Equity
Asia

The Year Ahead in Asia

Five themes for 2011

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HSBC Global Research

- **Another year of macro dominance has kept market correlations high, leaving many stocks mispriced**
- **We believe the macro environment will stabilise next year and stockpicking will become more important again**
- **We identify five themes, and the sectors and stocks that should benefit**

Macro factors have dominated equity markets since mid-2007. But the economic environment is likely to be somewhat more stable in 2011. And the risk-on/risk-off high-correlation environment of the past few quarters means that many stocks and sectors have moved together that should not have. This suggests that a more bottom-up stockpicking approach can be successful in 2011, as investors look for mispriced stocks and themes that were ignored in the macro hiatus.

In conjunction with HSBC's analysts in Europe and Asia, we have developed what we see as the themes that will drive markets in 2011. In this report, our analysts preview the outlook for their sectors in 2011, describe their highest conviction ideas, and identify the stocks they think will be most affected by our strategy themes.

Our five themes are:

1. **Pricing anomalies.** The high correlation of stock markets throws up some badly mispriced securities
2. **Effects of low rates.** Interest rates in the developed world will stay ultra-low for a long time. This boosts the income attraction of some stocks and reduces companies' borrowing costs
3. **Cash-rich companies.** Companies are sitting on piles of cash. Some will spend it on M&A or capex; others will return it to shareholders
4. **Winners from Chinese growth.** The China story still has a way to go. We identify some less obvious winners
5. **'Techtonic' shifts.** Technological developments of the past decade are coming to fruition in areas as diverse as smartphones, electric cars and solar energy

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Sectors

Banks 26

Earnings continue to rise on persistent loan growth, despite growing margin pressure and monetary tightening across Asia, as well as continued improvement in asset quality. Key themes for 2011 will be the effects of low rates and persistent economic expansion in Asia. Top picks are CCB, Axis Bank and Bank Mandiri as beneficiaries of economic growth in Asia and BOC-HK as being well positioned in the low rate environment.

China Infrastructure 32

Cement: tighter supply and strong demand leads to industry consolidation and structural ASP growth. Positive on cement and environmental sectors on reduced overcapacity and favourable policy; neutral on construction and toll roads. Top picks: Sinoma, CR Cement and CEI.

Conglomerates & Transport 37

We remain positive on passenger driven airlines, hotels and conglomerates leveraged to Asian consumption and more negative on cargo and Western-focused stocks. Key themes for 2011 will be sources of earnings growth and how cash-rich Asian companies utilise surplus cash. Top picks include Singapore Airlines, Jardine Matheson, Pacific Basin.

Consumer 42

The theme: dealing with excess liquidity. This will impact the consumer sector through interest rates, price controls and (high) valuations. Key ideas: Gome, Intime, Anta.

Industrials 50

We see improving prospects for the global capex cycle. Further investments expected in infrastructure and plants on top of strong commodity prices and resumption of suspended projects. Our highest conviction pick is Samsung Engineering; Hyundai Motor is most likely to benefit from pricing anomalies relative to peers, while Kia Motors should benefit from Chinese growth.

Insurance 54

Outlook for Chinese insurance shares remains uncertain as positive impact from rate hikes is offset by regulatory headwinds – we still see strong upside in Chinese insurance 'A' shares. Reiterate our preference for Composite over Life insurance names in Korea – most preferred stock is OW-rated Samsung F&M. In our view, OW(V)-rated China Taiping and LIG are the best stocks to play the 'Chinese growth' and 'Korean valuation' anomaly themes, respectively.

Metals & Mining 60

China's shift to a more sustainable growth model with focus on urbanisation and rural investment is positive for metals demand. Strong cash generation to support capital management initiatives and/or consolidation activity. Preference for upstream over midstream but steel looks oversold. Top picks OW(V)-rated China Coal and POSCO.

Oil, Gas & Chemicals 66

Urbanisation and wage increases in China will continue to drive demand for oil products and plastics. Key themes for 2011 will be unique value proposition from favourable product mix, pricing regime, LT strategy. Preference for Asian refining and chemicals over policy-ridden Chinese energy names. Top picks CNOOC, S-Oil and SK Energy.

Real Estate 70

China's real estate sector still clouded by policy headwinds; players with firm specific catalysts & solid recurrent income will outperform. HK property sales volume will take a breather while prices remain firm, underpinned by negative real rates; buy on dips. High conviction call: SHKP (16 HK, OW, TP HKD171.8).

Technology 75

We are positive on technology and particularly those companies benefiting from techtonic shifts in smartphones, LED televisions and tablets. Rather than attempt the one hot product of 2011, focus on sub-component plays on faster growth segments. Top picks: Samsung Electronics, TPK and UMC.

Telecoms & Media 82

We have shifted towards a more positive view on telecom services in developed markets based on wireless data/dividend catalysts. We remain positive on the China-Korea internet space, and are more cautious on the near-term profitability for China vendors. Key themes for 2011 will be the ability to monetise wireless data, a greater emphasis on returning excess cash to shareholders, and renewed interest in the internet services space. Top picks include Telstra, China Telecom and Korea Telecom.

Disclosure appendix 87

Disclaimer 91

Asia: Key winners from our five themes

Asia

	Sector	Reason	Potential beneficiaries
1. Pricing anomalies	Autos	Korean discount should fade away	Hyundai Motor (005380 KS, OW, KRW172,500, TP KRW240,000)
	Consumer	Corporate governance problems excessively punished	GOME Electrical Appliance (493 HK, OW(V), HKD3.06, TP HKD3.76)
	Insurance	Korean insurers priced on PB, not EV	LIG (002550 KS, OW(V), KRW20,200, TP KRW29,000)
	Technology	Many Taiwan tech companies have high dividend yields and low PBs	UMC (2303 TT, OW(V), TWD15.10, TP TWD16.50)
2. Effects of low rates	REITs	We like names with yield plus internal growth	Link REIT (823 HK, OW, HKD24.35, TP HKD28.50)
3. Cash-rich companies	Metals & mining	Positive cash flow may spur M&A	China Coal (1898 HK, OW(V), HKD12.28, TP HKD18.60)
	Shipping	Shippers with cash can buy low-cost vessels	Pacific Basin (2343 HK, OW(V), HKD5.25, TP HKD7.50)
	Telecoms	Surge in data usage boosting cash flow	KT Corp (030200 KS, OW, KRW46,500, TP KRW 67,000)
4. Winners from Chinese growth	Autos	Korean automakers growing market share	Kia Motors (000270 KS, OW, KRW48,950, TP KRW56,000)
	Cement	Government measures will increase share of top companies	CRC (1313 HK, OW, HKD6.11, TP HKD7.40)*
	Consumer	China consumption growth to continue	Genting (GENT MK, N, MYR10.10, TP MYR11.34), Intime (1833 HK, OW(V), HKD12.10, TP HKD15.21)
	Insurance	Chinese insurers premium growth to continue	China Taiping (966 HK, OW(V), HKD25.9, TP HKD37)
	Oil & gas	Strong underlying demand for oil and plastics	CNOOC (883 HK, OW, HKD16.84, TP HKD19.50)
	Real estate	We prefer commercial and high-quality residential	Shui On Land (272 HK, OW(V), HKD3.88, TP HKD4.70)
	Steel	Steel demand to remain stronger than consensus expects	Baosteel (600019 CH, OW(V), RMB6.28, TP RMB8.50)
5. 'Techtonic' shifts	Clean energy	China's next five-year plan focused on non-fossil fuels	CEI (257 HK, OW(V), HKD4.34, TP HKD5.40)
	Technology	Touchscreens are a key growth area	TPK (3673 TT, OW(V), TWD664.00, TP TWD850.00)
	Telecoms	Successful use of CDMA technology	China Telecom (728 HK, OW, HKD3.91, TP HKD5.10)

Source: HSBC; closing prices as of 30 November 2010 (*CRC priced at close 3 December 2010)

Europe: Key winners and losers from our five themes

Europe

	Sector	Reason	Beneficiaries	Most at risk
1. Pricing anomalies	Clean energy	Iberian stocks oversold on sovereign concerns	Acciona (ANA SM, OW(V), EUR54.33, TP EUR94.0)	
	Construction	Value of UK housebuilders' land holdings overstated		Barratt (BDEV LN, UW(V), GBP0.71, TP GBP0.63)
	Insurance	Sector implied cost of capital high	Catlin (CGL LN, OW(V), GBP3.38, TP GBP4.5)	
	Oil & gas	High correlations among oil services companies throwing up mispricing	Seadrill (SDRL NO, OW, NOK189.8, TP NOK225)	Lamprell (LAM LN, N(V), GBP309.7, TP GBP3.47)
	Real estate	Some stocks on excessive discounts to NAV	Atrium ERE (ATRS AV, OW, EUR4.2, TP EUR5.5)	Capital Shopping Centres (CSCG LN, UW, GBP3.56, TP GBP3.0)
	Metals & Mining	Copper stocks pricing in price appreciation, aluminium ones not	Norsk Hydro (NHY NO, OW(V), NOK37.2, TP NOK49)	Antofagasta (ANTO LN, UW(V), GBP13.2, TP GBP12.1)
	Telecom & Media	Misalignments between FCF and implied cost of capital	WPP (WPP LN, OW, GBP7.4, TP GBP8.40)	Portugal Telecom (PTC PL, N, EUR10.2, TP EUR10.0)
2. Effects of low rates	Insurance	High FCF and dividend yield	Allianz (ALV GR, OW(V), EUR89.0, TP EUR115.00)	
	Real estate	Property yields relative to risk-free rate	Gagfah (GFJ, GR, OW, EUR6.0, TP EUR8.0)	SEGRO (SGRO LN, UW, GBP2.843, TP GBP2.3)
3. Cash-rich companies	Beverages	Cash allows capex, M&A and will be returned to shareholders	Anheuser-Busch InBev (ABI BB, OW, EUR43.78, TP EUR53)	
	Business services	Healthy balance sheet allows more M&A	Bunzl (BNZL LN, OW, GBP7.04, TP GBP9.4)	
	Food	Cash for market share enhancing M&A	Beiersdorf (BEI GR, N, EUR44.6, TP EUR47.00)	
	Luxury goods	Strong balance sheets	Richemont (CFR VX, OW, CHF53.2, TP CHF66)	
	Metals & Mining	High prices, cost cutting and better balance sheets	Rio Tinto (RIO LN, OW(V), GBP40.7, TP GBP48.0)	ArcelorMittal (MT NA, N(V), USD31.9, TP USD39)
4. Winners from Chinese growth	Autos	11% sales growth in 2011, high profitability	Daimler (DAI GR, OW, EUR49.50, TP EUR56.0), PSA (UG FP, OW(V), EUR30.70, TP EUR39	
	Beverages	Growth in spirits	Pernod Ricard (RI FP, OW, EUR62.54, TP EUR75)	
	Building materials	Chinese demand for cement to remain robust	Holcim (HOLN VX, OW, CHF65.00, TP CHF75.00)	
	Capital goods	EM capex has overtaken DM	Siemens (SIE GY, OW, EUR83.65, TP EUR100), Schneider Electric (SU FP, OW, EUR106.75, TP EUR125)	
	Food	Room for big increase in penetration rate	Danone (BN FP, OW, EUR45.90, TP EUR55)	
	Luxury goods	Full impact of Chinese consumption not appreciated	Richemont (CFR VX, OW, CHF53.2, TP CHF66)	
	Oil & gas	Upside risk to oil price	BG Group (BG LN, OW, GBP11.85, TP GBP16.15)	
	Utilities	Technology transfer	Veolia (VIE FP, OW, EUR22.0, TP EUR27)	
5. Techtonic shifts	Business services	Shift of marketing dollar to internet	Experian (EXPN LN, OW, GBP7.26, TP GBP8.5)	
	Capital goods	Modern roads in EM trigger sales of sophisticated trucks	Volvo (VOLVB SS, OW, SEK97.95, TP SEK120)	
	Clean energy	Solar reaching scale	Wacker Chemie (WCH GY, OW(V), EUR131.15, TP EUR175)	
	Telecom & Media	Growth of smartphones will require more capex	Ericsson (ERICB SS, OW, SEK72.1, TP SEK95)	
	Utilities	Smart grid; shale gas extraction	National Grid (NG/ LN, N, GBP5.74, TP GBP6.1)	E.ON (EOAN GY, UW, EUR22.5, TP EUR19)

Source: HSBC; closing prices as of 23 November 2010

HSBC

High conviction ideas

Asia

Asia Sectors: 2011 high conviction stock ideas

		Ticker	Current price	Target price	Potential return (%)
Energy					
Oil, Gas & Chemicals	S-Oil	010950 KS	KRW80200	KRW100000	24.7
Materials					
Metals & Mining	POSCO	005490 KS	KRW454,500	KRW650,000	43.0
Industrials	Samsung Engineering	028050 KS	KRW185,500	KRW247,000	34.2
Conglomerates & Transport	Singapore Airlines	SIA SP	SGD15.4	SGD19.0	23.4
	Jardine Matheson	JM SP	USD43.2	USD54.0	25.0
	Pacific Basin	2343 HK	HKD5.3	HKD7.5	41.5
China Infrastructure	Sinoma	1893 HK	HKD7.53	HKD9.9	33.8
Consumer	Gome	493 HK	HKD3.1	HKD3.8	22.6
Financials					
Banks	CCB	0939 HK	HKD7.03	HKD10.20	50.5
	Axis Bank	AXBK BO	INR1,377	INR1,900	39.1
	Bank Mandiri	BMRI IJ	IDR6,550	IDR8,655	34.9
	BOC-HK	2388 HK	HKD26.6	HKD30.8	19.5
Insurance	Samsung F&M	000810 KS	KRW191,000	KRW270,000	41.0
Real Estate	SHKP	16 HK	HKD128.4	HKD171.8	34.0
Technology	Samsung Electronics	005930 KR	KRW826,000	KRW1,139,000	39.0
Telecoms & Media	Telstra	TLS AU	AUD2.81	AUD3.3	17.4

Source: HSBC, closing prices as of 30 November 2010

HSBC

High conviction ideas

Europe

Pan-European sectors: 2011 high conviction stock ideas

	Stock	Ticker	Current price	Target price	Potential return (%)
Energy					
Oil & Gas	Total	FP FP	EUR38.0	EUR49.0	30.0
Clean Energy	Vestas Wind	VWS DC	DKK168.9	DKK270.0	60.0
Materials					
Metals & Mining	Rio Tinto	RIO LN	40.7p	48.0p	18.0
Chemicals	BASF	BAS GR	EUR57.1	EUR66.0	15.6
Construction	Lafarge	LG FP	EUR43.0	EUR55.0	27.3
Industrials					
Aerospace & Defense	Safran	SAF FP	EUR23.7	EUR 29.00	22.4
Capital Goods	Siemens	SIE GR	EUR83.65	EUR100.0	19.5
Transport	Deutsche Post-DHL	DPW GR	EUR13.64	EUR17.5	28.3
Consumer Discretionary					
Automobiles	Peugeot	UG FP	EUR30.7	EUR39.0	26.8
Luxury Goods	Richemont	CFR VX	CHF53.2	CHF66.0	24.1
Food Retail	Morrison	MRW LN	272p	340p	25.2
Beverages	Anheuser-Busch InBev	ABI BB	EUR43.78	EUR53	21.1
General Retail	Inditex	ITX SM	EUR59.0	EUR69.0	17.0
Business Services	Aggreko	AGK LN	1479p	1690p	14.3
Consumer Staples					
Food & HPC	Danone	BN FP	EUR45.9	EUR55.0	19.9
Financials					
Banks	UBS	UBSN VX	CHF16.44	CHF26.50	61.0
Insurance	AXA	CS FP	EUR12.2	EUR20.0	65.0
Real Estate	Unibail-Rodamco	UL FP	EUR138.2	EUR130.0	-5.9
Telecoms, Media and Technology	Vodafone	VOD LN	168p	190p	13.1
Utilities	Centrica	CAN LN	321p	380p	23.7

Source: HSBC, closing prices as of 23 November 2010

(1) Pricing anomalies

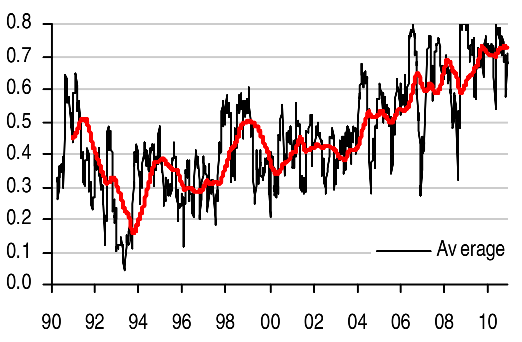
- Global equity markets have become increasingly correlated
- As conditions normalise, correlation should fall, presenting opportunities for investors to dig out mispriced securities
- We suggest some areas where these can be found

High correlations offer opportunities

The past decade – and the past three years in particular – have seen a big increase in correlations across equity markets. When markets, sectors and countries move together, irrespective of their different fundamentals, this should leave some dramatically mispriced securities, throwing up opportunities for investors.

A decade ago, the three-month correlation of weekly returns between the 47 countries in the MSCI All Country World Index (ACWI) and the overall index was about 40%; this year it has averaged 74%, and has been as high as 80% (Chart 1).

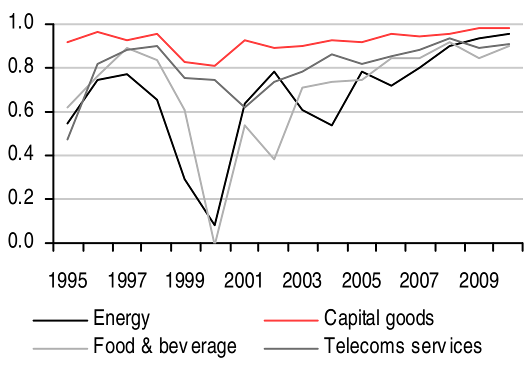
1. Correlation of MSCI country indexes with MSCI World



Source: HSBC, Thomson Reuters Datastream

The same is true at the sector level. In 2010 to date, none of the 24 sectors has had less than an 83% correlation with the index (the lowest is autos); the average sector correlation is 92%. Even sectors that 10 years ago moved to their own beat, such as food & beverage or energy, now move largely in line with the overall index (Chart 2).

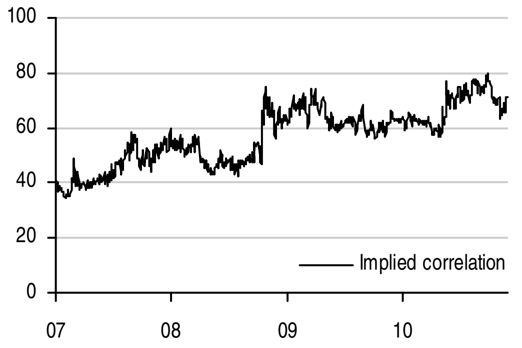
2. Correlation of MSCI sectors with overall index



Source: HSBC, Thomson Reuters Datastream

Correlation has risen sharply even among individual stocks. The options contract on S&P500 implied correlation (traded on the Chicago Board Options Exchange) shows that in late September this year correlation reached 80%, exceeding even the level at the time of Lehman Brothers' bankruptcy (Chart 3). Although it has fallen back slightly since to around 70%, it is still well above the 40% or so in the more normal times of early 2007 (when the contract was launched).

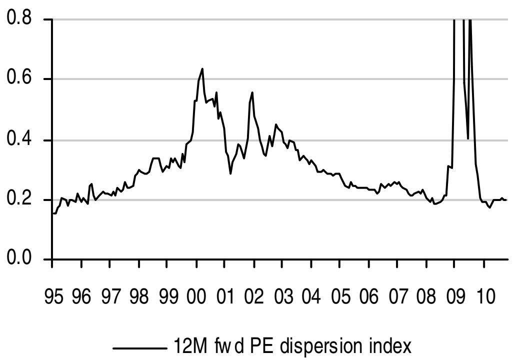
3. Implied correlation of S&P500 stocks (%)



Source: HSBC, Bloomberg

The heightened correlation has produced a much smaller range for sector valuations too. Currently the range between the cheapest industry group by 12-month forward PE in the MSCI ACWI index (diversified financials on 10.0x) and the most expensive (real estate, 19.6x) is about the narrowest it has been for 15 years. The dispersion of valuations has fallen steadily (except for a hiatus in the crisis of 1999) since the TMT bubble in 1999-2000 and is now the lowest since 1995 (Chart 4).

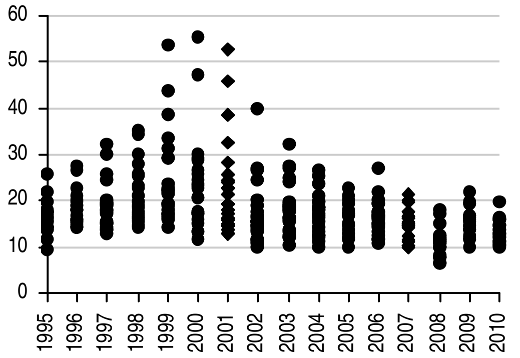
4. Dispersion of forward PEs, MSCI ACWI sectors



Source: HSBC, IBES, Thomson Reuters Datastream

What seems to have happened is that growth sectors (software, tech, media, pharma, personal products) which traditionally traded at a significant premium to the market, often with forward PEs of 20-30x, have lost their premium. Traditionally cheap sectors such as banks, energy and materials remain cheap. We think, therefore, that some growth sectors now look undervalued.

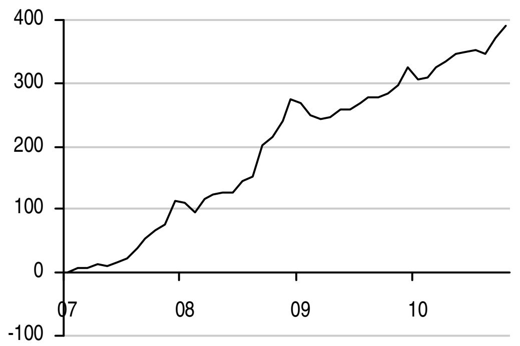
5. MSCI ACWI sector 12-month forward PEs



Source: HSBC, IBES, Thomson Reuters Datastream

What has caused markets to move together in this way? Partly it is a reflection of growing globalisation. Economic fundamentals, such as economic growth, have become more correlated since the 1990s too. Not only have capital flows become more globalised, but the growth of indexation and ETFs means that the components of an index tend to move more closely together. Over the past four years, for example, almost USD400bn has flowed in equity ETFs globally (Chart 6).

6. Cumulative global flows into equity ETFs (USDbn)



Source: EPFR

What are the implications?

As the economic situation continues to normalise over the coming few quarters, with markets being driven less by momentous macro shifts, in our view correlation will begin to decline. To an extent, this has already started to happen over the past couple of months, as Charts 1 and 3 above suggest. As correlation declines, investors should be rewarded for digging out under- (or over-) valued securities. Below we suggest some areas where we think these can be found.

In **Europe,** our analysts see such opportunities in sectors as varied as resources, real estate, construction and media. In the clean energy sector, our analyst argues that share prices of Iberian wind companies have been dragged down excessively because of sovereign risk concerns. In oil services, high correlation between stocks has thrown up opportunities particularly in dividend stocks.

In **Asia**, analysts find the largest number of underpriced stocks in Korea. Automakers such as Hyundai Motor (005380 KS, OW, KRW172,500, TP KRW240,000) have traditionally traded at a discount to global peers due to earnings volatility and high leverage, which is no longer justified. Korean insurance companies are usually priced on PB; on more sophisticated measures such as price to embedded value, they look cheap.

Technology companies generally look cheap relative to history. In Taiwan, for example, most of the companies under our coverage have 2011e dividend yields of around 5%.

Unloved stocks. One way to spot mispricings is to look at which sectors and stocks are most out of favour with investors and analysts. For example, Table 7 shows the country/sector pairs in the MSCI ACWI with the lowest average analyst ratings (where 1=Buy, 3=Hold and 5=Sell). Unsurprisingly, this throws up the financials sector in a number of countries; also materials, IT and healthcare.

7. Analysts' average rating (higher score, the more bearish)

	Current rating	10-year average
Spain Financials	3.33	2.93
Sweden Financials	2.82	2.54
Australia Consumer Staples	2.77	2.57
South Africa Materials	2.74	2.63
Italy Financials	2.73	2.63
France Materials	2.73	2.56
South Africa Financials	2.70	2.45
Taiwan IT	2.64	2.33
Germany Financials	2.62	2.54
Australia Financials	2.62	2.60
Japan Health Care	2.61	2.55

Source: HSBC, Thomson Reuters Datastream (Limited to country/sector pairs with at least 5 stocks and a market cap of 0.2% or more of the MSCI ACWI. We excluded sectors which have a more bullish rating now than the 10-year average)

Many of these examples illustrate a broader theme in which, in a low interest rate environment, stocks with dividend yields well above risk-free rates should attract attention. We discuss this in more detail in the next section.

(2) Effects of low rates

- Interest rates in the developed world are likely to remain at ultra-low levels for a prolonged period
- This will boost the income attraction of equities…
- …and will enable some companies to reduce borrowing costs and increase profitability

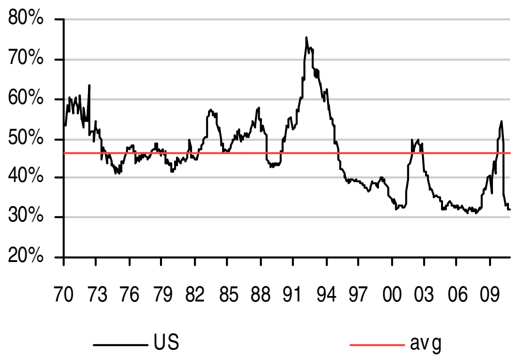
Playing the yield

We have argued for some time that in the current ultra-low interest rate environment, investors will increasingly see yield as a reason to buy stocks. Across much of the developed world equity yields look very attractive relative to the yield available on both government and corporate bonds. In addition, dividend-paying stocks have the added advantage of acting as a hedge against inflation and also have the potential for upside if earnings grow.

Of course, whilst the attraction of dividend yield is clear, it is important to remember that, unlike coupons on bonds, dividends are not guaranteed. We must therefore also consider whether the current level of dividends is sustainable. If companies must pay out a large proportion of their earnings to sustain their dividends then the risk of cuts is obviously higher.

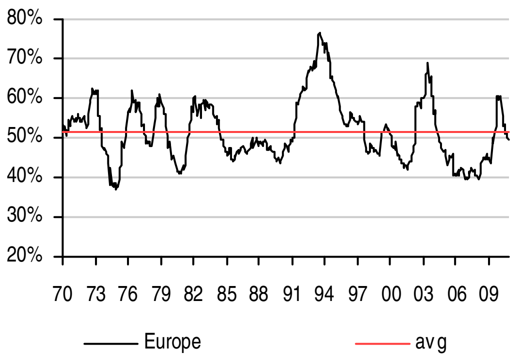
Charts 1 and 2 below show the trailing payout ratios for the US and European markets respectively. As could be expected these rose sharply during the recession as earnings fell faster than dividends were cut, but they have since returned to much more reassuring levels. In the US in particular the payout ratio is approaching a record low, although it should be noted that this doesn't take into account share buybacks which have risen considerably over the last 30 years. In Europe, where the rebound in earnings growth hasn't been as strong, the payout ratio is still back below its long-term average.

1. US payout ratio



Source: HSBC, Thomson Reuters Datastream, MSCI

2. Europe payout ratio



Source: HSBC, Thomson Reuters Datastream, MSCI

The picture is equally encouraging when we consider individual stocks. In table 3 we screen for companies from the MSCI All Country World universe that offer both high yields and sustainable dividends. Specifically we look for companies with a market cap greater than USD5bn, a dividend yield greater than the yield on 10-year US Treasuries (2.9%), potential for both dividend and earnings growth, and a relatively low payout ratio which is no more than 10% higher than its five-year average. We show the top 30 stocks ranked by their 2010 dividend yield from the 113 companies that meet the requirements.

Unsurprisingly the screen throws up many names from the high-yielding telecom and utilities sectors. It also includes a number of European insurers – a sector highlighted by our analysts as being a key beneficiary of this theme.

Other yield plays

Basic dividend yield is the most obvious way to find yield in the current environment, but there are some other attractive angles that are worth considering. In particular we would highlight interesting opportunities in REITs and in preference shares.

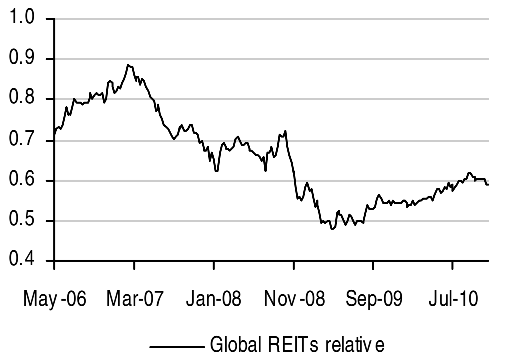
REITs are legally obliged to distribute a large proportion of their earnings in order to maintain their status and so naturally offer attractive yields. Indeed, despite having outperformed the wider market since late 2009, at 4.9% the MSCI All Country World REIT index still yields considerably higher than US Treasuries (Charts 4 and 5). In Asia, for example, our analysts like Hong Kong's Link REIT (823 HK, OW, HKD24.35, TP HKD28.50), which has an indicative yield of 4.3% as well as growth.

3. MSCI ACW stocks with high yield and sustainable dividend (MV>USD5bn, 2010 DY>2.9%, 2010e and 2011e DPS and EPS growth>0, payout ratio<70%, payout ratio < 5-year avg +10%)

Company	Industry group	MV	IBES consensus estimates							
			Dividend yield		DPS growth		EPS growth		Dividend payout ratio	
		USDbn	2010e	2011e	2010e	2011e	2010e	2011e	2010e	5-year avg
Vivendi	Media	31.8	**7.2**	7.3	0.5	0.5	2.5	1.4	64.1	65.5
Kpn Kon	Telecom Services	23.7	**7.0**	7.6	16.5	7.5	29.2	6.5	69.3	59.8
Kumba Iron Ore	Materials	18.5	**6.8**	8.1	90.7	20.1	86.0	12.7	68.6	58.7
Eni	Energy	82.8	**6.4**	6.6	0.8	2.3	28.2	11.1	54.5	56.2
Total	Energy	117.1	**6.1**	6.3	1.7	3.3	32.9	6.5	50.1	42.2
Cnp Assurances	Insurance	10.2	**5.9**	6.2	7.4	5.9	8.8	9.9	41.6	39.0
Axa	Insurance	36.0	**5.7**	6.6	21.9	16.9	6.1	23.4	42.6	50.2
Sampo 'A'	Insurance	14.3	**5.6**	5.9	8.3	5.6	76.5	0.4	53.8	76.3
ANZ Banking Group	Banks	55.6	**5.6**	6.2	23.1	11.6	15.7	16.6	67.5	69.8
SK Telecom	Telecom Services	11.9	**5.5**	5.7	0.9	3.7	6.5	15.6	50.6	45.6
KT Corp	Telecom Services	10.3	**5.5**	6.0	26.2	9.2	130.0	15.2	47.1	54.2
Korea Exchange Bank	Banks	6.6	**5.4**	5.5	25.0	1.8	12.3	3.0	41.0	31.6
Komercni Banka	Banks	8.2	**5.2**	5.9	24.6	12.0	15.0	9.8	63.5	68.0
Bae Systems	Capital Goods	18.1	**5.1**	5.3	8.0	3.7	4.1	3.0	40.9	47.9
Red Electrica Corp	Utilities	6.0	**5.0**	5.7	15.4	13.8	18.4	12.0	58.9	59.4
BCE	Telecom Services	25.8	**5.0**	5.4	11.0	7.6	12.6	2.2	62.3	60.9
Consolidated Edison	Utilities	14.0	**4.9**	5.0	0.4	1.7	11.1	2.6	69.5	70.2
Atlantia	Transportation	12.4	**4.8**	5.1	6.4	6.0	2.1	7.0	63.3	65.5
Amer.Elec.Pwr.	Utilities	17.2	**4.8**	5.0	4.9	4.7	2.0	4.3	56.8	54.4
Dte Energy	Utilities	7.6	**4.8**	5.0	1.9	4.2	8.8	3.3	60.2	64.6
Teliasonera	Telecom Services	35.4	**4.7**	5.0	15.6	5.4	10.2	6.1	56.1	100.2
British American Tobacco	Food Bev &Tobacco	74.6	**4.7**	5.1	12.9	9.1	13.9	9.6	64.3	64.0
Roche Holding	Pharma & Biotechnology	98.4	**4.7**	5.2	9.5	11.8	14.6	11.1	50.5	45.6
Scana	Utilities	5.2	**4.6**	4.7	1.1	1.6	5.3	6.7	63.3	62.4
Credit Agricole	Banks	31.9	**4.6**	6.5	3.4	41.0	119.4	58.6	42.1	59.1
Cemig Pn	Utilities	6.4	**4.6**	5.6	111.1	22.4	5.8	23.7	50.0	47.6
Orkla	Capital Goods	9.0	**4.5**	4.8	8.3	7.7	43.2	48.3	67.2	58.2
Centrica	Utilities	25.4	**4.5**	4.7	10.0	4.5	17.5	7.7	56.4	65.8
Reed Elsevier (Ams)	Media	8.8	**4.4**	4.7	1.9	5.6	59.9	7.8	52.9	80.8
Merck & Co.	Pharma & Biotechnology	107.2	**4.4**	4.5	1.3	2.6	3.7	13.1	45.7	63.6

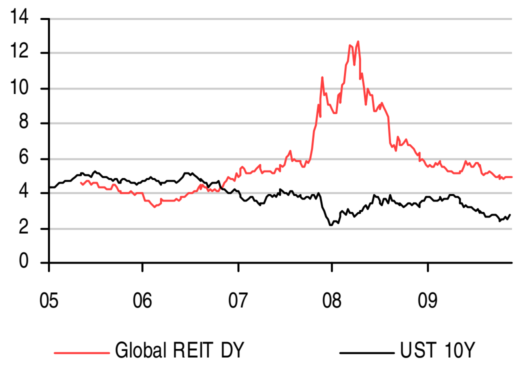
Source: HSBC, Thomson Reuters Datastream, IBES

4. REITs have outperformed this year



Source: HSBC, Thomson Reuters Datastream, IBES

5. But still offer very attractive yields



Source: HSBC, Thomson Reuters Datastream, IBES

Preference shares represent a hybrid between equity and debt. They pay a regular specified dividend and rank higher than ordinary shares in the case of liquidation, but usually carry no voting rights. Given this status, where they are more risky than debt but don't get the benefit of price appreciation like normal equity, preference shares often yield more than both. The current dividend yield for the S&P US Preferred Stock Index is 7.3% compared to a yield on the S&P500 of just 2%.

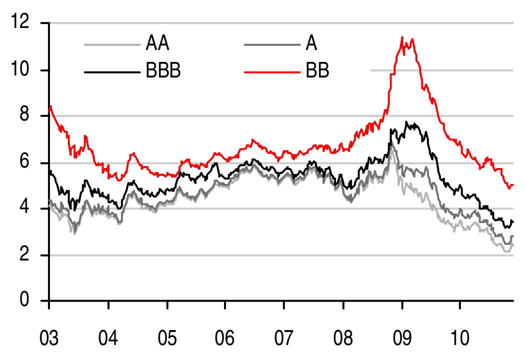
It should be noted that the majority of preference shares are issued by banks (over 80% of the S&P index) as they can be included in Tier 1 capital ratios and are often a cheaper form of financing than ordinary shares. However, the relatively few non-financial preference shares that are available also provide attractive yields.

Falling borrowing costs

On top of the dividend yield story, low interest rates are likely to provide further support for equities through lower borrowing costs. Many companies should be able to refinance their activities at lower rates and therefore increase margins and improve profitability.

In the US, corporate bonds currently yield around 3% (chart 6), whereas the average effective interest rate being paid by non-financial companies is 5.1%. If all non-financial corporate debt were refinanced at the lower rate, profits would rise by almost 10%. If, more realistically, only short-term debt were refinanced then the aggregate level of profits would rise by 1.5%.

6. Yield on 5-year US corporate bonds



Source: HSBC, Bloomberg

In Table 7 we screen for US non-financial stocks that could potentially benefit most from these lower costs. To do this we identify those stocks which have an effective interest rate (interest expense/total debt) which is higher than the yield on a five-year corporate bond with an equivalent rating. We use the most recent interim data (annualised) in order to capture any refinancing that may already have taken place this year. The table is ranked by the impact that refinancing all short-term debt would have on 2010 net income and only the top 30 companies are shown.

Obviously, whether or not these companies are willing or able to refinance their debt will be determined by many other company specific factors. However, this screen should provide a useful starting point for further analysis.

7. MSCI US ex financials companies with potential to lower borrowing costs (effective interest rate paid > yield on 5y corporate bond)

Company	Industry group	Interest/ 2010 EBIT %	Gross debt/ equity %	Short term/ total debt %	Effective interest rate %	Equivalent 5y bond yield %	I.R - BY %	Impact on 2010 net income: All debt refin %	Impact on 2010 net income: Short term refin %
Sears Holdings	Retailing	51.8	37	56.7	8.7	5.0	3.7	56%	**32%**
Deere	Capital Goods	55.5	390	31.4	6.4	2.8	3.6	44%	**14%**
Harsco	Capital Goods	n/m	78	27.6	5.3	2.8	2.5	42%	**12%**
Bunge	Food Bev &Tobacco	28.9	33	29.0	8.5	3.4	5.1	32%	**9%**
Qwest Comms.Intl.	Telecom Services	47.1	n/m	16.9	7.9	5.0	2.9	54%	**9%**
Martin Mrta.Mats.	Materials	36.7	73	23.8	6.6	3.4	3.2	37%	**9%**
Goodyear Tire & Rub.	Autos & Components	51.3	579	7.6	7.2	5.0	2.2	110%	**8%**
Firstenergy	Utilities	42.6	169	17.6	6.8	3.4	3.4	46%	**8%**
Avon Products	House & Personal Prod	19.6	206	37.7	8.3	2.8	5.5	21%	**8%**
Oneok	Utilities	27.5	193	20.8	6.1	3.4	2.7	38%	**8%**
Centerpoint En.	Utilities	47.9	298	11.3	6.7	3.4	3.3	70%	**8%**
Nisource	Utilities	41.6	152	19.6	5.2	3.4	1.8	40%	**8%**
Pepco Holdings	Utilities	45.8	103	14.4	6.3	3.4	2.9	52%	**7%**
Republic Svs.'A'	Comm Servs & Supps	30.2	89	15.8	7.2	3.4	3.8	40%	**6%**
Rowan Companies	Energy	27.0	46	31.9	6.7	3.4	3.3	19%	**6%**
Abbott Laboratories	Pharma & Biotechnology	20.8	87	31.0	9.0	2.4	6.6	19%	**6%**
Aes	Utilities	39.5	290	10.3	7.2	5.0	2.2	57%	**6%**
Dte Energy	Utilities	41.4	121	11.8	7.1	3.4	3.7	49%	**6%**
Nii Hdg.	Telecom Services	39.3	102	12.9	10.7	6.0	4.7	44%	**6%**
Integrys Energy Group	Utilities	n/m	86	21.9	5.7	3.4	2.3	24%	**5%**
Dow Chemical	Materials	33.5	118	14.7	6.9	3.4	3.5	35%	**5%**
Scana	Utilities	33.7	135	20.0	5.4	3.4	2.0	25%	**5%**
Mohawk Inds.	Cons Durables & Appl	37.7	50	21.2	7.3	5.0	2.3	23%	**5%**
Sunoco	Energy	35.0	87	11.5	6.8	3.4	3.4	41%	**5%**
Caterpillar	Capital Goods	32.8	291	28.9	4.2	2.8	1.4	16%	**5%**
General Electric	Capital Goods	85.9	428	23.2	2.8	2.4	0.4	18%	**4%**
Spectra Energy	Energy	32.5	147	15.7	5.8	3.4	2.4	27%	**4%**
Ingersoll-Rand	Capital Goods	22.9	48	20.2	8.0	3.4	4.6	21%	**4%**
Boston Scientific	Health Care Eq & Servs	35.6	55	15.0	6.1	3.4	2.7	28%	**4%**
Hormel Foods	Food Bev &Tobacco	4.2	15	100.0	7.4	2.8	4.6	4%	**4%**

Source: HSBC, Thomson Reuters Datastream, MSCI, Bloomberg

(3) Cash-rich companies

- Companies are sitting on piles of cash, appropriate during the liquidity crises but perhaps not so now
- With cyclical indicators picking up again, shareholder pressure on companies to deploy these cash reserves is likely to increase
- We see both investment (capex and M&A activity) and returns to shareholders (buybacks and dividends) increasing in 2011

Use it or lose it

Companies are cash-rich but will they start to spend it? We think the answer is yes. A combination of improving visibility on the macro picture and improving business confidence should persuade companies to deploy their surplus cash reserves. And for those that continue to hoard cash, the pressure is likely to build if investors, quite rationally, demand that companies use it (invest it) or lose it (return it to shareholders).

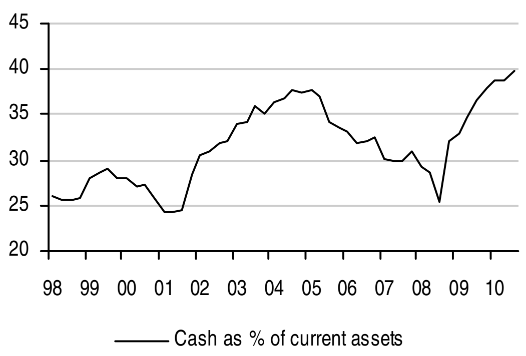
Interestingly, we are seeing tentative evidence that companies are beginning to loosen their wallets. Both the capex and M&A cycles appear to be turning up and returns to shareholders are increasing with dividends being raised and share buyback programmes being restarted. We see all of these drivers trending higher in 2011 and together they should provide support to stock prices.

Companies have surplus cash…

Chart 1 and Table 2 highlight the fact that companies are currently cash-rich. The first shows cash as a percentage of current assets for the MSCI US non-financials universe and the second the breakdown by sector. We focus on the US because the data is more time-sensitive due to quarterly reporting patterns. Nevertheless, this should be a good proxy of the global situation.

We can see that cash as a percentage of current assets currently stands at a record level of 40% for the market. And if we compare this to the average level of 32% it suggests surplus cash of around USD250bn for our MSCI US non-financials universe.

1. MSCI US non-financials: cash as % of current assets



Source: HSBC, Thomson Reuters Datastream, MSCI

Table 2 tells us that the healthy cash position is broad-based with all ten MSCI US sectors currently registering a cash surplus position (relative to the average since 1998).

HSBC

2. MSCI US sectors: cash as % of current assets

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	3Q10	Avg
Energy	14	16	16	15	18	23	32	32	28	25	29	24	**32**	23
Materials	8	9	8	15	16	18	21	20	19	17	19	29	**25**	17
Industrials	40	40	40	37	44	46	46	31	30	30	32	43	**40**	38
Consumer Discretionary	21	24	18	20	24	29	29	29	30	29	27	34	**37**	27
Consumer Staples	12	14	11	11	13	18	20	21	19	18	18	22	**24**	17
Health Care	28	29	32	34	34	33	39	42	36	35	35	39	**40**	35
IT	32	39	42	47	50	53	57	55	52	48	49	56	**58**	49
Telecoms	25	22	13	14	27	32	32	33	26	25	31	29	**33**	26
Utilities	15	19	13	22	20	20	18	13	23	20	26	27	**35**	21

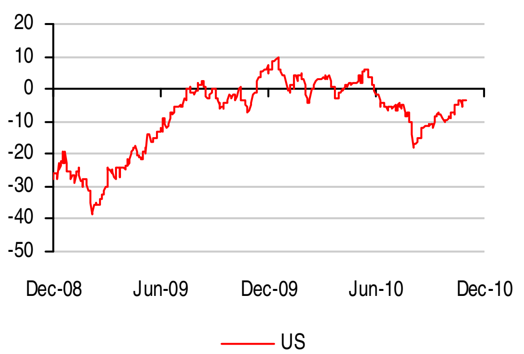
Source: HSBC, Thomson Reuters Datastream

…and are starting to spend it as the business cycle stabilises…

The surplus cash theme is one that we have actively been pushing since July when we published *Results season analysis: where's the double-dip?*, 30 July 2010.

In the report we argued that, if the macro backdrop were to show signs of stabilisation, companies would likely start to either invest their surplus cash reserves or return the money to shareholders.

3. HSBC US surprise index



Source: HSBC

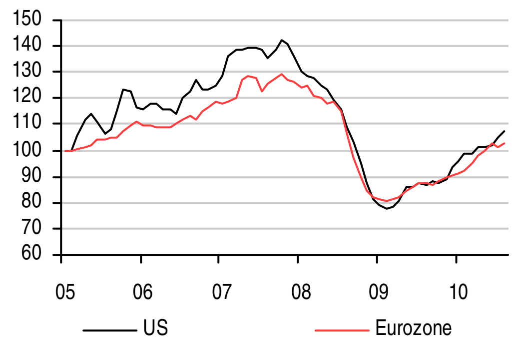
Interestingly, following a soft patch in Q2-Q3, we are seeing signs that business cycle indicators are beginning to stabilise and turn up again. This point is highlighted by our currency colleagues' 'US surprise index' (see Chart 3).

This stabilisation is clearly important both for those investors that feared another significant leg down in economic activity and in terms of business confidence in general.

…on capex…

All other things being equal, as companies become more confident in the recovery we would expect them to start to invest more. And the evidence suggests that capex is indeed on the rise, albeit from a very low level.

4. New orders: US and Eurozone



Source: HSBC, Thomson Reuters Datastream

In Chart 4 we show new orders for both the US and Eurozone. There are two important points to note about this chart. First, it highlights just how far capex budgets got cut during the recent slump in activity. Second, the global capex cycle appears to have clearly turned up.

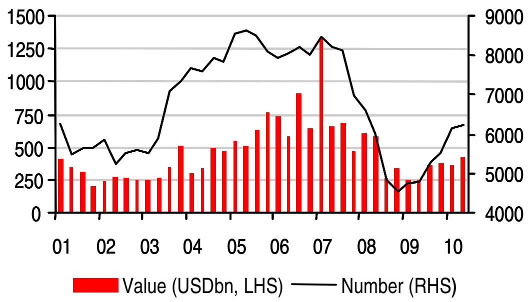
Ongoing economic strength in emerging markets and China specifically (see Theme 4, Chart 3) is a key reason to be remain positive on the outlook for capex and we reiterate our overweight call on the global industrials sector. We would also highlight technology and oil services as being additional beneficiaries from a continued pick up in capex.

…and on acquisitions…

Rather than growing organically via capex, a company may of course prefer to take the inorganic route and make an acquisition.

As Chart 5 shows, we are seeing evidence that the global M&A cycle is turning up – another indicator of corporate confidence and a sign that companies are starting to spend again.

5. Global M&A: number and value of deals



Source: HSBC, MSCI, Factset–Mergerstat

We expect to see upward momentum in the value of deals in 2011 on the back of a more stable macro backdrop, rising business confidence, an improvement in the availability of funds and attractive valuations.

…or starting to give it back to shareholders…

Of course, if companies cannot find any value-enhancing investment opportunities for their surplus cash then they may decide (or face investor pressure) to return it to shareholders.

…via share buybacks…

There were some high profile announcements during the Q3 results season that suggest share buybacks are back on the agenda. For example, BHP, having missed out on Potash, decided to acquire the remaining USD4.2bn of its shares from its USD13bn buyback programme which it suspended in 2007. And Cisco announced an additional buyback worth up to USD10bn as it moves to return part of its huge cash pile (USD39bn as at 30 October) to shareholders.

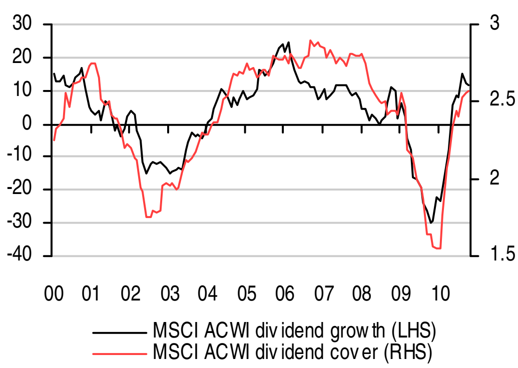
Record-low funding costs also appear to be driving buyback behaviour with Microsoft being the latest high-profile company to announce plans to issue debt to pay for dividends and share repurchases.

In aggregate (source: Bloomberg), US companies have announced USD258bn in buybacks during the first three-quarters of this year compared with just USD52bn in the same period in 2009. With companies generating strong cash flow in a low rate environment, we expect the trend increase in buyback activity to continue in 2011.

…and increased dividend payments

The same applies to dividends where the growth rate (year-on-year) has now turned positive for the MSCI AC World index (see Chart 6).

6. MSCI AC World dividend growth and dividend cover



Source: HSBC, Thomson Reuters Datastream, MSCI

This is an interesting development given the global equity dividend yield is already on a par with the global risk free-rate (the US 10-year Treasury yield). And with dividend cover a healthy 2.6x (versus a long-run average of 2.4x, see Chart 6) we see the potential for dividends to grow in 2011.

Selected company beneficiaries

Our sector analysts have identified the following companies as being beneficiaries from the surplus cash theme:

- **Rio Tinto (RIO LN, OW(V), GBP40.7, TP GBP48.0).** With the balance sheet now cleaned up and M&A risk limited given the board's guidance of a return to conservatism, we see the company generating cash returns over the next 12 months (even under our conservative commodity price assumption) and ending 2011 with a net cash position of USD5.5bn.
- **Richemont (CFR VX, OW, CHF53.2, TP CFH66.0).** Luxury companies' balance sheets were barely impacted by the downturn and we see cash piling up in 2011. With sizeable high-quality targets scarce, we expect the cash to be returned to shareholders. Richemont looks well placed with an expected net cash position of more than EUR2bn by end-March 2011 and annual FCF in excess of EUR1bn in the next three years.
- **Bunzl (BNZL LN, OW, GBP7.04, TP GBP9.40).** Growth strategy of reinvesting cash flow in small bolt-on acquisitions has delivered cash returns of around 15-25% historically. Ample scope for consolidation in a fragmented market and a healthy balance sheet supports an inorganic growth strategy.
- **Anheuser-Busch InBev (ABI BB, OW, EUR43.78, TP EUR53.0).** In 2011, we believe A-B InBev will consider alternative use of its cash due to the fact that the brewer has aggressively paid down its debt. This could include returning more cash to shareholders and looking to become active again in the brewer consolidation process.
- **China Coal (1898 HK, OW(V), HKD12.28, TP HKD18.60).** Strong cash flow will allow further acquisitions, enabling the company to hit its volume growth targets.
- **Pacific Basin (2343 HK, OW(V), HKD5.25, TP HKD7.50).** With cash of USD960m, the company can opportunistically acquire low-cost vessels to maximise returns.

HSBC

(4) Winners from Chinese growth

- It's an old story – but we think it still has a long way to run
- China's growth will remain robust for the next decade
- We focus on foreign companies with exposure to China – some not obvious

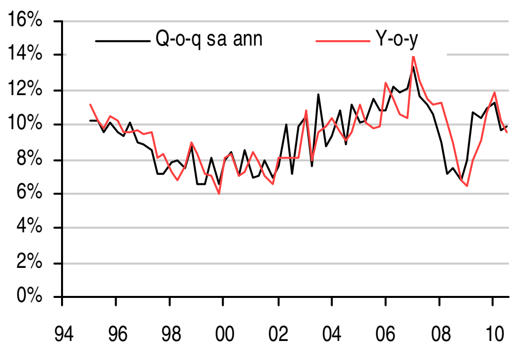
A way to go

The slowdown in Chinese economic growth over the past few quarters has worried many investors. Having grown 11.9% y-o-y in Q1 this year, real GDP growth slowed to 9.6% in Q3 (its slowest pace, apart from the 2008-09 recession since 2004). And, with the Chinese authorities sharply tightening monetary policy after inflation reached 4.4% y-o-y in October, many investors worry that growth could slow further. As a result, Chinese stocks have performed sluggishly this year, with MSCI China falling by 9% since early November.

We do not believe, however, that the China growth story is anywhere close to an end. The consensus continues to forecast about 9% real GDP growth in 2011 (HSBC forecasts 8.9%). In many ways, a slightly slower pace of growth would make it more sustainable and less inflationary.

China's growth is not likely to slow over the medium term either. It still has a lot of catching up to do, with GDP per capita only 7% of that of the US. When Japan, Korea and Taiwan were growing at 8-10% a year, they were already much richer relatively than China is now. China will eventually have demographic problems, but for the next decade its population will continue to grow by 0.6% a year, according to the United Nations (only fractionally slower than the 0.7% over the past 10 years). Even now, 40% of the population still work in agriculture, although this comprises only 11% of GDP.

1. Chinese real GDP growth



Source: HSBC, Bloomberg

All this suggests that China will remain a key driver of global demand over the coming years. It is hard to exaggerate how important Chinese demand is. It represents a large proportion of global demand for commodities, for example. As Table 2 shows, China last year comprised 59% of global demand for iron ore, and over one-third of demand for four other major metals. Perhaps more

HSBC

2. Chinese and global demand for metals

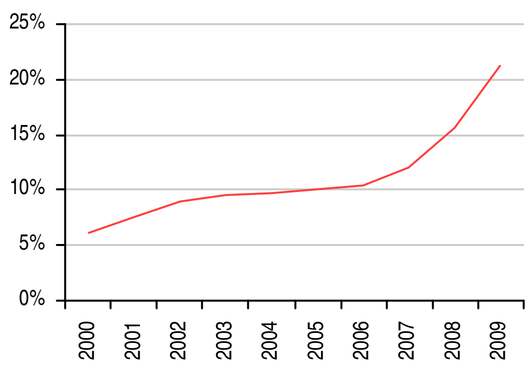
		Demand, 2009			Incremental demand growth, 2000-09		
		Global	China	China % of demand	Global	China	China % of demand growth
Steel	(mt)	1121	542	48%	361	418	116%
Iron ore	(mt)	1853	1098	59%	882	923	105%
Aluminium	(kt)	35301	13879	39%	10105	10504	104%
Copper	(kt)	17244	6520	38%	2084	4670	224%
Zinc	(kt)	10140	4061	40%	1156	2710	234%
Nickel	(kt)	1311	409	31%	196	344	176%

Source: Brook Hunt, WSA, CEIC

extraordinarily, China represented more than 100% of incremental demand for all six of the most important metals.

It also uses 10% of the world's oil, generates 18% of the electricity and has 17% of mobile phone subscribers. Last year, China carried out 21% of the world's capital investment (up from 6% at the beginning of the last decade, see Chart 3); in the past five years, 83% of the growth of investment globally has been contributed by China.

3. Chinese capital investment as percentage of world total



Source: HSBC, World Bank

China is, as yet, nothing like as important for consumption: in 2007 (the last year of available data), Chinese consumption was only 3.8% of total world consumption, making China only the fifth largest consumer market in the world (and barely one-tenth of the size of the US). In the past five years, China has provided only 7% of incremental demand growth. But that is set to change: McKinsey & Co estimates that Chinese consumption will grow at a 8.3% CAGR until 2020, by which time China will be the third-largest market in the world and almost one-quarter the size of the US.

4. Largest foreign groups in China by revenue (2007)

Foreign group	Sales (RMBbn)
Foxconn	278.8
Volkswagen	233.5
Quanta	188.0
Toyota	145.9
Nokia	140.1
Samsung	83.9
Motorola	79.1
Sony Ericsson	67.7
General Motor	65.1
Chimei Innolux	61.7
Honda	59.8
Inventec	58.6
Flextronics	44.6
DELL	39.5
Nissan	37.6
Acer	37.4
Total	35.6
TPV	31.7
Ford	28.7
Seagate	25.2

Source: Chinese Ministry of Commerce

All of this suggests, then, that investors should continue to look for companies exposed to China growth. Although obviously some of these can be found in China, the negatives of investing in Chinese companies (excessively government interference, poor corporate governance, risk in executing expansion plans, expensive valuations in attractive sectors) mean that our preference remains to look for foreign companies with strong and growing businesses in China.

Which foreign companies have the biggest businesses in China? Table 4 shows the largest foreign groups in China (compiled by aggregating the revenues of all subsidiaries and joint ventures).

In addition, HSBC's analysts highlight the following sectors, where they believe foreign companies' exposure to China has not been fully appreciated by the market.

- **Capital goods**. This year capex in emerging markets will be bigger than in developed markets for the first time. In China, in particular, wage pressures will push companies to increase factory automation to keep costs down.
- **Luxury goods.** Although China's growth is not exactly a new theme, our analysts believe investors still do not fully appreciate the impact of the rise of Chinese consumption, particularly sales to Chinese tourists abroad.
- **Beverages.** Chinese growth has been more significant for spirits companies than for brewers. We see Pernod Ricard (RI FP, OW, EUR62.79, TP EUR75) as a particular beneficiary, given its strong portfolio in scotch, cognac and vodka and its 42% market share in China.
- **Personal goods.** Penetration rates have a long way to go: per capita consumption of skin care products are only 30-50% of the level of mature markets, and also below the levels of Russia, Brazil and urban India.
- **Building materials.** Cement companies such as Holcim (HOLN VX, OW, CHF64.65, TP CHF75.0), for which emerging markets constitute 59% of capacity, should continue to see strong growth. We forecast 5.1% CAGR of sales to 2050 for the company, the highest among its peers.
- **Autos.** China became the world's largest auto market last year. We forecast 11% growth in auto sales in China in 2011, compared to 4.8% for the global market. On our projections, Chinese sales by 2014 will reach 21.9m units (25% of the global market), compared to 15.8m in the US. Our favourite stocks among beneficiaries of Chinese growth are PSA (UG FP, OW(V), EUR29.97, TP EUR39) and Daimler (DAI GR, OW, EUR50.22, TP EUR56) and, in Korea, Hyundai Motor (005380 KS, OW) and Kia (000270 KS, OW, KRW48,950, TP KRW56,000).
- **Oil & gas.** Chinese demand for oil and natural gas will continue to be strong. This should be positive for all energy companies, but our analysts particularly focus on natural gas, where concerns over global gas prices in 2010 have kept valuations cheap. We particularly like BG Group (BG LN, OW, GBP11.62, TP GBP16.15), one of the world's largest traders of LNG, an increasing amount of which is being imported by China.
- **Utilities.** China offers opportunities for European utilities companies which can offer technical innovation and technology transfer, such as Veolia (VIE FP, OW, EUR20.3, TP EUR27) (which already serves 25m people with water services in China).

And obviously there are many Chinese stocks that will benefit from domestic demand growth too, although one has to be selective because of regulatory risk. For example, in real estate our analysts like companies with exposure to commercial and high-quality residential property developments such as Shui On Land (272 HK, OW(V), HKD3.88, TP HKD4.70). We also think that investors have become too pessimistic about the outlook for infrastructure growth, and therefore like select names in steel and building materials (for example, Baosteel (600019 CH, OW(V), RMB6.28, TP RMB8.50) and CR Cement (1313 HK, OW, HKD6.11, TP HKD7.40). We are more selective in consumer-related companies because valuations are stretched, but can find one or two we like, for example, Intime (1833 HK, OW(V), HKD12.10, TP HKD15.21).

(5) 'Techtonic' shifts

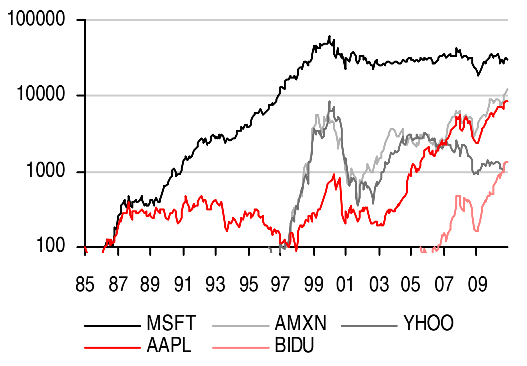
- The tech developments of the past decade are coming to fruition
- From smartphones to electric cars, a new wave of technology is going to change the investment landscape
- Our analysts pick their favourite areas and companies

The next tech wave

Technological advance is always a major driver of stock markets, albeit one that is very hard to identify as an investor.

An investor who spotted correctly the three big tech waves of the past 25 years – the rise of the PC, the development of the internet and the growth of smartphones and similar devices – could have made wonderful returns. Similarly, by not spotting that a technology was maturing (or by picking eventual losers) returns would have been poor.

1. Performance of selected tech stocks (log scale)



Source: HSBC, Bloomberg (Jan 1985 or IPO date=100)

In the late 1980s and early 1990s stocks such as Microsoft and Intel soared as PC demand took off, but Microsoft today is still 50% below its 2000 peak (Chart 1). Internet stocks jumped during the TMT bubble of 1998-2000. After it, some such as Amazon rebounded strongly and created sustainable businesses; others, such as Yahoo, lost their way. More recently, emerging market internet plays such as Baidu have also performed strongly. The launch of Apple's iPod in October 2001 and its subsequent evolution into the iPhone and iPad triggered growth in smartphone stocks. Apple's share price has risen 3400% over that time.

Technological advances move in waves, and it seems to us that a number of the scientific developments of the past decade (faster semiconductors, internet commerce, alternative energy, more efficient batteries) are all coming to fruition together now. Next year looks like being the year that smartphones really take off, with these devices forecast to grow from 270m units in 2010 (20% of total handsets) to 527m in 2014 (32% of the total). This will have repercussions for telecoms operators and equipment makers, as well as triggering new opportunities for internet-based businesses. The rising price of commodities is propelling the search for alternative energy sources, and for substitutions (for example, aluminium for copper, or growing use of plastics). Electric cars are close to becoming commercially viable.

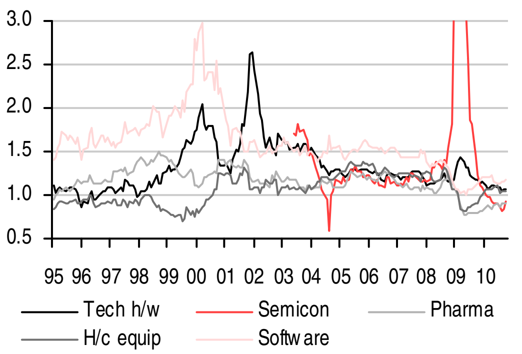
What is particularly exciting about these developments is that technology-related sectors are available very cheaply on global stock markets. After the TMT bubble burst in 2000, tech stocks underperformed massively (Chart 2). But they also lagged in the 2003-07 bull market, as investors preferred commodities and began to doubt the long-term business model of many tech companies (high capex, short product lifetimes, excess competition).

2. IT sector relative to MSCI All Country World Index

Source: HSBC, Bloomberg

Technology stocks have outperformed a little since the current bull market began in April 2009, but only by about 4%. This has left tech-related growth sectors looking cheap relative to the market. Where most such sectors have typically traded at a big premium (Chart 3), currently semiconductors and pharmaceuticals are on a discount to the market, and even the premium of the software sector is only 19%, compared to an average premium of 51% in 2003-07.

3. Forward PE relative to market, MSCI ACWI sectors



Source: HSBC, Bloomberg

But which technologies?

Identifying the technologies that will take off over the coming years (particularly those where this is not yet fully appreciated by the market) and picking the winners from these technologies is obviously a bottom-up judgement. So we asked HSBC's analysts to point to technologies and companies they see benefiting from the next tech wave. Here is what they came up with.

- **Touchscreen technology** will be a key growth area in 2011 as iPads and other tablets continue to grow in popularity. We think the P-cap technology, used in iPhones and iPads, will become the mainstream technology. TPK (3673 TT, OW(V), TWD664, TP TWD850) has 45-50% of market share with Apple.
- **Smart electricity grids**, which control the supply of power using two-way digital communications. The UK's National Grid (NG/ LN, N, GBP5.68, TP GBP6.1) is well placed in this technology, which should allow it to become a market leader in transmission.
- 2011 will be the year the **smartphone** really takes off. Industry projections expect 18% CAGR in 2010-14. We prefer to take exposure to this via sub-component and semiconductor makers.
- The growth of smartphones will also lead to a big rise in demand for mobile data. The capacity crunch this will produce will trigger a significant increase in **mobile telecoms capex**. We expect Ericsson (ERICB SS, OW, SEK72.55, TP SEK95) and other telecoms equipment vendors to benefit.
- Further shifts of marketing dollars to the **internet**. For example, credit and marketing services provider Experian (EXPN LN, OW, GBP7.35, TP GBP8.5) is launching additional online marketing products such as email marketing in emerging economies. Distributor

Electrocomponents (ECM.L, OW, 259p, TP 325p) is increasingly shifting sales of electronic products to a web-based platform.

- The falling cost of **solar energy** means it is approaching grid parity in key markets. But excess capacity in some areas of the business, means investors have to be choosy. We prefer high-quality upstream polysilicon players such as Wacker Chemie (WCH GY, OW(V), EUR132.0, TP EUR175).

- One focus of China's next five-year plan is to increase use of non-fossil fuels to 15% of energy use by 2020. This demonstrates the country's determination to be a leader in the clean energy field. As this is a crowded sector, stockpicking is important. We like China Everbright Int'l (257 HK, OW(V), HKD4.34, TP HKD5.40), an energy conglomerate, for its track record in waste treatment and sensible diversification into alternative energy.

- As emerging market infrastructure improves, high-tech products will sell for the first time. One less obvious implication of this is that, as China and India build out modern road systems, transport firms will be able to use heavy **advanced trucks**, rather than underpowered flatbed trucks they typically use now. The upfront costs of such trucks are higher but their superior performance will significantly boost productivity.

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Sectors

Banks

- Earnings continue to rise on persistent loan growth, despite growing margin pressure and monetary tightening across Asia, as well as continued improvement in asset quality
- Key themes for 2011 will be the effects of low rates and persistent economic expansion in Asia
- Top picks are CCB, Axis Bank and Bank Mandiri as beneficiaries of economic growth in Asia and BOC-HK as being well positioned in the low rate environment

2011 outlook

We remain constructive and generally positive for the banking sector in Asia in 2011. Whilst there are headwinds that could affect share price performance from time to time, we forecast profit growth of 20%+ y-o-y in 2011 on an EPS basis, in all markets except Singapore. The most significant factors to our earnings forecasts are:

- **Loan growth:** As Asian economic growth continues to be above the global average, bank lending is expected to remain robust. On a y-o-y basis, we expect 2011 loan growth to be slower in nearly all markets; India would be an exception as the credit expansion cycle is likely to accelerate into 2011.
- **Provisions:** Most of Asia did not have a meaningful credit cycle in the recent global financial crisis. We do not expect a deteriorating credit cycle in 2011 as Asian economies continue to expand and credit growth remains relatively strong. Benign credit costs persist except where we expect a sharp decline in provisions in Korea after three rounds of corporate loan restructuring in and weakening in project finance loan quality in 2010.
- **NIM:** We expect a mixed story in 2011. Markets with structurally higher rates (China, India and Indonesia) will see the greatest NIM expansion; however selective competition for new loans and/or funding likely moderates NIM expansion across the region. In highly liquid markets like Hong Kong, we see risks of moderate margin decline as competition narrows spread.

Next year seems poised to be another year of volume growth to drive profits. Expectations for the internationalisation of the RMB in 2010 have been a bit overzealous, in our view. The true contribution to earnings may fall short of market expectations in the near term. We continue to believe this is a key theme for the medium to long term; however near-term gains are likely only incremental and not a material driver of income growth in 2011.

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HSBC

Systemically important banks & CAR

We believe bank earnings and credit quality stability will be most affected by two continuing themes in 2011. First the effects of low rates in Western markets and the possible knock-on effects in Asia and reactions by policymakers. Second will be the continued economic growth in Asia, and in particular China and India.

Themes for 2011

Effects of low rates

Persistent low rates in the West, coupled with stronger economic growth in Asia, have created a wave of capital flows in 2010 that has begun to raise risks in Asia. From rising property prices to net inflows in equity markets to inflationary pressures driven by abundant liquidity, Asian economies have been thrown new challenges following the recent financial crisis.

The impacts to banks can be wide depending on the actions (or inaction) of central banks and monetary authorities in Asia. To simplify the discussion here we will focus on three possible implications for banking systems across the region:

Rising liquidity due to inflows. This so-called 'hot money' risk seems to be alive in Asia and perhaps has been somewhat exacerbated by appreciating currencies in Asia and actions by central banks in the region to raise rates. Left unattended, the consequences may include asset bubbles, declining spreads for banks and inflation. We expect the policy actions to continue into 2011. Central banks are likely to raise policy rates in all markets except Hong Kong, due to the USD peg, and there will be further actions to absorb abundant liquidity. Use of capital controls likely expands to slow 'hot money' and more specific actions on property prices should be expected. Initially, this sounds negative for banks. Yet we argue that these measures can be largely constructive for banks. Loan yield declines should slow in EM Asia, credit growth may be somewhat less linked to concerns of asset bubbles and interbank participants could see upside as liquidity is withdrawn.

'Carry trade' rising in loan books. We have seen evidence of so-called currency trades emerging to drive bank lending growth. Perhaps this is most pronounced in Hong Kong where RMB deposits have grown 246% from end-2009 which has really accelerated in 2H10. This was at a time when lending in Hong Kong began to accelerate from 18% y-o-y in 1H10 to 26% y-o-y by end-October. As rates remain low on USD loans and the RMB is set to appreciate c3% y-o-y, corporate loans have boomed. In essence a borrower is swapping USD deposits for RMB and pledging these deposits against a USD loan. After considering borrowing costs, deposit yield and RMB appreciation, borrowers could be gaining c200bps. The demand for this trade is accelerating loan growth and, in our opinion, is not sustainable through 2011. Nonetheless, without USD rates moving higher or RMB appreciation slowing it is unlikely that these loans will cease.

Improved market turnover from inflows. Weaker USD, low USD rates and appreciating currencies in Asia have increased the hunt for assets in EM Asia. Aside from property we have seen a significant rise in FII flows in some markets in Asia, pushing turnover and valuations higher; namely India and Hong Kong. Additionally Hong Kong has witnessed an increase in retail brokerage activities coming from mainland China investors. We expect these trends to continue pushing market turnover higher in 2011; especially in markets where the currency has an appreciation bias and potential for central bank actions that may increase the appreciation expectation of the currency. We also expect the Hong Kong market to see a boost in turnover from the perspective that USD can be more easily invested in equities that have underlying earnings derived from China growth.

Our preferred stock on the theme of lower rates is BOC-HK. The bank stands in a position to benefit from the continued lower USD rates, demand from loans as a byproduct of RMB appreciation and an expected rise in the turnover of the HKEx. Rates in Hong Kong will remain low. The banks are unlikely to raise prime lending rates with no action expected by the US Fed and HIBOR should remain low as liquidity remains abundant on the back of Asian growth and easing measures by the Fed and the ECB.

Persistent economic growth in Asia

Across the region, economic growth has posted solid rebounds in 2010. Recent PMI data and monthly GDP data suggest these trends will continue into 2011. We expect Asia ex Japan growth to slow from 8.8% in 2010e to 7.6% in 2011e. Whilst somewhat slower, we expect China and India to expand faster and to be key drivers of overall Asian growth. PMI readings continue to show expansion in Asia and consumption has remained steady as a buffer from near-term fallout from somewhat slower Western growth in 2011.

Continued economic growth should sustain the demand for credit with the most pronounced demands in China, India and Indonesia. Specifically in these markets, we expect system loans to expand in 2011 by 14% in China, 21% in India and 23% in Indonesia.

The key risk to watch on the growth front is inflation. Central banks in Asia have started to address inflationary concerns with rate hikes and efforts to absorb abundant liquidity to guard against misallocation of capital that could further fuel inflation. As mentioned earlier in this section, our economists forecast policy rate hikes across our coverage sectors except Hong Kong in 2011. In general terms, these rates hikes should be positive for bank earnings and coupled with robust loan growth in the higher economic growth markets, we expect NIMs and operating income to expand on volume and higher yields.

There is not a single bank that will give an investor maximum exposure to all high-growth economies in Asia. Thus we have three preferred plays on Asia's continued economic growth: China Construction Bank (CCB) in China, Axis Bank in India, and Bank Mandiri in Indonesia.

Valuation and risks

BOC-HK (2388 HK, OW, HKD26.7, TP HKD30.80)

BOC-HK sits in a unique position. In our view, this is the best bank on RMB internationalisation; but this is not really a theme for 2011. Instead we see BOC-HK well positioned take advantage of higher loan growth on low-cost liquidity flowing into Hong Kong and the fee-related services from a more buoyant market in Hong Kong.

Valuation

We value BOC-HK at 2.8x our 2011e book value using a simple Gordon growth methodology. Based on our 2011e book, we derive a target price of HKD30.80, implying a 20% potential return inclusive of dividends. BOC-HK is currently trading on 16x 2011e earnings and 2.4x 2011e book.

Risks

Key risks to our call are: 1) significant changes in economic and monetary conditions; 2) China policies that could affect RMB internationalisation and/or expansion of Chinese enterprises outward from China; and 3) sharply lower turnover or poor sentiment in the Hong Kong equity market.

China Construction Bank (939 HK/610939 CH, OW(V), HKD7.01/RMB4.63, TP HKD10.20/RMB8.50)

While CCB would not be the only Chinese bank to benefit from persistent growth in China, we see a few advantages including somewhat slower loan growth in the lending boom of 2009-10 than peers, a longer duration loan book to enhance yield from rate hikes, the largest consumer loan book in China and diversified fee income. Given policy risks and expectations of further monetary tightening, investors should consider that the Chinese banks are likely to underperform in the near term. Long-term investors may use this time to build positions, whereas shorter-term investors may wish to wait until we are closer to policy or earnings catalysts in 1Q/1H11.

Valuation

We value CCB at 2.6x our 2011e book which is derived using a simple Gordon growth model. Based on our 2011e book, we derive target prices of HKD10.20/RMB8.50 for the H- and A-shares respectively, implying a 50% potential return for the H-shares. CCB's H-shares are currently trading on 8.3x our 2011e earnings and 1.8x our 2011e book.

Risks

Key downside risks to our call are: 1) draconian policies that significantly impact the growth and profitability of the bank; 2) rise in provisions due to higher minimum thresholds or deterioration in asset quality; 3) significant asymmetric rate hikes that would narrow lending spreads for Chinese banks; and 4) measures to cool China's economy that result in more significant and persistent slowing of the economy.

Axis Bank (AXSB IN, OW, INR1329, TP INR1900)

Axis Bank is one of the banks well positioned to benefit from continued growth in India. The relatively high CASA deposit base (42%) should provide a buffer to protect or modestly expand margins in a growth cycle with more limited liquidity.

Valuation

We value Axis Bank at 3.6x our end-FY12e book using a weighted average combination of PE, PB and economic profit model methodologies. This approach derives a target price of INR1900, which implies a 40% potential return inclusive of dividends. Axis Bank is currently trading on 18x our 2011e earnings and 3x our 2011e book.

Risks

Key risks to our call include: 1) slower than expected loan growth; 2) deterioration of asset quality; 3) rising funding costs on the back of tighter liquidity in the market; and 4) slowing growth in India and/or policy moves on the back of rising inflation.

Bank Mandiri (BMR IJ, OW, IDR6,400, TP IDR8,655)

Bank Mandiri is well positioned to benefit from the underlying growth potential. A relatively low loan-deposit ratio (72%) plus sticky, low-cost deposits provide the bank with a buffer to avoid funding cost pressures relative to peers. We believe the bank is positioned better than peers to accelerate earnings growth in the context of broader economic growth of Indonesia.

Valuation

We value BMRI at 3.6x our 2011e book using a simple Gordon growth model. Based on our 2011e book, we derive a target price of IDR8,655, implying a 35% potential return inclusive of dividends. Bank Mandiri is currently trading on 13x our 2011e earnings and 3.35x our 2011 book.

Risks

Key risks to our call are: 1) short-term share overhang from upcoming 1Q11 rights issue; 2) slowing loan growth perhaps from slowing economic growth; 3) deteriorating asset quality; and 4) falling interest rates.

Asia banks: Valuation summary

Stock	Rating	Ticker	Curr	Target price	Share price	Potential return	Mkt cap (USDbn)	PE (x) 2010e	PE (x) 2011e	EPS growth 2010e	EPS growth 2011e	PB 2010e	PB 2011e	ROE 2010e	ROE 2011e	Dividend yield 2010e	Dividend yield 2011e
China H-share banks								**10.4**	**8.5**	**26.6%**	**22.9%**	**2.05**	**1.75**	**21.1%**	**22.1%**	**4.1%**	**5.0%**
Industrial & Commercial Bank of China - H	OW(V)	1398 HK	HKD	8.34	5.96	45.0%	232.6	11.0	8.7	26.7%	25.6%	2.28	1.93	22.4%	24.0%	4.1%	5.1%
China Construction Bank -H	OW(V)	0939 HK	HKD	10.20	7.03	50.5%	223.6	10.1	8.3	31.3%	21.4%	2.15	1.82	23.2%	23.9%	4.5%	5.4%
Agricultural Bank of China - H	N(V)	1288 HK	HKD	4.60	4.05	18.5%	131.1	11.3	9.1	22.9%	24.9%	2.08	1.75	20.3%	21.0%	4.6%	5.0%
Bank of China - H	OW(V)	3988 HK	HKD	5.60	4.17	40.0%	140.6	9.3	7.9	20.3%	18.3%	1.54	1.38	17.5%	18.2%	4.7%	5.7%
Bank of Communications - H	OW(V)	3328 HK	HKD	13.30	8.12	68.6%	52.5	9.5	7.7	19.5%	22.3%	1.70	1.47	19.6%	20.4%	3.6%	4.8%
China Merchants Bank - H	OW(V)	3968 HK	HKD	28.60	20.15	44.9%	44.7	13.1	10.2	37.9%	28.3%	2.91	2.38	23.9%	24.0%	2.3%	2.9%
China CITIC Bank - H	N(V)	0998 HK	HKD	6.50	5.43	23.2%	30.3	8.9	7.2	44.8%	22.7%	1.53	1.31	18.5%	19.4%	2.8%	3.5%
China Minsheng Bank - H	N(V)	1988 HK	HKD	8.40	6.91	22.9%	21.1	8.8	7.6	6.6%	15.8%	1.54	1.30	16.5%	18.5%	1.0%	1.3%
China A-share banks								**8.5**	**6.9**	**26.6%**	**22.9%**	**1.66**	**1.42**	**21.1%**	**22.1%**	**5.1%**	**6.2%**
Industrial & Commercial Bank of China - A	OW(V)	601398 CH	CNY	7.00	4.20	72.9%	232.6	9.0	7.2	26.7%	25.6%	1.87	1.59	22.4%	24.0%	5.0%	6.2%
China Construction Bank -A	OW(V)	601939 CH	CNY	8.50	4.62	91.1%	223.6	7.7	6.3	31.3%	21.4%	1.65	1.39	23.2%	23.9%	5.8%	7.1%
Agricultural Bank of China - A	OW(V)	601288 CH	CNY	3.80	2.61	52.2%	131.1	8.5	6.8	22.9%	24.9%	1.56	1.31	20.3%	21.0%	6.2%	6.6%
Bank of China - A	OW(V)	601988 CH	CNY	4.70	3.27	50.0%	140.6	8.5	7.2	20.3%	18.3%	1.41	1.26	17.5%	18.2%	5.2%	6.3%
Bank of Communications - A	OW(V)	601328 CH	CNY	11.00	5.56	103.8%	52.5	7.5	6.2	19.5%	22.3%	1.36	1.17	19.6%	20.4%	4.6%	6.0%
China Merchants Bank - A	OW(V)	600036 CH	CNY	23.70	13.05	85.5%	44.7	9.9	7.7	37.9%	28.3%	2.19	1.80	23.9%	24.0%	3.0%	3.9%
China CITIC Bank - A	UW(V)	601998 CH	CNY	5.30	5.43	0.6%	30.3	10.3	8.4	44.8%	22.7%	1.78	1.53	18.5%	19.4%	2.4%	3.0%
China Minsheng Bank - A	N(V)	600016 CH	CNY	7.00	5.07	39.6%	21.1	7.5	6.5	6.6%	15.8%	1.32	1.11	16.5%	18.5%	1.2%	1.5%
Hong Kong banks								**19.0**	**15.7**	**23.2%**	**20.5%**	**2.30**	**2.12**	**12.8%**	**13.7%**	**3.0%**	**3.5%**
BOC Hong Kong Holding	OW	2388 HK	HKD	30.8	26.6	19.5%	36.3	19.7	16.1	15.2%	22.6%	2.56	2.39	14.1%	15.4%	3.4%	3.7%
Bank of East Asia	UW	0023 HK	HKD	33.0	33.1	3.2%	8.7	18.1	16.1	34.8%	12.5%	1.67	1.46	10.0%	9.5%	2.8%	3.5%
Wing Hang Bank Ltd	UW	0302 HK	HKD	90.0	101.6	-9.8%	3.9	18.9	15.7	33.1%	20.5%	2.37	1.94	12.1%	13.1%	1.0%	1.6%
Dah Sing Financial	N	0440 HK	HKD	60.0	53.1	15.7%	2.0	13.6	11.0	62.5%	23.8%	1.22	1.13	6.9%	7.8%	1.3%	2.7%
Dah Sing Banking Group	N	2356 HK	HKD	15.0	13.76	11.4%	2.2	14.8	12.8	55.9%	15.7%	1.38	1.27	9.1%	9.6%	1.4%	2.4%
Hong Kong brokers								**26.1**	**18.7**	**23.8%**	**39.1%**	**2.49**	**2.29**	**13.8%**	**12.7%**	**1.3%**	**1.9%**
Guotai Junan International	N(V)	1788 HK	HKD	4.20	4.76	-9.9%	1.0	26.1	18.7	23.8%	39.1%	2.49	2.29	13.8%	12.7%	1.3%	1.9%
Taiwan FHCs								**28.0**	**17.1**	**138.5%**	**49.5%**	**1.50**	**1.41**	**7.1%**	**8.7%**	**3.0%**	**3.8%**
Cathay Financial Holding Co.	N	2882 TT	TWD	52.40	46.05	15.9%	15.3	55.0	23.8	-23.0%	130.6%	2.07	1.88	3.8%	8.1%	0.9%	2.1%
Chinatrust Financial Holding Co.	OW	2891 TT	TWD	23.80	18.35	33.1%	6.5	13.4	11.9	888.1%	12.9%	1.40	1.31	10.9%	11.4%	3.0%	3.4%
Fubon Financial Holding Co.	OW	2881 TT	TWD	44.50	37.20	25.3%	10.4	13.4	12.3	13.5%	8.3%	1.46	1.42	10.9%	11.4%	4.9%	5.7%
Sinopac Financial Holding Co.	N	2890 TT	TWD	12.00	11.10	11.9%	2.6	16.6	13.2	403.7%	25.9%	0.90	0.85	5.5%	6.6%	1.8%	3.8%
Yuanta Financial Holding Co.	OW	2885 TT	TWD	22.80	18.65	26.9%	5.0	17.6	17.3	18.3%	1.6%	1.29	1.27	7.4%	7.4%	4.6%	4.6%
Mega Financial Holding Co.	OW	2886 TT	TWD	23.00	20.25	19.4%	7.3	14.5	13.7	7.8%	5.8%	1.12	1.10	7.8%	8.1%	5.5%	5.8%
First Financial Holding Co.	N	2892 TT	TWD	21.50	20.40	8.2%	4.3	21.7	17.6	124.4%	23.4%	1.26	1.21	5.9%	7.0%	2.3%	2.8%
Shin Kong Financial Holding Co.	UW	2888 TT	TWD	10.70	11.10	-2.6%	2.9	43.0	21.1	95.4%	104.0%	1.05	0.98	2.2%	4.2%	0.0%	1.0%
Korean banks								**34.3**	**8.0**	**41.7%**	**327.0%**	**1.08**	**0.90**	**7.7%**	**11.5%**	**1.3%**	**2.9%**
KB Financial Group	OW	105560 KS	KRW	67,100	54,100	28.4%	18.0	98.2	8.0	-60.5%	1120.4%	1.18	0.92	1.2%	12.7%	0.3%	4.3%
Shinhan FGL	N	055550 KS	KRW	54,600	44,700	24.1%	18.2	10.4	9.6	81.2%	7.8%	1.28	1.03	9.8%	9.8%	1.5%	1.9%
Woori FHC	N(V)	053000 KS	KRW	17,000	14,300	20.9%	9.9	10.6	7.4	12.7%	43.6%	0.83	0.76	7.8%	10.4%	1.1%	2.0%
Hana FGL	OW	086790 KS	KRW	48,200	38,000	29.3%	6.9	8.7	6.9	199.4%	26.0%	0.78	0.71	9.3%	10.6%	1.7%	2.5%
Industrial Bank of Korea	OW	024110 KS	KRW	21,600	16,200	36.6%	7.6	8.1	6.7	80.4%	20.2%	1.01	0.90	13.1%	14.0%	2.2%	3.3%
Daegu Bank	OW	005270 KS	KRW	19,000	14,450	34.7%	1.6	7.5	6.2	49.6%	21.3%	0.96	0.86	13.6%	14.7%	2.4%	3.2%
Busan Bank	N	005280 KS	KRW	16,700	13,700	24.4%	2.2	7.2	7.1	44.0%	1.9%	1.06	0.94	15.5%	13.9%	2.1%	2.5%

Source: HSBC estimates; Closing prices as of 30 Nov 2010

Asia banks: Valuation summary (cont'd)

Stock	Rating	Ticker	Curr	Target price	Current price	Potential return	Mkt cap (USDbn)	PE (x)		EPS growth		PBV		ROE		Dividend yield	
								2010e	2011e	2010e	2011e	2010e	2011e	2010e	2011e	2010e	2011e
Korean Brokers								**14.9**	**13.7**	**13.8%**	**7.8%**	**1.45**	**1.33**	**10.0%**	**9.9%**	**1.6%**	**1.9%**
Mirae Asset Securities Co	N	037620 KS	KRW	61,000	54,100	14.2%	1.9	13.7	13.2	27.1%	4.0%	1.30	1.19	9.8%	9.4%	1.4%	1.4%
Samsung Securities Co Ltd	OW	016360 KS	KRW	71,000	65,000	11.5%	3.7	17.7	15.3	6.8%	15.4%	1.71	1.56	9.8%	10.4%	1.5%	2.3%
Korea Investment Holding	N(V)	071050 KS	KRW	39,000	34,550	14.7%	1.7	10.0	10.6	nm	-5.1%	1.03	0.96	10.6%	9.2%	2.0%	1.8%
Korean non-bank monolines								**13.3**	**11.9**	**-3.6%**	**11.7%**	**1.36**	**1.28**	**11.5%**	**11.0%**	**2.7%**	**3.3%**
Samsung Card Co Ltd	OW	029780 KS	KRW	72,000	63,400	16.9%	6.7	13.3	11.9	-3.6%	11.7%	1.36	1.28	11.5%	11.0%	2.7%	3.3%
India Banks & NBFCs								**24.9**	**19.8**	**16.2%**	**25.7%**	**3.56**	**3.13**	**16.8%**	**17.6%**	**1.2%**	**1.3%**
State Bank of India	UW	SBIN IN	INR	2,800	2,968	-4.5%	41.3	20.6	16.5	0.5%	24.7%	2.86	2.52	14.8%	16.2%	1.0%	1.1%
Bank of Baroda	N	BOB IN	INR	1,070	935	16.3%	7.4	11.2	8.7	37.3%	29.1%	2.48	2.02	24.3%	25.7%	1.9%	1.9%
Punjab National Bank	N	PNB IN	INR	1,375	1,216	15.4%	8.4	9.8	8.7	26.4%	13.0%	2.36	1.95	27.6%	24.6%	1.8%	2.3%
Canara Bank	OW	CNBK IN	INR	814	737	12.3%	6.6	10.0	7.9	45.8%	26.4%	2.41	1.92	26.8%	27.0%	1.4%	1.8%
Union Bank Of India	N	UNBK IN	INR	428	356	21.8%	3.9	8.7	8.5	20.2%	1.9%	2.04	1.70	26.2%	21.8%	1.5%	1.5%
HDFC	N(V)	HDFC IN	INR	602	688	-11.2%	21.8	35.0	29.0	22.7%	20.6%	6.50	5.93	20.0%	21.4%	1.0%	1.3%
HDFC Bank	OW	HDFCB IN	INR	2,850	2,314	23.8%	23.0	34.6	26.9	26.7%	28.6%	4.92	4.29	16.3%	17.0%	0.5%	0.6%
ICICI Bank	OW	ICICIBC IN	INR	1,350	1,146	19.0%	28.5	31.7	25.2	6.9%	26.2%	2.48	2.32	8.0%	9.5%	1.0%	1.2%
Axis Bank Ltd	OW	AXBK BO	INR	1,900	1,377	39.1%	12.2	22.2	17.9	22.7%	24.0%	3.48	3.03	19.2%	18.1%	0.9%	1.2%
Yes Bank	OW(V)	YES IN	INR	534	309	73.5%	2.3	22.0	15.7	37.5%	40.2%	3.41	2.88	20.3%	19.8%	0.5%	0.7%
IndusInd Bank	OW	IIB IN	INR	400	292	43.6%	3.0	34.3	25.9	104.3%	32.3%	5.55	3.54	19.5%	17.4%	6.2%	6.8%
Bank of India	N	BOI IN	INR	546	470	18.0%	5.3	14.2	8.5	-42.1%	66.3%	1.93	1.63	14.2%	20.7%	1.7%	1.8%
Singapore Banks								**13.1**	**12.5**	**24.5%**	**4.6%**	**1.90**	**1.77**	**9.8%**	**10.9%**	**4.2%**	**4.4%**
DBS Group	UW	DBS SP	SGD	13.00	14.04	-2.3%	24.4	12.1	11.8	30.2%	2.9%	1.51	1.43	6.3%	10.2%	5.0%	5.1%
UOB	UW	UOB SP	SGD	17.70	18.48	0.1%	21.8	12.1	11.7	30.1%	3.6%	1.91	1.78	12.2%	11.3%	4.3%	4.3%
OCBC	UW	OCBC SP	SGD	8.80	9.84	-6.9%	25.1	14.9	13.9	14.0%	7.3%	2.28	2.10	11.1%	11.3%	3.4%	3.6%
Indonesia Banks								**16.6**	**13.8**	**24.9%**	**20.8%**	**4.29**	**3.63**	**25.7%**	**26.5%**	**2.5%**	**3.0%**
Bank Central Asia Tbk PT	OW	BBCA IJ	IDR	8,400	6,350	35.4%	16.5	18.5	15.8	23.1%	16.8%	5.01	4.32	27.9%	28.3%	2.7%	3.2%
Bank Rakyat Indonesia	N	BBRI IJ	IDR	13,400	10,750	27.5%	14.3	14.8	12.2	22.1%	21.2%	4.20	3.39	29.8%	29.7%	2.4%	2.9%
Bank Danamon Indonesia Tb	UW	BDMN IJ	IDR	4,700	6,250	-21.4%	6.0	17.2	14.8	52.5%	16.0%	3.32	2.98	18.3%	19.3%	2.9%	3.4%
Bank Mandiri Persero Tbk	OW	BMRI IJ	IDR	8,655	6,550	34.9%	14.8	16.2	12.8	18.3%	26.8%	3.97	3.35	22.3%	24.3%	2.2%	2.7%
Exchanges								**35.3**	**27.1**	**8.7%**	**30.1%**	**20.13**	**17.85**	**57.8%**	**69.7%**	**2.6%**	**3.3%**
Hong Kong Exchange	N	0388 HK	HKD	210	178	21.5%	24.7	37.1	27.4	9.8%	35.5%	22.64	20.01	62.7%	77.7%	2.4%	3.3%
Singapore Exchange	UW	SGX SP	SGD	8.60	8.62	3.3%	7.0	28.7	25.9	5.1%	11.0%	11.25	10.22	40.3%	41.6%	3.1%	3.5%

Source: HSBC estimates; Closing prices as of 30 Nov 2010

HSBC

China Infrastructure

- Cement: tighter supply and strong demand leads to industry consolidation and structural ASP growth
- Positive on cement and environmental sectors on reduced overcapacity and favourable policy; neutral on construction and toll roads
- Top picks: Sinoma, CR Cement and CEI

2011 outlook

- **Strong demand:** Demand from infrastructure construction has been filtering through to the cement industry since 2H09; we expect this to last for 2-3 years as most of the key projects take some time to complete. Together with boosting affordable housing construction, this should offset slower demand from the private property market. Based on estimated fixed asset investment growth of 22%, we estimate cement production will grow by 10.4% to 2.0bn tonnes in 2011.

- **Tighter new supply:** Following the tightening of cement investment requirements in September 2009, we expect slowing new capacity releases. Year-to-October, China's cement investment grew just 8.7% y-o-y, down from 60% over the past two years. As the construction period for cement plants is usually 18-20 months, new capacity should slow from 2H11. Currently, we forecast new supply to come down to 195mt in 2012 from 247mt in 2009.

- **Faster old capacity elimination:** The government has been strict about eliminating vertical kiln capacity. As of September, the total phase-out of old capacity reached 90mt, more than the number of 74mt in 2009. Following the 107mt to be eliminated in

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China: Cement production and capacity, 2008-13e

	2008	2009	2010e	2011e	2012e	2013e	10-13e CAGR	HSBC comment
Production (mt)	1,383	1,631	1,801	1,989	2,211	2,402	10.1%	Assume inventory and exports stay at 1- 2% of production
y-o-y	*2.1%*	*18.0%*	*10.4%*	*10.4%*	*11.2%*	*8.6%*		
Capacity (mt)	1,805	1,984	2,124	2,265	2,390	2,488	5.4%	NDRC estimates total capacity in 2008 at 1.87bn tonnes
-Newly added (mt)	178	253	247	221	195	163	-13.0%	We expect 322m tonnes of vertical kilns to be shut down in 2010-13e
-Phase out (mt)	-76	-74	-107	-80	-70	-65	-15.3%	
y-o-y	*6.0%*	*9.9%*	*7.1%*	*6.6%*	*5.5%*	*4.1%*		NSP as % of clinker production increased from 81% to 100% by 2013e
Net change in s/d	-72	77	24	37	88	85		The rising demand gap should drive up cement price in 2012-13e
as % of total production	-5.2%	4.7%	1.4%	1.9%	4.0%	3.5%		

Source: Digital Cement, HSBC estimates

2010, we expect another 80mt to be phased out next year. The risk is to the upside.

- **Structural ASP growth:** In view of the improving supply/demand dynamic, we expect structural ASP growth starting in 2H11 with the slowing of new capacity. In 1H11, ASPs may fall on seasonality, particularly in Eastern China where we saw a 13.6% h-o-h increase in 2H10 largely due to one-off power restriction measures.
- **Earnings outlook:** Northwest and Southern regions should see the most stable ASPs in the short term, given the strong demand from infrastructure and pricing power of local producers. Hence, we expect higher margins or gross profit per tonne in 2011. Coal prices are likely to stay at high levels with mild increases. Capacity and volume growth, which is largely driven by M&As, will be the key to earnings growth.

Infrastructure construction

- **Strong railway investment:** The Ministry of Railways (MoR) is on track to meet its budget of RMB700bn (up 16.7% y-o-y, a record high) of railway investment in 2010. Railways are still the focus of transport development in the 12th Five-Year Plan. Based on the government's budget, we expect railway investment to remain high at RMB700bn pa over the next two years. New order flow for the two railway constructors – CRC (1186 HK, N, HKD9.22, TP HKD12) and CRG (390.HK,N, HKD5.44, TP HKD7.0) – should remain strong in 2011-12. However, orders for CCC (1800 HK, N, HKD6.76, TP HKD8.0) are still slow as the majority of its sales are from port construction and global port machinery.
- **Low pricing power:** The structure or system of railway investment should not see major changes over the next five years. That means the MoR is still the largest railway investor, accounting for nearly 95% of projects, while CRC and CRG should take about 90% of the construction market share. The price-setting mechanism for the construction of high-speed railways has not yet been set. This is up to the MoR while constructors have little say in the matter.
- **Slow margin recovery.** Gross margins saw a slower-than-expected recovery in 2010. The unstable margin was due to rising raw material costs and delay in compensation on high-speed railway projects. We do not expect a significant margin improvement in 2011 as it is a structural issue, unless the constructors gain more pricing power.
- **High policy risk:** CRC's substantial loss on its overseas project (light rail in Saudi Arabia) reflects the political risk it faced. It registered a RMB4.15bn loss in 3Q10, accounting for 44% of our original full-year earnings. Being one of the three largest constructors in China, they have a social responsibility both domestically and overseas (to carry out government-related projects), thus there are significant policy and execution risks.

Toll roads

- **Steady traffic growth:** We see slow organic traffic volume growth, while traffic diversion due to new roads or high-speed rail is a long-term threat. For Jiangsu Expressway (177 HK, OW, HKD8.45, TP HK10) and Zhejiang Expressway (576.HK, N, HKD7.32, TP HK8.0), we expect 6-7% organic volume growth in 2011. The latter is facing traffic diversion away from one of its operating toll roads, Shangsan, where traffic volume fell by 12.3% y-o-y in 3Q10 after a new road commenced operation in July. It will take a year to stabilise the y-o-y impact.

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- **Stable toll rate:** JSE has applied for rate hikes, subject to local government approval. We do not expect rate hikes to be granted given inflation concerns.
- **Growth priced in.** JSE and ZJE are trading at 16x 2011e PE, close to their 3-year average of 15-16x, the high end of regional and international peers with comparable growth.

Top pick

Sinoma (1893 HK, OW(V), HKD7.53, TP HKD9.9)

Sinoma is the largest cement operator in Northwest China with 40% local market share. It is also the largest cement equipment and engineering services provider in the world.

Strong demand came from infrastructure construction, with fairly stable ASPs as 50% of sales (for key projects) are under contracted prices. For cement equipment, overseas orders should be the key growth driver. We expect new orders to grow by 15% and 10% in 2011-12.

Valuation

At HKD7.53, it trades at 13.2x 2011e PE, below its mid-cycle PE of 17.2x. Our target price of HKD9.9 is based on a sum-of-the-parts methodology and implies 33.8% potential return.

Risks

The key risks to our view are new capacity in Northwest China and the potential for fundraising. Catalysts include M&A and cement equipment orders.

Themes for 2011

Winners from Chinese growth

The listed cement producers would be benefited from the elimination of obsolete capacities and restriction on approval of new capacities and gaining market share from M&As. The government aims to reduce the number of cement producers from 5,000+ to 3,500 by 2010 and 2,000 in 2020e. The market share of the top 10 producers is expected to rise from 23% to 60% by 2015.

CR Cement (1313 HK, OW, HKD6.11, TP HKD7.4)

CRC is the largest cement operator in Southern China with 15-20% market share. We are optimistic on earnings growth owing to high visibility on new capacity, sales volume upside surprises and stable ASPs on improving supply/demand conditions and strong pricing power. Margins and gross profit per tonne should remain high, delivering the highest earnings growth in our cement universe.

Valuation

At HKD6.11, the stock trades at 13.4x 2011e PE, a 29% discount to Conch (914 HK, N, HKD33, TP HKD38.1), with higher margins and earnings growth (EPS CAGR: 38.9% vs 15.8% in 2010-12e). We think this is unjustified. We use PE and EV/t pricing methodology to arrive at our target price of HKD7.4, which implies a 21.1% potential return. (See our recent note, *Gaining pricing power via acquisition*, 6 December 2010.)

Risks

Key risks to our view include weaker ASPs, equity fundraising and operation risk in JVs. Catalysts include M&A and falling coal costs.

Techtonic shifts

Under the 12th Five-Year Plan, China promises to increase the use of non-fossil fuels as a percentage of total energy expenditure to 15% by 2020; and reduce unit GDP energy consumption to 40-45%. In early 2009, the PRC government drafted a proposal on energy development which entailed investing RMB5trn in clean and traditional energy over 2011-20. We favour CEI given its solid track record in waste treatment and its diversification into alternative energy.

HSBC

CEI (257 HK, OW(V), HKD4.34, TP HKD5.4)

CEI is a conglomerate focusing on environmental protection and alternative energy projects, including waste-to-energy (WTE), solar photovoltaic energy, industrial solid waste landfill, waste water treatment (WWT), etc.

Earnings growth is picking up as construction is on track, while traffic remains stable, utilisation is rising and operating margins are increasing. The government's RMB5trn investment in new energy sectors over the next 10 years should accelerate its diversification from WWT/WTE to alternative energy, supporting long-term growth.

Valuation

At HKD4.34, CEI trades at 21.6x 2011e PE. We value each project using a DCF methodology (risk-free rate of 4%, market risk premium of 6.0% for China and WACC of 8.0%). Our target price of HKD5.4 implies a potential return of 25.1%.

Risks

The key risks to our view include delays in project execution and funding requirements for new projects. Catalysts include encouraging policies and projects in the pipeline.

China Infrastructure: Valuation summary

Company	Ticker	Mkt cap (USDm)	Rating	Price (local)	Perf YTD	TP (local)	Potential return (%)	EPS* 2010e	EPS* 2011e	EPS CAGR 2010-12e	PE (x) 2010e	PE (x) 2011e	PB (x) 2010e	PB (x) 2011e	2011e Div yield (%)	2011e RoE (%)	2011e Net margin (%)	Consensus earnings (2011e) YTD chg (%)	Consensus earnings (2011e) Mth'ly chg (%)	Consensus earnings (2011e) HSBC vs cons'us (%)
Construction																				
CRG	0390 HK	14,097	N	5.44	-9.9	7.0	31.0	0.43	0.55	30.7	12.6	9.9	1.5	1.3	2.3	14.4	1.9	-1.7	2.5	1.7
CRC	1186 HK	13,149	N	9.22	-7.3	12.0	32.4	0.51	0.91	49.8	18.2	10.1	1.6	1.5	2.3	14.4	2.1	0.8	-0.5	11.5
CCC	1800 HK	16,037	N	6.76	-9.0	8.0	21.3	0.58	0.72	27.7	11.6	9.4	1.5	1.3	2.9	13.9	2.9	-7.5	-0.3	-3.0
CSC	3311 HK	2,523	OW(V)	6.41	94.2	7.6	20.7	0.30	0.45	40.4	21.2	14.3	3.8	3.2	2.1	23.1	7.5	47.8	6.5	4.1
Building Materials																				
Anhui Conch	0914 HK	18,074	N	33.00	32.3	38.1	16.6	1.51	1.80	15.8	21.9	18.3	3.1	2.7	1.2	15.7	14.3	6.0	4.5	-4.1
CNBM	3323 HK	5,712	N(V)	17.90	11.5	17.4	-2.1	1.17	1.34	19.3	15.2	13.4	2.1	1.8	0.7	14.7	6.4	10.7	3.0	-12.5
CR Cement	1313 HK	5,131	OW	6.11	60.8	7.4	21.1	0.29	0.46	38.9	20.9	13.4	2.8	2.4	0.7	19.1	15.0	-6.6	7.7	2.8
Sinoma	1893 HK	3,070	OW(V)	7.53	30.5	9.9	33.8	0.40	0.57	33.2	18.9	13.2	2.6	2.3	2.3	17.2	3.4	3.1	1.8	3.3
Shanshui Cement	0691 HK	2,209	OW(V)	6.32	11.7	5.9	-3.7	0.39	0.52	27.1	16.2	12.1	2.6	2.3	3.0	19.5	9.4	-15.5	-0.2	0.0
TCC Int'l	1136 HK	1,226	N(V)	3.03	-17.2	3.3	10.9	0.23	0.30	20.9	13.3	10.1	1.0	0.9	2.0	9.5	11.1	-0.0	0.6	-20.1
AC China	0743 HK	683	UW	3.45	-25.8	3.4	-0.3	0.17	0.16	6.7	20.7	21.3	0.7	0.6	1.2	3.0	3.8	-30.8	-15.4	-51.9
Taiwan Cement	1101 TT	3,668	UW(V)	31.35	-7.8	25.1	-15.0	1.70	2.09	14.6	18.5	15.0	1.4	1.4	5.0	9.4	33.1	-5.3	15.6	2.4
Asia Cement	1102 TT	3,053	UW	30.20	-12.7	25.2	-10.3	2.34	2.32	3.0	12.9	13.0	1.3	1.3	6.1	10.0	73.0	-7.7	5.0	6.0
Toll roads																				
Jiangsu Exp.	0177 HK	4,581	OW	8.45	22.1	10.0	24.8	0.54	0.59	11.6	15.8	14.2	2.4	2.3	6.4	16.1	39.2	17.7	2.2	-3.4
Zhejiang Exp.	0576 HK	3,985	N	7.32	1.8	8.0	14.7	0.46	0.50	10.7	16.1	14.7	1.9	1.8	5.4	12.4	28.7	-0.5	-1.4	-6.1
WTE																				
CEI	0257 HK	1,984	OW(V)	4.34	8.5	5.4	25.1	0.17	0.20	25.1	21.6	3.3	3.1	0.7	14.1	19.4	25.1	11.8	-0.2	3.3
Machinery Equipment																				
Sany Heavy Equip. Int.	0631 HK	3,367	OW(V)	12.42	26.6	12.6	2.6	0.42	0.50	23.8	29.7	24.6	4.7	4.2	1.1	17.9	22.5	n/a	6.2	-16.3
Lighting																				
NVC	2222 HK	1,673	OW(V)	4.26	N/a	4.4	5.0	0.15	0.18	22.4	28.9	23.2	3.6	3.3	1.7	15.0	12.7	n/a	0.3	7.1

Source: Thomson Reuters Datastream, HSBC estimates; Closing prices as of 30 Nov 2010, except CR Cement – priced at 3 December close (see note *Gaining pricing power via acquisition*, 6 December 2010); *Local currency

HSBC

Conglomerates & Transport

- We remain positive on passenger driven airlines, hotels and conglomerates leveraged to Asian consumption and more negative on cargo and Western-focused stocks
- Key themes for 2011 will be sources of earnings growth and how cash-rich Asian companies utilise surplus cash
- Top picks include Singapore Airlines, Jardine Matheson, Pacific Basin

2011 outlook

Aviation

We forecast our Asian airline coverage will generate an aggregate 2010 recurring profit of USD6.8bn, a sharp rebound from recurring losses in 2009. The earnings recovery has been driven by a strong pick-up in passenger and cargo demand which has boosted load factors and yields. Cargo has been the star performer and has helped the sector outperform the MSCI AEJ by 22% y-t-d. While the airline outlook remains good, we believe profit growth will stall in 2011. In particular, we expect profit from cargo to fall y-o-y in 2011. There has been a clear slowdown in cargo growth while capacity has rebounded and we believe this will cause load factors and yields to drop y-o-y in 2011. Our top pick in the sector is Singapore Airlines, which is more passenger focused, has significant net cash balances and is the best value Asian airline.

Hotels

A sector that enjoys the benefits of a travel rebound but has lagged the airlines is hotels. Since the occupancy-led recovery in 2010, occupancy levels have stabilised and we expect hoteliers to push up room rates. We forecast this will cause a sharp earnings rebound in 2011. In general, every dollar of revenue earned from a rate hike is three times more profitable than that earned from occupancy increases. In addition, we believe mergers and acquisitions will be a key theme in 2011 as some of the cash-rich companies may target competitors still in financial distress from the recent economic slowdown.

Shipping

We remain generally less enthusiastic about shipping. Drybulk vessel supply is still huge, and we forecast that demand growth in 2010-12 will moderate versus the previous cycle in 2004-08, resulting in the gap between demand-supply becoming wider. We do not believe drybulk

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shipping rates will return to previous highs, and expect them to remain rangebound. Container shipping rates have rebounded from 2009 lows. However, we believe a sustainable rate recovery is conditional on liners maintaining price discipline and curbing capacity as volume growth starts to decline. With most new orders destined for this route, we expect Asia-Europe spot rates to come under pressure as more capacity enters the market. As Transpacific rate hikes are negotiated annually, we expect this trade to be more resilient.

Ports

The HSBC port index has outperformed the Hang Seng Index by 13% year to date. While we forecast slower growth in port throughput in 2011, we remain bullish on the Asian port sector's profit outlook. We believe the two key profit drivers will be a turnaround in recent investments in new terminals and industry-wide tariff increase. With limited acquisition opportunities for Asian port operators within China, we believe they will look for greenfield or brownfield acquisitions outside China. A key risk is that greenfield investments may prove to be value-destroying.

Themes for 2011

Winners from Chinese and Asian growth

In 2011, we expect Chinese and Asian growth will continue to diverge from developed markets. The inventory rebuild in 2010 boosted trade with the West despite relatively weak underlying demand and allowed air and containerised sea freight to stage substantial recoveries. As we now believe restocking is largely complete, our favourite plays for 2011 will be those that are primarily driven by Asian demand.

Therefore, we prefer passenger and travel-related stocks to cargo-driven companies, and conglomerates with businesses focused in Asia. Possible inflation and rising commodity prices as a result of strong Asian growth also tends to be negative for the airlines and container shipping companies if fuel prices rise.

Our favourite play on Asian growth is Jardine Matheson. Almost all its businesses are Asian focused and it is leveraged to pan-Asian consumption, commodity prices and HK investment properties. Our least favourite play is China Cosco. This company is highly exposed to Asia-EU container trade and has a large vessel orderbook locked in at high prices, which will depress returns in the medium term.

Cash-rich companies

Another theme for 2011 will be how some of our cash-rich coverage companies use their funds. We expect cash-rich airlines to return funds to shareholders as we believe foreign ownership rules limit the acquisition opportunities in Asia (and in the rest of the world). In contrast, given the significant fall in dry bulk vessel prices and decent returns on assets at the moment, we expect dry bulk shippers to increasingly acquire more vessels. Hoteliers are another sector where assets priced at distressed levels may enter the market. Finally, the port sector has plenty of potential investors but a limited pool of attractive assets and we are wary of greenfield investments, particularly in transhipment ports.

We argue the best placed is Pacific Basin: it has cash of USD960m and net cash of USD86m as at 1H10 which it can use to opportunistically acquire low cost vessels (newbuilds and secondhand) to maximise returns. Indeed, it recently announced it will be constructing 10 new handy vessels consisting of 6 handysize and 4 handymax (and purchase options for 2 handysize vessels) for delivery in 2012-13.

A possible loser in this scenario is port operator China Merchants Holdings International. With limited acquisition opportunities in China, China

Merchants may increase investments overseas (for example: Sri Lanka, Vietnam and Nigeria). We are generally negative on China Merchants' international expansion, particularly greenfield investments at transhipment ports, which may prove to be value-destroying.

Valuation and ratings

Singapore Airlines (SIA SP, OW, SGD15.42, TP SGD19)

Valuation

We continue to value SIA using our rating to economic profit multiple which sets an enterprise value/invested capital multiple using our forecast ROIC/WACC. Based on this approach, our target is SGD19 and this plus FY11e DPS of SGD0.80 implies a 28% potential return. At our target, SIA would trade at 12x FY12e PE, 1.4x P/BV and provide an FY12e dividend yield of 5%. Apart from SIA's compelling value, the key price driver is likely to be measures to utilise its significant surplus net cash.

Risks

SIA's share price tends to be driven by earnings momentum (0.60 correlation since 2006) and its performance relative to the MSCI AEJ is highly negatively correlated with the change in jet fuel prices. Another downside risk is further expansion by the Gulf airlines on SIA's key routes between Australia and Europe.

Jardine Matheson (JM SP, OW, USD43.24, TP USD54)

Valuation

JM remains attractively valued at FY11e 12x PE. Our appraised valuation is USD77/share (from USD70). We continue to argue that JM should trade at around the midpoint of its historical range (2005-8: 28-45% discount to appraised value). We set our target at USD54, at a 30% discount (from 35%). Our target plus FY11e dividend implies a 28% potential return.

Risks

70% of our appraised valuation comprises Dairy Farm, HK Land and JC&C. Downside risks are sharp declines in Asia consumption, reversionary rents and commodity prices.

Pacific Basin (2343 HK, OW(V), HKD5.25, TP HKD7.5)

Valuation

We value Pacific Basin at HKD7.5 based on rating to economic profit (REP) combining returns and invested capital. We apply a historical REP multiple of 0.8x and used ROIC/WACC at 1.1x to derive our enterprise value/invested capital (EV/IC). Our target price implies a potential return of 48% including dividend yield of 5%. At our target price, the stock is trading at 1.1x FY11e BV, which is also the stock's average trading multiple (range 0.6-3.1x).

Risks

Pacific Basin's share price tends to move closely with the Baltic Dry Bulk Index (0.4 short term and 0.9 medium term) even when it has locked in a high portion of revenue at healthy levels. Other risks to our rating and estimates include handysize rates weakening due to slower to ship commodities and/or excess supply due to owners prolonging use of older vessels or greater than expected new orders entering the market.

China Cosco (1919 HK, UW(V), HKD8.49, TP HKD5.9)

Valuation

We value China Cosco at HKD5.9 based on rating to economic profit (REP) based on enterprise value equalling to invested capital given the absence of economic profit and ROIC/WACC of 0.6x. Our target price implies a total negative return of 31% (zero dividend yield). At our target price, the stock is trading at 1.0x adjusted FY11e BV, which is at a discount to its average trading multiple of 1.8x (range 0.7-5.8x).

HSBC

Risks

China Cosco's share price is highly correlated to the Baltic Dry Bulk Index (0.4 short term and 0.9 medium term) and short-term earnings momentum (0.7). Other risks to rating and estimates include capesize rates recovering strongly in 2011-12 due to massive cancellation or scrapping of vessels or demand for iron ore rising substantially or port congestion absorbing capesize capacity.

China Merchants (144 HK, N, HKD30.65, TP HKD31)

Valuation

After an 18% rise in the share price since its strong 1H10 results, we argue the stock is now fully valued. At our unchanged target of HKD31, it is currently trading at 19x 2011e PE and 1.9x 2011e PB, higher than the long-term historical average of 15x. Our target price is based on a sum-of-the-parts valuation (DCF for key ports) and implies a 3% potential return, including dividend yield; thus we remain Neutral.

Risks

Key upside risk is higher-than-expected increases in average container handling tariffs. Key downside risks include a slowdown in global trade that causes slower-than-expected port throughput growth and a de-rating of the port sector. CMHI's aggressive international expansion could also pose a risk in future and it does not have a track record of managing ports outside Hong Kong and China.

Conglomerates and Transport: Valuation summary

Company	Ticker	Ccy	Target price	Share price	Rating	PE 2010e	PE 2011e	P/B 2010e	P/B 2011e	ROE 2010e	ROE 2011e	EV/EBITDA 2010e	EV/EBITDA 2011e	EV/IC 2010e	EV/IC 2011e	ROIC 2010e	ROIC 2011e	REP 2010e	REP 2011e	Dividend yield 2010e	Dividend yield 2011e
Airlines																					
Air China - H	753 HK	HKD	10.25	10.12	N(V)	13.4x	14.5x	2.9x	2.5x	28.1%	19.4%	9.3x	8.8x	1.8x	1.7x	7.9%	8.1%	2.5x	2.2x	2.1	1.8
Cathay Pacific	293 HK	HKD	23.00	22.65	N	8.6x	10.4x	1.7x	1.5x	25.1%	15.0%	5.1x	5.4x	1.3x	1.2x	13.5%	11.0%	0.9x	1.1x	3.6	3.9
China Airlines	2610 TT	TWD	18.00	24.35	UW	8.5x	10.5x	2.0x	1.7x	25.5%	16.8%	8.3x	8.2x	1.3x	1.2x	8.7%	7.7%	1.5x	1.5x		1.0
China Eastern - H	670 HK	HKD	3.90	4.58	UW(V)	12.4x	13.7x	3.7x	2.9x	60.9%	25.1%	9.9x	9.9x	2.3x	2.1x	10.4%	9.2%	3.0x	3.2x		
China Southern - H	1055 HK	HKD	3.90	5.67	N(V)	15.0x	19.7x	2.0x	1.8x	24.7%	10.9%	9.4x	9.5x	1.2x	1.2x	5.6%	5.0%	2.3x	2.4x	1.5	0.9
EVA Air	2618 TT	TWD	25.00	34.70	N(V)	8.2x	9.5x	2.3x	1.9x	32.8%	21.8%	7.4x	7.1x	1.3x	1.3x	10.3%	9.8%	1.3x	1.4x		1.0
Jet Airways	JETIN IN	INR	1000	804	OW(V)	17.7x	8.2x	3.2x	2.3x	21.9%	32.7%	8.2x	7.0x	1.2x	1.2x	7.7%	9.6%	1.5x	1.2x		
Korean Air	003490 KS	KRW	66000	71000	UW	7.6x	9.7x	1.4x	1.2x	19.9%	13.4%	6.9x	7.1x	1.1x	1.1x	8.6%	6.6%	1.2x	1.6x	0.7	1.0
Singapore Airlines	SIA SP	SGD	19.00	15.42	OW	11.2x	10.1x	1.2x	1.2x	10.6%	11.9%	4.3x	3.9x	1.2x	1.2x	11.7%	13.3%	0.9x	0.8x	5.2	6.5
Airports / aviation service providers																					
Hong Kong Aircraft Engine	44 HK	HKD	114.00	124.20	N	31.1x	21.9x	3.8x	3.5x	12.8%	17.0%	20.4x	14.3x	2.9x	2.6x	7.0%	10.3%	3.6x	2.1x	2.1	3.0
SIA Engineering	SIE SP	SGD	4.50	4.19	N	17.4x	15.9x	3.4x	3.2x	19.0%	20.5%	22.0x	19.5x	8.0x	7.6x	17.9%	22.9%	3.8x	2.8x	4.6	5.0
Singapore Airport Ter. Ser.	SATS SP	SGD	3.25	2.87	OW	15.8x	14.1x	2.0x	2.0x	12.1%	13.1%	9.1x	8.0x	2.3x	2.3x	12.4%	14.5%	1.6x	1.4x	4.9	5.5
Conglomerates and Ports																					
Astra International	ASII IJ	IDR	60000	51900	N	15.7x	13.2x	4.3x	3.6x	29.0%	28.6%	11.5x	9.2x	3.9x	3.5x	18.5%	20.3%	2.4x	1.9x	2.4	2.7
China Merchants Int'l	144 HK	HKD	31.00	30.65	N	21.4x	18.4x	2.1x	2.0x	10.3%	11.2%	25.6x	22.2x	2.4x	2.2x	16.6%	18.5%	1.1x	1.0x	2.0	2.2
Citic Pacific	267 HK	HKD	22.50	19.46	OW(V)	13.0x	11.2x	1.1x	1.0x	8.8%	9.5%	10.1x	6.7x	1.1x	1.0x	7.4%	9.7%	1.2x	0.9x	2.1	2.6
Cosco Pacific	1199 HK	HKD	15.70	12.30	OW(V)	14.2x	11.3x	1.2x	1.1x	9.2%	10.4%	19.2x	15.4x	1.3x	1.2x	9.2%	10.7%	1.5x	1.2x	3.5	3.5
Dairy Farm International	DFI SP	USD	8.50	8.93	N	29.5x	24.9x	17.1x	13.4x	65.5%	60.5%	17.9x	15.0x	31.0x	27.9x	100.8%	108.6%	2.6x	2.2x	2.0	2.4
Hutchison Whampoa	13 HK	HKD	86.00	77.70	N	21.3x	13.9x	1.1x	1.1x	6.0%	7.7%	12.3x	9.8x	1.1x	1.0x	3.5%	5.1%	2.3x	1.5x	2.2	2.2
Jardine Matheson	JM SP	USD	54.00	43.24	OW	11.5x	10.3x	1.4x	1.3x	16.4%	12.7%	6.8x	5.8x	1.2x	1.1x	11.3%	12.1%	0.9x	0.8x	2.2	2.9
Jardine Strategic	JS SP	USD	34.00	26.20	OW	11.3x	10.4x	1.4x	1.2x	17.3%	15.1%	9.2x	7.1x	1.8x	1.2x	12.6%	10.6%	1.2x	0.9x	0.8	0.8
Shanghai industrial	363 HK	HKD	44.00	32.75	OW(V)	13.4x	9.7x	1.4x	1.3x	10.8%	13.5%	7.1x	5.1x	2.1x	1.8x	20.7%	27.5%	0.9x	0.6x	4.7	3.6
Singamas	716 HK	HKD	2.70	2.37	OW(V)	13.2x	7.6x	1.8x	1.6x	14.6%	22.1%	8.8x	5.0x	1.4x	1.3x	14.1%	19.1%	1.1x	0.8x	2.2	4.5
Swire Pacific	19 HK	HKD	144.00	119.60	OW	16.3x	15.8x	1.1x	1.0x	11.7%	5.8%	20.2x	18.0x	1.0x	0.9x	3.5%	4.1%	2.1x	1.7x	3.0	3.1
Wharf (Holdings)	4 HK	HKD	58.00	52.20	N	21.0x	18.6x	1.1x	1.1x	9.8%	5.3%	14.6x	13.2x	1.0x	1.0x	4.2%	5.1%	1.8x	1.4x	1.9	1.9
Shipping																					
China COSCO Holdings	1919 HK	HKD	5.90	8.49	UW(V)	14.7x	14.1x	1.6x	1.4x	12.8%	10.3%	7.7x	7.3x	1.0x	1.1x	7.5%	8.4%	1.5x	1.4x		1.4
China Ship. Contr. lines	2866 HK	HKD	2.50	3.10	UW(V)	748.2x	80.7x	1.3x	1.2x	0.2%	1.6%	19.4x	15.2x	0.9x	0.9x	0.3%	1.4%	31.8x	7.8x		0.2
China Shipping Dev.	1138 HK	HKD	16.40	10.78	OW(V)	16.7x	10.7x	1.4x	1.2x	74.6%	71.8%	2.4x	2.4x	1.4x	1.3x	48.9%	44.3%	0.3x	0.3x	1.2	1.8
Evergreen Marine Corp	2603 TT	TWD	17.70	25.65	UW(V)	222.2x	195.6x	1.5x	1.4x	0.7%	0.7%	11.5x	11.9x	1.4x	1.5x	1.3%	1.3%	10.8x	11.2x		0.1
Neptune Orient Line	NOL SP	SGD	2.10	2.17	N(V)	32.9x	16.0x	1.1x	1.0x	3.1%	6.5%	7.8x	7.0x	0.9x	1.0x	7.3%	9.4%	1.4x	1.2x		1.2
Orient Overseas Int'l	316 HK	HKD	70.20	75.35	OW(V)	47.0x	17.0x	1.5x	1.4x	3.1%	8.5%	8.3x	6.3x	0.8x	0.7x	6.7%	8.1%	1.2x	0.9x	0.5	1.4
Pacific Basin Shipping	2343 HK	HKD	7.50	5.25	OW(V)	8.0x	6.1x	0.8x	0.8x	8.2%	10.3%	6.2x	5.0x	1.0x	0.7x	12.0%	11.5%	0.8x	0.6x	5.1	7.0
Sinotrans	598 HK	HKD	3.20	2.34	OW	11.6x	8.8x	0.9x	0.9x	9.6%	11.7%	5.6x	4.8x	1.1x	1.0x	10.3%	11.4%	1.0x	0.8x	2.6	3.4
Sinotrans Shipping	368 HK	HKD	5.40	2.97	OW(V)	13.9x	9.4x	0.7x	0.7x	5.3%	7.6%	3.1x	2.0x	0.4x	0.4x	8.6%	14.4%	0.5x	0.3x	2.4	3.6
STX Pan Ocean	STX SP	SGD	12.50	13.68	UW(V)	18.9x	17.1x	0.9x	0.9x	5.3%	5.2%	7.8x	7.6x	1.1x	1.0x	9.7%	9.5%	1.3x	1.2x	0.9	0.9
U-Ming Marine Transport	2606 TT	TWD	62.90	61.80	N(V)	13.0x	16.0x	1.8x	1.7x	18.2%	10.7%	6.1x	7.0x	2.3x	2.1x	20.2%	14.1%	1.2x	1.5x	4.9	3.1

Notes: (V) = Volatile, please see disclosure appendix. PE calculated from recurring EPS. REP= rating to economic profit which is EV/IC divided by ROIC/WACC.
Source: HSBC estimates; Closing prices as of 30 Nov 2010

Consumer

- The theme: dealing with excess liquidity
- This will impact the consumer sector through interest rates, price controls and (high) valuations
- Key ideas: Gome, Intime, Anta

2011 outlook

Dealing with excess liquidity

For 2010, we wrote that the big theme in Chinese consumers was the regional diversification of the consumer landscape. Consumer markets would move from a few (Chinese) people with a lot of money to spend to many with less money to spend. Consumer markets in tier 2 and 3 cities would become the driver of overall consumer spending.

This has happened and is likely to continue to be a theme in the coming year. Growth in tier 3 and 4 cities has outpaced tier 1 cities across China. For example, Hengdeli, a luxury watch retailer, indicated that growth in its stores was as high as >30% in the lower-tier cities while growth in tier 1 cities (Shanghai, Beijing, Guangzhou) was about 15-20%.

In our view, a new theme for the consumer sector in 2011 will be the impact of excess (monetary) liquidity on the sector.

Excess liquidity impacts investors in the consumer sector in various ways. We expect the market will toy with the impact of (1) higher interest rates, (2) inflation and price controls, (3) exchange rate movements, and (4) stock valuations.

First of all, there is a risk of further interest rate increases across Asia Pacific, which could impact consumer spending, most likely more so on products that need to be financed (cars, high-ticket items). Note also that Chinese consumers, having a strong net-cash position backed by plenty of savings, might actually find a positive income effect from higher interest rates – they simply earn more interest on savings.

Meanwhile, excessive liquidity and inflation could also lead to intervention in markets. Especially in China, there is an increasing risk of price controls in food-related industries.

A change in the exchange rate will also have an impact, especially on those companies that either import or export their products. In our universe, pulp and paper companies are probably most impacted by these rate movements.

The last effect of excessive liquidity on consumer stocks could come through valuations. Already, we believe that investors need to be very careful and selective when investing in Asian consumer stocks. A common argument is that valuations for the sector are high against their own history. While this is true, loose liquidity conditions and low (perceived) risk to earnings can, at times, sustain such high valuations.

Practically, what this means is that consumer stocks can run a little further than what we believe

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would be reasonable valuations, but also that downside risk to the sector is most likely to come from either higher interest rates and the introduction of price controls.

Below we provide a very quick snapshot of the key themes playing in various sub-sectors in Asian consumers (Chinese sub-sectors first, followed by SEA, Korea and India):

Chinese department stores

This sector deals with rapid expansion of new department stores across many cities in China.

The fastest-growing sector within department stores are those that offer new, fresh shopping formats with a larger variety of stores and services within the hypermarket or department stores. These new services can be anything from a children's playground to a larger variety of brands surrounding a traditional supermarket, all within one large complex.

These new format department and hypermarket stores are often also located in new, high-growth locations. These new locations are not always in the centre of a city, where they traditionally have been. Better infrastructure and higher car ownership allow consumers to travel to areas on the periphery of a city.

Hence, 'new format, new location' department stores have in the last year started to grow faster and offer better margins than the traditional hypermarkets located in the centre of a city.

Companies that have adapted to these new trends and have come with new, innovative ideas and formats are Intime and Golden Eagle.

F&B

Rising food prices have become a concern to the market in late 2010. Although China is self-sufficient in rice, wheat and corn, products like palm oil and soybean are imported. Lower acreage and limits to supply of many of these foodstocks have been some of the reasons why food prices have increased in late 2010.

Whether this continues and is the start of a trend of sustained inflationary pressures is questionable. Indeed, our economists believe this is a near-term phenomenon and headline inflation is likely to ease after Chinese new Year. However, short supply in various specific food items (palm oil, vegetables) is likely to continue to put upward pressure on some food items.

For F&B companies that deal with rising raw materials, the best way to deal with this is to either:

- raise retail prices and pass on these costs to the consumer, or
- improve their product mix so that their ASPs increase, even if retail prices for various goods remain stable.

This is exactly what companies such as Mengniu are doing – gradually introducing new, higher-priced dairy products. This will continue to be a key feature for earnings growth in this Chinese sub-sector in 2011.

Chinese sportswear

In this sector, the key earnings driver is entrance into tier 2-5 cities. This is where penetration of the larger brands is still relatively low and where income growth is sufficient to support higher sales and higher sales productivity.

Companies such as Xstep and Anta are key beneficiaries of this trend. And this growth in earnings and cash flow is reinvested into brand-building through advertising and promotions of their new products. Indeed, some of these companies have allocated large parts of their budgets to sponsor local Chinese sport teams (Olympic teams). However, this growth in tier 3 and 4 cities will continue to be a key driver of earnings in 2011.

Emerging Chinese brands

A group of companies in China is now trying to build local brands. This is not easy and, for many, this will be a multi-year programme of investing in brand awareness and product quality.

The issue for these newly emerging Chinese brands is their ability to manage growth and formulate a correct strategy.

For example, Bawang, a shampoo brand, has struggled with rapid diversification in (too many?) new products and sudden weakness in their core product, men's shampoo.

Meanwhile, menswear maker Lilang aims to build a brand that appeals to higher-end consumers instead of low-income consumers.

Expect continued investment in advertisements and promotions in local brands in the coming year. Companies that appear to be successful in building strong, homegrown brands should continue to receive plenty of attention in the markets in 2011.

Paper

The paper sector in 2011 is likely to be characterised by continuous demand growth and a shift in the industry structure.

On the demand side, we expect packaging paper consumption to grow at over 8% per annum on rising domestic demand and a rebound in exports.

On the supply side, we expect the government to announce a new round of environmental and emission control initiatives under its 12th Five-Year Plan, which is likely to result in an accelerated shutdown of small paper mills.

Under this macro background, we expect large manufacturers like Nine Dragons (2689 HK, OW(V), HKD11.76, TP HKD18.00) and Lee & Man Paper (2314 HK, OW(V), HKD6.14, TP HKD7.40) to benefit through continuous capacity expansion and diversification into higher-end packaging paper.

The major headwind faced by the paper manufacturers is rising interest rates in China. Nine Dragons and Lee & Man Paper have net gearings of around 0.6-0.7x in 2010. With higher interest expenses related to RMB rate hikes, Nine Dragons is particularly affected, as about 70% of its borrowings are in RMB. According to Nine Dragon, a 100bps increase in effective interest rate would hurt the bottom line by 3%. Lee & Man is less affected as all of its borrowings are denominated in HKD or USD.

Southeast Asia

SEA consumer markets are undergoing substantial changes. Incomes are rising and, in some markets, new emerging local rivals are threatening the position of local and international incumbents.

Meanwhile, other multinationals are positioning themselves strategically to secure long-term exposure in these rapidly growing markets. Most focus goes, for now, to Indonesia, which has proven to offer strong growth in consumer demand and a stable political environment for investment.

We prefer Southeast Asian stocks that are strong incumbents trading at reasonable valuations. Our top pick in this respect is Thai Beverage (THBEV SP, OW, SGD0.29, TP SGD0.35)

India

For investors, there are two issues at play in India. First, raw material prices are rising and although many companies can pass this on to consumers via higher prices, it might take time to raise retail prices. As such, margins might face a temporary squeeze.

In addition, India's consumer stocks are expensive. India is the only Asian country where consumer stocks are trading back at levels seen in 2007. In China and Korea, valuations are still below previous peaks. We believe these high valuations against their own history will keep further performance in check.

Korea

For Korean consumer companies, the domestic market is nearly saturated and shows low demand growth. While there are some changes in consumer behaviour that take place in Korea, the core issue is how the Koreans can benefit from growth elsewhere, especially in China.

Many have entered the Chinese market in an attempt to build fast-growing businesses, but experiences have been mixed.

In general, the product offering in China is different, supply chains are different and brands that are popular in the Korean market are relatively unknown in the Chinese market.

Some, however, seem to have been able to get to grips with practices in the Chinese department store market and are starting to see a meaningful contribution from their China operations. Of these, our top pick is Lotte Shopping (023530 KS, OW, KRW473,500, TP KRW600,000)

2011 high conviction idea

Gome (493 HK, OW(V), HKD3.06, TP HKD3.76)

Our research on multiple performance measures, such as single store efficiency and margins, shows Gome is now either overtaking or closing the gaps with Suning. We expect Gome to stop losing market share to Suning from 2H10 as it has returned to positive network expansion. We also expect margins to improve on investments in management systems, distribution capacity and reduction in restructuring related costs.

We are ahead of FY12 consensus, and our 2010-12e net profit CAGR of 28% is above the peer group average of 21%.

In the past, the issue for Gome has been corporate governance. We now believe the current structure provides a balance of power between the largest shareholder, management and institutional investors. Share options issued to key management and other employees have increased management stability and reduced succession risk. We also believe Bain will continue to play a key role in improving corporate transparency. Gome now trades at an average 30-40% discount (on HSBC earnings) to the leaders in retail sub-groups, which we think will close as historic perceptions of governance problems fade.

As such, we believe Gome will be one of the best-performing stocks in the Asian consumer space in 2011.

Winners from Chinese growth

Stocks that benefit from this are obviously the Chinese consumer stocks. But the Korean retailers are increasingly building businesses in China and investors should also think about companies such as Genting in Malaysia, which benefit from Chinese gambling in Southeast Asia.

Intime (1833 HK, OW(V), HKD12.10, TP HKD15.21)

In our view, one of the best ways to play this is through Chinese retailers such as Intime. This company is at the bottom of the profitability cycle, as its fast expansion in 2007-09 diluted profitability.

Being very active in industry consolidation opportunities, it just recently acquired 50% of Yansha, a famous department store chain in Beijing. We take this as a very positive move as Yansha only has four stores now but has already been able to build a strong brand name.

For Intime, this is an excellent way to enter Beijing, which is traditionally not where the company is strong. Intime originates from

Zhejiang province and while it is widely known in those regions, it is a relative newcomer with little brand visibility in Beijing.

Stock most at risk: Bawang (1338 HK, N(V), HKD3.15, TP HKD3.10)

Shampoo company Bawang is in an excellent position to benefit from Chinese growth, but a small management team and fast diversification into new products (skincare, herbal teas) raises execution risks. A recent incident where it was suggested that some of its shampoo carried too much dioxane, a substance that is allowed only within certain limits, has hurt its image. While the allegations have been refuted, such newsflow has severely damaged the brand and sales have subsequently fallen.

Thus, a relative small management team has wound up trying to rebuild their core brand while also diversifying into new markets, such as for skincare and herbal teas. This, we argue, will keep execution risk high in 2011.

Pricing anomalies

Gome

We think the biggest example of a stock price anomaly is Gome. This stock is slowly shrugging off the corporate governance issues that plagued it in the past. For more details, see the previous paragraphs on Gome.

Valuations and risks

Gome

Valuation

Our HKD3.76 target price is based on 20.9x 2011e EPS and implies a 23% potential return. The forward multiple is the average of 1) our bull case, which assumes Gome shares return to trading in line with peers as corporate governance issues are resolved, and 2) our bear case, which assumes boardroom battles continue to drag on the shares and the 40% discount to peers remains.

Taking the midpoint of these scenarios reflects the most likely outcome, which is that the recovery of investor confidence in the company will be slow but the market will eventually respond to the improved earnings that we forecast to result from its operational restructuring.

Catalysts: formal announcement of Gome's strategy based on a plan mutually agreed between the largest shareholder and the board and stronger than expected industry sales at above an FY08-10 CAGR of 10%.

Risks

Changes in the shareholding structure, changes in the management team that might slow or change the decision-making process or corporate strategy, competitive pressures in retailing.

Intime

Valuation

We rate this stock OW(V) with a TP of HKD15.21. We use a target multiple of 30x to reflect: 1) 30% core earnings CAGR for FY10-12e, and 2) a strong store opening pipeline in 2013 in the company's home market, Hangzhou, and new market, Hefei, with total GFA of about 400,000sqm. Intime currently has about 815,000sqm GFA.

Risks

In our view, key risks include delays in store openings and weaker than expected sales.

Bawang

Valuation

We use a multiple of 15.5x forward earnings, which represents the average PE between July and November 2009, and set a TP of HKD3.1. We have a N(V) rating on the stock. Note that if we used the lowest-ever PE that Bawang shares have traded on (12.7x in September 2009), our fair value would fall to HKD2.5.

Risks

The key risk is the aftermath of the dioxane incident. On 12 November we lowered our 2H profit forecast to reflect weaker sales and rising advertising costs to rebuild Bawang's brand.
At that time, we maintained our EPS forecast for 2011, which implied a return to normality next calendar year, on two key assumptions:

- Monthly run rate for Bawang shampoo would recover from RMB90m in October 2010 to the 2009 normal level of RMB120m by April 2011.
- Herbal tea sales would reach RMB306m in FY11 from RMB84m in FY10. It is the largest sales growth driver in 2011, contributing 35% to overall sales growth.

There is now a risk that weak sales performance might extend into 2011 if the brand remains tainted by the 2010 dioxane incident. This illustrates how fragile new brands can be in China. Upside risks include sell-through of herbal tea and new product launches.

Asia Consumer: Valuation summary

Company	Ticker	Rating	Currency	Share price	Target price	Market cap (USDm)	Reporting currency	EPS 2010e	EPS 2011e	P/E (x) 2010e	P/E (x) 2011e	P/B (x) 2010e	P/B (x) 2011e	EV/EBITDA 2010e	EV/EBITDA 2011e	ROA (%) 2010e	ROA (%) 2011e	ROE (%) 2010e	ROE (%) 2011e	Net debt/q Equity (%) 2010e	Net debt/q Equity (%) 2011e	Dividend yield (%) 2010e	Dividend yield (%) 2011e
Greater China																							
Anta	2020 HK	OW(V)	HKD	14.48	18.00	4,648	RMB	0.61	0.75	21	16	5.3	4.6	17	12	24	26	28	30	-43	-50	3.2	4.0
Bawang	1338 HK	N(V)	HKD	3.15	3.10	1,179	RMB	0.05	0.17	53	16	3.8	3.2	39	10	6	18	7	22	-72	-66	1.3	1.9
Belle	1880 HK	N(V)	HKD	14.12	14.90	15,331	RMB	0.40	0.48	30	25	6.3	5.9	23	17	17	20	21	24	-37	-39	3.0	3.2
China Agri	606 HK	N(V)	HKD	9.28	10.30	4,824	HKD	0.66	0.81	14	11	1.8	1.7	8	8	6	7	12	13	47	52	1.8	2.2
China Dongxiang	3818 HK	N(V)	HKD	3.47	4.40	2,531	RMB	0.29	0.29	10	10	2.1	2.0	8	5	20	19	21	20	-86	-87	7.1	7.2
China Fishery	CFG SP	OW(V)	SGD	2.18	2.60	1,664	USD	0.16	0.19	10	9	2.4	2.0	7	7	14	14	26	25	35	19	3.0	3.8
China Lilang	1234 HK	N(V)	HKD	11.20	8.20	1,731	RMB	0.35	0.46	28	21	6.1	5.2	25	17	19	22	24	27	-45	-43	1.4	1.9
China Mengniu Dairy	2319 HK	OW	HKD	22.15	30.50	4,955	RMB	0.78	1.04	24	18	3.4	3.0	14	9	9	11	15	17	-63	-68	0.9	1.4
China Yurun Food	1068 HK	UW(V)	HKD	27.75	27.00	6,470	HKD	1.30	1.54	21	18	3.7	3.2	27	19	14	14	21	19	-13	-10	1.2	1.4
CyberLink	5203 TT	N(V)	TWD	111.50	131.00	432	TWD	8.09	9.01	14	12	2.4	2.4	10	6	14	15	18	20	-85	-87	5.9	6.5
Daphne	210 HK	N(V)	HKD	8.85	9.60	1,866	HKD	0.41	0.49	22	18	5.5	4.4	13	9	16	17	29	28	-49	-56	1.5	1.8
Esprit	330 HK	OW(V)	HKD	37.55	52.00	6,227	HKD	3.22	3.28	12	11	2.9	2.6	9	7	18	17	26	24	-25	-22	4.4	5.2
Giant Manufacturing	9921 TT	N	TWD	117.00	120.00	1,368	TWD	7.89	9.20	15	13	3.1	2.7	10	8	10	11	23	23	12	1	2.0	2.4
Golden Eagle	3308 HK	OW(V)	HKD	22.70	22.40	5,677	RMB	0.50	0.65	39	30	11.0	9.0	26	19	15	16	31	33	-39	-25	1.0	1.3
GOME	493 HK	OW(V)	HKD	3.06	3.76	6,573	RMB	0.13	0.16	21	17	2.3	2.2	14	10	5	6	14	14	-48	-69	0.0	0.0
Hengan	1044 HK	N	HKD	71.60	73.00	11,284	HKD	2.21	2.66	32	27	8.6	7.7	23	18	18	20	27	29	-16	-13	1.9	2.2
Hengdeli	3389 HK	N(V)	HKD	5.05	4.70	2,847	RMB	0.13	0.17	33	25	3.9	3.6	20	14	9	9	16	16	-18	-6	1.1	1.3
Huabao	336 HK	OW(V)	HKD	12.30	12.00	4,984	HKD	0.48	0.58	25	21	8.7	7.1	21	16	31	31	37	36	-47	-56	1.8	2.2
Intime	1833 HK	OW(V)	HKD	12.10	15.21	2,744	RMB	0.32	0.35	32	29	4.9	4.9	18	17	7	8	14	16	17	-5	1.2	1.4
Lee and Man	2314 HK	OW(V)	HKD	6.14	7.40	3,707	HKD	0.39	0.46	16	13	2.5	2.3	10	11	9	10	18	18	64	64	2.2	2.7
Li & Fung	494 HK	N(V)	HKD	48.40	45.00	25,036	HKD	1.28	1.68	38	29	9.5	8.7	32	25	10	12	26	32	22	14	2.2	2.9
Li Ning	2331 HK	N(V)	HKD	20.45	23.90	2,769	RMB	1.06	1.01	17	17	5.2	4.4	11	10	19	16	35	28	-49	-56	2.5	2.3
Lifestyle	1212 HK	N(V)	HKD	19.92	14.40	4,305	HKD	0.66	0.73	30	27	5.0	4.5	21	19	9	10	16	16	-6	-37	1.4	1.6
L'Occitane	973 HK	N(V)	HKD	20.95	22.00	3,983	EUR	0.07	0.08	31	27	7.2	5.7	19	14	16	14	33	24	-55	-65	2.6	2.3
Maoye	848 HK	N(V)	HKD	4.02	3.46	2,660	RMB	0.11	0.14	31	24	4.8	4.2	16	12	7	7	14	15	6	41	1.0	1.2
New World Department	825 HK	N(V)	HKD	7.19	7.70	1,561	HKD	0.34	0.46	21	15	2.5	2.3	12	7	8	10	12	15	-68	-57	2.2	2.6
Nine Dragons	2689 HK	OW(V)	HKD	11.76	18.00	7,048	RMB	0.59	0.82	17	12	2.3	2.0	9	9	7	9	14	17	70	59	1.3	1.6
Parkson	3368 HK	N(V)	HKD	12.92	15.05	4,672	RMB	0.37	0.50	30	22	7.1	5.8	18	13	9	11	26	28	-19	-70	1.2	1.6
Ports Design	589 HK	OW(V)	HKD	24.00	22.80	1,751	RMB	0.91	1.09	23	19	5.8	5.0	18	14	20	23	35	36	-12	-19	2.6	3.2
Pou Sheng	3813 HK	OW(V)	HKD	1.50	2.10	828	USD	0.01	0.01	22	14	1.1	1.0	9	7	3	5	5	7	-2	-8	0.0	0.0
Tingyi Holding	322 HK	OW	HKD	19.22	23.10	13,823	USD	0.08	0.10	31	24	8.0	6.7	14	11	12	13	21	22	-15	-22	1.6	2.1
Tsingtao Brewery	168 HK	N	HKD	42.10	43.00	7,204	RMB	1.25	1.46	29	25	5.1	4.5	17	14	10	11	18	19	-46	-55	1.0	1.4
Uni-President Enterprises	1216 TT	N	TWD	42.15	37.00	5,951	TWD	1.95	2.12	22	20	2.4	2.2	58	61	8	8	12	12	30	27	2.1	2.3
Want Want	151 HK	N	HKD	6.69	6.40	11,378	USD	0.03	0.04	30	24	10.5	9.0	23	17	19	20	36	40	-24	-28	2.3	3.4
Wumart	8277 HK	UW(V)	HKD	20.50	12.90	3,300	RMB	0.44	0.54	40	33	6.3	5.7	19	14	8	7	19	17	-75	-84	1.1	1.4
Xtep Int''l	1368 HK	OW	HKD	6.77	9.00	1,896	RMB	0.36	0.45	16	13	3.8	3.4	13	9	20	23	25	28	-69	-74	4.6	5.5
Youyuan International	2268 HK	OW(V)	HKD	4.44	4.80	572	RMB	0.23	0.34	16	11	2.9	2.5	11	9	13	14	25	24	12	29	1.4	2.2
Yue Yuen Industrial	551 HK	OW	HKD	28.05	32.90	5,954	USD	0.28	0.31	13	12	1.8	1.6	9	8	8	8	13	14	2	-1	3.2	3.6
Mean										**24**	**19**	**4.8**	**4.2**	**18**	**13**	**13**	**14**	**21**	**22**	**-21**	**-25**	**2.1**	**2.5**

Note: All numbers calendarised.
Source: Bloomberg, HSBC estimates; Closing prices as of 30 Nov 2010

Asia Consumer: Valuation summary (cont'd)

Company	Ticker	Rating	Currency	Share price	Target price	Market cap (USDm)	Reporting currency	EPS 2010e	EPS 2011e	PE (x) 2010e	PE (x) 2011e	PB (x) 2010e	PB (x) 2011e	EV/EBITDA 2010e	EV/EBITDA 2011e	ROA (%) 2010e	ROA (%) 2011e	ROE (%) 2010e	ROE (%) 2011e	Net debt/q Equity (%) 2010e	Net debt/q Equity (%) 2011e	Dividend yield (%) 2010e	Dividend yield (%) 2011e
Korea																							
Amorepacific	004370 KS	N	KRW	204,500	240,000	1,080	KRW	21,208	22,631	10	9	0.9	0.9	7	4	7	7	10	10	-34	-39	2.0	2.0
CJ Cheil Jedang	097950 KS	OW	KRW	214,000	320,000	2,373	KRW	50,055	24,916	4	9	1.2	1.1	7	9	16	8	32	13	30	19	1.6	1.6
Hite Brewery	103150 KS	OW	KRW	117,000	150,000	971	KRW	10,106	11,252	12	10	1.3	1.2	5	8	4	5	11	12	93	79	2.4	2.4
Hyundai Department Store	069960 KS	OW	KRW	120,000	150,000	2,366	KRW	11,588	12,330	10	10	1.4	1.2	11	11	9	9	14	13	16	14	0.5	0.5
JINRO	000080 KS	OW(V)	KRW	36,300	48,000	1,276	KRW	2,578	2,917	14	12	2.0	1.9	9	10	7	8	15	16	36	29	4.1	4.8
KT&G	033780 KS	OW	KRW	62,700	84,000	7,473	KRW	6,761	6,346	9	10	1.8	1.7	9	7	18	15	22	18	-12	-17	4.8	5.1
LG Household & Health Care	001800 KS	OW	KRW	408,000	440,000	2,112	KRW	36,458	18,184	11	22	3.6	3.2	23	25	19	9	38	15	45	39	0.5	0.5
Lotte Shopping	023530 KS	OW	KRW	473,500	600,000	11,939	KRW	32,059	39,363	15	12	1.0	1.0	8	8	5	5	7	8	23	21	0.3	0.3
Shinsegae	004170 KS	N	KRW	567,000	660,000	9,284	KRW	58,965	44,088	10	13	1.5	1.4	8	9	10	7	19	11	41	32	0.2	0.2
Mean										**11**	**12**	**1.7**	**1.5**	**10**	**10**	**11**	**8**	**19**	**13**	**27**	**20**	**1.8**	**1.9**
India																							
Colgate-Palmolive	CLGT IN.	N	INR	860	928	2,583	INR	33.31	38.05	26	23	30.4	25.1	20	16	42	35	132	122	-189	-212	2.7	3.2
Dabur India	DABUR IN.	OW	INR	93	114	3,559	INR	3.34	3.99	28	23	6.1	4.6	22	18	25	24	52	45	-29	-47	1.5	1.5
Gitanjali Gems Ltd	GITG IN.	OW(V)	INR	249	341	464	INR	30.60	40.92	8	6	0.9	0.8	3	6	5	5	13	15	97	96	1.4	1.9
Godrej Consumer Products	GCPL IN.	N	INR	410	445	2,926	INR	14.86	18.80	28	22	8.4	6.6	21	17	20	17	39	34	54	43	1.3	1.9
Hindustan Unilever Ltd	HUVR IN.	UW	INR	298	287	14,350	INR	9.87	11.14	30	27	21.9	19.1	23	19	21	22	78	76	-87	-93	2.3	2.6
ITC	ITC IN.	N	INR	169	180	28,671	INR	6.28	7.32	27	23	4.0	3.4	18	16	20	21	31	32	-8	-16	2.1	2.1
Marico Industries	MRCO IN.	UW	INR	130	132	1,762	INR	4.33	5.19	30	25	9.6	7.5	20	17	18	19	37	33	7	-14	0.6	1.1
Nestle India	NEST IN	UW	INR	3,566	3,400	7,550	INR	89.59	106.11	40	34	48.1	40.0	27	23	38	36	133	130	-35	-57	1.8	2.2
Pantaloon Retail	PF IN.	N(V)	INR	410	445	1,936	INR	13.25	17.34	31	24	2.5	2.1	9	10	4	4	10	11	99	91	0.1	0.1
Shoppers Stop Ltd	SHOP IN.	UW(V)	INR	712	618	645	INR	12.32	15.54	58	46	4.4	3.5	21	18	6	6	13	11	3	-6	0.2	0.2
Titan Industries Ltd	TTAN IN.	N	INR	3,684	3,731	3,611	INR	77.61	103.44	47	36	18.0	13.8	31	23	15	15	43	44	-15	-19	0.8	1.1
Mean										**32**	**26**	**14.0**	**11.5**	**20**	**17**	**19**	**19**	**53**	**50**	**-9**	**-21**	**1.4**	**1.6**
Mean - Grand total										**24**	**19**	**6.1**	**5.1**	**17**	**14**	**14**	**14**	**27**	**26**	**-12**	**-18**	**1.9**	**2.3**

Note: All numbers calendarised.
Source: Bloomberg, HSBC estimates; Closing prices as of 30 Nov 2010

HSBC

Industrials

- We see improving prospects for the global capex cycle
- Further investments expected in infrastructure and plants on top of strong commodity prices and resumption of suspended projects
- Our highest conviction pick is Samsung Engineering; Hyundai Motor is most likely to benefit from pricing anomalies relative to peers, while Kia Motors should benefit from Chinese growth

2011 outlook

We expect the global capex cycle to continue to trend up in 2011, mainly driven by 1) the resumption of suspended projects, which have shown an incremental recovery since last year (after the financial crisis in 2008), 2) strong commodity prices (eg, crude oil), which look set to provoke further investment in infrastructure as well as plants, and 3) sustainable demand growth from emerging markets.

Engineering & construction

To date, the strongest demand for overseas plant construction has come from Middle East, including Saudi Arabia and the UAE, largely driven by national oil companies such as Arabian-American Oil Co (ARAMCO), Saudi Basic Industries Co and Abu Dhabi National Oil Company. While we find that massive capital investments have led to fierce competition among the global engineering and construction players, we believe Korean companies who successfully diversify their new order streams both by project type and region will eventually benefit.

Autos

We expect the momentum of HMC and Kia's new models to continue into 2011 in the US, China and EM and estimate their 2011 retail volume to increase by 12% to 6.5m. In 2010, the two Korean automakers likely sold 5.7m vehicles globally, up 18%, helping HMC and Kia's combined global market share to increase to 8.2% from 7.7% in 2009. For 2011, we expect China and EM to continue to grow at 20% and the US to recover by 10%. We believe HMC and Kia's operating margins will rise to 9% and 7% in 2011, driven by the economies of scale and cost efficiency through platform integration.

Shipbuilding

We believe the shipbuilding industry bottomed out in 2009 following two consecutive years of order declines. We expect a gradual recovery to continue in 2010/11 due to a low base effect. We expect new orders to rise around 18% to 32.9m CGT in 2011. However, we would not view this recovery as cyclical. Many concerns remain, such as profitability of current new orders, overcapacity and demand from shipowners, delays and price cuts. We believe that more time is definitely needed to see another strong cyclical upturn as in 2006-08.

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2011 high conviction idea

Top pick: Samsung Engineering (028050 KS, OW(V), KRW185,500, TP KRW247,000)

We believe Samsung Engineering is the best positioned name, especially given its first-ever order win from the United States (Dow Chemical order), an oligopoly market largely dominated by leading domestic peers such as Fluor Corp. As most of the US projects look set to be carried out through a 'cost + fee base' mechanism, we believe its entrance into new markets will continue to provide a strong cushion to offset margin contraction risks from fierce competition in the Middle East.

Looking ahead, we believe 2011 new order guidance (KRW13.5trn) looks highly achievable, as a steady pace of diversification backed by proven quality works should continue to improve order visibility ahead. We believe Samsung Engineering has reached a turning point in its business, entering a new USD100bn market and FEED business (front-end engineering and design). While EV to backlog is a good way to look at E&C valuations, a proprietary approach to gauge how far shares are trading on their future earnings in the upcycle. Samsung Engineering now trades at 29% 2010e EV to backlog versus the major overseas peers at 121%.

Valuation

Out target price of KRW247,000 is based on a sum-of-the-parts valuation. For the core operations, we apply target EV/EBITDA of 15.5x reflecting the new fair EV to 2011e backlog (30%). With non-core asset value at KRW87.4bn, we add net cash worth of KRW1.4trn.

Risks

Key risks are higher raw material prices that erode margins of industrial plants, further KRW appreciation that weakens pricing power and heightened tensions with North Korea.

Pricing anomalies

Korean auto and auto parts stocks have historically traded at a discount to global peers, due to the earnings volatility and high leverage. However, we believe the discount factors are fading away given solid global sales and strengthened balance sheets.

Hyundai Motor Company (005380 KS, OW, KRW172,500, TP KRW240,000)

We believe HMC deserves to trade at Toyota's upcycle average multiple during 2004-07, as the two companies' global volume growth and margin expansion stories look similar.

Valuation

We apply a target PB multiple of 1.6x to derive our TP of W240,000. Our target multiple is based on Toyota's average 1-year forward PB during the 2004-07 upcycle.

Risks

Key downside risks to our view include slower-than-expected demand recovery in global markets, any significant quality problems with HMC vehicles and heightened tensions with North Korea.

Stock most at risk: Mando (060980 KS, N(V), KRW132,500, TP KRW140,000)

With the stock trading at 1.6x 2011e PB and 10x PE, we think Mando's share price momentum has abated due to the KCC overhang.

Valuation

We apply a target PB multiple of 1.8x to 2011e BVPS, which implies a 20% discount to our 2.2x target multiple for Mobis, given that Mando's 2011e ROE 16% is lower than Mobis' 23%.

Risks

Key downside risks to our view include dependency on OEM product cycle, earnings sensitivity to FX movement and heightened tensions with North Korea.

Winners from Chinese growth

The combined market share of HMC and Kia in China has grown to 10.2% in 2010 from 9.8% in 2009. We estimate that Korean automakers will outperform the Chinese auto market in 2011, in light of the successful launch of Sportage R, K5 and YF Sonata.

Kia Motors (000270 KS, OW, KRW48,950, TP KRW56,000)

We estimate Kia's Chinese retail sales will grow 25% in 2011, following 40% growth in 2010. With the launch of Sportage R (4Q10) and K5 (1Q11), momentum in SUVs and D-segment sedans should continue into 2011. As such, Kia's 2011 Chinese market share is likely to rise to 3.7% from 3.4% in 2010.

Valuation

We apply a target PB multiple of 1.9x to 2011e BVPS to derive our TP of W56,000. At our TP, the shares would be trading at 8.7x 2011e EPS with 12.3% growth. Our target multiple of 1.9x is based on a 20% premium to our target PB for HMC of 1.6x, given Kia's higher ROE.

Risks

Key downside risks to our view include any significant quality issues with Kia's cars and heightened tensions with North Korea.

Korea Industrials: Valuation summary

Company		Samsung Eng.	Samsung C&T	GS E&C	Hyundai E&C	Daelim Ind.	Hyundai Dev.	Hyundai Heavy	Samsung Heavy	Hyundai Motor	KIA Motor	Hyundai Mobis	KEPCO	Doosan Heavy	KEPCO E&C	KPS	BHI
Code		028050 KS	000830 KS	006360 KS	000720 KS	000210 KS	012630 KS	009540 KS	010140 KS	005380 KS	000270 KS	012330 KS	015760 KS	034020 KS	052690 KS	051600 KS	083650 KS
Rating		OW(V)	OW(V)	N(V)	OW	OW(V)	N(V)	OW(V)	OW	OW	OW	OW	OW	OW(V)	N(V)	OW(V)	N(V)
Market cap	(KRWbn)	7,420	11,998	5,100	7,038	3,776	2,552	28,234	7,665	37,998	19,394	26,770	17,771	8,550	3,616	2,516	306
	(USD m)	6,288	10,167	4,322	5,964	3,200	2,163	23,927	6,496	32,201	16,436	22,686	15,061	7,246	3,064	2,132	259
Share price	(KRW)	185,500	76,800	100,000	63,200	108,500	33,850	371,500	33,200	172,500	48,950	275,000	27,700	80,800	94,600	55,900	23,400
Target price	(KRW)	247,000	80,000	108,000	75,000	105,000	30,000	460,000	42,000	240,000	56,000	310,000	40,000	110,000	130,000	80,000	31,000
Potential return	(%)	34.2%	4.8%	9.0%	19.6%	-3.1%	-10.2%	25.2%	28.0%	39.8%	15.6%	13.3%	44.4%	36.8%	39.1%	43.1%	32.5%
EV/EBITDA	2009	19.2	37.7	7.1	14.6	9.3	23.0	8.2	7.4	7.8	9.1	7.6	6.7	18.3	21.4	13.7	11.6
	2010e	16.4	29.2	8.5	11.1	10.2	14.4	7.7	7.5	7.4	7.5	7.0	5.0	12.2	15.4	11.2	7.2
	2011e	11.1	24.7	6.5	9.8	6.0	13.4	8.2	7.6	6.6	6.3	6.0	4.2	10.2	11.7	9.8	6.0
EBITDA mgn.	2009	9.6%	2.9%	8.1%	5.2%	7.3%	7.3%	17.9%	10.3%	10.9%	10.3%	25.0%	20.2%	7.9%	28.2%	19.0%	17.1%
	2010e	9.0%	3.4%	7.5%	6.1%	7.1%	10.4%	16.0%	10.0%	10.5%	10.3%	24.0%	25.3%	10.0%	29.3%	20.7%	17.2%
	2011e	9.3%	3.7%	7.5%	6.2%	8.4%	9.9%	14.6%	9.1%	10.4%	10.2%	24.0%	28.1%	10.3%	29.7%	20.9%	17.2%
P/E	2009	28.7	40.2	13.3	15.4	12.2	51.9	9.6	9.1	7.1	8.3	10.7	-36.5	46.3	29.4	21.7	14.9
	2010e	20.9	37.9	12.1	14.6	13.6	13.5	8.9	9.3	6.9	7.6	9.9	11.7	16.6	21.7	17.7	9.3
	2011e	15.6	32.9	11.5	12.5	8.7	12.4	9.6	12.2	6.4	6.9	8.9	6.8	12.9	17.0	15.8	8.2
EPS growth	2009	37.4%	-10.9%	0.3%	22.1%	238.2%	-78.4%	36.5%	3.7%	75.4%	49.0%	43.4%	402.9%	-155.8%	48.8%	20.5%	-8.7%
	2010e	37.3%	5.9%	10.3%	5.4%	-9.9%	283.7%	8.8%	-1.8%	3.8%	10.0%	8.2%	-412.9%	178.7%	35.6%	22.2%	59.6%
	2011e	34.2%	15.3%	5.2%	17.0%	56.5%	9.0%	-8.1%	-23.7%	7.6%	10.5%	11.8%	71.7%	28.7%	27.5%	12.3%	13.2%
P/B	2009	9.6	1.7	1.5	2.3	1.1	1.1	2.2	2.1	1.3	2.0	2.6	0.4	2.5	9.0	4.7	3.1
	2010e	7.0	1.3	1.4	2.1	1.1	1.1	1.8	1.8	1.1	1.7	2.1	0.4	2.2	7.1	4.0	2.4
	2011e	5.1	1.2	1.3	1.8	1.0	1.0	1.5	1.5	1.0	1.4	1.7	0.4	1.9	5.7	3.5	1.9
ROE	2009	38.7%	5.0%	12.1%	15.3%	9.8%	2.1%	25.7%	25.1%	21.0%	27.4%	27.1%	-1.2%	5.4%	34.1%	23.0%	23.0%
	2010e	38.6%	3.5%	12.1%	15.4%	15.0%	8.1%	22.1%	21.1%	18.6%	24.2%	23.1%	3.6%	13.9%	36.7%	24.4%	28.9%
	2011e	37.8%	3.8%	11.5%	15.5%	12.0%	8.2%	17.1%	17.5%	17.2%	21.8%	21.0%	5.8%	15.7%	37.2%	23.9%	25.4%

Source: Bloomberg, HSBC estimates; Closing prices as of 30 Nov 2010

Insurance

- Outlook for Chinese insurance shares remains uncertain as positive impact from rate hikes is offset by regulatory headwinds – we still see strong upside in Chinese insurance ‘A’ shares
- Reiterate our preference for Composite over Life insurance names in Korea – most preferred stock is OW-rated Samsung F&M
- In our view, OW(V)-rated China Taiping and LIG are the best stocks to play the ‘Chinese growth’ and ‘Korean valuation’ anomaly themes, respectively

2011 outlook

China

The MSCI China Insurance Index has risen 2% year to date, in line with MSCI China. PICC P&C was the strongest performer y-t-d, rising a staggering 66% in light of better than expected operational performance (6.8%pt unexpected swing in interim combined ratio) and a continuation of strong top-line growth. The worst performer was China Life ‘A’ shares, down 30% y-t-d, driven by an unexpected slowdown in new business value (NBV) growth and its unwelcome tag as an A-share proxy (Shanghai composite down 14%).

We are cautious on the Non-life space; PICC P&C is both expensive and poorly capitalised. We accept there is a risk that the starting point of a grossly overvalued stock may be overlooked and the shares trade on momentum (e.g. car sales, interest rate hikes) as they have done this year. Although operational results were much better than expected given the clampdown by the CIRC, the regulatory outlook may not be as positive going forward. The CIRC is considering allowing up to 17 foreign insurers to sell compulsory auto products which can be used to cross-sell more profitable non-compulsory lines.

We continue to see share price upside in the ‘H’ and ‘A’ shares of China Life, China Taiping and Ping An, which supports our current Overweight ratings. That said we see downside risks from the intensification of uneconomic competition (evident in 1H), technical pressure from potential new listings (eg, Taiking Life, PICC Group, New China Life, according to local media such as *21st Century Business Herald* and Hexun) and fallout from regulatory changes. This past three months we have already seen potentially damaging guidance from the CBRC on bancassurance and also the CIRC proposing to liberalise Traditional Life guarantee rates.

Korea

The Korea SE Insurance index has fallen 11% year to date, underperforming the KOSPI, which rose 13% during the period. The Life names have dragged the index down, with Tong Yang Life

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being the worst performer (-17%) and both Korea Life and Samsung Life trading below their listing prices. It seems investors share our cautious view on the Korean Life insurance industry that is 'generally' characterised by weak capital bases (on a more realistic RBC basis), relatively high exposure to negative spread products and growing concern about the provision of unhedged income & capital protection guarantees.

The best-performing Korean insurance share was OW(V)-rated Hyundai F&M, which rose 22% YTD, closely followed by Korea Re (+21%) and Dongbu (+20%).

Looking into 2011 we continue to have a strong preference for Non-life names where we see lower risks, more valuation upside (even in the unlikely event that the industry embraces the unloved Embedded Value methodology) and stronger balance sheets. We could also see share price catalysts in the form of a long overdue second round of auto insurance price hikes early next year.

India

There are no quoted pure play insurers in the Indian market although that could be about to change with the expected listing of Reliance Life (spun out of Reliance Capital) and Standard Life HDFC. The successful listing of an Indian insurer coupled with a long-awaited increase in FDI limits could open the floodgates for more listings in this important market, where the Life insurance penetration rate (4.6%) is 2x that of China (2.3%).

We hope that 2011 will herald a more stable regulatory environment for the Indian Life insurance industry, which has been hit with fee caps, surrender penalty caps and the proposed withdrawal of much-needed tax breaks on key products by 2012.

2011 high conviction idea

Overweight Samsung F&M

Samsung F&M is a well managed and well capitalised group that offers value at current share price levels. Key attractions of stock include:

- **Capital redeployment.** Samsung F&M is holding KRW3,604bn (=38% current market cap) above the 200% solvency ratio and is considering deploying some of their 'to be defined' excess capital and have kept all options on the table including M&A, organic growth, a special dividend and a share buyback.
- **Quality play.** Samsung F&M benefits from having a strong brand, excellent group connections (management talent, intra-group sales) and significant economy of scale benefits (26% market share). The group has a track record for product innovation, EV disclosure and responsible management – investors can sleep relatively easy at night.
- **Auto loss ratio improvement**. One key catalyst could come from an improvement in the share price sensitive auto loss ratio which is at cyclical high. Loss ratios tend to improve from January and Samsung F&M could improve further owing to a second round of auto price increases and positive regulatory intervention (replace lump sum deductible for proportional claims insurance).

Valuation

Samsung F&M shares offer a 41% potential return against our KRW270,000 target price, which is predicated on 30% weight to EV and a 70% weight to PB methodologies.

Risks

Key risks to our OW rating comes from weaker than expected capital markets and a value destructive acquisition.

Winners from Chinese growth

Chinese insurers should benefit

Despite posting impressive premium growth over the past decade, we still believe China's insurance industry offers significant premium growth potential, driven by a plethora of powerful forces:

- Increased recognition by the government that net exports and investments can no longer be the drivers of long-term GDP growth and that consumption will have a bigger role to play, which should be positive for life insurance.
- The life insurance market remains relatively underpenetrated. China is on the cusp of an average GDP per capita level where consumers withdraw deposits and replace them with higher return long-term structured products.
- Potential introduction of tax-advantaged insurance products which remains the biggest delta in the insurance industry

We estimate annual insurance premium growth for the Chinese insurance market over the next 15 years after making assumptions about nominal GDP growth and what the insurance penetration rate will rise to within the next 15 years.

Our current valuations are predicated on our base-case Life and Non-life 15-year premium CAGR assumptions of 12% and 16%. In our more bullish scenario we assume Life and Non-life 15-year premium CAGRs of 21% and 24%, respectively.

Stock beneficiary

Migration from our base case to bull case premium growth assumptions would have an impact on our valuations, as detailed in Exhibit 2. In the sensitivity analysis, we assume that the additional valuation benefit of higher Life premium growth from the introduction of generous, easy-to-understand and tax-advantaged retirement savings products is offset by the likely lower margins on these products (we have assumed a margin haircut of 50%).

We believe the best way to play the Chinese growth story is through Overweight (V)-rated China Taiping. The least exposed to the growth story is Underweight (V)-rated PICC P&C.

Exhibit 2: Sensitivity of target price to the introduction of generous, easy to understand and tax-advantaged insurance pension annuities

		Current		Bull case	
	FX	TP	Pot'l return	TP	Pot'l return
China Life 'H'	HKD	42	19%	55	65%
China Pacific 'H'	HKD	37	12%	50	62%
China Taiping	HKD	37	28%	53	105%
PICC 'H'	HKD	7.8	-34%	8	-31%
Ping An 'H'	HKD	110	20%	154	72%
China Life 'A'	CNY	35	44%	46	106%
China Pacific 'A'	CNY	31	24%	42	81%
Ping An 'A'	CNY	92	52%	131	131%

Source: HSBC estimates

Risks

The biggest risks to our valuation comes from lower than expected growth. We consider our base case premium growth forecasts to be extremely conservative as they are predicated on world average penetration rates in 2015 that are significantly below the levels seen in other Asian countries.

Pricing anomalies

Korea embracing Embedded Value

The Korean insurance industry is a genuine anomaly where stocks are valued on a punitive PB methodology instead of a more conventional Embedded Value (EV) approach.

Korean insurers offer deep value on more appropriate embedded value metrics. The Korean sector is trading on just 0.7x our 2011e group embedded value, which implies a meagre 8% ROEV versus our average expectation of 16%. A multiple of 1.6x is more appropriate for a sector given our ROEV expectation, 1% sustainable growth and a 10.5% required return.

It is interesting to note that the Korean insurers trade at a significant discount to their Chinese counterparts on price to embedded value multiples and yet there is only a 5ppt difference in our average ROEV (akin to ROE in EV calculation) between the two sectors over the next three years.

While the listing of three pure play life insurers will help the embedded value cause, it will be some time before Korean insurance investors fully embrace the embedded value methodology which gives rise to materially higher valuations. The biggest challenges to overcome the valuation methodology are:

- **Disclosure shift**. It is no wonder that many analysts and investors focus on PB given that Korean insurers provide monthly earnings data (versus annual EV data) and earnings targets (versus no EV targets). Management must improve the quantity of EV data (e.g. quarterly NBV) and target focus if they want investors to buy into EV.
- **Investor education**. Many of the Korean non-life insurers shot themselves in the foot when they delayed the publication of EV data. While Samsung F&M has disclosed EV data for 5 years, its slower-moving peers only have 2 years of data.
- **Embedded value disclosure improvements**. Korean insurers need to materially improve their embedded value disclosure in a number of key respects, including; a reconciliation from 'shareholders funds' to 'adjusted net worth', standalone EV calculations and roll forwards for Life and Group basis and adoption of EEV methodology to allow investors to draw a line in the sand with respect to embedded high fixed return guarantees.

Stock beneficiaries

All Korean insurers screen inexpensive in both absolute and relative terms on embedded value metrics. In Exhibit 3 we highlight that the total potential return estimates increase from 23% to 132% if we were to base our price targets solely on the embedded value methodology.

We believe the best way to play the Korean valuation anomaly story is through Overweight (V)-rated LIG, whose shares should benefit the most from the migration to 100% weight to embedded value. Interestingly, Underweight (V)-rated Korea Life shares will be least exposed.

Exhibit 3: Potential return increases from 20% to 134% under EV methodology

		Current		100% EV	
	FX	TP	Pot'l return	based TP	Pot'l return
Dongbu	KRW	38,000	-1%	101,783	166%
Hyundai	KRW	29,000	29%	69,579	211%
Korea Life	KRW	7,000	-5%	11,302	54%
Korean Re	KRW	14,000	19%	23,107	97%
LIG	KRW	29,000	44%	65,410	224%
Meritz	KRW	8,300	7%	18,502	138%
Samsung F&M	KRW	270,000	41%	492,532	158%
Tong Yang Life	KRW	14,000	20%	25,774	121%

Source: HSBC estimates

Risks

The biggest risk is if the market does not embrace embedded value methodology. There is little impact on our current price targets as we only assign a 10-50% weight to EV in our price target derivation calculation.

Valuation and risks

Samsung F&M (000810 KS, OW(V), KRW191,000, TP KRW270,0000)

We derive our KRW270,000 target by weightings of 30% and 70% to our 'price to group embedded value' (KRW462,184) and 'price to adjusted book value' methodologies (KRW204,199). We also incorporate a 10% discount to allow for weak disclosure. With 41% potential return indicated, we maintain our OW(V) rating.

Downside risks are: (1) Group uses 'excess' capital to make a value-destructive deal. Samsung F&M showed an intention to expand in the overseas market in its FY08 results release: above

400% solvency ratio is the highest among life and non-life peers in Korea. (2) The market continues to obsess about competition with Life insurers, especially Samsung Life. Samsung Life is the largest life insurer in Korea and aims to grow in the lining benefit market and retirement pension market where Samsung F&M is focusing with long-term products.

LIG (002550 KS, OW(V), KRW20,200, TP KRW29,000)

We derive our KRW29,000 target by weightings of 10% and 90% to our 'price to group embedded value' (KRW60,404) and 'price to adjusted book value' methodologies (KRW33,859). We also incorporate a 20% discount to allow for weak disclosure. With 44% potential return indicated, we maintain our OW(V) rating.

Key downside risks to our rating include a faster than expected deterioration in the group's large loan book, weaker than expected capital markets and a further deterioration in 13th persistency ratio, which is relatively lower than peers.

China Taiping (966 HK, OW(V), HKD25.9, TP HKD37)

We derive our HKD37 price target by weightings of 70% and 30% to our 'price to group embedded value' (HKD38) and 'price to embedded value' methodologies (HKD35).

Key downside risks are: (1) capital raising, (2) further deterioration in ICBC relationship, and (3) weaker than expected NBV growth.

Korea Life (088350 KS, UW(V), KRW7,360, TP KRW7,500)

We derive our KRW7,500 target price by applying 50% weights to the valuation implied by 'price to book value' (KRW9,260) and 'price to group embedded value' (KRW12,073). We apply a 30% discount in light of disclosure (limited EV reporting track record), high burden of problematic fixed interest rate guarantee policies and relative capital weakness under a more realistic application of a RBC model.

Key upside risks are: (1) investors put greater weight on embedded value methodology. (2) Fall in exposure to high interest rate guarantee through financial engineering, policy lapse or rapid growth in new sales.

PICC P&C (2328 HK, UW(V), HKD11.64, TP HKD7.8)

We value PICC using our PB methodology, with a sustainable ROE assumption of 20%, based on our average ROE forecast over the FY10-12 period. We assume a long-term growth rate of 4% and a cost of equity of 10.4%, which generates a target price-to-book ratio of 2.5x. We apply this to our FY10 forecast of book value per share of HKD3.2, and roll forward the valuation date to 12 months from today, to arrive at a valuation and 12-month target price of HKD7.8.

Key upside risks are: a stronger-than-expected A-share market and an earlier-than-expected listing of PICC's parent on the A-share market.

Asia Insurance: Valuation summary

Company	Country (Curr)	Rating	Market cap (LCYm)	Market cap (USDm)	Share price	Target price	Potential return	P/EV 2011e	Avg ROEV 2011-13e	P/B 2011e	Avg ROE 2011-13e	P/TNAV 2011e	Avg RoTNAV 2011-13e	PE 2011e	PE 2012e	Div Yld 2011e
China Life 'H'	HKD	OW(V)	788,808	101,576	33.4	42.0	26%	2.4x	20%	3.3x	18%	3.3x	18%	19.7x	17.0x	1.9%
China Pacific 'H'	HKD	N(V)	241,221	31,062	30.9	37.0	20%	1.8x	20%	2.6x	11%	2.6x	11%	26.1x	22.0x	1.5%
China Taiping	HKD	OW(V)	44,095	5,678	25.9	37.0	43%	2.4x	25%	3.2x	12%	3.2x	12%	33.2x	24.7x	0.3%
PICC 'H'	HKD	UW(V)	129,691	16,701	11.6	7.8	-33%	3.6x	19%	3.6x	20%	3.6x	20%	18.7x	16.3x	0.3%
Ping An 'H'	HKD	OW(V)	572,109	73,672	89.6	110.0	23%	2.6x	23%	4.7x	17%	5.1x	18%	32.0x	24.6x	0.5%
China Life 'A'	RMB	OW(V)	677,210	101,576	22.3	35.0	57%	1.9x	20%	2.6x	18%	2.6x	18%	15.7x	13.8x	2.3%
China Pacific 'A'	RMB	OW(V)	207,094	31,062	23.2	31.0	34%	1.6x	20%	2.3x	11%	2.3x	11%	23.4x	20.1x	1.7%
Ping An 'A'	RMB	OW(V)	491,168	73,672	56.7	92.0	62%	2.0x	23%	3.5x	17%	3.9x	18%	24.1x	19.0x	0.6%
Dongbu	KRW	N(V)	2,708,099	2,336	38,250	42,000	10%	0.6x	18%	0.9x	19%	1.8x	35%	5.2x	4.5x	2.4%
Hyundai	KRW	OW(V)	2,002,559	1,727	22,400	29,000	29%	0.5x	19%	1.0x	18%	3.8x	58%	6.0x	5.2x	3.1%
Korea Life	KRW	UW(V)	6,392,380	5,514	7,360	7,500	2%	0.7x	13%	0.9x	12%	1.6x	22%	8.0x	6.7x	1.4%
Korean Re	KRW	N(V)	1,361,925	1,175	11,750	14,000	19%	0.8x	16%	0.8x	15%	0.8x	11%	6.0x	5.2x	3.0%
LIG	KRW	OW(V)	1,211,999	1,045	20,200	29,000	44%	0.4x	13%	0.7x	15%	4.4x	87%	5.5x	4.9x	3.2%
Meritz	KRW	N(V)	960,688	829	7,760	8,600	11%	0.4x	15%	0.9x	17%	-20.5x	-516%	5.2x	4.7x	4.5%
Samsung F&M	KRW	OW(V)	9,048,592	7,805	191,000	270,000	41%	0.8x	17%	1.1x	12%	1.5x	16%	9.2x	8.5x	1.8%
Tong Yang Life	KRW	N(V)	1,252,961	1,081	11,650	14,000	20%	0.6x	15%	1.0x	13%	4.2x	53%	8.3x	7.1x	2.6%
China	**USD**			**228,689**			**42%**	**2.1x**	**21%**	**3.2x**	**16%**	**3.3x**	**17%**	**22.1x**	**18.2x**	**1%**
Korea	**USD**			**21,510**			**24%**	**0.7x**	**16%**	**1.0x**	**14%**	**1.2x**	**7%**	**7.6x**	**6.8x**	**2%**
Asia - Sector*	**USD**			**250,200**			**40%**	**2.0x**	**21%**	**3.0x**	**16%**	**3.2x**	**16%**	**20.8x**	**17.2x**	**2%**

Source: Thomson Reuters Datastream, HSBC estimates; Closing prices as of 30 Nov 2010

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Metals & Mining

- China's shift to a more sustainable growth model with focus on urbanisation and rural investment is positive for metals demand
- Strong cash generation to support capital management initiatives and/or consolidation activity
- Preference for upstream over midstream but steel looks oversold. Top picks OW(V)-rated China Coal and POSCO

2011 outlook

A better year ahead

2010 has been a turbulent year for the Metals & Mining sector, driven largely by macro forces, Chinese policy changes and of course dollar swings. For 2011, we believe the clouds should begin to lift. China's moves towards a more sustainable consumption driven growth model should ultimately prove positive for commodity markets.

While we forecast commodity prices to moderate from current levels, prices should remain well supported at relatively high levels, providing strong cash generation and balance sheets. In turn, we expect this will likely underpin further consolidation activity and capital management initiatives. Within the sector, we prefer coal and steel plays over iron ore in the bulks, while aluminium is preferred over copper in the metals.

Macro uncertainty and rising European sovereign risks will likely remain an ongoing influence in commodity (and equity) markets. So long as full-blown contagion is avoided, the prospect of sub-par growth in the West and continued strength in the East is perhaps the 'goldilocks' scenario for commodity markets. Under such a scenario, Asian inflationary pressures may be contained with its growth avoiding derailment. This is crucial as it is Asia that is driving global commodity markets at present. Asia now accounts for nearly two-thirds of global demand across most commodities. Over the past decade, while commodities demand in the US and Europe has actually fallen, the shortfall has been more than offset by Asia.

China's 12th Five-Year plan is critical in the outlook for commodities. With the shift towards a consumption (and more sustainable) driven economic growth model (ie, less investment and export-driven), the natural inclination is for investors to think that this is negative for commodities demand. We disagree. While growth should clearly moderate to more sustainable levels, in shifting to a more consumer-driven economy, China will focus on urbanisation and increasing investment in rural areas. Both are supportive of commodities demand. Meanwhile, increased focus on reducing carbon intensity should help contain excess supply. Together, these efforts should keep commodities market relatively tight and support prices at higher for longer levels.

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In the rest of Asia, just like China, the process of urbanisation and industrialisation remains well in train. Barring any unforeseen events, sustained economic growth in emerging markets should continue to drive global commodities demand. New capacity continues to be held back by environmental, governmental and local approvals. In such an environment, we expect commodity prices to remain well supported at relatively (to history) high levels. Given the volatility in commodity markets, there will be times of overshoot (from macro concerns or dollar swings), but overall we remain in the 'stronger for longer' camp.

Relatively high commodity prices should see the sector generate strong cash flows. In our view, this will underpin further consolidation activity and or capital management initiatives. Indeed, corporate interest is not only arriving from horizontal integrations (growth in the same sector). We are now seeing an increased appetite from vertical integrations, for instance steel companies acquiring raw material mines. In addition, with many Asian countries now recognising their dependence on imports, many state enterprises are increasingly becoming active in consolidation.

2011 high conviction idea

POSCO (005490 KS, OW(V), KRW454,500, TP KRW650,000)

POSCO remains our top regional steel pick for its diverse high-end product mix, low-cost operations and resilient balance sheet. An aggressive investment campaign through the cycle is likely to ensure the company is well positioned for the next upswing.

Year to date, POSCO shares (down 27%) have underperformed the KOSPI (up 15%) and its domestic peers Dongkuk (DKS) +4%, Hyundai Steel (HSC) +27% but in line with its regional peers (excluding India) at -30% .We believe there have been two key factors driving this underperformance:

1 **2H10 disappointment** – POSCO was not alone in downgrading FY10 guidance, with regional and global companies also doing the same. A margin squeeze as a result of sluggish regional demand is at the root of 2H10 disappointment. However, specific to POSCO was the company's overstocked position in higher priced raw materials (at 3Q contract price levels) due to expansion delays mainly at Pohang No. 3 blast furnace (+2mtpa). While this overstocked position resulted in higher raw material costs in 4Q10, it also means the benefit of lower 4Q10 contract prices for iron ore and coal in 1Q11.

2 **Hyundai Steel's blast furnace expansion –** The start up of HSC's second blast furnace (4mtpa, cumulative 8mtpa since the beginning of 2010) along with its announcement that it will consider a third blast furnace (c4mtpa) has raised investor concerns on oversupply. This has not been helped by POSCO's own announcement that it will invest KRW1.6trn for a 3.3mt of HRC plant in Gwangyang (operational in 2014e). The reality here is that Korea has been a significant importer of around 14-15mtpa of high-end flat steel for a very long time, primarily from Japanese mills. HSC and POSCO's growth will replace imports so it will ultimately be the Japanese mills that will lose out, not POSCO. In any case, Japanese exports will likely fill the void created by China's continued withdrawal from export markets as it looks to reduce the economy's export reliance.

We see POSCO as a value play with strong organic growth potential going forward. At 0.9x PB, POSCO shares trade at a significant discount to its regional peer average PB of 1.1x and in line with late 2008/early 2009 global financial crisis valuation levels. With domestic capacity of 34mtpa set grow to 41mt over the next few years with additional potential upside from offshore capacity growth in Indonesia and India, earnings are poised to grow accordingly, all other factors being equal.

Valuation

We maintain our OW(V) rating with a target price of KRW650,000, valuing the stock at 1.3x PB (same) and our 2011e book value of KRW515,705 per share. We arrive at a PB multiple of 1.3x from our residual income model (P/B= ROE-g/COE-g) using our 2010-12 forecast ROE of 16%.

Risks

The upside and downside risks for POSCO lie in the movement of steel prices. The key downside risks are a more severe slowdown in the US or China, which in turn would negatively impact steel consumption growth. On the raw material side, movements in iron ore, coal and nickel prices provide additional risk.

Winners from Chinese growth

Over the past decade, heavy FAI in domestic infrastructure and construction projects has provided the major backbone to China's, and in turn, global demand for commodities. With the 12th Five-Year plan expected to mark China's shift from an investment-/export-driven economy to a consumption-based growth model, the natural inclination for investors is to conclude that commodities will be the loser. In our view, this is too simplistic and ignores China's progressive or gradual approach, and more importantly the fact that urbanisation and rural investment will remain a significant part of the shift towards a consumption-based economy.

Baosteel (600019 CH, OW(V), RMB6.28, TP RMB8.5)

With its dominant market position in both the domestic home appliances and automobiles industry, we see Baosteel as a key beneficiary of consumption-driven Chinese economic growth. Management sees its key 2010 end-use demand segments being automobiles (19.6% of sales) and home appliances (11.5%). Looking forward to 2011, the company projects home appliance production growing by 15% while the domestic auto industry is forecast to increase output by 10% y-o-y. As China's national steel champion, Baosteel has set ambitious targets in its 2010-15 Strategic Development Plan, aiming to grow revenue to RMB270bn by 2015 (+37% from 2010 levels) with 2015 crude steel capacity increasing to 33mt (+25% from 2010 levels).

Valuation

We have an Overweight (V) rating on Baosteel and our target price of RMB8.50 is based on 1.4x PB and 2011e book value of RMB6.29/share. We arrive at a PB of 1.4x from our residual income model (PB = ROE-g/COE-g) using a sustainable ROE of 15%, in line with its 2002-09 historical average.

Risks

The key downside risk, in our view, lies in the movement of steel prices. On the raw material side, movements in coal, nickel, and iron ore prices provide additional risks. In particular, Baosteel relies on imported iron ore from Australia and Brazil.

Stock most at risk: Maanshan Iron & Steel (323 HK, N(V), H-share: HKD4.09, TP HKD4.7; A-share: RMB3.43, TP RMB3.9)

The shift away from investment-driven growth inherently means that large-scale capital commitment to infrastructure and construction projects may be a thing of the past. As a steel company strongly leveraged to construction-

HSBC

driven long steel products, Maanshan stands out as a losing player in this changing market dynamic. That said, we believe the current pipeline of existing road, rail and construction projects will ensure steady demand in the near/medium term, with a gradual decline the most likely outcome. As such, Maanshan should be able to optimise its product mix going forward to successfully adapt to shifting demand.

Valuation

We have a Neutral (V) rating and a target price of HKD4.70 for the H-shares based on 1.1x PB and 2011e book value of HKD4.55/share. We arrive at a PB of 1.1x from our residual income model (PB = ROE-g/ COE-g) using a sustainable ROE estimate of 9% in line with our forecast average ROE over 2010-12. Our target price for the A-shares, at RMB3.90, is based on the A-share discount to the H-shares at the time the target prices were set.

Risks

Movement in steel prices represents a key risk for the stock. Any potential credit tightening by the government, having an impact on stimulus spending, represents a key downside risk, as Maanshan, with its exposure to long steel, has been a key beneficiary of the stimulus. A better than expected recovery in the train wheels segment poses a key upside risk.

Cash-rich companies

A broad-based recovery from the carnage of the global financial crisis has seen balance sheets across the Metals & Mining spectrum largely restored. Support from strengthened demand (particularly from Asia) and firm commodity prices have allowed for positive cash-flow generation. We see companies across the sector deploying capital in developing extensive pipelines of growth projects. In the absence of viable greenfield projects, industry consolidation should be an ongoing theme in 2011. In particular, mid-stream smelters that have been excessively squeezed by upstream raw material costs are likely to accelerate investment in upstream assets. For those industry players that are constrained to single commodities with near to medium term headwinds, diversification into other commodities through acquisitions is seen as a viable pathway.

China Coal (1898 HK, OW(V), H-share: HKD12.28, TP HKD18.6; A-share: RMB10.59, TP RMB16)

China Coal has acquired 10bt of coal resources in four coal bases, and the parent also increased its coal resources by 2bt through consolidation of local coal mines in Shanxi. The acquisitions will support the volume growth and its targets to double output to 200mtpy and earnings to RMB20bn by 2014. Volume growth will come from (1) capacity planned or under construction – 50mtpa in 4 years (2) Shanxi/Shaanxi/Inner Mongolia new resources with production of 20mtpa (3) parent M&A with a capacity of 40mtpa and resources of more than 2bt. The restructuring will be in steps and expect most injections to take place in 2013/2014.

Valuation

We have an Overweight (V) rating on China Coal. Our H-share target price of HKD18.6 is based on a 2011e PE of 17x using the midpoint of China Shenhua Energy’s average PE of 20x since its listing and the global coal peers’ PE of 14x. This target PE is below China Coal’s average PE of 23x. Our A-share target price of RMB16 is based on an A- to H-share discount of 14%.

Risks

Downside risks to our rating and estimates include slower-than-expected Chinese economic and industrial growth and an increase in the coal resource tax. In addition, the company’s relatively risky investments in coal-to-chemical operations remain a concern.

Potential share price catalysts include higher-than-expected coal prices, an upgrade in the company's output guidance and progress on the coal mine acquisitions. The resumption of a coal-power linkage, permitting power companies to raise tariffs, would be positive for thermal coal prices.

Stock most at risk: Chalco (2600 HK, N(V), H-share: HKD6.95, TP HKD8.5; A-share: RMB10.10, TP RMB14)

Given unfavourable aluminium price moves for much of 2010 and a continually rising cost base, Chalco has been one of the few companies in our coverage universe that has not been cash-flow positive. With 2010e year-end gearing (ND/ND+E) at 126%, Chalco's balance sheet is cash constrained. However, this has not stopped the company embarking on domestic growth projects and diversifying into iron ore through its Simandou iron ore investment. As a result of these coming capex commitments, we believe a potential new issue of 1bn A-shares remains a key overhang on the stock heading into 2011, which we estimate may dilute 2011 EPS by 6%.

Valuation

We have a Neutral (V) rating on Chalco with an H-share target price of HKD8.50, valuing the stock at an equally blended EV/EBITDA and NPV valuation approach. We apply an EV/EBITDA multiple of 10.5x, in line with its five-year average, to our 2011e EBITDA for Chalco and arrive at a value of HKD5.66 per share. We arrive at an NPV of HKD11.33 per share using a DCF valuation assuming a WACC of 8.8%. We value Chalco's core business at HKD7.55 and Chalco's stake in Simandou at HKD3.78. Our Chalco A-share target price is RMB14.00 based on the current premium to the H-shares.

Risks

The main upside and downside risks for Chalco, in our view, relate to movements in aluminium, alumina and energy prices.

Asia Metals & Mining: Valuation summary

Company	Rating	RIC	Curr.	Target Price	Current Price	Pot'l Return	Mkt cap (USDm)	HSBC EPS growth (%)			HSBC PE (x)			P/B (x)			EV/ EBITDA (x)			Yield (%)		
								2009	2010e	2011e	2009	2010e	2011e	2009	2010e	2011e	2009	2010e	2011e	2009	2010e	2011e
Steel																						
POSCO	OW(V)	005490 KS	KRW	650,000	454,500	43%	29,545	-30%	47%	29%	11.0	7.5	5.8	1.1	1.0	0.9	6.5	4.9	3.3	1.8	2.7	3.5
Nippon Steel	OW(V)	5401 JP	JPY	360	277	30%	23,393	-85%	229%	90%	60.1	18.3	9.6	1.1	1.0	0.9	10.2	7.3	4.9	0.9	1.2	2.0
JFE	OW(V)	5411 JP	JPY	3,350	2,661	26%	19,900	-58%	60%	39%	25.1	14.6	8.1	1.1	1.0	0.9	8.2	6.6	5.2	1.4	1.8	2.4
Baosteel	OW(V)	600019 SS	CNY	8.50	6.28	35%	16,736	-10%	124%	4%	18.9	8.4	8.1	1.2	1.1	1.0	6.5	4.4	4.0	3.2	5.3	5.5
Angang A	N(V)	000898 SZ	CNY	9.00	7.75	16%	7,148	-75%	400%	73%	74.6	14.9	8.6	1.1	1.0	0.9	11.4	7.6	5.7	0.8	3.4	5.8
Angang H	N(V)	347 HK	HKD	12.50	11.20	12%	1,566	-75%	400%	73%	92.5	18.5	10.7	1.3	1.3	1.2	11.4	7.6	5.7	0.6	2.7	4.7
Maanshan A	N(V)	600808 SS	CNY	3.90	3.43	14%	3,070	-51%	299%	81%	67.3	16.9	9.3	1.0	1.0	0.9	6.8	5.3	4.0	1.2	2.0	3.8
Maanshan H	N(V)	323 HK	HKD	4.70	4.09	15%	913	-51%	299%	81%	68.9	17.3	9.6	1.0	1.0	0.9	6.8	5.3	4.0	1.1	2.0	3.7
China Steel	OW(V)	2002 TT	TWD	37.0	31.4	18%	13,893	-24%	92%	9%	20.5	10.7	9.8	1.7	1.5	1.5	23.2	10.1	9.1	4.3	8.0	8.7
SAIL	N	SAIL IN	INR	205.0	178.8	15%	16,049	1%	-8%	-7%	11.3	12.3	13.1	2.5	2.1	1.9	7.4	7.9	8.2	1.7	2.6	2.8
TATA	OW(V)	TATA IN	INR	730.0	591.9	23%	11,607	-75%	120%	39%	24.0	10.9	7.9	1.6	2.3	1.7	10.3	7.1	5.4	1.8	1.3	1.3
JSW	N(V)	JSTL IN	INR	1,370.0	1,132.2	21%	5,391	34%	13%	52%	15.9	13.2	9.1	2.6	2.2	1.4	10.9	8.1	6.1	0.7	0.9	0.9
JSPL	OW	JSP IN	INR	820.0	624.3	31%	12,674	na	-47%	2%	13.0	15.1	14.8	1.2	5.2	3.9	11.7	10.1	9.2	0.4	0.2	0.2
Bluescope	OW(V)	BSL AU	AUD	2.85	1.93	48%	3,379	-89%	41%	105%	31.6	24.3	12.7	0.6	0.6	0.6	9.3	6.4	4.5	2.6	3.0	5.5
Average											**27.8**	**12.7**	**9.2**	**1.4**	**1.6**	**1.4**	**9.8**	**7.0**	**5.7**	**1.8**	**2.7**	**3.4**
Base metals & Diversifieds																						
Chalco A	N(V)	601600 SS	CNY	14.0	10.1	39%	14,514	na	-118%	374%	na	161.8	34.1	2.7	2.7	2.5	69.8	16.2	11.5	0.0	0.1	0.9
Chalco H	N(V)	2600HK	HKD	8.5	7.0	22%	3,530	na	-118%	374%	na	95.5	20.1	1.6	1.6	1.5	69.8	16.2	11.5	0.0	0.1	1.5
Hindalco	OW(V)	HNDL IN	INR	260.0	201.8	29%	8,392	-37%	46%	28%	21.3	14.7	10.4	1.8	1.3	1.4	7.8	6.6	6.4	0.7	0.7	0.7
Nalco	UW	NACL IN	INR	350.0	352.3	-1%	4,933	-32%	19%	40%	25.6	21.3	15.1	2.3	2.2	2.0	15.4	11.4	7.4	0.9	1.2	1.4
Alumina Ltd	N(V)	NACL IN	AUD	2.2	2.0	11%	4,675	-100%	na	180%	na	59.2	21.2	1.6	1.7	1.6	38.4	12.4	8.6	0.9	1.8	2.8
Zhongwang	N(V)	1333 HK	HKD	5.0	4.2	18%	2,973	49%	-23%	-16%	5.1	6.6	7.9	1.4	1.2	1.1	2.6	2.4	2.9	6.3	4.6	3.8
Jiangxi Copper A	UW(V)	600362 SS	CNY	37.0	35.2	5%	14,743	-3%	106%	-11%	47.9	23.3	26.1	4.7	3.6	3.2	23.7	12.5	12.5	0.3	0.9	0.8
Jiangxi Copper H	UW(V)	358 HK	HKD	20.0	22.5	-11%	14,743	-3%	106%	-11%	26.3	12.8	14.3	2.6	2.0	1.8	23.7	12.5	12.5	0.5	1.7	1.5
OZL	N(V)	OZL AU	AUD	1.7	1.5	11%	4,917	na	1311%	12%	180.9	12.8	11.4	1.9	1.6	1.5	18.0	5.2	4.5	0.0	3.5	4.4
BHP Ltd	N(V)	BHP AU	AUD	42.0	42.7	-2%	216,664	-12%	81%	28%	28.5	14.5	10.6	5.7	4.7	3.1	9.2	7.2	5.3	2.1	2.1	2.0
RIO Ltd	OW(V)	RIO AU	AUD	97.0	82.2	18%	130,821	5%	147%	14%	26.1	10.6	9.3	3.5	3.1	2.7	9.9	4.8	4.1	1.1	1.1	1.1
Sterlite	OW	STLT IN	INR	210.0	162.0	30%	11,831	-59%	-30%	18%	11.2	12.0	10.2	0.4	0.4	1.4	8.5	7.5	6.2	3.3	2.3	2.0
Hindustan Zinc	N	HZ IN	INR	1,280.0	1,115.9	15%	10,248	18%	2%	12%	13.1	12.4	11.1	3.2	2.5	2.1	9.1	6.4	4.8	0.5	0.5	0.5
Sesa Goa	OW(V)	SESA IN	INR	390.0	311.6	25%	5,822	na	62%	14%	10.5	6.8	5.6	5.1	3.2	1.9	7.5	4.2	2.8	1.0	1.5	2.8
NMDC	UW(V)	NMDC IN	INR	250.0	240.1	4%	20,688	-36%	34%	34%	26.1	20.0	14.6	8.2	6.7	5.0	17.6	12.8	8.6	0.8	0.7	0.7
Average											**28.6**	**19.3**	**11.9**	**4.6**	**3.8**	**2.8**	**13.4**	**7.4**	**5.8**	**1.5**	**1.6**	**1.6**
Coal																						
China Coal A	OW(V)	601898 SS	CNY	16.0	10.6	51%	14,537	10%	25%	29%	17.9	14.4	11.2	2.2	1.9	1.7	10.0	7.7	5.0	1.4	1.7	2.3
China Coal H	OW(V)	1898 HK	HKD	18.6	12.3	51%	6,494	10%	25%	29%	17.8	14.3	11.1	2.2	1.9	1.7	10.0	7.7	5.0	1.4	1.7	2.3
China Shenhua A	OW(V)	601088 SS	CNY	37.0	24.2	53%	59,884	19%	25%	15%	15.2	12.1	10.5	2.8	2.3	2.0	9.0	7.2	6.1	2.2	2.7	3.1
China Shenhua H	OW(V)	1088 HK	HKD	45.0	32.7	38%	14,289	19%	25%	15%	17.6	14.1	12.2	3.3	2.7	2.3	9.0	7.2	6.1	1.9	2.3	2.7
Yanzhou Coal A	OW(V)	600188 SS	CNY	33.6	26.3	28%	11,659	-37%	100%	-3%	31.4	15.7	16.2	4.4	3.6	3.1	18.1	9.1	8.8	1.0	1.9	1.8
Yanzhou Coal H	OW(V)	1171 HK	HKD	25.6	21.6	19%	5,435	-37%	100%	-3%	22.1	11.0	11.4	3.1	2.5	2.2	18.1	9.1	8.8	1.4	2.7	2.6
Hidili International	N(V)	1393 HK	HKD	8.2	7.2	14%	1,944	-60%	105%	47%	31.7	15.5	10.6	2.0	2.1	1.6	26.6	11.5	8.4	1.6	1.6	2.4
Fushan Intl'	N(V)	639 HK	HKD	4.5	5.4	-16%	3,818	39%	39%	0%	20.0	14.3	14.4	1.3	1.3	1.2	9.5	6.9	5.7	4.6	2.4	2.4
Average											**18.3**	**13.2**	**11.6**	**2.9**	**2.4**	**2.1**	**10.8**	**7.6**	**6.3**	**1.9**	**2.4**	**2.7**

Source: HSBC estimates; Closing prices as of 30 Nov 2010

HSBC

Oil, Gas & Chemicals

- Urbanisation and wage increases in China will continue to drive demand for oil products and plastics
- Key themes for 2011 will be unique value proposition from favourable product mix, pricing regime, LT strategy
- Preference for Asian refining and chemicals over policy-ridden Chinese energy names. Top picks CNOOC, S-Oil and SK Energy

2011 outlook

Crude oil

The Brent crude price has risen from USD76/bbl in January to USD86/bbl in November, above HSBC's house view. From an Asian standpoint, we believe a number of factors may continue to support oil prices in 2011-12.

First, China is running out of oil. In 2010, China produced 4.7% of the world's crude but consumed 10.5% of it. The nation's aggregate reserve life of 10.7 years is less than a quarter of the world average. This will continue to drive Chinese oil majors into global markets to secure oil assets at potentially aggressive valuations and boost the oil price outlook in both the short and long term.

Second, there is a demand/supply mismatch for crude types. This year, China's oil demand growth was driven by diesel. According to IEA's 2010 medium-term forecast, non-OPEC supply will significantly decline from 2012 and dependence on OPEC is expected to increase. However, a significant portion of OPEC crude is natural gas liquids (NGLs), which yield less middle-distillate products. The potential diesel shortage could prompt an oil price rally as witnessed in 2007-08.

Natural gas

China's gas economics look set to continue to deteriorate due to insufficient price increases in spite of China's ambitious expansion in gas infrastructure and unconventional gas development drives.

According to the National Development and Reform Commission (NDRC), China's gas market should increase from 90bcm in 2009 to 250-300bcm in 2020. By 2020, about 45% of demand should be supplied by imported gas and unconventionals. China's current wellhead selling price for gas is RMB0.76/cm. On the other hand, gas production costs vary from RMB0.38/cm for existing onshore production to RMB0.70/cm for new onshore, RMB0.7-1.0/cm for unconventional gas (shale, CBM), RMB2.0/cm for pipe gas at the border and RMB3.0-3.5/cm for LNG at the receiving terminal, according to PetroChina.

Using a typical gas economics model, without imports, China's gas EBITDAX margin is 40%. With 10% supply assumed to come from pipe gas and unconventional, the EBITDAX margin plunges to 17%. For China's gas economics to be restored to a 40% EBITDAX margin, China

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would have to increase domestic gas prices by 30% pa till 2015.

Refining

Declining supply addition in China in 2011-12, coupled with robust domestic demand growth, is likely to turn China into a net importer of refined products. While China's refining capacity growth could accelerate in 2013, new regulations in Japan could cut the country's refining capacity by c1.2m b/d (c4% of Asian capacity), offsetting potential exports from China. We expect Singapore complex margins to recover from USD4/b to USD7/b by 2014.

Chemicals

After peaking at 18% in 2010, Asia/Middle East combined petrochemical capacity growth will sharply decline to 4.4% pa in 2011-14. Assuming Chinese demand growth is sustained at 1.0x GDP based on continuing urbanisation in the central and western parts of the country, China's demand will likely absorb 80-85% of that incremental capacity from Asia/Middle East till 2014. Given the usual ramp-up delays of new projects, it essentially predicts a market in which both Asian and Middle Eastern producers can co-exist.

2011 high conviction idea

S-Oil (010950 KS, OW, KRW80,200, TP KRW100,000)

As Korea's only pure refiner, S-Oil is the most leveraged to improving refining margins. The refining segment will contribute 45% of 2011 EBIT with the balance from associated refinery products, lube base oil and aromatics. Thus, we believe the company is best positioned to benefit from the refining margin uptrend in 2011-12.

S-Oil is also the best poised in Asia to benefit from a sustained increase in PX operating margins which are even higher than refining's (15% vs. 5%). Responding to the UN's gasoline embargo, Iran has reduced production of petrochemicals to maximise gasoline production, thus decreasing the supply of PX and driving margins up 50% in 4Q10. The embargo appears unlikely to end soon, and S-Oil is the best positioned in Asia to benefit from robust PX margins as it will double its PX/ benzene capacity in 2Q11.

Valuation

We value S-Oil at KRW100,000 based on 2011-12e PB of 2.4x, based on a historical PB model. Due to recent earnings revision and ROE improvement from robust PX margins, FX effects, YTD oil prices and other factors, our RV-based PB came out at 2.8x, much higher than the historical peak of 2.3-2.4x. However, we will use historical multiple until we see signs of dividend payout improvement. At the current stock price, our TP implies a potential return of 26% including dividend yield.

Risks

We believe our forecasts could be materially affected by the following: 1) PX margin collapse, 2) disappointing refining margin recovery, 3) new aromatics unit ramp-up delay, 4) major production disruptions at existing facilities, 5) massive non-operating losses, and 6) regulatory fines.

Winners from Chinese growth

CNOOC (883 HK, OW, HKD16.84, TP HKD19.5)

CNOOC is the most leveraged to Chinese growth within our China universe based on its exceptional earnings growth potential without downstream dilution. As pure oil play (80% of sales, 60% of reserves), its earnings stand to benefit most from any oil price surprise. If we were to use the current spot oil price vs our current forecast of USD76/bbl, 2011 EPS would increase by 15% and DCF by 18%. Future production growth prospects are bright given China's strong underlying demand for oil products and plastics and stockpiling needs to fill new reserve and pipeline systems. It also boasts a competitive cost structure, strong returns and ample excess cash with a lack of debt.

We had been worried that CNOOC would overpay for assets but the company made the last two acquisitions at lower-than-expected valuations (ie, Eagle Ford shale project at a 20% discount, Pan American at 25% below the speculated price). Also, the company made a strategic acquisition to keep the oil:gas ratio in its reserves at the current 60:40. This should shield the company from policy objectives in China.

Valuation

We value CNOOC at HKD19.5 based on a DCF methodology with a WACC of 10% and a long-term oil price of USD84/b. At the current share price, our TP implies a potential return of 18%, including a dividend yield of 2.5% for FY10.

Risks

Our forecasts could be materially affected by: 1) oil and gas prices higher/lower than our base case, 2) production disruption/project delays, 3) value-eroding, aggressive M&As, 4) uneconomical investments under government pressure.

Techtonic shift

SK Energy (096770 KS, OW(V), KRW165,500, KRW177,000)

SK Energy is set to evolve from a low-margin refinery/chemical producer (2-3%/7-8% EBIT margin) to an integrated energy company with E&P earnings contribution (40-60% EBIT margin) rising to roughly half of total EBIT.

Until 1Q10, SKE hadn't aggressively addressed its key upstream assets, such as Brazil deepwater blocks (20% and 27% stakes in Brazil BMC-30 and BMC-32) and Vietnam shallow-water assets, largely due to its long-standing company culture as a downstream giant in Korea. However, the market sentiment is rapidly catching up. Using spot market data, the sum-of-the-parts value of SKE comes out at KRW190,000. From 0.5x SoTP value by mid-2010, the current share price stands at 0.9x.

We expect the next catalyst to come from the corporate de-merger effective from 1 January 2011, which will enhance divisional autonomy in business strategy and asset sales. Also, SoTP value itself will rise from any upside risk to our current oil price forecast of USD76/b for 2010 and LT USD84/b, timely ramp-ups of new E&P projects and continued management commitment to raise market awareness on E&P value.

Valuation

We value SKE at 1.6x target PB on normal ROE of 17.8%, cost of equity 12.9% and a long-term growth rate of 4.5% (vs sector average 3.0%). Normal ROE of 17.8% is the return when SKE's E&P EBIT represents 45% of total at HSBC's base-case oil price assumption of USD76/b.

Based on a sum-of-the-parts method, SKE's intrinsic value comes out at KRW190,000/share.

We choose the PB method (or the residual value model) over SoTP in order to establish a common valuation methodology for the Asian refining and petrochemical sector.

Risks

Our forecasts could be materially affected by: 1) Failure to prove reserve potential at Brazil blocks, 2) major production disruptions, 3) lower oil prices or refining and chemicals margins below our base case/consensus, 4) massive non-operating losses, 5) regulatory fines.

HSBC Asia Energy comps

Company	Ticker	Rating	Target price	Share price	Mkt cap USDm	PE (x) 2009a	PE (x) 2010e	PE (x) 2011e	PE (x) 2012e	EV/EBITDA (x) 2009a	EV/EBITDA (x) 2010e	EV/EBITDA (x) 2011e	EV/EBITDA (x) 2012e	PB (x) 2010e	PB (x) 2011e	Yield (%) 2009a	Yield (%) 2010e	ROE (%) 2010e	ROE (%) 2011e
China																			
CNOOC	883 HK	OW	HKD19.5	16.84	96,888	21.9	11.6	10.8	10.6	11.4	6.3	5.8	5.5	3.0	2.5	1.8%	1.8%	28.8%	25.4%
Petrochina	857 HK	N(V)	HKD9.5	9.65	227,483	14.7	12.1	11.0	9.4	7.1	5.6	5.2	4.7	1.7	1.5	2.3%	2.7%	14.2%	14.5%
Sinopec	386 HK	N(V)	HKD6.4	7.23	80,822	8.7	7.8	7.5	6.3	5.6	5.1	4.8	4.1	1.3	1.1	2.1%	2.3%	17.2%	15.8%
China Oilfield Services	2883 HK	OW(V)	HKD12.3	14.2	8,222	17.5	15.0	12.8	11.5	11.2	9.5	8.6	7.9	2.4	2.0	0.8%	1.0%	16.3%	17.1%
Sinopec Shanghai Petrochemical	338 HK	N(V)	HKD3.3	3.81	3,533	14.8	11.2	9.9	8.7	8.5	7.4	6.7	6.1	1.4	1.2	0.7%	1.0%	13.2%	13.2%
Kunlun Energy	135 HK	UW(V)	HKD9.4	11.3	7,905	46.3	26.9	24.1	16.9	28.0	18.0	15.3	9.4	3.4	3.0	0.6%	0.9%	14.1%	13.2%
Petrochina A	601857 SS	OW(V)	RMB13	11.07	303,972	19.6	16.2	14.7	12.6	9.2	7.2	6.7	6.0	2.2	2.0	2.3%	2.8%	14.2%	14.5%
Sinopec A	600028 SS	OW(V)	RMB10.8	8.13	105,863	11.4	10.2	9.8	8.3	6.8	6.1	5.8	5.0	1.6	1.5	2.2%	2.3%	17.2%	15.8%
China Oilfield Services A	601808 SS	N(V)	RMB14.7	21.98	14,824	31.5	27.0	23.1	20.7	17.2	14.6	13.4	12.4	4.2	3.7	0.6%	0.7%	16.3%	17.1%
Sinopec Shanghai Petrochemical A	600688 SS	UW(V)	RMB7	8.42	9,096	38.1	28.8	25.5	11.2	18.6	16.6	15.5	14.2	3.6	3.2	0.4%	0.5%	13.2%	13.2%
Average						**22.5**	**16.7**	**14.9**	**11.6**	**12.3**	**9.6**	**8.8**	**7.5**	**2.5**	**2.2**	**1.4%**	**1.6%**	**16.5%**	**16.0%**
Average ex A-shares						**20.7**	**14.1**	**12.7**	**10.6**	**12.0**	**8.6**	**7.7**	**6.3**	**2.2**	**1.9**	**1.4%**	**1.6%**	**17.3%**	**16.5%**
Korea																			
LG Chem	051910 KS	N(V)	KRW367000	388000	22,067	19.6	12.6	13.8	11.6	11.0	8.2	8.6	7.1	3.5	2.8	0.9%	0.9%	31.4%	22.4%
SK Energy	096770 KS	OW(V)	KRW177000	165500	13,172	22.6	11.8	10.0	9.6	14.0	8.9	8.6	7.8	1.7	1.5	1.3%	1.3%	15.5%	15.7%
S-Oil	010950 KS	OW	KRW100000	80200	7,791	40.3	15.8	9.3	8.7	22.7	13.7	7.8	6.6	2.4	2.0	1.7%	1.7%	14.8%	22.9%
GS Holdings	078930 KS	OW(V)	KRW70000	62900	5,043	11.8	8.2	11.8	11.7	13.0	8.6	12.4	12.2	1.2	1.1	1.6%	1.6%	16.0%	9.8%
Hanhwa	009830 KS	UW(V)	KRW17000	31750	3,843	13.1	11.0	15.5	12.0	11.5	10.6	13.5	10.6	1.5	1.5	1.4%	1.4%	14.2%	9.7%
Average						**21.5**	**11.9**	**12.1**	**10.7**	**14.4**	**10.0**	**10.2**	**8.9**	**2.0**	**1.8**	**1.4%**	**1.4%**	**18.4%**	**16.1%**
Taiwan																			
Formosa Petrochem	6505 TT	UW	TWD68	84.4	26,338	20.5	22.5	20.3	17.7	12.7	13.9	13.3	12.4	3.5	3.4	4.5%	4.0%	15.5%	17.1%
Formosa Plastics	1301 TT	N	TWD75	90.7	18,187	20.2	17.6	19.1	16.7	27.2	22.6	27.8	26.1	2.4	2.4	4.4%	5.1%	13.9%	12.7%
Formosa Chem & Fibre	1326 TT	OW	TWD81	90.3	16,833	17.2	15.2	14.4	13.5	26.4	17.1	16.2	16.0	2.2	2.1	5.0%	5.2%	14.4%	14.7%
Nan Ya Plastics	1303 TT	N	TWD63	67.9	17,466	32.0	16.4	15.7	13.6	36.8	23.0	25.2	22.6	2.1	2.1	2.8%	5.5%	12.9%	13.3%
Average						**22.5**	**17.9**	**17.4**	**15.4**	**25.8**	**19.2**	**20.6**	**19.3**	**2.5**	**2.5**	**4.2%**	**4.9%**	**14.2%**	**14.4%**
Thailand																			
PTT E&P	PTTEP TB	N	THB195	167	18,291	24.9	15.2	12.4	10.3	7.2	6.4	5.3	4.3	3.4	2.9	1.6%	2.6%	23.7%	25.1%
PTTCH	PTTCH TB	OW(V)	THB130	153.5	7,653	33.9	26.1	15.6	12.8	18.0	15.2	10.1	8.1	2.2	2.0	1.3%	1.5%	8.7%	13.6%
Thai Oil	TOP TB	OW(V)	THB65	67.25	4,536	11.4	19.2	11.9	9.8	7.8	10.1	7.1	5.9	1.9	1.8	3.8%	2.1%	10.4%	15.5%
PTT	PTT TB	N	THB270	309	29,005	14.7	12.4	10.5	9.0	8.7	7.9	7.5	6.1	1.8	1.6	2.8%	2.4%	15.7%	16.4%
Average						**21.2**	**18.2**	**12.6**	**10.5**	**10.4**	**9.9**	**7.5**	**6.1**	**2.3**	**2.1**	**2.4%**	**2.2%**	**14.6%**	**17.6%**
Region average (excluding A-shares)						**21.5**	**15.5**	**13.7**	**11.8**	**15.7**	**11.9**	**11.5**	**10.1**	**2.3**	**2.1**	**2.3%**	**2.5%**	**16.1%**	**16.2%**

Source: Thomson Reuters Datastream, HSBC estimates; Closing prices as of 30 Nov 2010

Real Estate

- China's real estate sector still clouded by policy headwinds; players with firm specific catalysts & solid recurrent income will outperform
- HK property sales volume will take a breather while prices remain firm, underpinned by negative real rates; buy on dips
- High conviction call: SHKP (16 HK, OW, TP HKD171.8)

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China property – 2010 recap

The China property market has experienced several rounds of tightening in 2010, but the property market has been indifferent to the austerity measures announced, with Beijing and Shanghai secondary prices up 2% and 7% in the year to October.

There exists a tug-of-war between the government and developers, with the government showing little tolerance for further price inflation, as underlined by the timing, frequency and nature of the measures announced. Developers, on the other hand, are anxious to recoup cash flows to alleviate balance-sheet strains through active project launches, resulting in robust sales – an indication of strong market demand which may invite more restrictive property measures.

2011 outlook

Headwinds persist

We think the developers' dilemma of lowering prices and taking a more passive land banking approach (against the backdrop of new tightening concerns) will persist in 2011, given the inherent nature of the business model which requires fast asset turnover. In our view, the rapid jump in supply in 2011 could be a remedy, forcing market players to sell projects at lower prices for the much-needed cash that needs to be spent on construction capital expenditure so as to meet aggressive 2012 completion targets. The combination of these factors will lead to more notable declines in physical market property prices, which hopefully will put an end to the current tightening environment.

In term of sales volume, limitations on households' home purchases in 16 cities and noise about direct price intervention are a double-whammy to developers. According to Soufun, new home sales volumes in Beijing and Shanghai were down 38% and 17% m-o-m in October. In spite of this, we believe the property measures have not yet been fully reflected in the market.

We believe 1H11 will continue to be a challenging period for developers as the follow-on effects of policies filter through the system. In our view, the restriction on the usage of pre-sale proceeds may be imposed in more cities than the existing three, namely Beijing, Chengdu and Dalian. With more than 40% of developers' capital coming from pre-sale proceeds, we would not be surprised to see cash-strapped players pull back on heavy construction capex in 2011, leading to completion slippage in 2012. In our view, a more sustainable property price recovery will not come until 2H11.

Despite the cloudy physical market outlook in 1H11, we believe equity investors should revisit the sector during the period, as shares tend to rebound 4-9 months ahead of property price recovery. We believe home purchase demand is solid but the timing of purchases is highly dependent on expectations of policy measures and price trends. For investors currently looking for exposure in the sector, we recommend stocks with company-specific drivers and recurrent income, such as Shui On Land.

HK property – 2010 recap

Recapping key events in 2010, the HK government stunned the market by imposing a special stamp duty of as high as 15% on speculative deals with holding periods of 6 months or less, on the back of rapid residential price growth of 18% in the first 10 months of 2010. The new levy has put a dent in near-term market sentiment, with weekly secondary residential volume in 35 estates slumping 80% w-o-w immediately post-announcement. Home prices, however, have seen little impact thus far.

2011 outlook

Maintain positive stance – volume takes a breather but not price

With the latest measures announced on 19 November, we expect mass residential market transactions to shrink 40-60% from present levels through the lunar year holidays in February 2011, followed by a 'lunar year rebound' in sales volume. During periods of property tightening in the past, we note that transaction volume generally takes a breather over a period of 6-8 weeks. This time round, sales volume will take longer to recover, as the measures were harsher than expected.

Indeed, our breakeven analysis indicates that home prices need to rise 24% and 16% in order to offset the new levy based on investment horizons of 6 months and 1 year, respectively.

Our view is that home prices will decline by 5-10% before regaining upward momentum in 2Q11. The combination of soaring inflation expectations, a negative rate environment as well as spillover demand from Chinese buyers will continue to provide solid support to property prices. On this, we recommend investors to buy on dips.

2011 high conviction idea

We have a preference for HK developers over China developers, as risk/reward profiles in Hong Kong are more attractive.

SHKP: better placed to weather the storm

Based on our view that properties with price tags of less than HKD3m will be most affected by the special stamp duty, we think SHKP will be best positioned to weather the storm, given the strong sales pipeline in the luxury end of the residential market, as well as a balanced development property/investment property portfolio.

We estimate a luxury residential pipeline of ~1m sqft GFA in 2011 to bring in some HKD12bn of revenue if fully sold. Together with strong growth in the commercial leasing market, SHKP is well placed to capitalise on both residential sales and the commercial leasing market as it is one of the largest landlords in HK generating gross rental income of over HKD11bn/year.

Valuation

We have an OW rating on SHKP with a target price of HKD171.8, which is based on a 20% premium to our 12-month forward NAV of HKD143.2. Our target implies a potential return of 36%, including a dividend yield of 2.1%, over the closing price of HKD128.4 as at 30 November.

Risks

Key downside risks to our rating are (1) faster- and sharper-than-expected interest rate hikes, and (2) delays in project launches or completions.

Winners from Chinese growth

Since 2005, China's turbo-charged economy has surged more than 150% in terms of nominal GDP. During the same period, the property market has been growing hand-in-hand, with average residential prices in Beijing surging ~200%.

Shui On Land (0272 HK, OW(V), HKD3.88, TP HKD4.70)

High-quality IP highly sought after

With China's GDP expected to grow by 8.9% in 2011 (based on HSBC Economics estimates), increasing maturity in the real estate market in terms of product mix, and a more established system for resident relocation, SOL's high-quality investment properties will be highly sought after, allowing the company to generate high growth in recurrent income and hence cash flow. Furthermore, SOL's exposure to commercial property in turn offers protection against policy risks such as bank credit tightening, lending rate hikes and other austerity measures. Last but not least, faster-than-expected relocation in Shanghai is a key catalyst for the stock for substantial re-rating in NAV, as the new relocation scheme (introduced in end-2009) has thus far been effective in shortening the process.

Valuation

We have an OW(V) rating and a target price of HKD4.7, set at a 25% discount to our 12-month forward NAV of HKD6.2. Our target price implies a potential return of 24%, including a dividend yield of 3.0%.

Risks

Key downside risks include (1) slippage in development, (2) lower-than-expected ASP, and (3) general execution and business risks.

Most at risk

GZ R&F (2777 HK, UW(V), HKD10.32, TP HKD9.4)

High debt level a key concern

GZ R&F's high gearing has been a concern to us, as a result of overly aggressive land acquisitions in recent years. The company has seen its repayment of borrowings exceed operating cash inflow since 2008. In our view, recouping cash from property sales and a temporary suspension of land purchases is the best way to de-lever, but it has become a challenging task in the wake of the tightening measures.

Valuation

We have an UW(V) rating on GZ R&F with a target price of HKD9.4, which is based on 50% discount to our 12-month forward NAV of HKD18.8. The steep NAV discount is applied given the concerns stated above and based on average trading range during the previous downcycle in 2008. Our target implies a potential return of -7%, including a dividend yield of 2.2%.

Risks

Key risks include: (1) stronger-than-expected contracted sales and completions and (2) looser-than-expected political environment targeting the property sector.

Key beneficiary of low rates

Cap rates of investment properties in Hong Kong have been hovering at historical low levels, benefiting landlords of commercial properties in terms of valuation uplift as well as REITs generating DPU yields well above the HKMA 10-year note.

Link REIT: more juice from AEI; yield spread still attractive (823 HK, OW, HKD24.35, HKD28.5)

Link REIT's internal growth story (through asset enhancement initiatives and rental mark-ups) is intact over the next 2-3 years, with c40% of IFA expiring in 2H11 and FY12, presenting a tremendous opportunity to raise rents on the back of strong retail sales. In addition to growth from mark to market of existing leases, the existing AEI pipeline will take five years to exhaust, assuming the historical project completion run rate of around six properties per annum holds.

Based on our estimated ROI of 26% (historical average ROI) for the 28 retail properties that have not yet gone through substantial enhancement works, we estimate the incremental NPI to be HKD601m. In aggregate, we estimate an NPI uplift of HKD1bn upon completion of all enhancement works at the top 50 properties.

Valuation

We have an OW rating on Link REIT with a target price of HKD28.5, which is based on a yield of 4.2% and our FY11/12 DPU estimate of HKD1.2/unit. We believe the DPU yield spread above the HKMA 10-year note of 189bp is still attractive. Our target price implies a potential return of 21%, including a dividend yield of 4.4%.

Risks

Key risks include (1) political/social issues such as protests against rent rises, (2) delays in AEI projects and (3) a softer-than-expected retail property market.

Most at risk

HKL: Fundamentally sound but valuation stretched (HKL SP, UW, USD6.78, USD5.7)

With the largest market share in the Grade-A office market in Central, HKL by default is the key beneficiary of the low cap rate environment as well as robust rental recovery cycle. While the Central office market recovery will carry through 2011 due to tight availability and a robust owner-occupier market, HKL shares are up 51% since May 2010, trading at a 4% premium to our NAV estimate. Hence, in spite of sound fundamentals, we believe HKL's valuation is stretched and see higher downside risks for the stock.

Valuation

We have an UW rating on HKL. The company is trading at 1.1x our 2011e BV, which is the peak since 1994 and well above the mid-cycle PB range of 0.75x since 1990. Our target price for HKL is USD5.7, based on a 15% discount to our NAV estimate of USD6.8. Our target implies a potential return of -15%, including a dividend yield of 2.4%.

Risks

Key upside risks to our UW rating include a stronger and faster-than-expected recovery in the office leasing market.

Stock coverage

Company	Ticker	Rating	Share price (HKD)	Target price (HKD)	+/- (%)	Market cap (HKDbn)	12M Fwd NAV (HKD/sh)	(Disc)/Prem (%)	Core PE (x) FY09	Core PE (x) FY10e	Core PE (x) FY11e	Yield (%) FY10e	P/B (x) FY10e
HK Props													
Hang Lung Properties	101 HK	N(V)	36.15	37.5	4	150	32.62	11	22.5	23.5	22.7	2.0	1.6
Hongkong Land (USD)	HKL SP	UW	6.89	5.7	(17)	15	6.75	2	19.9	20.5	24.8	2.4	1.1
Hysan	14 HK	OW(V)	32.25	32.4	0	34	43.18	(25)	30.3	27.7	26.3	2.3	1.0
Kerry Properties	683 HK	OW(V)	39.20	50.7	29	56	56.33	(30)	26.1	16.6	15.6	1.9	1.1
Sino Land	83 HK	OW(V)	16.24	18.6	15	79	18.62	(13)	21.8	22.5	19.1	2.5	1.2
Sun Hung Kai Prop.	16 HK	OW	128.40	171.8	34	329	143.23	(10)	26.5	23.7	19.4	2.1	1.3
REITs													
Champion REIT*	2778 HK	UW(V)	4.41	3.4	(23)	22	3.73	18	16.9	20.9	19.5	4.8	0.8
Link REIT*	823 HK	OW	24.35	28.5	17	54	20.31	20	25.1	22.9	20.3	4.4	1.3
China Props													
China Overseas Land	688 HK	N(V)	14.92	19.7	32	122	19.72	(24)	18.7	13.6	10.9	1.3	2.5
China Resources Land	1109 HK	OW(V)	13.92	21.8	57	75	21.81	(36)	22.2	16.1	11.8	2.2	1.6
Franshion Properties	817 HK	OW(V)	2.44	3.0	23	22	4.63	(47)	21.3	17.3	15.1	1.3	1.4
Guangzhou R&F	2777 HK	UW(V)	10.32	9.4	(9)	33	18.79	(45)	12.1	7.8	6.2	*2.2*	1.6
Shimao Property	813 HK	UW(V)	11.72	12.1	3	41	18.64	(37)	10.7	11.1	9.7	2.7	1.4
Shui On Land	272 HK	OW(V)	3.88	4.7	21	19	6.18	(37)	9.9	15.0	18.7	3.0	0.8
SOHO China	410 HK	N(V)	5.84	5.1	(13)	30	7.81	(25)	16.0	8.1	9.8	2.5	1.3

Source: HSBC estimates; Closing prices as of 30 Nov 2010

HSBC

Technology

- We are positive on technology and particularly those companies benefiting from techtonic shifts in smartphones, LED televisions and tablets
- Rather than attempt the one hot product of 2011, focus on sub-component plays on faster growth segments
- Top picks: Samsung Electronics, TPK and UMC

Semiconductors

Chasing Moore's Law

Moore's Law continues to be an influence in the semiconductor space, continually driving faster and cheaper new-generation chips. This situation is clearly playing out within the foundry space, where the likes of TSMC, GlobalFoundries and Samsung push the law's limits, ramping up volume at 40/45nm and setting the stage for a battle in 28/32nm next year. 2010 will be remembered as the year when ARM-based architecture (made possible because of seemingly never-ending process shrink) emerged as a serious competitor to Intel's x86 thanks to smartphones.

We see smartphone penetration rates continuing to increase together with the emergence of tablets. The continued process shrinks in the semiconductor space will allow for even lower power consumption in these mobile devices, memory storage in devices will also become greater. However, competition at 28nm in 2H11 from the likes of GlobalFoundries and Samsung may put pressure on pricing and hence margins may decline.

PCBs

Greater demand for HDI suppliers

We see the continued growth for smartphones and tablets remaining a key theme for PCB and IC substrate suppliers in 2011, driving demand for high density interconnect (HDI) boards and chip scale packages (CSP). However, we see greater upside for HDI suppliers for two reasons. Firstly, smartphones and tablets consume a greater dollar value of HDI (on the order of USD4-8 per unit) than CSP (less than USD2 per unit). Secondly, we believe that all tablets will use an HDI board, while not all tablet devices will use CSP-based ICs (Windows/x86-based tablets likely to use flip-chip BGA-based Intel CPUs).

Handsets

Smartphones fuel growth

Following expected 14% and 55% y-o-y global shipment growth for the handset and smartphone markets this year, IDC forecasts that 2011 will continue to be a good year for smartphones. The growth of smartphones (2010-14e CAGR of 18%) will continue to outpace that of handset industry (2010-14e CAGR of 6%).

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The replacement of feature phones will continue to drive smartphone growth in the handset industry. Based on IDC forecasts, global handset shipments will grow from 1.3bn units in 2010 to 1.7bn units in 2014 (a 2010-14e CAGR of 6%), and smartphone shipments will grow from 270m units (20% of total handset) in 2010 to 527m in 2014 (32% of total handsets, representing a 2010-14e CAGR of 18% vs. 6% for the industry overall).

The Android OS will continue to gain market share during 2010-14, based on IDC forecasts. Android's market share is forecast to increase to 25% in 2014 from 16% in 2010 (a 2010-14e CAGR of 31%). However, the competition is intensifying within Android OS. HTC has been first to market with Android versions but Google has started to work with other vendors such as Huawei (Android 2.2) and Motorola (Android 3.0). In addition, version migration for smartphones will start to slow in 2011, which will also lower the technology barrier and allow latecomers such as LGE to catch up.

LED

LED TV penetration to reach 50% in 2011

A major inventory adjustment happened industry-wide in 3Q10 due to disappointing sales of LED-backlit LCD televisions (LED-LCD TVs), in line with the thesis in our 10 May 2010 report *Expectations high – but so are the risks*.

But we have recently turned positive as we believe LED-LCD TV demand will accelerate for two reasons: 1) retail prices will soon reach mass market levels (ie, 15% below current prices);
2) the phasing out of CCFL-LCD TV models;
3) legislation that will benefit the sector.

This will pave the way for positive surprises in 2011 for LED-LCD TV sales and LED demand. We expect the penetration rate (the percentage of LED-backlit LCD TVs) to reach 50% in 2011 (60% by end-2011) from below 20% in 2010 (20% now), implying y-o-y shipment growth of 194%.

Solar

The end of Oligo-poly

Poly-Si prices at the peak of the shortage in 2008 surpassed USD450/Kg (9x current prices). Given that the production cost of a fully-ramped up poly plant is only USD20-30/Kg, several Asian competitors were lured by the strong business case. New entrant build-out resulted in overcapacity and prices crashed to USD50/Kg by the end of 2009. A strong pull-in of demand due to various subsidy cuts at the end of 2010 has helped prices to rise by 10% since then, but oversupply looks set to return in 2011 (see our sector downgrade report, *Brace for the hangover*, 27 September 2010 for details).

In our view, the impact of the poly oversupply in 2011 could be significantly worse than in 2009 as the end of an oligopolistic market is cemented. The top-5 poly producers which accounted for 95% and 75% of production in 2006 and 2008 respectively would account for less than 45% while exiting 2009. Increased fragmentation has also come along with a more homogenous cost structure as well as declining differentiation. This means that cutting oversupply in the sector would require much sharper price cuts than in the past. We estimate that more than 90% of global supply produces at a cash cost of under USD30/Kg and price pressure will be severe when demand drops below 18GW in 2011 (HSBC estimate: 13.2GW).

Cheaper poly is a clear negative for producers of polysilicon as well as its substitutes (thin-film solar players). GCL-Poly (3800 HK, UW(V), HKD2.52, TP HKD1.30), the fourth-largest polysilicon producer, is our key underweight in this space. At the same time, poly oversupply is a positive for downstream solar manufacturers which could offset part of the price pressure on their products by lower polysilicon prices. In this space, our preference is for Suntech Power (STP US, N(V), USD7.14, TP USD8.50), which is the biggest cell & module maker globally.

Display

Lack of catalysts for pure panel players; 2011 the year of component makers

We do anticipate a recovery for the LCD sector's business outlook starting from late 1Q11. However, the recovery will be mild compared to the V-shape recovery seen in 2009, which was driven mainly by strong restocking demand. Also, product migration from CCFL-based LCD TVs to LED-based LCD TVs, which are priced 30-50% higher, has slowed down size migration in the LCD TV segments. We forecast the panel price recovery in 2Q11/3Q11 will be only 5-10% from trough to peak (vs. 15-20% in the last cycle).

Though the LCD food chain has gone through inventory adjustment for about six months, we believe only the NB and monitor segment (accounting for 40% of area demand for the LCD sector) inventory levels in the food chain are back to slightly lower levels. However, even with recent better than expected LCD TV sell-through in China, the excess inventory level in the LCD TV segment (55% of total area) improved only marginally from a global perspective

We forecast ROE for LCD panelmakers will stand at 1-7% in 2011, which cannot justify a sustained share price rebound. Thus the upside will be limited, if any. Meanwhile we see a number of component players that are leveraging on the three major themes – rising LED penetration, touch-panel adoption and LCD utilisation – that we expect for 2011, and offer better investment prospects versus the pure panel players.

High conviction call

Samsung Electronics (005930 KR, OW, KRW826,000, TP KRW1,139,000)

To sum it all up, we believe Samsung Electronics is well positioned to benefit greatly from the key 2011 techtonic shifts (discussed above) in smartphones, LED televisions and tablets thanks to its diversified business model and strong product portfolios.

Samsung's flagship smartphone model, the Galaxy S, is a huge success, hitting sales of more than 7m units worldwide since its launch in June. Being the global market leader in LED TVs, we also believe that strong LED penetration growth rates will enable even higher sell-through in television units for the company, maintaining its global No.1 ranking. The increasing number of major flagship smartphone models and new TV products with AMOLED display to come into the market looks set to further boost Samsung's LCD division. Lastly, the proliferation in tablets next year will benefit Samsung greatly due to the explosive demand for NAND; the Galaxy Tab also reached sales of 600,000 units in its first month after launch.

Valuation

Our TP of KRW1,139,000 is derived using an average of 2011e PB of 2.2x, sum-of-the-parts (industry-average 2011e EV/EBITDA multiple), and DCF (12% WACC).

Risks

Risks to our rating and estimates include a stronger KRW, sharp rise in industry capacity in memory and TFT-LCD, ASP erosion on key products such as handsets, and a protracted delay in the global economic recovery. Potential catalysts include strong quarterly results, upward revisions to market forecasts on memory, new product launches, business expansion into promising areas, and global IT demand recovery.

2011 themes

Techtonic shift

A key growth area in the display space for 2011 will be touchscreens. We expect the increasing popularity of tablet PCs (iPads and iPad-like) and robust growth in smartphone sales to drive about 45% growth for touchscreens in 2011.

There are many touchscreen technologies available. Apple's iPhone and iPad use what is called the P-cap solution, the ideal method to achieve responsive, stylus-free, multi-touch performance. We expect the projected capacitive (P-cap) solution, which has 40% of the touchscreen market now, to become mainstream in 2011 and its area demand to increase at an even more robust +110% in 2011.

TPK (3673 TT, OW(V), TWD664, TP TWD850)

Leader in P-cap, Apple touchscreen supplier

TPK was the first company to adopt and commercialise P-cap on display screens. Back in 2007 the company developed the touchscreen of the first-generation iPhone, which was the first commercially successful device with a multi-touch function. The success brought TPK opportunities to develop touchscreens for other Apple devices.

Due to the close relationships forged during the co-developments, we expect TPK to maintain 45-50% share of Apple's business in the long run. As more smartphones and tablets (other than Apple's) adopt P-cap technology, we expect TPK to be a main beneficiary with its leading technology.

Valuation

Our target price of TWD850 is based on 20x 2011e EPS. The multiple is based on a 20% premium to the normalised peak of YFO (Young Fast-3622 TT, another major touchscreen supplier) of 16.5x. The premium is justified by the company's high exposure to new technology (YFO – mostly conventional resistive) and Apple.

Risks

The company's own yield issues and/or improvement in the yields of competitors will reduce the technology gap of TPK and is the biggest risk faced by the company. In addition, the company generates well over 50% of sales from Apple alone, which creates risk from high single customer exposure.

Pricing anomalies

2010 and 2011 are two good years for investors for lofty dividend payments into 2012. Most of the Taiwan technology companies in our coverage universe have 2011e dividend yields of around 5%. In the current investment climate, where capital gains are hard to find, we believe investors can seek defensive exposure by buying companies which pay out good dividends. Furthermore, there is limited debt on the balance sheets of Taiwan technology companies, which should also help dividend payouts.

UMC (2303 TT, OW(V), TWD15.1, TP TWD16.5)

We continue to prefer UMC based on improved cycle-to-cycle metrics, valuation (0.8x book and 66% of market cap in cash/investments), and dividend yield (8%+ sustainable for at least two years, in our view).

Valuation

Our target price is TWD16.5, based on 1.0x 2011e book value. As a reminder, UMC shares did not trade below 1.3x prior to early 2008. However, in the depths of the last downturn, the shares bottomed at approximately 0.6x book value and now trade at 0.86x 2011e book.

Risks

The risks to our rating include: weak end-demand limiting recovery; relatively high customer concentration from customers such as Texas Instruments, Xilinx and Mediatek; potential increased competition in the foundry space resulting in loss in market share or margin pressure; struggles with technology roadmap; and continued valuation multiple compression. Potential upside catalysts include increased demand offsetting oncoming supply or a potential takeout by a larger competitor (unlikely in our view, but not impossible).

Asia tech: Valuation comparison

Company	Rating	Share price	Target price	Pot'l return	Mcap (USDm)	Rev growth 2010e	Rev growth 2011e	EBIT margin 2010e	EBIT margin 2011e	ROE 2010e	ROE 2011e	Div yield 2010e	Div yield 2011e	PE 2010e	PE 2011e	PB 2010e	PB 2011e	EV/EBITDA 2010e	EV/EBITDA 2011e
Foundry																			
TSMC	N(V)	63.4	65.0	8%	51,746	41%	8%	38%	35%	29.4%	23.5%	4.7%	5.2%	10.3x	11.2x	2.8x	2.5x	5.8x	5.5x
UMC	OW(V)	15.1	16.5	18%	13,236	37%	7%	19%	18%	11.1%	10.5%	3.3%	8.6%	8.0x	8.4x	0.9x	0.9x	6.4x	6.1x
Vanguard	N(V)	12.5	13.0	11%	658	28%	5%	12%	13%	8.9%	9.7%	3.2%	7.3%	11.6x	10.3x	1.0x	1.0x	2.8x	2.4x
SMIC	UW(V)	3.6	3.6	0%	64	46%	6%	0%	3%	-2.3%	1.2%	0.0%	0.0%		79.3x	0.8x	0.9x	4.2x	4.6x
Average						**38%**	**6%**	**17%**	**17%**	**11.8%**	**11.2%**	**2.8%**	**5.3%**	**10.0x**	**10.0x**	**1.4x**	**1.3x**	**4.8x**	**4.6x**
Packaging and Test																			
ASE	N(V)	31.5	28.0	-5%	5,603	123%	8%	12%	12%	23.7%	21.2%	2.5%	5.8%	10.3x	9.9x	2.2x	1.9x	5.6x	4.9x
Siliconware	N(V)	31.8	33.0	8%	3,045	11%	-1%	9%	8%	7.9%	6.7%	8.1%	4.1%	19.4x	22.8x	1.5x	1.5x	5.9x	5.9x
ASM Pacific	N(V)	73.6	69.0	-1%	886	97%	-4%	33%	32%	65.3%	46.1%	4.7%	5.1%	10.7x	11.7x	5.9x	4.9x	8.4x	8.4x
Chroma ATE	OW(V)	77.9	90.0	21%	876	73%	16%	30%	30%	28.8%	27.6%	2.9%	5.9%	13.3x	12.1x	3.5x	3.1x	13.1x	11.0x
Average						**76%**	**5%**	**21%**	**20%**	**31.4%**	**25.4%**	**4.6%**	**5.2%**	**13.4x**	**14.1x**	**3.3x**	**2.9x**	**8.2x**	**7.6x**
Fabless																			
Mediatek	UW	390.5	304.0	-16%	13,497	-1%	-6%	28%	26%	28.9%	24.1%	6.0%	6.2%	13.2x	15.4x	3.7x	3.7x	8.5x	9.3x
Spreadtrum	OW(V)	16.4	19.7	20%	2,228	224%	51%	21%	20%	43.0%	39.3%	0.0%	0.0%	13.7x	10.0x	4.9x	3.3x	27.5x	19.0x
Average						**112%**	**22%**	**24%**	**23%**	**36.0%**	**31.7%**	**3.0%**	**3.1%**	**13.5x**	**12.7x**	**4.3x**	**3.5x**	**18.0x**	**14.2x**
PCB/Substrates																			
Unimicron	N(V)	55.6	55.0	4%	2,572	50%	16%	13%	14%	16.0%	16.9%	2.5%	5.1%	11.1x	9.3x	1.6x	1.5x	5.2x	4.3x
Tripod	N(V)	133.0	123.0	-4%	1,979	26%	16%	14%	14%	24.2%	23.7%	2.0%	3.1%	13.0x	11.3x	2.8x	2.6x	5.8x	5.1x
Nan Ya PCB	N(V)	108.0	110.0	5%	2,104	31%	27%	4%	11%	5.4%	13.3%	5.0%	2.7%	36.6x	14.7x	2.0x	1.9x	14.3x	6.0x
Kingboard Lam	OW(V)	7.6	8.9	23%	2,876	49%	7%	22%	22%	25.6%	23.3%	5.7%	5.9%	8.9x	8.6x	2.1x	1.9x	6.2x	5.7x
Average						**39%**	**16%**	**13%**	**15%**	**17.8%**	**19.3%**	**3.8%**	**4.2%**	**17.4x**	**11.0x**	**2.1x**	**2.0x**	**7.9x**	**5.3x**
Memory																			
Samsung	OW	826,000	1,139,000	39%	99,704	15%	8%	12%	11%	20.4%	17.0%	1.5%	1.5%	8.6x	8.7x	1.6x	1.4x	3.6x	3.4x
Hynix	OW(V)	23,500	32,000	36%	11,853	64%	5%	27%	20%	42.6%	22.6%	0.0%	0.0%	4.9x	6.6x	1.7x	1.3x	2.6x	2.5x
LG Elec.	OW	103,000	140,000	38%	12,180	7%	11%	0%	3%	-0.6%	15.7%	1.5%	1.9%	-258.4x	10.0x	1.7x	1.5x	9.5x	2.5x
Samsung Techwin	OW(V)	108,500	135,000	25%	4,581	24%	9%	8%	10%	21.0%	23.4%	0.6%	0.6%	23.1x	17.0x	4.4x	3.6x	18.1x	13.6x
Elpida Memory	OW(V)	997	1,500	50%	2,298	41%	39%	6%	17%	3.2%	23.0%	0.0%	0.0%	23.6x	2.8x	0.6x	0.6x	3.0x	1.9x
Inotera Memories	N(V)	13.4	17.0	27%	1,915	30%	39%	-8%	8%	-11.3%	5.6%	0.0%	0.0%	-11.1x	21.6x	1.2x	1.2x	4.5x	2.8x
Nanya Tech	N(V)	15.8	19.8	25%	1,945	0%	0%	-5%	5%	-13.0%	2.3%	0.0%	0.0%	-13.4x	77.8x	1.8x	1.8x	9.6x	6.3x
Winbond	OW(V)	7.9	10.8	38%	889	64%	6%	12%	7%	10.4%	5.2%	0.0%	0.0%	7.7x	14.3x	0.8x	0.7x	2.5x	2.3x
Average						**31%**	**15%**	**6%**	**10%**	**9.1%**	**14.4%**	**0.4%**	**0.5%**	**-26.9x**	**19.8x**	**1.7x**	**1.5x**	**6.7x**	**4.4x**
PC Hardware																			
Hon Hai	OW(V)	108.5	143.0	34%	33,015	40%	21%	3%	3%	16.7%	17.3%	1.7%	2.0%	13.4x	11.4x	2.1x	1.9x	7.8x	6.1x
Asustek	OW(V)	263.5	306.0	19%	5,279	-27%	-13%	4%	4%	9.2%	8.9%	2.9%	2.9%	10.2x	10.3x	0.9x	0.9x	2.5x	2.4x
Acer	OW(V)	90.0	106.0	24%	7,769	15%	15%	3%	3%	16.4%	18.4%	4.8%	5.8%	15.3x	12.7x	2.4x	2.3x	9.0x	7.2x
Lenovo	OW(V)	5.2	5.7	11%	860	12%	36%	1%	2%	8.8%	17.1%	1.1%	2.3%	47.8x	21.8x	3.9x	3.5x	12.4x	8.2x
Quanta	N(V)	59.9	57.6	3%	7,179	34%	14%	2%	2%	19.9%	22.7%	5.8%	7.3%	10.4x	8.3x	2.0x	1.8x	7.5x	5.8x
Wistron	OW	61.8	72.0	24%	3,822	16%	25%	2%	2%	21.9%	24.2%	5.8%	7.1%	9.5x	7.7x	2.0x	1.8x	5.2x	4.3x
Compal	N	37.9	41.0	15%	5,253	32%	13%	3%	3%	22.4%	19.7%	7.1%	6.9%	7.2x	7.4x	1.5x	1.4x	3.3x	3.8x
D-Link	N(V)	31.3	35.0	16%	614	10%	14%	3%	4%	8.9%	10.4%	3.1%	3.7%	16.3x	13.3x	1.4x	1.4x	8.5x	7.0x
Synnex	OW(V)	76.3	90.0	22%	3,481	23%	22%	2%	2%	17.2%	18.9%	3.3%	3.9%	20.1x	16.9x	3.3x	3.1x	23.0x	16.7x
Catcher	N	93.5	83.5	-8%	1,929	21%	17%	21%	19%	9.3%	8.7%	2.3%	2.5%	17.7x	16.1x	1.4x	1.4x	9.9x	8.2x
Ju Teng	N(V)	3.1	3.6	18%	109	-5%	10%	9%	10%	12.4%	12.3%	2.6%	2.2%	6.6x	5.9x	0.8x	0.7x	4.6x	4.3x
Average						**17%**	**16%**	**3%**	**3%**	**15.7%**	**17.5%**	**4.0%**	**4.7%**	**15.9x**	**12.0x**	**2.0x**	**1.8x**	**8.5x**	**6.7x**

Source: Factset, HSBC estimates; Closing prices as of 30 Nov 2010

Asia tech: Valuation comparison (cont'd)

Company	Rating	Share price	Target price	Pot'l return	Mcap (USDm)	Rev growth 2010e	Rev growth 2011e	EBIT margin 2010e	EBIT margin 2011e	ROE 2010e	ROE 2011e	Div yield 2010e	Div yield 2011e	PE 2010e	PE 2011e	PB 2010e	PB 2011e	EV/EBITDA 2010e	EV/EBITDA 2011e
Flat Panel/Display																			
AUO	UW(V)	30.5	25.0	-17%	16,684	36%	11%	3%	2%	3.5%	2.7%	1.1%	0.9%	27.3x	35.2x	0.9x	0.9x	5.7x	4.9x
Innolux	UW(V)	41.8	32.0	-23%	9,495	196%	15%	0%	1%	-0.9%	1.3%	-0.1%	0.2%		88.9x	1.1x	1.1x	16.3x	4.6x
LG Display	UW	39,550	32,000	-18%	22,901	25%	14%	5%	4%	9.9%	7.4%	1.1%	0.9%	13.8x	17.2x	1.3x	1.2x	6.6x	5.2x
Novatek	OW	97.0	125.0	35%	1,795	32%	12%	14%	16%	20.5%	23.8%	5.3%	5.9%	12.9x	10.1x	2.6x	2.3x	8.1x	5.3x
Sharp	UW(V)	805.0	820.0	4%	9,953	-3%	2%	2%	2%	0.7%	1.1%	2.1%	1.7%		78.0x	0.9x	0.9x	4.7x	4.6x
Radiant	OW	53.0	63.0	24%	701	29%	24%	6%	6%	15.8%	16.0%	4.2%	5.1%	9.7x	8.8x	1.5x	1.4x	6.8x	6.1x
Everlight	OW(V)	82.8	111.0	37%	1,078	50%	26%	13%	13%	15.9%	16.7%	2.4%	2.9%	14.3x	12.3x	2.2x	1.9x	8.4x	6.6x
Epistar	OW(V)	103.5	133.0	33%	2,725	57%	27%	28%	26%	15.2%	15.5%	4.0%	4.4%	15.2x	13.6x	2.2x	2.0x	9.3x	8.0x
SemCo	OW	125,000	152,000	22%	292,375	31%	29%	12%	12%	19.2%	16.8%	0.0%	0.0%	16.8x	16.2x			7.0x	5.9x
LG Innotek	OW(V)	130,000	185,000	43%	82,185	70%	29%	6%	6%	16.4%	15.1%	0.2%	0.4%	13.5x	11.5x	1.8x	1.7x	3.6x	3.3x
Seoul Semi	OW(V)	38,800	51,000	32%	69,102	91%	47%	12%	14%	19.2%	24.2%	0.3%	0.3%	22.8x	14.3x	3.4x	2.7x	16.0x	10.3x
Samsung SDI	OW(V)	165,500	210,000	27%	236,358	4%	3%	7%	7%	6.8%	8.2%	0.4%	0.4%	21.5x	17.4x	1.5x	1.4x	4.6x	3.6x
Cheil Industries	OW	106,500	134,000	27%	166,980	18%	22%	7%	7%	13.6%	13.9%	0.9%	0.9%	17.1x	14.2x	2.1x	1.9x	9.4x	7.8x
TPK	OW(V)	664.0	850.0	32%	4,622	187%	135%	9%	9%	50.4%	66.7%	0.8%	3.8%	38.9x	15.7x	14.2x	7.8x	25.6x	10.7x
Coretronic	OW	43.5	60.0	48%	978	18%	9%	5%	5%	17.9%	17.9%	9.0%	9.7%	7.8x	7.2x	1.3x	1.2x	3.9x	3.6x
Corning	OW	17.7	23.0	31%	857	17%	1%	22%	22%	19.3%	18.3%	1.1%	1.1%	8.7x	7.7x	1.5x	1.3x	8.8x	7.6x
Average						**54%**	**25%**	**9%**	**9%**	**15.2%**	**16.6%**	**2.0%**	**2.4%**	**17.2x**	**23.0x**	**2.6x**	**2.0x**	**9.1x**	**6.1x**
Handsets																			
HTC	N	845.0	742.0	-4%	21,464	92%	44%	16%	14%	51.7%	45.2%	5.8%	8.1%	16.6x	13.7x	7.6x	5.2x	13.7x	10.7x
FIH	UW(V)	5.5	3.7	-32%	651	12%	10%	-2%	0%	-6.0%	0.3%	0.0%	0.0%			1.5x	1.5x		24.4x
Largan	OW	676.0	820.0	25%	2,721	52%	28%	38%	38%	28.4%	30.2%	2.6%	3.3%	21.1x	16.5x	5.4x	4.6x	15.4x	11.8x
AAC	OW(V)	21.4	23.4	11%	3,178	52%	35%	32%	32%	25.2%	27.4%	1.7%	2.2%	23.5x	17.9x	5.3x	4.4x	17.2x	12.8x
Silitech	OW	97.1	120.0	31%	530	28%	21%	15%	14%	28.1%	27.3%	6.8%	7.2%	10.6x	9.7x	2.8x	2.5x	5.6x	4.6x
Merry	N	49.1	54.0	18%	237	24%	16%	11%	11%	16.8%	17.5%	8.1%	8.2%	10.0x	9.1x	1.6x	1.6x	5.5x	4.6x
Compal	UW(V)	21.3	21.0	0%	410	-12%	-1%	0%	0%	2.5%	1.9%	1.5%	1.2%	43.9x	51.4x	1.0x	1.0x	3.4x	1.1x
Average						**36%**	**22%**	**16%**	**15%**	**20.9%**	**21.4%**	**3.8%**	**4.3%**	**21.0x**	**19.7x**	**3.6x**	**3.0x**	**10.1x**	**10.0x**
Media/Telecom Equip																			
ZTE	N(V)	28.6	32.0	13%	10,987	22%	15%	8%	8%	17.4%	16.6%	0.8%	1.2%	20.3x	17.6x	3.1x	2.7x	10.1x	8.6x
Perfect World	N(V)	23.7	29.0	22%	1,381	15%	31%	42%	46%	35.8%	33.8%			8.7x	6.3x	2.7x	1.8x	6.1x	3.2x
Tencent	OW(V)	172.7	187.0	9%	39,610	52%	31%	51%	51%	48.7%	42.9%	0.4%	0.5%	35.5x	26.8x	13.5x	9.7x	25.0x	18.7x
Netease	OW(V)	38.2	45.0	18%	4,890	46%	31%	45%	47%	26.3%	27.5%			15.4x	11.2x	3.5x	2.6x	9.5x	6.4x
Shanda	N(V)	39.5	44.0	11%	2,824	13%	22%	25%	28%	8.2%	10.4%			16.9x	12.4x	1.3x	1.2x	4.0x	2.8x
Baidu	N(V)	105.1	116.0	10%	29,124	81%	55%	48%	47%	53.5%	49.5%					32.0x	19.7x	46.4x	30.2x
Average						**38%**	**31%**	**37%**	**38%**	**31.6%**	**30.1%**	**0.6%**	**0.9%**	**19.3x**	**14.9x**	**9.4x**	**6.3x**	**16.9x**	**11.7x**
Solar																			
Suntech	N(V)	7.1	8.5	19%	1,279	63%	-20%	9%	12%	9.6%	9.5%	0.0%	0.0%	8.5x	8.4x	0.8x	0.8x	6.1x	4.8x
Yingli	UW(V)	9.9	8.1	-18%	1,504	66%	-20%	21%	17%	20.7%	9.9%	0.0%	0.0%	6.7x	12.1x	1.3x	1.1x	5.1x	6.8x
LDK Solar	UW(V)	10.0	6.0	-40%	1,438	111%	-21%	16%	9%	24.0%	5.7%	0.0%	0.0%	5.6x	20.0x	1.3x	1.2x	5.6x	8.6x
Motech	UW(V)	112.5	70.0	-34%	1,329	100%	-25%	14%	9%	22.5%	9.2%	4.8%	3.7%	9.8x	19.3x	1.8x	1.7x	5.9x	9.3x
Trina	UW(V)	22.3	21.0	-6%	3,650	86%	-20%	23%	18%	32.1%	13.1%	0.0%	0.0%	6.0x	10.6x	1.4x	1.2x	3.9x	5.2x
GCL	UW(V)	2.5	1.3	-48%	5,435	197%	8%	26%	20%	17.9%	11.0%	0.0%	0.0%	14.4x	20.7x	2.8x	2.5x	10.3x	10.4x
Average						**104%**	**-16%**	**18%**	**14%**	**21.1%**	**9.7%**	**0.8%**	**0.6%**	**8.5x**	**15.2x**	**1.5x**	**1.4x**	**6.2x**	**7.5x**

Source: Factset, HSBC estimates; Closing prices as of 30 Nov 2010

HSBC

Telecoms & Media

- We have shifted towards a more positive view on telecom services in developed markets based on wireless data/dividend catalysts. We remain positive on the China-Korea internet space, and are more cautious on the near-term profitability for China vendors
- Key themes for 2011 will be the ability to monetise wireless data, a greater emphasis on returning excess cash to shareholders, and renewed interest in the internet services space
- Top picks include Telstra, China Telecom and Korea Telecom

2011 outlook

Telecom services

We are cautiously optimistic on the Asian telecom services space, based on an improved outlook for core business earnings growth and a shift towards higher dividend payouts. The key driver for telecom services is the shift towards a data-centric, wireless broadband business model. Smartphone customers consume 10x as much data capacity as feature phone customers. This capacity crunch creates challenges for operators that have underinvested in network capex but opportunities for operators that have overinvested to grab high-end, data-centric customers. We see initial signs that some operators are regaining pricing power, allowing for significant increases in average revenue per customer (ARPU) on two-year contracts. This growth in organic demand/core business earnings is also allowing some operators to increase dividend payouts to shareholders, rather than chasing "risky" out-of-sector/market growth.

At this juncture, this is a developed market story and our Overweights are concentrated in Korea, Hong Kong, Japan, and Singapore. In more developed markets we like Korea Telecom, Smartone, PCCW, DoCoMo, eAccess, and Telstra. In contrast, we have just one Overweight rating in each of the traditional growth markets of China, India and Indonesia. In developing markets we like China Telecom, Axiata-Excelcomindo, and Tulip. We see increased investor interest in India on the back of the resignation of telecoms minister Andimuthu Raja but believe it's too early to invest.

Internet services

We remain structural bulls on both the China and Korea internet services space and believe that content creation-distribution companies are the most attractive subsegment in our coverage universe. China is still in the early stages of the broadband revolution, with 30% internet penetration and dramatic increases in broadband access funded by a wave of Chinese telecom operator capex. In contrast to the telecoms services space, China internet services enjoy no

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government players, no tariff/rate of return restrictions, and a focus on shareholder value creation. We are OW(V) on both Tencent and Netease and are bullish on the China online gaming, online advertising, and e-commerce markets and believe these emerging companies are much better structural proxies for the China domestic consumption story. In Korea we like Daum Communications, which is highly geared to the uptake in mobile ad spending that we expect to see as the smartphone penetration rate surges, and NCsoft, a leading global game developer that is geared to the China story.

Telecoms equipment vendors

We remain longer-term structural bulls on the Chinese telecom equipment vendors, but are cautious on the near-term outlook for domestic capex earnings. China has moved to the old Korean-style management of the telco sector, with a focus on supporting domestic telecom equipment vendors at the expense of the domestic telecom services providers. China's decision to build three huge, overlapping 3G networks based on three different technology standards is ample evidence of this bias. In particular, the decision to task dominant wireless operator China Mobile with the national service obligation to fund the development of the native TD-SCDMA standard is a harbinger. Domestic Chinese vendors Huawei, ZTE and Comba have emerged as powerful global competitors, fuelled in part by a combination of direct/indirect subsidies/tax breaks. We expect these trends to continue and see another wave of domestic China capex coming with the deployment of 4G LTE and modernisation of the Chinese cable TV (CATV) industry in 2012. Our Neutral (V) rating on ZTE reflects a cautious view on near-term earnings, as an aggressive focus on handsets/GEM expansion drags down OP margins (1% in 3Q10). Our OW rating on Comba reflects a more bullish view on the antenna space.

Top pick for 2011

Telstra (TLS AU, OW, AUD2.81, TP AUD3.3)

We believe Telstra is a high risk/high return play given the uncertainty over the regulatory framework for network separation – the National Broadband Network (NBN). Telstra has moved up over the past few weeks on positive management comments on the stable dividend for the next two years and the possibility of a special dividend in the event of a rapid NBN resolution. We argue the proposed NBN deal, which would generate an NPV for Telstra shareholders of AUD11bn, is a fair-equitable solution that could be finalised before the end of the year. Management lost focus on the core business earlier in the year and the commitment to invest AUD1bn in operating costs in FY June 2011 to recapture market share is positive. Telstra has the best wireless network in Australia and is well positioned to regain share in the high-end, data-centric smartphone segment.

Valuation: We value Telstra using a dividend discount model – our target price is AUD3.3 per share. Telstra is our top dividend play.

Risks: The key risks for Telstra relate to uncertainty over the dividend payment/NBN. The current political coalition ruling Australia is fragile and the opposition party has suggested a wholesale review of NBN is likely if they return to power, creating uncertainty over the dividend.

Themes for 2011

Techtonic shifts

The emergence of smartphone-based wireless broadband services provides the biggest structural catalyst for the developed market telecom business model in the past decade. The release of Apple's iPhone followed by a much wider range of Google Android-based devices has created a powerful, easy-to-use interface to high speed networks and rich content. The development of the Apple and Google applications stores has allowed telecoms operators to outsource content development/management to skilled media companies. Explosive customer demand for these services is creating wireless capacity crunch pressures, which in turn are allowing selected telco operators to push through de facto price increases. China is driving down retail prices of low-end smartphones into the USD150-200 range, creating the potential for global adoption of the smartphone-driven wireless broadband operating-business model. ZTE's recent release of a low-cost Indian smartphone in the run-up to 3G launch highlights the potential of this technology to stimulate a global shift in wireless data growth.

China Telecom (728 HK, OW, HKD3.91, TP HKD5.1)

China Telecom is our only OW in the China space and is one of our top regional telco services picks. It has executed a remarkable turnaround in the CDMA business and should surpass Verizon as the largest CDMA operator in the world in 1Q11 with over 100m subscribers. It has expanded handset inventory and aggressively bundled services, but careful cost management and a preferential off-balance sheet lease structure for the CDMA network should allow a doubling of net profit margin (NPM) to 8.5% in 2010.

Valuation: Our target price of HKD5.1 is based on 13x 2011e EPS.

Risks: Investor scepticism on CDMA runs deep, raising questions about the stock's ability to re-rate despite strong sub growth. China Telecom's 3G net ads are focused on the lower ARPU youth-student segment, in a market where most investors continue to focus on top-line versus bottom-line growth. The core fixed-line business continues to compress as PHS migrate off, which could overshadow the dramatic turnaround in the wireless segment.

Cash-rich companies

One of the key themes for our telecom services companies is the re-rating catalyst created by higher dividend payouts. The smartphone-driven wireless model creates the potential for a structural shift in core business revenue/profit growth. We are encouraged by the recent trend towards Asian operators returning cash to shareholders rather than chasing higher-risk acquisitions outside their core markets/countries. Given our cautious stance on wireless penetration and M&A driven growth strategies, the development of a yield-centric domestic investor base is encouraging.

KT Corp (030200 KS, OW, KRW46,500, TP KRW67,000)

KT provides a rare combination of growth and yield at compelling valuations. KT has undergone a dramatic transformation over the last two years via the full integration of former wireless unit, KTF, the shift towards a bundled services model designed to lower sales and marketing costs, and a new CEO with the political power to push through a 16% cut in the workforce. The key challenges are the technical issue of the foreign ownership cap being filled, smartphone-related marketing expenditure remains high, and local investors remain focused on top-line growth. We are 20% and 38% above consensus operating profit estimates for FY11-12.

Valuation: Our target price of KRW67,000 is based on 8x 2011e EPS.

Risks: Korea is our favourite market in Asian telco services on a growth/valuation basis and the key risks relate to industry level shifts in competitive intensity, regulatory approach and capital management. If all operators don't continue to benefit from the smartphone shift, we could see a return to value-destructive pricing/marketing spend wars. We are optimistic on the near-term KT dividend yield but acknowledge long-term systemic risks associated with the industry focus on IT services.

Asia Telecoms and Media: Valuation summary

Company (USDm)	Ticker	Price	Target	Potential return	Rating	MCAP	EV	EV/EBITDA 2011e	EV/EBITDA 2012e	PE 2011e	PE 2012e	Dividend yield 2010e	Dividend yield 2011e	Dividend yield 2012e
		Local Currency												
China / HK -Telcom														
China Mobile	0941.HK	78.1	81.0	3.7%	N	201,713	162,561	4.4x	4.0x	11.6x	11.1x	3.8%	3.9%	4.5%
China Telecom	0728.HK	4.0	5.1	29.1%	OW	41,150	49,331	3.3x	2.7x	9.9x	8.4x	2.3%	2.8%	3.2%
China Unicom	0762.HK	10.5	6.7	-36.1%	UW	31,785	45,434	4.7x	4.2x	30.5x	20.8x	0.6%	1.0%	1.6%
PCCW	0008.HK	3.1	3.0	-2.0%	OW	2,864	6,012	6.4x	6.2x	11.1x	10.1x	5.0%	5.8%	7.0%
Comba Tel. Systems	2342.HK	8.8	11.1	25.6%	OW (V)	1,502	1,454	9.0x	8.1x	13.2x	13.3x	1.8%	1.9%	1.9%
CITIC 1616	1883.HK	2.6	2.7	5.9%	OW (V)	783	546	7.3x	6.4x	11.9x	11.2x	4.0%	4.2%	4.5%
SmarTone	0315.HK	11.8	14.1	19.1%	OW	779	635	3.4x	0.2x	14.5x	12.7x	4.3%	6.9%	7.9%
South Korea-Telcom														
SK Telecom	017670.KS	171,500	179,000	4.4%	N	12,051	15,923	3.6x	3.1x	7.7x	6.3x	5.5%	6.3%	7.9%
KT Corp	030200.KS	46,150	67,000	45.2%	OW	10,487	15,623	2.9x	2.4x	5.6x	4.5x	5.5%	7.2%	8.9%
LG U+	032640.KS	7,120	8,700	22.2%	OW	3,190	3,851	2.2x	2.0x	6.2x	5.4x	4.9%	4.8%	5.8%
SK Broadband	033630.KQ	5,380	6,200	15.2%	N	1,386	2,420	4.2x	3.5x	24.6x	9.6x	0.0%	2.0%	5.8%
Japan														
NTT DoCoMo Inc.	9437.T	135,600	141,000	4.0%	N	70,489	64,066	3.4x	3.2x	11.5x	11.5x	3.8%	3.8%	4.0%
NTT	9432.T	3,805	4,000	5.1%	N	65,435	138,507	3.4x	3.1x	10.5x	9.9x	3.2%	3.2%	3.7%
SoftBank Corp.	9984.T	2,943	2,400	-18.5%	UW	37,820	61,755	5.9x	5.6x	12.2x	12.1x	0.2%	0.2%	0.2%
KDDI Corp	9433.T	486,000	528,000	8.6%	OW	25,874	30,700	2.8x	2.7x	8.1x	7.5x	2.7%	2.7%	2.7%
eAccess Ltd	9427.T	50,700	88,000	73.6%	OW (V)	2,084	2,410	5.8x	3.9x	13.5x	7.1x	4.7%	1.2%	1.6%
Taiwan														
Chunghwa Telecom	2412.TW	74.2	75.0	1.1%	N	23,648	20,461	6.7x	6.8x	14.6x	14.6x	6.1%	6.1%	6.1%
Taiwan Mobile Co.	3045.TW	68.4	69.0	0.9%	N	8,545	8,667	9.4x	9.5x	12.9x	12.6x	7.5%	7.9%	8.3%
Far EasTone	4904.TW	43.0	39.0	-9.2%	UW	4,600	3,716	5.0x	4.8x	13.9x	13.5x	6.4%	5.8%	5.9%
Australia														
Telstra Corp	TLS.AX	2.8	3.3	18.3%	OW	33,428	46,683	4.9x	4.5x	11.1x	9.5x	10.0%	10.0%	10.1%
India														
Bharti Airtel	BRTI.BO	350.6	370.0	5.5%	N (V)	29,323	29,565	9.2x	7.5x	20.8x	15.5x	0.0%	0.0%	0.0%
Reliance Communications	RLCM.NS	137.3	170.0	23.9%	UW (V)	6,240	10,621	7.4x	6.0x	18.2x	16.3x	0.0%	0.0%	0.0%
Idea Cellular Ltd	IDEA.BO	72.1	75.0	4.1%	N (V)	5,239	6,658	10.0x	7.6x	47.1x	47.0x	0.0%	0.0%	0.0%
GTL Infrastructure	GTLI.BO	44.0	39.0	-11.4%	UW (V)	928	1,402	23.1x	14.8x	NM	51.3x	0.0%	0.0%	0.0%
Tulip Telecom	TULP.BO	180.9	235.0	29.9%	OW	578	770	5.6x	4.5x	8.8x	7.3x	0.9%	1.0%	1.2%
Indonesia														
PT Telkom	TLKM.JK	8,150	9,600	17.8%	N	18,214	26,290	6.0x	5.4x	14.0x	11.9x	4.2%	4.2%	4.7%
Indosat	ISAT.JK	5,250	5,800	10.5%	UW	3,163	5,426	4.6x	4.4x	18.7x	13.9x	1.0%	1.9%	2.6%
XL Axiata	EXCL.JK	5,850	7,700	31.6%	OW (V)	5,518	6,520	5.7x	5.1x	12.3x	10.5x	0.3%	1.4%	4.7%
Singapore														
Singapore Telecom	STEL.SI	3.1	3.3	4.2%	N	38,020	26,489	6.8x	6.4x	13.6x	13.1x	4.5%	4.8%	5.0%
Starhub	STAR.SI	2.7	2.9	9.8%	N	3,466	3,954	8.3x	7.7x	16.6x	14.8x	7.7%	8.3%	8.3%
M1 Ltd.	MONE.SI	2.2	2.3	3.8%	N	1,522	1,714	7.1x	6.8x	13.3x	12.6x	6.2%	6.8%	7.1%
China-Internet														
Tencent Holdings	0700.HK	174.0	240.0	37.9%	OW (V)	41,088	38,261	18.8x	13.8x	26.5x	20.2x	0.4%	0.5%	0.7%
Baidu.com Inc.	BIDU.OQ	105.2	116.0	10.3%	N (V)	28,540	27,538	29.6x	20.8x	48.1x	34.7x	0.0%	0.0%	0.0%
Netease.com	NTES.O	38.2	54.0	41.4%	OW (V)	4,958	3,772	6.4x	4.8x	10.9x	9.4x	0.0%	0.0%	0.0%
Shanda	SNDA.O	39.5	43.0	8.8%	N (V)	2,861	1,061	2.7x	2.0x	12.1x	10.1x	0.0%	0.0%	0.0%
Perfect World Co	PWRD.O	23.7	33.0	39.2%	N (V)	1,364	988	3.0x	1.3x	6.2x	4.6x	0.0%	0.0%	0.0%
South Korea-Internet														
NHN Corp	035420.KQ	193,500	211,000	9.0%	N	8,105	7,197	10.4x	8.4x	13.9x	11.4x	0.0%	0.0%	0.5%
NCsoft	036570.KS	255,000	320,000	25.5%	OW (V)	4,839	4,245	12.1x	8.4x	19.8x	14.4x	0.3%	0.4%	0.7%
Daum Communications	035720.KQ	76,300	113,000	48.1%	OW	885	725	5.8x	4.2x	11.9x	8.4x	0.0%	0.0%	1.3%
NEOWIZ Games	095660.KS	47,600	53,000	11.3%	OW (V)	874	738	5.3x	4.3x	9.9x	8.6x	0.0%	2.1%	8.4%
CJ Internet	037150.KQ	15,700	16,000	1.9%	N (V)	312	141	1.9x	1.4x	9.2x	8.4x	1.3%	1.6%	1.8%
GAMEVIL INC	063080.KQ	27,750	39,000	40.5%	OW (V)	133	96	4.7x	3.2x	8.8x	6.5x	0.0%	1.7%	2.3%
COM2US Corporation	078340.KQ	13,000	18,500	42.3%	OW (V)	113	80	11.0x	7.2x	17.0x	11.4x	0.0%	0.0%	0.0%
Asia Pac Average (ex Internet stocks)						**19,377**	**22,304**	**7.6x**	**6.2x**	**14.7x**	**13.7x**	**3.1%**	**3.3%**	**3.8%**

Source: HSBC estimates. Closing prices as at 1 Dec 2010

Notes

HSBC

Disclosure appendix

Analyst Certification

Each analyst whose name appears as author of an individual chapter or individual chapters of this report certifies that the views about the subject security(ies) or issuer(s) or any other views or forecasts expressed in the chapter(s) of which (s)he is author accurately reflect his/her personal views and that no part of his/her compensation was, is or will be directly or indirectly related to the specific recommendation(s) or view(s) contained therein.

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Stock ratings and basis for financial analysis

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Rating definitions for long-term investment opportunities

Stock ratings

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*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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Overweight (Buy)	47%	(22% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(19% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(21% of these provided with Investment Banking Services)

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HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
ALUMINUM CORP OF CHINA	2600.HK	7.13	03-Dec-2010	4, 11
AXIS BANK LTD	AXBK.BO	1406.15	04-Dec-2010	1, 2, 4, 5, 7, 11
BANK MANDIRI PERSERO TBK	BMRI.JK	6700.00	03-Dec-2010	6, 7
BAWANG INTERNATIONAL	1338.HK	3.10	03-Dec-2010	1, 5
BOC HONG KONG HOLDINGS	2388.HK	27.65	03-Dec-2010	2, 11
CHINA COAL ENERGY CO	1898.HK	11.72	03-Dec-2010	4, 11
CHINA COMMUNICATIONS CONS	1800.HK	6.89	03-Dec-2010	11
CHINA CONSTRUCTION BANK	0939.HK	7.10	03-Dec-2010	1, 2, 4, 5, 6, 7, 11
CHINA COSCO HOLDINGS CO	1919.HK	8.55	03-Dec-2010	4, 11
CHINA EVERBRIGHT INTL	0257.HK	4.42	03-Dec-2010	2, 7
CHINA MERCHANTS INT'L	0144.HK	31.50	03-Dec-2010	6, 11
CHINA MOBILE	0941.HK	77.95	03-Dec-2010	6, 7, 11
CHINA NATIONAL MATERIAL C	1893.HK	7.06	03-Dec-2010	4
CHINA RESOURCES CEMENT	1313.HK	6.11	03-Dec-2010	4
CHINA TAIPING INSURANCE	0966.HK	27.50	03-Dec-2010	11
CHINA TELECOM CORPORATION	0728.HK	3.95	03-Dec-2010	4, 7
CHINA UNICOM	0762.HK	10.62	03-Dec-2010	7, 11
CNOOC LTD.	0883.HK	17.74	03-Dec-2010	4, 11
DONGBU INSURANCE CO LTD	005830.KS	38000.00	03-Dec-2010	7
GENTING BERHAD	GENT.KL	10.66	03-Dec-2010	1, 2, 5, 6, 7
GOME ELECTRICAL APPLIANCE	0493.HK	3.09	03-Dec-2010	4
GUANGZHOU R&F	2777.HK	10.86	03-Dec-2010	4, 11
HONGKONG LAND HOLDINGS LI	HKLD.SI	7.04	03-Dec-2010	1, 5, 6, 11
HYUNDAI MARINE & FIRE INS	001450.KS	22100.00	03-Dec-2010	7
HYUNDAI MOTOR	005380.KS	184000.00	03-Dec-2010	1, 5, 7, 11
INDUSTRIAL & COMMERCIAL BANK OF CHINA	1398.HK	5.98	03-Dec-2010	1, 2, 4, 5, 11
INTIME DEPARTMENT STORE	1833.HK	12.70	03-Dec-2010	4
JARDINE MATHESON	JARD.SI	44.74	03-Dec-2010	7
KIA MOTORS	000270.KS	51700.00	03-Dec-2010	1, 2, 5, 7
KOREA LIFE INSURANCE	088350.KS	7530.00	03-Dec-2010	7
KT CORP	030200.KS	45650	03-Dec-2010	6, 7, 11
MAANSHAN IRON & STEEL	0323.HK	4.23	03-Dec-2010	4, 7, 11
MANDO CORPORATION	060980.KS	132000.00	03-Dec-2010	4
PACIFIC BASIN SHIPPING	2343.HK	5.33	03-Dec-2010	1, 2, 4, 5, 6, 7
PICC PROPERTY & CASUALTY COMP	2328.HK	11.62	03-Dec-2010	4, 7, 11
PING AN INSURANCE (GROUP)	2318.HK	90.95	03-Dec-2010	4, 6, 7
POSCO	005490.KS	469000.00	03-Dec-2010	2, 7, 11
SAMSUNG ELECTRONICS	005930.KS	894000.00	03-Dec-2010	6, 11
SAMSUNG FIRE & MARINE	000810.KS	192000.00	03-Dec-2010	6
SHUI ON LAND LIMITED	0272.HK	4.04	03-Dec-2010	4
SINGAPORE AIRLINES	SIAL.SI	15.78	03-Dec-2010	5, 6, 7
SK ENERGY CO LTD	096770.KS	174000.00	03-Dec-2010	11
SUN HUNG KAI PROPERTIES	0016.HK	130.80	03-Dec-2010	1, 4, 5, 6, 11
TELSTRA CORP	TLS.AX	2.82	03-Dec-2010	1, 2, 5, 7, 11
TENCENT	0700.HK	171.6	03-Dec-2010	4, 7, 11
THE LINK REIT	0823.HK	24.05	03-Dec-2010	1, 5, 6, 7
ZTE CORP.	0763.HK	30.8	03-Dec-2010	4, 7, 11

Source: HSBC

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