

2010 Research Outline

Rainbow after Storm

to summarize...

- Sharp rebound of Hong Kong market in 2009 after the financial tsunami.
- Our new coverage yield at 52.2% relative to HSI during the year.
- China's 2010 outlook remains positive with extra fuel from export and domestic consumption sectors.
- Bullish on Hong Kong stock market with confidence from China's encouraging economy performance.
- Sectors with obvious policy support may outperform.
- Picks of existing coverage include Fufeng (546 HK), Pacific Andes (1174 HK), Ju Teng (3336 HK) and United Laboratory (3933 HK).

Sharp V-shape rebound in 2009. 2009 sets to be memorable. Hong Kong stock market slid further in 1Q following the unprecedented crash in 4Q last year. Nevertheless, when most investors were still in panic, rally started. HSI re-climbed on to 20,000 points in Jul from bottom of 11,344 points in Mar and reached 22,944 points year high in Nov. For small & mid caps, MSCI China Small Caps also has recovered from below 500 points at the year beginning to 1,200 points level presently, close to which in 2007. We attribute this sharp V-shape rebound to: 1) huge liquidity pumped into financial system by central banks; 2) improving economy figures and, thus, market confidence backed by global effort to pull economy out of the recession.

52.2% relative return from new coverage. Our portfolio consists of 20 stocks with active updates (at least once in 2009). Latest recommendations comprise 10 BUY calls (50.0%), 8 HOLD (40.0%) and 2 SELL (10.0%). During the year, we initiated coverage on six companies, which are Wasion (3393 HK), Fufeng (546 HK), China State Construction (3311 HK), Ju Teng (3336 HK), Citic 1616 (1883 HK) and RCG (802 HK), sequentially. Average absolute return of these six stocks was 94.3% since inception (till 22 Dec) or 52.2% relative to HSI.

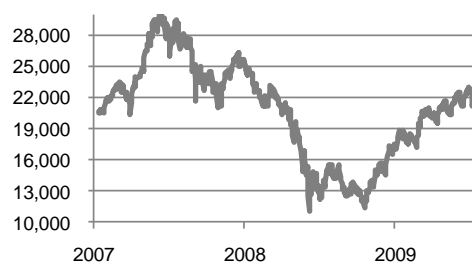
Table 1. Summary of active coverage in 2009

Company	Ticker	Last update	Latest rating
Fufeng	546 HK	12/16/2009	BUY
RCG	802 HK	11/3/2009	BUY
China Green	904 HK	10/5/2009	BUY
Pacific Andes	1174 HK	8/21/2009	BUY
Citic 1616	1883 HK	8/27/2009	BUY
CSCI	3311 HK	8/18/2009	BUY
Ju Teng	3336 HK	9/11/2009	BUY
Wasion	3393 HK	9/22/2009	BUY
United Lab	3933 HK	11/20/2009	BUY
China Renji	648 HK	5/7/2009	BUY
Tingyi	322 HK	9/2/2009	HOLD
I.T	999 HK	2/13/2009	HOLD
Hengan	1044 HK	9/4/2009	HOLD
Sino Biopharm	1177 HK	12/16/2009	HOLD
Weigao	8199 HK	11/19/2009	HOLD
Natural Beauty	157 HK	4/17/2009	HOLD
Stella	1836 HK	1/7/2009	HOLD
Anta	2020 HK	9/1/2009	HOLD
A8	800 HK	9/23/2009	HOLD
GZ Pharm	874 HK	3/31/2009	SELL

Source: SBI E2-Capital

Market Sector	Hong Kong Equity Small & mid caps
HSI	22,063.16
HSCEI	12,794.13
MSCI China Small Cap	1,226.83

HSI



HSCEI



MSCI China Small Cap



Source: Bloomberg

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Table 2. Coverage review

Company	Ticker	Date of inception	Price at inception (HK\$)	Spot price (HK\$)	Abs. Return (%)	Rel. return (%)
Fufeng	546 HK	12/16/09	2.00	5.57	178.5	137.1
RCG	802 HK	11/3/09	10.50	10.28	-2.1	-4.1
Citic 1616	1883 HK	8/27/09	1.99	2.63	32.2	22.5
CSCI	3311 HK	8/18/09	2.80	3.30	17.9	-2.4
Ju Teng	3336 HK	9/11/09	6.14	7.73	25.9	18.7
Wasion	3393 HK	9/22/09	1.96	8.11	313.8	141.5
Average					94.3	52.2

Source: SBI E2-Capital

Optimistic economy outlook in 2010. We are optimistic towards China's economy outlook in 2010. GDP growth may go back to 9.0-10.0% from -8.0% this year, considering:

- Export sector – Export amount totalled US\$113.7b in Nov, which was only 1.2% lower than the same period of last year, though it still dropped 18.8% YoY on an YTD basis. China's export has been picking up rapidly since Aug. Given the general recovery of major trading partners like US and Western Europe, we expect this trend to extend into 2010.
- Domestic consumption – Total retail sales of consumable goods increased 15.8% in Nov to RMB1.1t or 15.3% in Jan-Nov, which was partly due to favourable governmental measurements such as consumption coupon, “Home Appliances to Countryside” (“家電下鄉”), “Vehicle to Countryside” (“汽車下鄉”). The Chinese government has explicitly declared its intension to boost up domestic consumption and most of those favourable policies will maintain. Therefore, we reckon domestic consumption sector will remain robust in 2010.
- Investment sector – PBoC (as well as the Fed) has issued standard statements on the continuing of the loosening of the monetary policy for the time being. Hence, a sudden and substantial investment contraction is unlikely at least in 1H. However, the government will: 1) strengthen control on specific industries (steel, cement, flat glass, coal chemical, polysilicone, wind power generation equipment, aluminium, shipbuilding and soybean crashing) to avoid over expansion; 2) probably re-tighten credit market later if over-heating is spotted and confirmed, in our view.

Bullish on stock market. For the current Hong Kong stock market, we identify resistance, including:

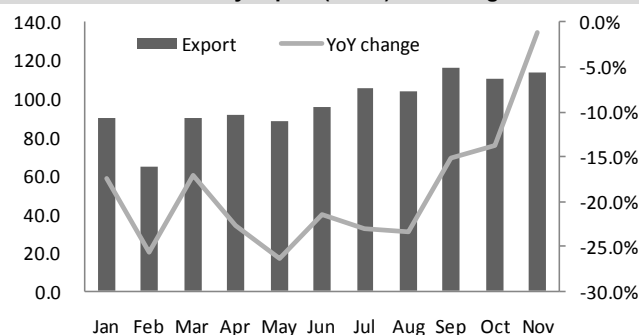
- “Dubai World” crisis – Debt repayment delay by a sovereign fund obviously rattled market confidence and raised concern on other high-gearing nations.
- Insufficient earnings visibility – According to our observation, for most companies, one-off and short-term contracts still account for a large portion of orders in hand.
- Profit taking activities – Investors turn cautious after the Mar-Jul rally (HSI doubled in the four months period) and try to lock in their profit at the moment.
- Strengthening US dollar – US dollar has been strengthening since beginning of Dec. This trend, if continue, will unwind US\$ carry trade and bring selling pressure on the stock market.

Nevertheless, buoyed by China's improving macro picture, we believe the stock market, overall, should perform well in 2010, especially after digesting short-term pressure from the “Dubai World” crisis and profit taking activities.

Policy-oriented sector pick. Sector wise, our preference is broadly in line with the market mainstream, i.e. domestic consumption-related sectors (e.g. consumer, automobile, etc), pharmaceutical & healthcare, new energy and environmental protection. We believe, in China, government still plays a key role for a certain industry's development. Thus, we think:

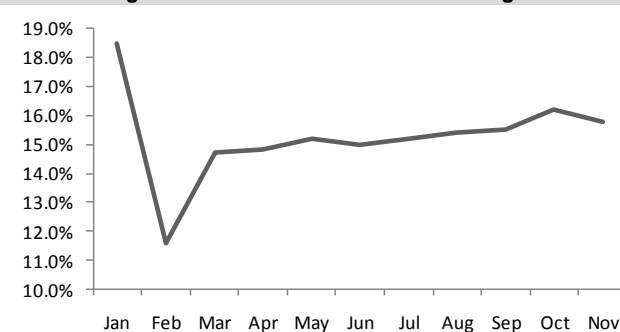
- Automotive, home appliance and pharmaceutical & healthcare – These sectors enjoy direct support from the government.

Chart 1. China's monthly export (US\$b) and YoY growth in 2009



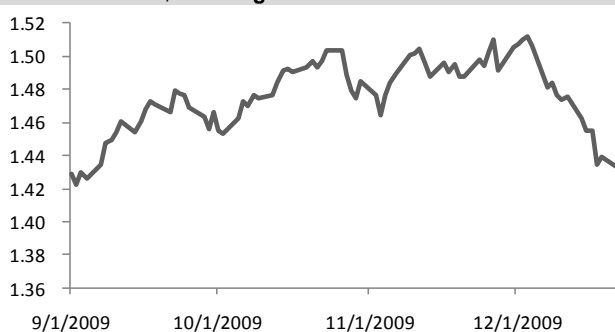
Source: China Customs

Chart 2. YoY growth of retail sales of consumable goods in 2009



Source: National Bureau of Statistics

Chart 3. EUR/US\$ exchange rate



Source: Bloomberg

Extraordinary earnings may extend into 2010, which will continue to catch investors' attention.

- New energy and environmental protection sectors – Growth of these sectors will likely accelerate with foreseeable long-term prosperity as the government has clear commitments in these areas.
- Cyclical sectors – Sectors like export and shipping should move out of recession gradually and step into a new round of expansion.

Table 3. Governmental policies with direct impact on industries

Company	Remarks
Home appliance & automotive	<ul style="list-style-type: none"> ▪ Government offers subsidy for old car replacement at RMB5,000-18,000 in 2010. ▪ Purchase tax rate reduce to 7.5% for cars under 1.6l in 2010. ▪ The subsidiary for motorcycle will remain effective till January 2013. ▪ Home appliance subsidiary policy will remain unchanged and price cap has been revised up substantially. ▪ Trial of old home appliance replacement scheme will end in May 2010 and will officially launch thereafter. ▪ Each province can add one more home appliance product to the subsidiary list.
Pharmaceutical & healthcare	<ul style="list-style-type: none"> ▪ The government investment totals RMB850b, including RMB331.8b from the central government. ▪ Government medical insurance coverage ratio has reached 90% nationwide. Government will offer aid of RMB120 per person per year plus in-patient claiming rate being 6 times or above of average annual income. ▪ The country will build or renovate 3,700 community healthcare service centre in urban area and 11,000 healthcare service points.
New energy	<ul style="list-style-type: none"> ▪ Renewable energy will account for 15% total energy consumption by 2020. ▪ Solar-based power generation capacity will reach 20GW by 2020 ▪ The government offers RMB20/W for application of solar photovoltaic technology on Construction. ▪ According to the "Golden Sun project", the government will provide financial support to solar projects. Qualified ones will receive subsidy as much as 50% of total investment or even 70% in remote area.
Environmental protection	<ul style="list-style-type: none"> ▪ China targets 20% reduction in energy intensity by 2010 comparing to 2005. ▪ CO₂ emission per unit GDP will be reduced by 40-45% of 2005 level by 2020.

Source: compiled SBI E2-Capital

Unchanged focus on high-growth mid-caps. We have reviewed our existing coverage and made adjustments accordingly. Top picks among existing covered stocks include Fufeng (546 HK), Pacific Andes (1174 HK), Ju Teng (3336 HK) and United Laboratory (3933 HK). In 2010, we will expand our coverage mainly within chosen sectors and maintain concentration on under-covered / undervalued high-growth stocks with sound size (market cap.: US\$750m) and liquidity. Top-down method will be mainly adopted in screening stocks, though a bottom-up model will also be used under circumstances when sectors lack clear momentum or policy support.

Table 4. Coverage review

Company	Ticker	Latest rating	Spot price (HK\$)	Target price (HK\$)	Remarks
Tingyi	322 HK	HOLD	18.78	14.52	<ul style="list-style-type: none"> The stock is widely covered. We keep watching it mainly for its leading position in China F&B industry. Share price exceeded our target and we are reviewing our model.
Fufeng	546 HK	BUY	5.12	5.98	<ul style="list-style-type: none"> Explosive earnings growth is anticipated for FY12/09A thanks to soft raw materials costs in 1H and strengthening MSG price in 4Q. In longer-term, The company should benefit from industry consolidation.
A8	800 HK	HOLD	3.16	3.50	<ul style="list-style-type: none"> Market competition is intensifying However, we are interested in the company due to its special UGC music platform has potential bring surprise.
RCG	802 HK	BUY	9.80	19.80	<ul style="list-style-type: none"> RFID sector is heating up after the Chinese government raised "Internet of Things" concept.
GZ Pharm	874 HK	SELL	5.45	1.40	<ul style="list-style-type: none"> We expect government-oriented restructuring next year, including potential assets injection. The share price stayed solid unexpectedly. We are reviewing our model.
China Green	904 HK	BUY	7.65	7.61	<ul style="list-style-type: none"> Geographic expansion should provide the company a steady growth. The new organic farming business, which will launch in 2011, could be a breakthrough. Share price approached our target and we are reviewing our model.
I.T	999 HK	HOLD	1.17	0.48	<ul style="list-style-type: none"> The company has strong brand equity. It may be a beneficiary of China's robust domestic consumption. Share price has exceeded our target and we are reviewing our model.
Hengan	1044 HK	HOLD	55.35	44.73	<ul style="list-style-type: none"> All three main business segments perform well. Supreme earnings will come from the tissue division this year or even the next due to low-cost pulp inventories. Share price has exceeded our target and we are reviewing our model.
Pacific Andes	1174 HK	BUY	1.48	2.09	<ul style="list-style-type: none"> South Pacific expansion should be a key driver in short term. The company targets on 300,000 catch volume in the region in 2010. We are reviewing our forecast as the company changed its fiscal year end from Mar to Sep.
Sino Biopharm	1177 HK	HOLD	2.19	2.35	<ul style="list-style-type: none"> The sector carries strong momentum. Fundamentals are solid in our view. The company has net cash of HK\$1.8b in hand and pays generous dividend (payout ratio above 40%)
Citic 1616	1883 HK	BUY	2.47	2.89	<ul style="list-style-type: none"> Various events next year around world might encourage international data usage. The company has rich cash position with potential to do M&As.
CSCI	3311 HK	BUY	3.22	3.77	<ul style="list-style-type: none"> Hong Kong has aggressive construction plan in coming years. The company is expanding aggressively in Mainland China.
Ju Teng	3336 HK	BUY	7.20	8.37	<ul style="list-style-type: none"> The ramping up metal casing operation should be a main driver plus the company should benefit from the recovering PC market.
Wasion	3393 HK	BUY	8.03	8.14	<ul style="list-style-type: none"> Demand for automatic high-precision electricity power metre is expected to increase substantially as China plans to build its own smart grid. Wasion is an industry leader and actively involved in related standard making process. The spot price has approached our target and we are reviewing our model.
United Lab	3933 HK	BUY	4.03	5.04	<ul style="list-style-type: none"> The company is a leading pharmaceutical company in China with strong nationwide distribution network. The sector has bright outlook.
Weigao	8199 HK	HOLD	25.60	19.96	<ul style="list-style-type: none"> The company has strong product pipeline to support its long term growth.
Natural Beauty	157 HK	HOLD	1.31	1.27	<ul style="list-style-type: none"> We will cease coverage on the stock due to our internal personnel change.
China Renji	648 HK	BUY	0.06	0.10	<ul style="list-style-type: none"> We will cease coverage on the stock due to our internal personnel change.
Stella	1836 HK	HOLD	14.48	7.36	<ul style="list-style-type: none"> We will cease coverage on the stock as it has been well covered and we have insufficient communication with the management.
Anta	2020 HK	HOLD	11.18	9.88	<ul style="list-style-type: none"> We will cease coverage on the stock as it has been widely covered.

Source: SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Limited acted as sole placing agent for the RCG Holdings Limited (stock code: 802) at September 2009.

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BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

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