), the online business is valued at HK$14.3 per share (accounting for 39.5% of the overall valuation); 2) In line with other IP content creation company P/E average (32.3x), IP operations and other businesses are valued at HK$21.9 per share (accounting for 60.5% of the overall valuation), with a “Neutral” rating. (Current price as of June 26).

Fig 1. Performance of Recommended Stocks

Time	Ticker	Company	Analyst	Rating	Price on Recommendation Date	Target Price	Expected Return	Last Month Closing Price	Last Month Return	Closing Price 2M ago	1M Price Chg
20230612	3808 HK	Sinotruk	ZJ	BUY	12.26	16.1	31.32%	15.24	24.31%	11.08	37.55%
20230616	601689 CH	Tuopu	ZJ	Accumulate	67.72	73.5	8.54%	80.7	19.17%	58.13	38.83%
20230614	1368 HK	Xtep International	EL	Accumulate	8.34	9.61	15.20%	7.98	-4.32%	7.8	2.31%
20230615	1397 HK	Baguio Green Group	EL	Buy	0.68	1.18	73.50%	0.61	-10.29%	0.51	19.14%
20230628	772.HK	China Lit	ES	Neutral	34.85	36.2	3.87%	32.95	-5.45%	29.6	11.32%

A stock is calculated by RMB yuan.
Source: 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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