

# 2017 results review: a firm step to growth-quality improvement

## 2017 full-year result a beat

HK- and US-listed Chinese companies' reported net profit grew 23% yoy in aggregate in 2017, implying acceleration in 2H17 (19/27% in 1H/2H17). The result is better than the Bloomberg consensus full-year forecast of 18% and our expectation. Non-financials' bottom-line growth reported at 50% in 2017 (53/48% in 1H/2H17), and financials' profit increased by 6.8% yoy with notable growth pickup across all sub-sectors in 2H17. Profitability recovery continued in 2H given a slowdown in top-line growth for non-financials which led them to have wider margins, better ROEs, and rapid declines in net gearing. We maintain our previous forecast of 14-15% profit growth for the China market in 2018E, which is slightly higher than consensus of 13.5%, due to our more optimistic view on financials. In our view, the strong result in 2017 has laid a solid foundation for growth quality improvement this year which will be the anchor for the China/HK market, despite an [extended turbulent outlook in 2Q18](#).

## Growth acceleration in 2H17 mainly came from financials

In 2H17, bottom-line growth stayed strong for non-financials despite a less favorable base and beat Bloomberg consensus, most significantly in the property, transportation, and healthcare sectors. Of the financials sectors, the banks' result beat consensus — on improved NIM and asset quality — and banks were the largest contributor to the overall net profit growth acceleration of Chinese companies in 2H; in addition, insurance and diversified financial sectors also registered growth slightly better than previous market expectations. Compared to 1H, the consumer durables and apparel, tech hardware, insurance, consumer services, pharma, and banking sectors delivered the greatest growth acceleration in 2H; meanwhile, growth in the media, commercial and professional services, retailing, auto, capital goods, and transportation sectors slowed in 2H.

## Notable profitability improvement in non-financials

1) Non-financials' aggregate EBIT margin increased by 1.8pp yoy to 10.6% in 2H, led by property, materials, and energy companies, and was primarily thanks to higher sales prices. In contrast, media, utilities, transportation, and commercial and professional services observed thinner EBIT margin in 2H17 compared to 2H16. 2) ROE of Chinese non-financials continued its upward trend, improving by 3.1pp to 11.3% for 2017; ROE deteriorated only in the semiconductors, auto, media, utilities, and commercial and professional services sectors. 3) Aggregate net gearing for non-financials declined by 4.6pp to 40.0% in 2017, led by materials, energy, and capital goods, largely on improved profitability and restrained capex.

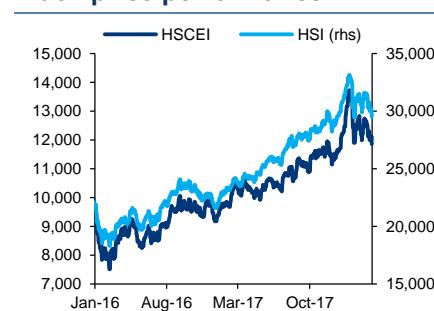
## Key risks to earnings in 2018

Looking into 2018, we believe [quality improvement](#) should become investors' focal point. During the results season, 2018 market consensus net profit forecasts have risen for the energy, materials, real estate, insurance, and healthcare equipment and services sectors, but have fallen for the utilities, semiconductors, commercial and professional services, and telecom sectors. Downside risks for earnings, in our view, include rising financing costs for select highly leveraged sectors, weaker than expected infrastructure investment due to strict rules on PPP and government debt, weaker overseas demand, and higher import costs caused by trade conflicts.

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## Index price performance



Source: Bloomberg, Huatai HK Research

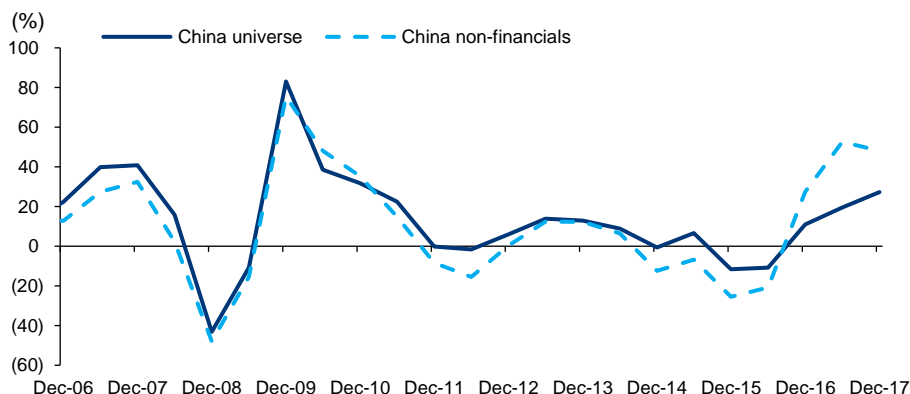
Fig.1. Net income growth of China universe

Sector	Mkt cap weights (%)	Net income weights 2014-16 (%)	Net profit growth (%)							2018E	2018 Bbg
			2H15	1H16	2H16	1H17	2H17	2017	Huatai	cons	
<b>Energy</b>	3.7	6.0	(77)	(81)	83	550	45	161	56	52	
<b>Materials</b>	2.6	0.8	(274)	8.2	201	106	167	142	35	27	
<b>Industrials</b>	6.1	7.3	(37)	(20)	47	46	17	30	11	5.9	
Capital Goods	4.0	5.4	(36)	(13)	55	37	7.4	20	6.9	6.8	
Commercial & Professional Svcs	0.5	0.2	32	32	30	21	(3)	6.8	33	33	
Transportation	1.6	1.7	(42)	(40)	24	85	62	73	22	1.2	
<b>Consumer Discretionary</b>	8.5	2.8	(1.0)	24	62	19	19	21	32	43	
Automobiles & Components	2.2	2.0	22	27	58	6.4	0.8	3.7	28	30	
Consumer Durables & Apparel	1.8	0.7	2.0	11	21	0.5	35	28	11	11	
Consumer Services	1.5	0.1	141	17	(2)	81	504	73	134	134	
Media	0.2	0.0	442	(77)	(79)	(23)	(556)	(789)	616	616	
Retailing	2.8	0.0	(193)	1,953	151	4,546	508	570	56	144	
<b>Consumer Staples</b>	2.0	0.5	15	123	(31)	27	96	42	16	18	
Food & Staples Retailing	0.0	-0.0	(678)	(86)	13	(264)	39	37	37	37	
Food, Beverage & Tobacco	1.7	0.3	20	213	(49)	30	153	51	17	21	
Household & Personal Products	0.3	0.1	35	9.2	16	17	3.7	10	6.1	6.1	
<b>Health Care</b>	3.2	1.1	7.0	4.9	25	17	47	30	5.4	4.8	
Pharmaceuticals, Biotechnology	2.8	0.7	4.2	(0.9)	33	18	64	37	2.0	1.2	
Health Care Equipment & Svcs	0.4	0.4	12	19	13	17	16	17	12	12	
<b>Financials</b>	20.7	60.8	(0.0)	(4.6)	1.2	2.9	12	6.8	10	8.3	
Banks	14.9	49.9	0.7	6.9	0.7	1.5	5.3	3.3	8.9	6.9	
Diversified Financials	1.9	5.0	15	(46)	(8.4)	12	14	12	10	10	
Insurance	3.9	6.0	(17)	(31)	19	8.5	73	34	17	17	
<b>Information Technology</b>	34.5	5.4	60	(20)	(15)	54	69	62	29	34	
Software & Services	32.0	4.4	134	(25)	(22)	80	62	68	27	34	
Technology Hardware & Eqpt	1.5	0.7	(56)	(27)	(60)	8.2	503	84	49	49	
Semiconductor	1.1	0.3	(193)	94	195	(35)	(24)	(29)	(2.5)	0.4	
<b>Utilities</b>	1.9	2.4	2.9	(4.0)	(38)	(27)	30	(9)	33	26	
<b>Telecom</b>	6.6	5.7	1.5	(1.9)	(15)	5.3	6.3	5.8	8.2	8.2	
<b>Real Estate</b>	10.2	7.1	(8)	(22)	27	69	80	74	0.7	0.4	
<b>Overall China universe</b>	100.0	100.0	(12)	(11)	11	19	27	23	15	14	
- Ex Banks	85.1	50.1	(22)	(26)	22	42	47	44	19	19	
- Ex Banks & Energy	81.4	44.1	(10)	(19)	19	29	47	38	15	15	
<b>China non-financials</b>	79.3	39.2	(25)	(21)	27	53	48	50	20	20	

Note: includes HK- and US-listed Chinese companies with total mkt cap greater than USD300mn

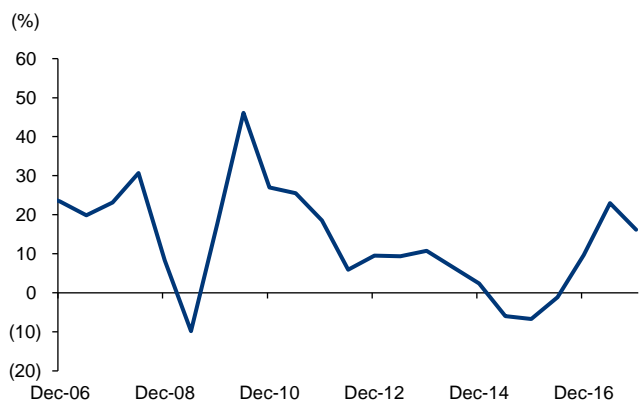
Source: Bloomberg, Huatai HK Research

**Fig.2. Net income growth of China universe**



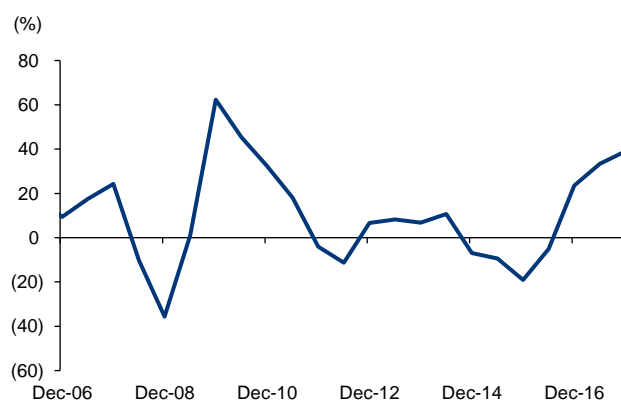
Source: Bloomberg, Huatai HK Research

**Fig.3. Revenue growth of China non-financials**



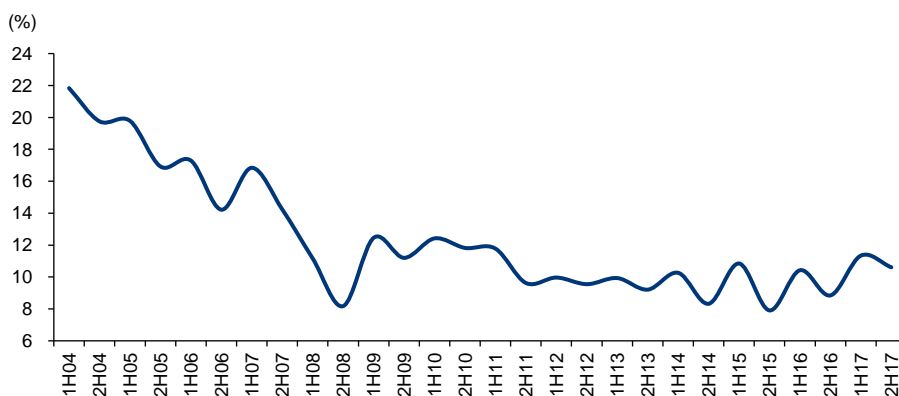
Source: Bloomberg, Huatai HK Research

**Fig.4. EBIT growth of China non-financials**



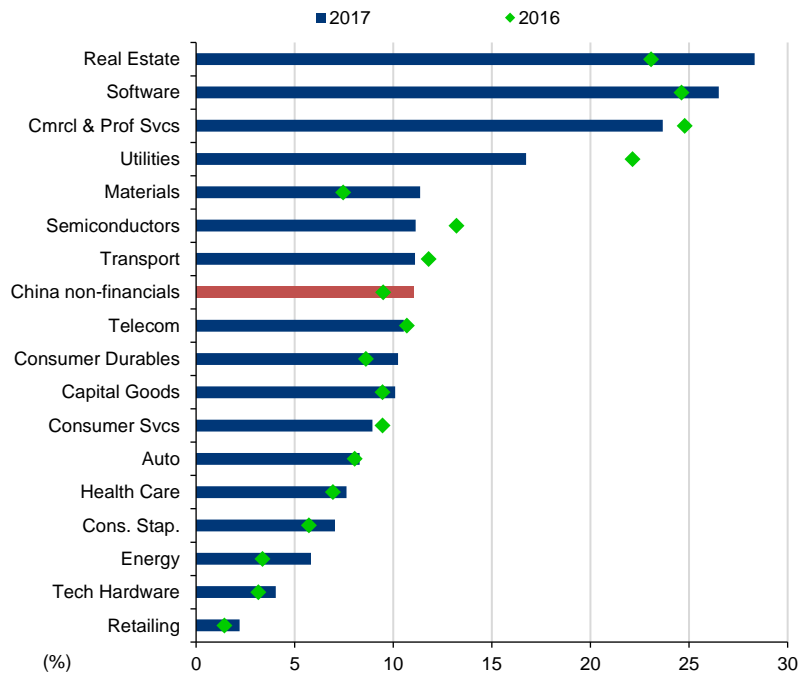
Source: Bloomberg, Huatai HK Research

**Fig.5. EBIT margin of China non-financials**



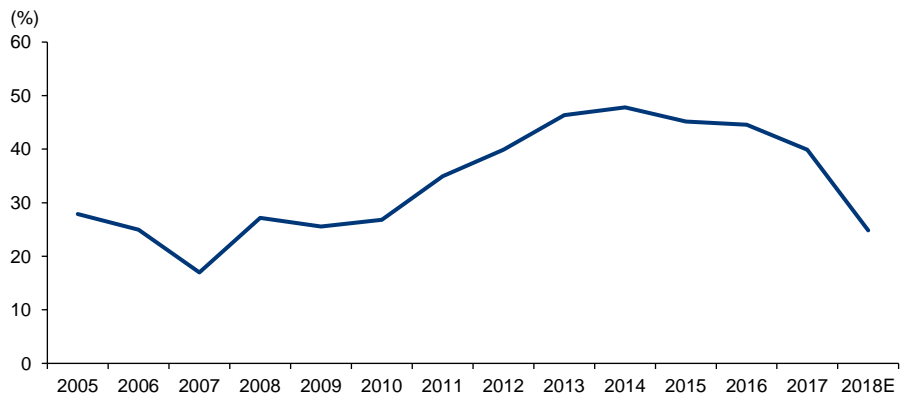
Source: Bloomberg, Huatai HK Research

**Fig.6. EBIT margin of China non-financials by sector**



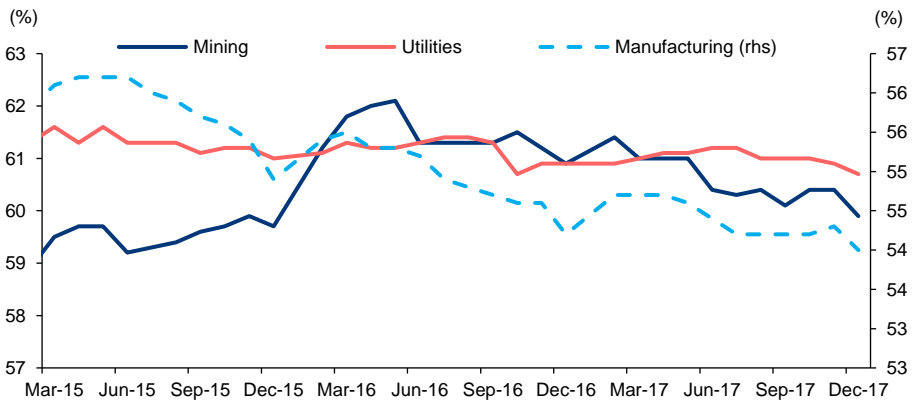
Source: Bloomberg, Huatai HK Research

**Fig.7. Net gearing of China non-financials**



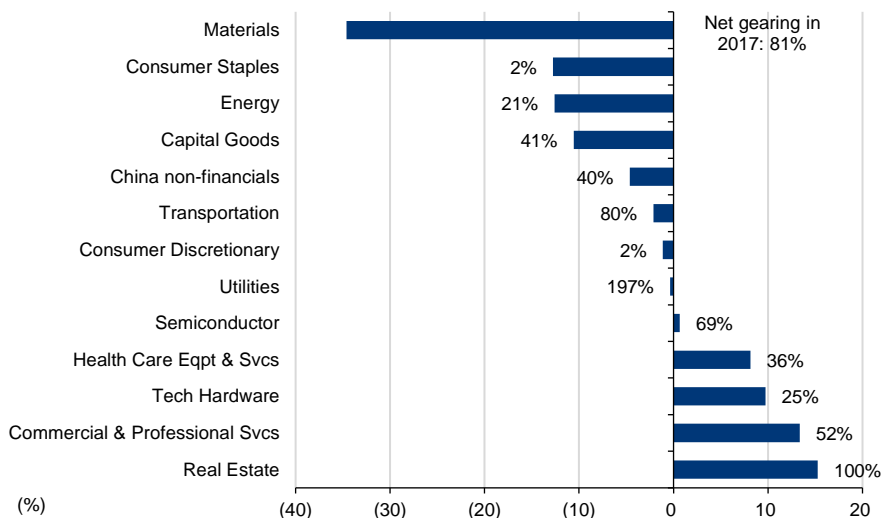
Source: Bloomberg, Huatai HK Research

**Fig.8. Leverage ratio of China Industrials (including non-listed companies)**



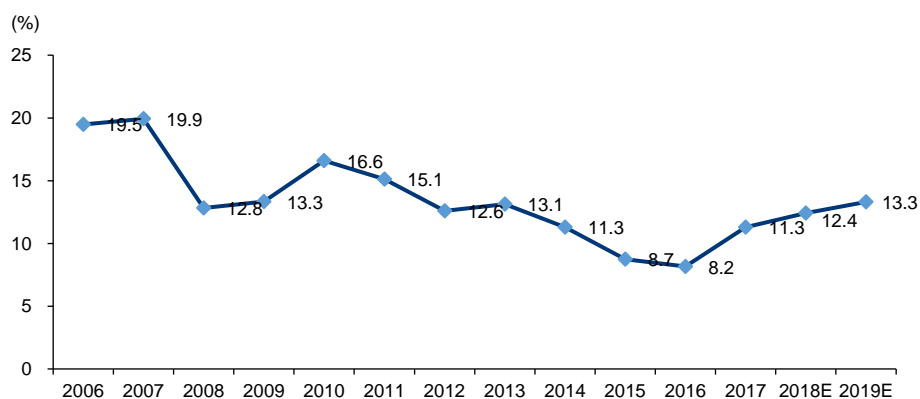
Source: Wind, Huatai HK Research

**Fig.9. Change in net gearing by sector, 2017 vs 2016**



Source: Bloomberg, Huatai HK Research

**Fig.10. ROE of China non-financials**



Source: Bloomberg, Huatai HK Research

Fig.11. China universe valuation table

Sector	Mkt cap weights (%)	PE (x) 2018E	Net earnings growth (%)			PB (x)		ROE (%)		Div yield (%) 2017	PEG (18E PE vs 17-19E CAGR)
			2017	2018E	2019E	2017	2018E	2017	2018E		
<b>Energy</b>	3.5	9.3	162.4	51.7	3.5	1.0	0.9	5.5	8.1	4.7	0.4
<b>Materials</b>	2.7	8.1	153.4	25.1	10.4	1.4	1.1	12.2	13.1	2.5	0.5
<b>Industrials</b>	6.1	9.1	30.7	6.3	15.6	1.0	0.9	10.3	10.4	2.6	0.8
- Capital Goods	3.9	7.7	19.6	7.2	13.0	0.9	0.8	10.3	10.4	2.8	0.8
- Commercial & Professional Svcs	0.4	16.3	6.8	33.1	25.1	3.0	2.7	13.3	15.5	1.2	0.6
- Transportation	1.7	12.4	80.2	1.6	22.4	1.2	1.1	10.0	10.4	2.4	1.1
<b>Consumer Discretionary</b>	9.3	17.2	23.6	36.5	24.0	2.6	2.5	11.8	13.2	1.3	0.6
- Automobiles & Components	2.2	10.2	3.8	29.8	18.0	2.3	1.9	15.3	17.0	1.7	0.4
- Consumer Durables & Apparel	2.3	15.9	16.1	9.9	18.4	2.6	2.5	15.0	16.3	2.7	1.1
- Retailing	2.7	24.9	301.7	99.0	43.5	2.5	2.6	6.5	7.0	0.4	0.4
<b>Consumer Staples</b>	3.5	21.2	28.8	19.0	15.0	3.1	2.8	11.5	13.5	1.6	1.2
<b>Health Care</b>	3.7	29.4	36.2	6.6	18.9	4.0	3.4	13.2	12.2	0.8	2.3
<b>Financials</b>	20.1	7.0	6.9	8.5	11.2	1.1	0.9	13.6	13.3	3.5	0.7
- Banks	14.0	6.3	3.4	7.0	10.0	0.9	0.8	13.9	13.4	4.2	0.7
- Diversified Financials	2.3	7.7	13.6	10.6	15.7	1.0	0.9	10.3	10.9	2.2	0.6
- Insurance	3.8	11.7	33.6	17.3	16.1	2.0	1.7	14.0	14.5	2.0	0.7
<b>Information Technology</b>	32.4	28.3	55.6	26.6	30.2	6.5	5.4	17.8	18.8	0.2	1.0
- Software & Services	29.2	30.2	63.9	26.3	32.6	7.8	6.3	21.7	21.2	0.1	1.0
- Technology Hardware & Eqpt	2.1	15.9	64.7	34.1	18.2	2.7	2.5	13.8	13.5	1.5	0.6
- Semiconductors	1.1	14.6	-18.2	0.1	21.1	2.5	1.1	7.7	7.5	0.4	1.4
<b>Utilities</b>	2.4	12.3	-3.6	29.0	19.0	1.6	1.5	9.0	10.8	2.2	0.5
<b>Telecommunication Services</b>	6.1	11.3	5.8	8.3	7.5	1.1	1.0	8.6	8.9	3.7	1.4
<b>Real Estate</b>	10.2	7.8	61.7	4.0	24.5	1.2	1.1	14.7	15.6	2.5	0.6
<b>Overall China Universe</b>	100.0	12.2	22.2	13.2	14.6	1.8	1.6	12.0	12.6	1.9	0.9
- Ex Banks	86.0	14.6	42.2	18.1	17.6	2.1	1.9	10.8	12.1	1.5	0.8
<b>China non-financials</b>	79.9	15.1	47.0	18.9	18.0	2.1	1.9	10.5	11.9	1.5	0.8

Note: includes HK- and US-listed Chinese companies with total mkt cap greater than USD300mn

Source: Bloomberg, Huatai HK Research

Fig.12. Southbound universe valuation table

Sector	Mkt cap weights (%)	PE (x)		Net earnings growth (%)			PB (x)		ROE (%)		Div yield (%)
		2017	2018E	2017	2018E	2019E	2017	2018E	2017	2018E	
<b>Energy</b>	3.3	16.5	9.3	159	51.9	3.4	1.0	0.9	5.4	8.0	4.8
<b>Materials</b>	2.1	11.1	8.0	101	28	9.9	1.3	1.1	12.1	13.2	2.8
<b>Industrials</b>	7.8	11.2	9.8	33	2	15.2	1.0	0.9	9.8	9.8	2.9
- Capital Goods	5.0	9.2	8.2	21	5.6	12.4	0.9	0.8	10.0	10.1	3.2
- Commercial & Professional Svcs	0.3	17.3	13.5	22	18	18.8	2.7	2.3	13.0	16.7	1.8
- Transportation	2.5	18.4	15.6	111	(10)	23.9	1.2	1.1	9.1	8.7	2.5
<b>Consumer Discretionary</b>	9.6	20.9	16.1	6	26	18.2	2.7	2.6	13.1	16.3	2.0
- Automobiles & Components	2.1	14.0	10.2	4	30	18.1	2.4	1.9	15.3	17.2	1.6
- Consumer Durables & Apparel	2.4	19.5	16.0	0	22	18.3	2.6	2.3	11.9	15.6	2.7
- Consumer Services	3.8	30.5	23.2	3	20	17.3	3.6	4.2	14.1	18.7	1.9
- Media	0.5	78.0	33.5	19	153	26.3	2.5	2.6	2.3	8.0	0.8
- Retailing	0.9	15.9	13.7	37	20	19.4	1.8	1.7	10.0	12.1	2.5
<b>Consumer Staples</b>	3.4	27.2	20.9	18	18	14.9	3.2	2.9	12.5	13.9	1.6
- Food & Staples Retailing	0.3	28.8	25.2	9	5.5	8.1	3.4	3.1	12.7	12.8	1.6
- Food, Beverage & Tobacco	2.8	27.8	20.7	22	22	16.3	3.0	2.7	11.5	13.3	1.5
- Household & Personal Products	0.3	21.7	19.1	5.5	6.1	9.3	4.9	4.4	24.6	23.7	3.1
<b>Healthcare</b>	3.2	31.9	26.5	45	5	17.3	4.0	3.4	14.1	13.4	0.7
- Pharmaceuticals, Biotechnology	2.6	35.8	30.0	45	1	19.5	4.6	3.9	14.6	13.5	0.6
- Health Care Equipment & Svcs	0.6	19.2	15.6	46	12	13.0	2.3	1.9	13.1	13.1	1.4
<b>Financials</b>	29.2	9.9	8.7	11	9.2	11.1	1.2	1.1	13.0	12.8	3.7
- Banks	19.7	8.6	7.6	8.6	7.1	9.9	1.0	0.9	12.9	12.8	4.5
- Diversified Financials	3.0	12.5	10.6	(4)	33	15.3	1.4	1.3	11.3	11.0	2.4
- Insurance	6.4	15.6	14.1	36	12	15.4	2.1	1.9	14.3	14.3	1.8
<b>Information Technology</b>	15.9	40.4	29.0	81	18	26.2	6.6	5.5	10.3	4.6	0.5
- Software & Services	13.1	49.4	35.1	102	(2)	30.9	10.9	8.2	14.7	26.1	0.2
- Tech Hardware & Eqpt	2.2	23.2	15.7	102	27	18.7	2.7	2.3	9.8	1.7	1.8
- Semiconductor	0.6	15.7	15.3	22.1	(3)	15.4	1.6	1.4	10.0	9.7	1.1
<b>Utilities</b>	4.7	16.7	14.9	2.6	13	12.5	1.8	1.7	9.8	10.9	2.8
<b>Telecom</b>	6.3	13.4	11.5	8.4	5	7.6	1.1	1.0	8.9	8.9	3.8
<b>Real Estate</b>	14.5	10.4	9.1	58.7	(23)	19.6	0.8	0.9	11.8	10.1	3.0
<b>SB universe</b>	100.0	13.8	11.6	24.4	6.8	12.8	1.4	1.3	11.3	10.8	2.7

Note: earnings growth is calculated based on estimated earnings in RMB

Source: Bloomberg, Huatai HK Research

**Fig.13. HSI: 12-month forward PE**



Note: data as at 4 April close

Source: Bloomberg, Huatai HK Research

**Fig.14. HSCEI: 12-month forward PE**



Note: data as at 4 April close

Source: Bloomberg, Huatai HK Research



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