UOBKayHian

Hong Kong/ China Morning Notes

Thursday, February 19, 2009

CHINA

Sector

Oil & Gas Page 2

Sino-Russia 20-year oil supply contract positive for China; widening H- vs A-share discount presents buying opportunity. Maintain OVERWEIGHT.

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Coal import only has marginal impact on both IPPs and coal miners. Maintain MARKET WEIGHT.

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January premiums up 23% yoy, reflecting an excellent start to the year.

HONG KONG

Sector

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We double-check our price targets and assumptions, which are still among the most bearish in the market, and find they are not at all far-fetched.

Key Indices

Key Indices	Prev Close	1D %	1W %	1M %	YTD %
DJIA	7555.6	0.0	(4.2)	(8.8)	(13.9)
FTSE 100	4006.8	(0.7)	(5.4)	(3.4)	(9.6)
AS30	3366.9	(1.3)	(1.5)	(4.6)	(8.0)
CSI 300	2275.8	(4.6)	(2.4)	13.1	25.2
FSSTI	1651.1	0.8	(4.1)	(5.5)	(6.3)
HSI	13016.0	0.5	(3.9)	(2.4)	(9.5)
JCI	1330.6	1.0	0.4	(1.5)	(1.8)
KLCI	895.2	(0.4)	(0.2)	0.6	2.1
KOSPI	1113.2	(1.2)	(6.5)	(3.3)	(1.0)
Nikkei 225	7534.4	(1.5)	(5.2)	(8.7)	(15.0)
SET	439.6	0.3	(1.0)	0.9	(2.3)
TWSE	4498.4	0.1	(1.7)	3.0	(2.0)
BDI	1986	4.8	(3.4)	125.4	156.6
CPO (RM/mt)	1935.5	(3.0)	0.0	6.5	18.7
Nymex Crude (US$/bbl)	34.6	(0.9)	(7.8)	(5.2)	(22.4)

Source: Bloomberg

Top BUYs/SELLs

	Ticker	Current Price (lcy)	Target Price (lcy)	Pot. +/- (%)
Top BUYs				
China Life	2628 HK	22.45	30.50	35.9
China Mobile	941 HK	71.50	90.00	25.9
China Petroleum	386 HK	4.23	6.93	63.8
China Railway	390 HK	4.68	5.90	26.1
China Shenhua	1088 HK	16.82	23.00	36.7
Maanshan Iron	323 HK	2.88	3.70	28.5
Bumi Resources	BUMI IJ	740.00	1,010.00	36.5
Public Bank	PBK MK	9.10	10.90	19.8
DBS Group	DBS SP	8.10	10.55	30.2
Indofood Agri	IFAR SP	0.56	0.80	42.9
SingTel	ST SP	2.47	2.95	19.4
Advanced Info	ADVANC TB	77.00	101.00	31.2
Quality Houses	QH TB	0.86	1.49	73.3
Top SELLs				
Aluminum Corp	2600 HK	4.07	3.00	(26.3)
Parkson Retail	3368 HK	6.53	4.89	(25.1)
Wharf Hldg	4 HK	16.72	14.60	(12.7)
S'pore Airlines	SIA SP	10.22	9.70	(5.1)
S'pore Exchange	SGX SP	4.90	3.00	(38.8)
Amata Corp	AMATA TB	3.60	2.52	(30.0)

Key Assumptions

GDP (% yoy)		2008	2009F	2010F
US*		1.3	(1.9)	1.8
Euro Zone*		0.7	(1.8)	0.8
Japan*		(0.7)	(2.9)	n.a.
Singapore		1.2	(4.0)	4.0
Malaysia		5.1	0.9	4.0
Thailand		4.2	0.5	4.3
Indonesia		6.0	3.6	6.3
Hong Kong		2.2	(0.8)	1.5
China		9.0	7.1	8.0
Brent Crude Oil	(US$/bbl)	100	55	65
Aluminium *	(US$/MT)	2,623	1,763	2,090
Copper *	(US$/MT)	6,884	3,834	4,578
Gold Price London *	(US$/ounce)	873	942	981
Iron Ore *	(USc/dmtu)	153	107	99
CPO	(US$/MT)	818	520	685
BDI		6,338	2,500	1,500

** Bloomberg*
Source: UOB, UOB Kay Hian

Corporate Events

	Venue	Type	Beg	Close
China/Commodities-Energy	Malaysia	AP	18-Feb	19-Feb
China/Commodities-Energy	Hong Kong	AP	20-Feb	20-Feb

** AP: analyst presentation*

Oil & Gas

Sino-Russia oil deal and widening H-A gap present buying opportunities

The just-concluded Sino-Russia loan-for-oil deal carries an implied oil price of US$22/bbl, a positive for China. Widening H- vs A-share discount suggests further upside for H-shares. Maintain OVERWEIGHT for sector.

Sector Events

China, Russia sign 20-year deal swapping oil for loans. China signed a US$25b energy deal that will secure oil supplies from Russia for the next 20 years in return for loans. As part of the broad energy supply deal, China will lend US$15b to Rosneft, Russia's state-owned oil major, and US$10b to Transneft. In return, Russia promised to guarantee annual oil supply of 15 million tons, or 300,000 barrels per day, for 20 years to China.

Sector Impact

Positive for China's energy safety. The interest rate embedded in the deal is believed to be about 6%. If it is the case, the implied oil purchase price for China will be approximately US$22/bbl, which is very reasonable given the current spot price of US$40/bbl and long-term consensus of US$75/bbl. Furthermore, 15 million tons is a significant supply, amounting to some 8% of China's oil imports in 2008 and 4% of China's total consumption.

Still too early to pin down impact on oil majors. Our bet is that PetroChina and Sinopec will likely share this contracted oil supply. But due to the limited information available at this point, there is no indication of how this supply will be split between the 2 oil majors or even the oil price at which they will be charged. However, given Sinopec's refining capacity is 40% greater than PetroChina's, it is likely that Sinopec will be allocated more oil from this deal.

Earning Revision

Sinopec recently announced that its net profit in FY08 will drop more than 50% yoy due to a) big refining losses in 1H08 and b) drop in price and demand for its chemical products. For these reasons, we slash our net profit forecast for 2008 to Rmb26.3b, or Rmb0.30/share. We leave our forecast for 2009 unchanged.

Recommendation

After the recent 30% rebound in the A-share market, the H- vs A-share discount has been widening for both Sinopec and PetroChina. Sinopec's 57% H- vs A-share discount has been close to the historical high. This implies a good buying opportunity for its H-shares.

At this juncture, we maintain our **BUY** ratings on **Sinopec** and **PetroChina**. Our target prices for Sinopec and PetroChina are HK$6.93 and HK$8.82, which correspond to 1.6x and 1.8x 2009 P/B respectively

CHINA

Oil & Gas

OVERWEIGHT

PetroChina (857 HK)

BUY
Current Price: HK$5.92
Target Price: HK$8.82

Sinopec (386 HK)

BUY
Current Price: HK$4.23
Target Price: HK$6.93

Sinopec's H-A Discount

Source: Bloomberg, UOB Kay Hian

PetroChina's H-A Discount

Source: Bloomberg, UOB Kay Hian

Analyst

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Stock	Rec.	Price 18 Feb 09 (HK$)	Net Profit 2007 (Rmbm)	Net Profit 2008F (Rmbm)	Net Profit 2009F (Rmbm)	EPS 2007 (Rmb)	EPS 2008F (Rmb)	EPS 2009F (Rmb)	PE 2007 (x)	PE 2008F (x)	PE 2009F (x)	ROE 2007 (%)	Market Cap (HK$b)	Yield 2007 (%)
PetroChina	BUY	5.92	145,625	140,188	108,926	0.80	0.77	0.60	6.5	6.8	8.7	22.5	124.9	6.8
Sinopec	BUY	4.23	56,533	26,279	81,510	0.65	0.30	0.94	5.6	12.0	3.9	19.8	70.9	4.5

Power

Coal import only has marginal impact

Local press reported that dominant IPPs and China Resources will import coal, amid the deadlocked coal price negotiation. Given the limited import volume, industry impact will likely be marginal. Maintain MARKET WEIGHT.

Sector Events

IPPs will import more coal this year. According to local press, the five major power groups, including Huaneng Group, Huadian Group, Datang Group, Guodian Group and China Power Investment Group, together with China Resources Group, have teamed up to import coal from overseas suppliers to satisfy their own demand. In the meantime, the contract negotiations for thermal coal are still deadlocked.

Sector Impact

Marginal impact for both IPPs and coal miners. We think coal imports will merely serve as a strategic warning to coal miners under the current deadlocked coal price negotiation. In fact, the volume of imported coal will only account for less then 5% of the total coal demand for Independent Power Producers (IPPs). Even if IPPs are able import more coal, imported coal can only be used in coastal cities given transportation problems. From the business perspective, importing coal is actually not a good choice for IPPs as international coal price and supply are usually more volatile, even though prices may now be cheaper. Therefore, we expect coal imports to have only a marginal impact on the domestic coal prices. On the other hand, we think it will support international coal price and narrow the price gap between China and overseas coal due to higher demand.

IPPs' coal cost will depend on domestic demand/supply dynamics. There has been much news or speculation concerning the thermal coal price negotiation. However, we think investors should be focussing more on the current coal demand/supply dynamics and spot price, as both parties can default if there is price divergence.

Recommendation

Maintain **MARKET WEIGHT** for the power sector given the uncertain coal price negotiation and coal price trend. Currently, we continue to prefer well-diversified IPPs, including **CR Power** and **Datang Power**, given their lower coal cost risk in the longer term and better earnings visibility. **Maintain BUY** for both companies with a DCF-based target prices of HK$17.70 (WACC=9.6%, g=3%) and HK$4.90 ((WACC=8.5%, g=3%) respectively.

CHINA

Power

MARKET WEIGHT

CR Power (836 HK)

BUY
Current Price: HK$14.08
Target Price: HK$17.70

Datang Power (991 HK)

BUY
Current Price: HK$3.60
Target Price: HK$4.90

Huaneng Power (902 HK)

SELL
Current Price: HK$5.17
Fair Price: HK$4.70

Huadian Power (1071 HK)

SELL
Current Price: HK$1.65
Fair Price: HK$1.50

China Power (2380 HK)

HOLD
Current Price: HK$1.43
Fair Price: HK$1.70

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Sector Comparison

Company	Ticker	Rec.	Price 18 Feb 09 (HK$)	Net Profit 2007 (Rmbm)	Net Profit 2008F (Rmbm)	Net Profit 2009F (Rmbm)	EPS 2007 (Rmb)	EPS 2008F (Rmb)	EPS 2009F (Rmb)	PE 2007 (x)	PE 2008F (x)	PE 2009F (x)	ROE 2007 (%)	Market Cap (HK$m)	Yield 2007 (%)
Datang Power	991 HK	BUY	3.60	3,406	510	3,169	0.29	0.04	0.27	11.9	79.5	12.8	13	11,632	4.2
CR Power	836 HK	BUY	14.08	3,161	563	4,132	0.80	0.14	1.01	17.6	102.7	14.0	17	18,493	1.8
Huaneng Power	902 HK	SELL	5.17	6,161	(3,979)	2,281	0.51	(0.33)	0.19	9.1	n/a	24.6	12	15,796	6.4
Huadian Power	1071 HK	SELL	1.65	1,197	(1,362)	116	0.20	(0.23)	0.02	7.5	n/a	77.3	6	2,361	4.2
China Power	2380 HK	HOLD	1.43	592	(782)	403	0.16	(0.22)	0.11	8.0	n/a	15.2	6	2,855	5.1

CR Power's financials are in HK$
Source: Company data, UOB Kay Hian

Ping An Insurance

January premiums up 23% yoy, reflecting excellent start to the year

January premiums up 23% yoy, better than consensus estimates. Earnings recovery expected this year as key negatives have been mostly factored into earnings. Maintain BUY.

Corporate Events

Ping An announced January premiums of Rmb13.3b, up 23% yoy, which exceeded consensus expectations. Property and casualty (P&C) premiums came in at Rmb3.6b, up 12.7% yoy.

Stock Impact

Like China Life, Ping An is off to an excellent start to the year in terms of premium growth. Premium growth is particularly impressive, given that January was a shortened working month due to the Chinese New Year and the very strong loan growth experienced in Jan 08.

We believe Ping An's premium growth was further helped by Ping An maintaining its universal life credit rate, which remained unchanged at 5.25% for a 138bp spread above the five-year benchmark deposit rate.

P&C premiums were also slightly better than expected given the shortened month of January. Going forward, P&C premium growth will be challenged by slowing auto sales. However, China Insurance Regulatory Commission's (CIRC) enforcement of insurer solvency and strict regulation of commissions may help Ping An break even in terms of underwriting this year.

Earnings Risk

A-share market volatility and prolonged period of low interest rates.

Recommendation

We maintain our BUY recommendation on Ping An as we believe the majority of the headwinds it faced in 2008 have been fully priced in. Earnings of Chinese life insurers will also likely recover this year. With the A-share market being the top performing market in the world year-to-date, the investment outlook has also improved substantially from last year. Our target price remains HK$47.75, reflecting 2.5x P/EV and 25x NBV. However, China Life remains our top pick for the insurance sector due to its simple business structure, dominance in the rural business and absence of loss-making foreign investments.

CHINA

Ping An Insurance (2318 HK)

BUY

Current Price: HK$34.75
Target Price: HK$47.75

Sector	Insurance
52-Wk Avg Daily Vol. (m)	21.8
Market Cap (HK$m)	264,147
(US$m)	33,865
Major Shareholders (%)	
HSBC	16.80
Book NTA per Share (Rmb)	13.36
ROE (%)	24.3
Results Due	
Interim	August
Final	April

Price Chart

Source: Bloomberg

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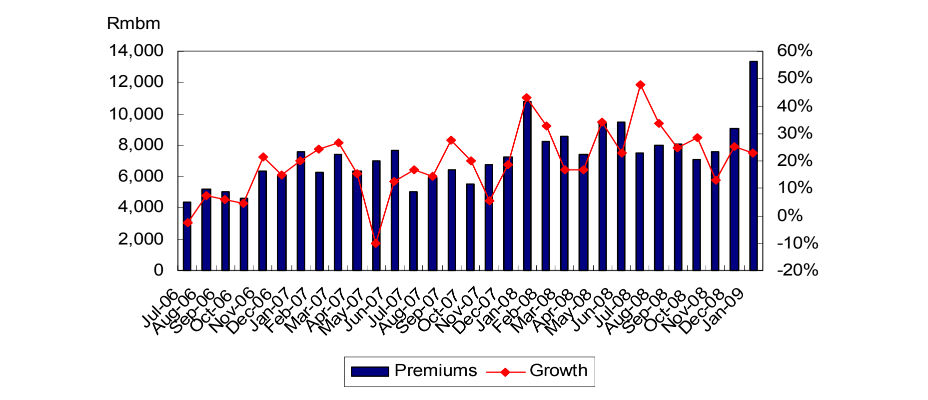
31 Dec	Net Earned Premium (Rmbm)	EBITDA (Rmbm)	Net Profit (Rmbm)	EPS (Rmb)	EPS Growth (%)	PE (x)	P/EV (x)	DPS (Rmb)	Yield (%)
2006	63,013	8,548	7,838	1.05	53.8	29.8	3.0	0.34	0.88
2007	73,606	22,004	18,688	2.50	138.4	12.5	1.5	0.50	1.30
2008F	92,297	2,068	437	0.06	-97.7	535.4	2.1	0.01	0.03
2009F	108,560	16,700	13,848	1.85	3069.9	16.9	1.8	0.37	0.96
2010F	131,647	21,169	18,316	2.45	32.3	12.8	1.6	0.47	1.22

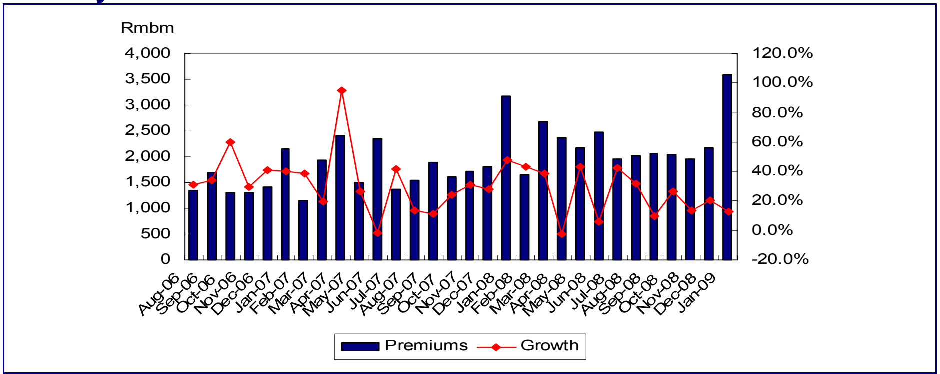
Consensus Net Profit – FY08: Rmb3,552m
– FY09: Rmb14,897m

Monthly Life Premiums



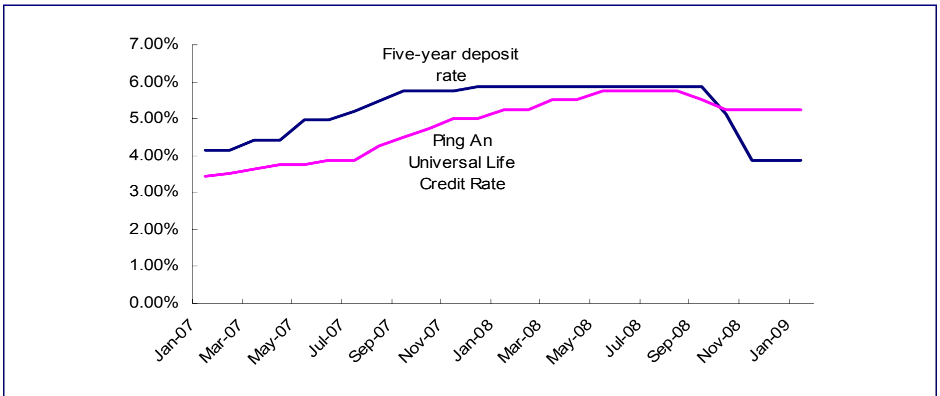
Source: Ping An, UOB Kay Hian

Monthly P&C Premiums



Source: Ping An, UOB Kay Hian

Universal Life Credit Rate



Source: Ping An, UOB Kay Hian

Profit & Loss

Year to 31 Dec (Rmbm)	2006	2007	2008F	2009F	2010F
Net earned premiums	63,013	73,606	92,297	108,560	131,647
Net Investment income	12,198	15,257	17,373	20,279	27,265
Net profit	7,838	18,688	437	13,848	18,316
EPS	1.27	2.54	0.06	1.85	2.45

Balance Sheet

Year to 31 Dec (Rmbm)	2006	2007	2008F	2009F	2010F
Investment Assets	341,557	511,825	488,286	536,718	635,331
Total Assets	493,539	691,298	730,993	815,870	924,191
Total Liabilities	446,559	577,447	613,917	689,661	785,795
Equity	46,375	113,851	114,202	125,328	139,477

Property

We are not overly pessimistic

HONG KONG

Property

UNDERWEIGHT

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Our price targets, which are based on another 25% fall in residential prices this year, are still among the most bearish in the market. We double-check our assumptions and are satisfied that they are not far-fetched at all.

Sector Events

We differ. Overall, the market was shocked by the surge in unemployment to 4.6% in January (released on Tuesday). While that has effectively removed the last thread of hope that anyone might still be holding on property prices remaining stable, many commentators are only expecting residential prices to fall 10-15% this year, much smaller than our 25%. One reason we are more pessimistic than others is because unemployment could reach 7% by year-end, against the market's typical 6%.

Utmost task to preserve employment. Unemployment rose 16,400 in January, triple that of the 4,900 in December, even before the massive closure of businesses expected to take place after the Lunar New Year. The government's prime aim now is to ease pressure on the job market. The Budget, to be released next Wednesday (25 February), will focus on this area. In order to hold up the fast-eroding confidence, the government has recently announced these plans:

a) To create 55,000 construction jobs in fiscal year 2009-10 by accelerating infrastructure and minor works projects,

b) To recruit 7,700 civil servants and create 4,000 temporary openings in the next 14 months,

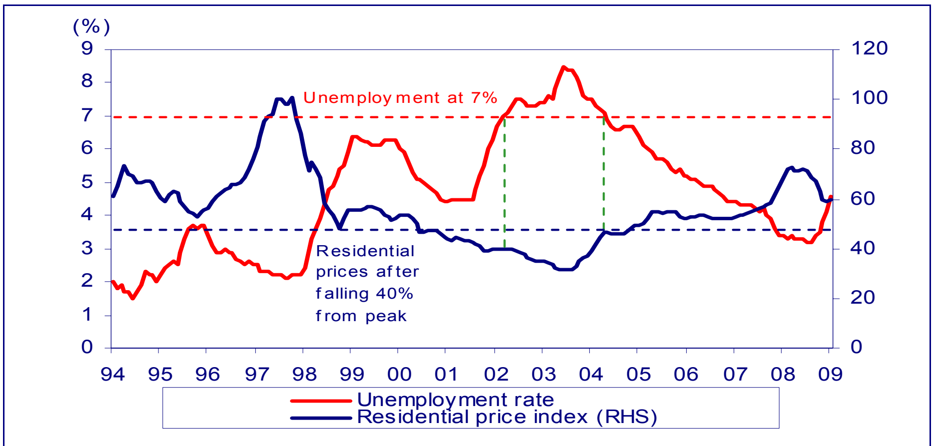
c) Over 20 statutory bodies will recruit some 6,000 employees and create about 2,000 temporary jobs or internship opportunities this year, and

d) The Labour Department will continue to organise larger-scale job fairs in shopping malls and community centres.

Question on implementation. For a start, we are sceptical on how fast these planned government jobs can actually materialise, particularly in view of the large number involved. In the private sector, there are already reports that companies are pulling out of the job fairs as expansion plans are halted.

Even if successfully implemented, unemployment could still top 7%. Here is a rough calculation: 14,300 jobs were lost in January. Assuming an average of 14,000 jobs will be gone in each of the next 11 months, a further 154,000 positions will be lost by December. Assuming all the proposed government jobs will be created this year, 74,700 new positions will be added, reducing the net loss in jobs to 79,300. Adding 38,500 new headcounts (based on the 10-year average) to the labour force, such as graduates and school-leavers, unemployment could rise from 157,700 at present to 275,500, or over 7%, by year-end.

Unemployment vs Residential Price Index



Source: HKSAR, Centaline

40% drop in residential prices from peak not that remote. For some time, we have been holding the view that residential prices will have to fall 40% from peak before bottoming. This will bring prices back to levels last seen in 1Q04. Many find this retrenchment hard to comprehend. But if we are indeed facing a financial crisis that only takes place once in a hundred years, it follows that perhaps none of us is in a position to comprehend the likely outcome.

We saw that in the past. Moreover, the Unemployment vs Residential Price Index chart shows unemployment hit 7% twice in the last seven years. The last time was in May 04, and at the time residential prices were hovering on levels equivalent to a 36% fall from the 2008 peak. In Mar 02, prices were even lower, equivalent to some 46% below the 2008 peak. Thus, our 40% base-case decline is not that far-fetched. One might argue new supply is much tighter now, but at the same time, the local or the global economy was not under as much stress then.

Downward spiral on prices. Suffice to say, the lack of job security will significantly undermine any desire to buy a new home. Moreover, without any salary increase (let alone the possibility of pay cuts), upgrading demand will also dissipate. We expect developers to start cutting prices more notably, especially on unsold inventories. This will only prompt the few that are still looking to buy a flat at this stage to wait for lower prices, drying up transaction volume further, which will put more pressure on prices. A downward spiral has been formed. Residential prices fell 20% in 2H08, thus we expect another 25% drop this year.

Potential Price Cuts On Unsold Inventories

Original launch date	Project	Location	Developer	No. of units	Units sold	Units unsold	Avg launch price (HK$psf)	Current price in area (HK$psf)	Potential price cut (%)
Jan 09	The Sail at Victoria	Western District	Hongkong Land	95	2	93	10,000	7,000	(30)
Jan 09	Vista	Sham Shui Po	Sino Land	173	106	67	5,200	4,400	(15)
Dec 08	Le Billionaire	Kowloon City	Chinachem	488	92	396	6,000	5,000	(17)
Dec 08	Cite 33	Prince Edwards	Henderson Land	107	47	60	6,300	5,000	(21)
Nov 08	Peak One	Shatin	SHKP	519	200	319	7,300	5,800	(21)
Nov 08	La Grove	Yuen Long	SHKP	543	400	143	3,200	3,000	(6)
Oct 08	The Dynasty	Tsuen Wan	Sino Land	256	90	166	6,200	4,800	(23)
Aug 08	One Madison	Cheung Sha Wan	Sino Land	126	60	66	6,000	5,000	(17)
Jun 08	York Place	Wanchai	Chinese Estates	94	35	59	15,000	10,000	(33)
Jun 08	Beacon Lodge	Cheung Sha Wan	SHKP	166	60	106	7,000	5,000	(29)
May 08	Celestial Heights	Homantin	Cheung Kong	939	490	449	10,000	7,000	(30)
Dec 07	Harbour Place	Hunghom	SHKP/New World	2,470	1,530	940	7,000	5,200	(26)
Nov 07	Island Lodge	North Point	Swire	184	98	86	10,000	7,000	(30)
Oct 07	Long Beach	Tai Kok Tsui	Hang Lung Prop.	1,829	605	1,224	7,200	5,300	(26)

Source: UOB Kay Hian

Stock Recommendation

We are not overly bearish. Our target prices are among the most bearish in the market for two reasons: a) our base-case assumption of a 40% fall in residential prices from the peak is still among the most pessimistic, and b) they are based on trough discount to NAV during past crises. By definition, the trough discount represents an overshooting situation and thus would appear aggressive. Share prices could rebound swiftly after hitting the trough levels.

Target Price Based On Trough Discount to NAV

	Ticker	Rating	Share price 18 Feb 09 (HK$)	End-09 NAV (HK$)	Discount to End-09 NAV (%)	Avg trough discount to NAV during past crises (%)	Target based on past trough discount (HK$)	Downside to target %
Cheung Kong	1 HK	SELL	66.70	77.31	(13.7)	(33)	51.80	(22)
Hang Lung Prop	101 HK	SELL	14.28	15.75	(9.3)	(38)	9.71	(32)
Henderson Land	12 HK	HOLD	25.30	45.15	(44.0)	(42)	26.18	3
Kerry Properties	683 HK	SELL	14.70	41.68	(64.7)	(70)	12.50	(15)
New World Dev	17 HK	SELL	7.34	16.54	(55.6)	(65)	5.79	(21)
Sino Land	83 HK	SELL	6.32	10.65	(40.7)	(63)	3.91	(38)
SHK Properties	16 HK	SELL	62.25	81.60	(22.9)	(38)	50.32	(20)

Source: UOB Kay Hian

http://research.uobkayhian.com

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