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## Quammentary: Is there a Market Bubble?

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At Thursday's close of 26,974, the HSI surged 35% since the start of the year. Given the substantial rise, investors may wonder whether the stock market is overvalued. Quam reiterates that it is not always about the market play. Examining the valuations of individual companies can offer a twist in a general market story and present a unique investment opportunity.

The HSI is valued at an estimated P/E of 19x. During the past six years, the index had an average P/E of 15x. The inclusion of high-growth China plays has boosted the HSI valuation upward. Current valuation of the index as a whole is still fair. However, it is desirable to avoid or reduce expensive shares such as China property developers, consumer shares and insurance counters. On the other hand, international banks, HK banks, HK retailers, selected China banks, China ports and China toll roads are of more attractive valuations.

### Stock Recommendations

HSBC (5) gained HK\$1.3 despite the market, contributing a 34-point increase to the index. The HSCEI slumped 3.4% to 16,727. Resource plays took a hit after recent high flying trade. Gold miners Zijin (2899) and Zhaojin (1818) dived 8.7% and 5.6% respectively. Market turnover retreated to HK\$147B.

China Mobile (941) has the biggest weighting in the HSI, accounting for 14.4%. This is closely followed by HSBC (5), at 14.3%. For both companies, Quam does not see a bubble, particularly for HSBC, which closed at HK\$149. HSBC's share is valued at a 2008 P/E of only 10.8x, which is very low. Should US economy accelerate, HSBC will directly benefit.

China Mobile, at HK\$126.6, may be valued at a 2008 P/E of 23x. Based on [DCF calculation](#), Quam estimated that the company may be worth HK\$117.4 per share. However, the fair value of the company should increase with time (i.e. lower discounting). Quam considers the valuation of China Mobile reasonable.

### Mainland banks at reasonable valuations

Among China companies registered in HK or H shares, China Construction Bank (**939, CCB**), Industrial & Commercial Bank of China (**1398, ICBC**), Bank of Communications (**3328, BoCom**) and Bank of China (**3988, BOC**), represented 13.8% of the HSI.

The two life insurers, China Life (**2628**) and Ping An (**2318**), represented another 9.2%. Given their strong results, these China financials have been a major driving force to the HSI. However, Quam finds valuations of the two insurers to be aggressive as recent results were substantially buoyed by A-share investment gains. Quam considers valuations of the banking shares to be more reasonable.

### **Selected properties -- accumulate on weakness**

The property developers have also been important contributors to the HSI this year. Cheung Kong (**1**), Sun Hung Kai (**16**), Hang Lung (**101**), Henderson (**12**), New World (**17**) and Sino Land (**83**), accounted for a 10.8% weighting of the HSI. Quam considers there is still unrealized value for these counters, particularly as property prices are likely to have further gains. But given the recent rallies, investors may prefer to accumulate on weakness to secure more value.

### **HKEx – Demanding**

The Hong Kong Exchange (**388, HKEx**) accounted for a 4.6% weighting of the HSI. Surging market turnover in recent months is a positive driver to its earnings. Given its strategic value, investors may still hold the share, but exposure should not be excessive as current valuation is not cheap at all.

### **ACCUMULATE, LOW RISK: Standard Chartered (2888) -- Targets 200 China Outlets in 5 yrs**

At HK\$255, Standard Chartered (**2888, StanChart**), trades at a prospective 2008 P/E of 14.1x. Taking into account the synergy and earnings from the newly acquired American Express Bank, 2009 P/E valuation could be decently lower. Quam reiterates **ACCUMULATE & LOW RISK** rating for the share.

The London-based bank with footprints across Asia, Middle East and Africa, plans to accelerate its Mainland development pace. In the 5 years to 2012, StanChart targets an outlet network of 200, up from the current 40. Given China's strong economic growth and potential market expansion, Quam is not surprised by its ambitious target. Rivals like Citigroup, HSBC and Bank of East Asia (**23**) have 28, 45 and 46 outlets respectively in China.

### **ACCUMULATE, MEDIUM RISK: CR Power (836) -- Eyes Coal Mines**

China Resources Power (CRP) entered into a placement agreement of 200 mln shares at HKHK\$24.3 per share. The placement represents 5.12% of the existing issued share capital or 4.86% of enlarged issued share capital.

Estimated net proceeds amount to HK\$4,817M, which the company intends to invest on coal mines in Inner Mongolia. Negotiations with related local authority and government agents are underway and a joint venture agreement with China partners is expected. Given the rising coal prices in China, the investment in coal mines is believed to secure the coal supply, stabilize the company's coal procurement cost, and enhance the company's profitability.

Assuming the net proceeds could earn HK\$383M based on the company's return on capital of 7.95% in FY06, we expect the net profit of the company in FY08 to be HK\$5,000M or HK\$1.22 per share. Priced at HK\$26.55, the company is trading at FY08 prospective P/E of 21.8x. In the backdrop of a strong power earnings growth, probable higher coal price and probable rising power plant utilization, the company's earnings may further improve in the coming years

and beat our earnings forecast. Quam therefore upgrades its rating for CRP from HOLD & MEDIUM RISK to **ACCUMULATE** with **MEDIUM RISK**.

Disclosure : SIU Chee Long Raymond (AMW 596) , the author(s) of this document declare(s) that as at the date of the publication of this report, he/she/they hold an interest in 5 2888 .

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