Daiwa
Daiwa Institute of Research

18 November 2008 (No. of pages: 172)

2009 Outlook for Asia

DIR Asia Pacific research team

Finding a phoenix

Summary

- Great investment ideas will rise like a phoenix from the ashes of global recession, perhaps starting some time in 2009. Asian economies should rebound faster than those of the US and Europe, which will take several years to rebuild balance sheets and deleverage the consumer.

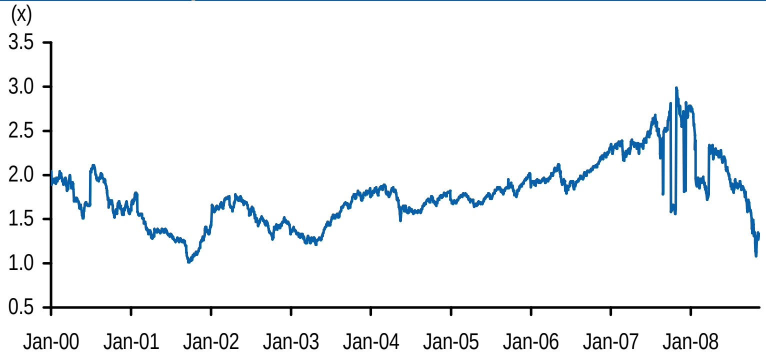
- Organisation for Economic Co-operation and Development (OECD) economies are entering the worst recession in 50 years, in our view. Asia will certainly sell much less to the West next year, and domestic consumption is not ready to completely fill the gap … yet. Private consumption in key emerging markets is now 60% of the US level and expanding twice as fast.

- 2009 should be volatile for equities. Next year, we expect Asian markets to fight a tug-of-war between global recessionary forces and waves of policy stimulus. Asian economies are generally well-armed for the battle, having built up substantial reserves since the Asian crisis a decade ago. Savings rates are high (50% of GDP for China, about 35% for the rest of Asia ex-Japan) and public debt/GDP is low (21% for China).

- Some of the negative outlook is starting to be priced in by equity markets. Asia ex-Japan equities are trading at a PBR of just 1.3x, having rebounded from an October low of 1.08x, which represents a key level of downside support … and selected opportunity.

- Rather than time the bottoms or dips, in this report we identify structural winners in the eventual rebound, complete with 'entry prices' from which we would expect stocks to double over three years. We will look to this *Phoenix List* for great ideas next year, whenever the sky appears to be falling.

MSCI Asia ex-Japan: PBR



Source: MSCI

IMPORTANT DISCLOSURES, INCLUDING ANY REQUIRED RESEARCH CERTIFICATIONS, ARE PROVIDED ON THE LAST TWO PAGES OF THIS REPORT.

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Sifting through the ashes …

Dear Investors,

This year, we are doing things differently.

Most banks produce an annual tome of well-argued broad predictions and recommendations for the year to come. We are taking a longer-term view, by identifying core stocks that investors can buy in next year's panics, and whose share prices we expect to double over three years.

We expect the wild ride in 2008 to continue in 2009. There is simply too much uncertainty and too many potential negative surprises to expect anything smooth – up or down. We certainly do not expect the kind of low-volume 'boring' markets of all true market bottoms. Next year could see several periods of acute downward spikes, even panics, followed by aggressive bounces. We do not pretend to be able to predict when these drops will happen, but we can prepare ourselves by identifying good stories to buy aggressively during any 'sky is falling' periods next year.

The outlook for Asian markets beyond 2009 actually looks quite promising, in our view. Unlike during the 1997-98 Asian financial crisis, Asian economies are solid structurally, with ample reserves and healthy balance sheets. Our Chief Economist, P.K. Basu, makes a compelling case for the structural soundness of Asian economies later in this report. Asian governments are now fiscally very well-armed, enough to accelerate greatly the ongoing displacement of US demand by Asian demand. We expect Asian markets to emerge from the current global recession expanding strongly, in sharp contrast to the US, where rebuilding bank balance sheets and deleveraging the consumer could take years.

The good news is that global financial integration (or contagion, depending on your point of view) has delivered Asian investors historically low valuations. The cost of equity has gone global. Failing US banks push down equity valuations irrespective of positive regional factors. On a three-year view, this is very attractive for Asian investors, and is the focus of our *2009 Outlook*.

We identify, on a sector-by-sector basis, the companies that we believe are best-positioned to emerge from the mayhem with stronger market positions. Maybe they acquire weaker players, maybe they will launch killer new products, maybe they open new distribution channels, maybe competitors will slip to sub-scale production levels, maybe they will grab market share because competitors sacrifice long-term growth for short-term survival. Every sector will see winners.

Our analysis here focuses necessarily more on structural than cyclical factors. We score every company on our three-year outlook for management, product demand, market share, pricing power and margins. From the winners, we then turn to valuations, and estimate three-year target prices for the most attractive stories, and break down the source of the upside potential: earnings growth? multiple expansion? dividends?

Finally, we turn the more traditional analysis upside down, by setting 'entry prices', from which we expect the stock to double in three years. Some stocks are already trading at below our entry prices, others are not. We further discuss catalysts and the outlook for getting there.

The end result is a simple list. We will keep the list near our screens, and every time the sky appears to be falling, we will scan it for solid, long-term and value-driven investment ideas. We hope you will do the same.

Very truly yours,

Masatoshi Makino
Head of Regional Research

Craig Irvine
Co-head of Regional Research

Asia: our picks for 2009

Sector	Company name	Stock code	Share price* 12-Nov-08	Rating	Six-month target price*	+/- (%)	PER (x) 2007	2008E	2009E	2010E	Three-year target price*	Upside potential (%)	Entry price for 100% upside*	2009 PER at entry price (x)
Hong Kong/China														
Automobiles (China)	Denway Motors	203 HK	1.66	2	3.51	111.4	5.4	4.5	4.0	3.3	4.66	180.7	2.33	5.6
Aviation (China)	TravelSky Technology	696 HK	2.93	2	4.28	46.08	-	8.8	7.7	7.0	6.75	130	3.38	8.5
Banks (Hong Kong)	Bank of East Asia	23 HK	15.40	2	18.10	18	5.8	n.m.	7.6	-	30.00	95	15.00	7.4
Banks (China)	China Construction Bank	939 HK	4.25	2	4.70	10.6	13.2	7.9	7.3	-	8.59	102	4.30	7.4
Coal (China)	China Shenhua Energy	1088 HK	14.30	2	22.69	58.7	12.9	8.1	5.8	4.0	41.1	188	20.6	8.3
Conglomerates (Hong Kong)	Hutchison Whampoa	13 HK	41	2	71.5	74.4	5.7	9.7	7.0	3.3	84.27	106	42.1	7.3
Consumer (Hong Kong)	Li & Fung	494 HK	14.26	2	29.4	106.0	15.9	14.0	10.4	7.7	38.67	171	19.3	14.0
Department Store (China)	Parkson	3368 HK	5.8	2	7.95	37.1	22.2	16.1	13.1	10.7	10.68	84.1	5.34	12.1
Electronics (Hong Kong/China)	Kingboard Laminates	1888 HK	1.88	3	6.25	232.4	3.1	2.9	2.7	2.5	6.44	243	3.22	4.6
Insurance (China)	Ping An	2318 HK	34.00	1	62.41	84	12.2	33.6	10.5	-	65.00	91	32.50	10.1
Marine (Hong Kong/China)	China Shipping Container Lines	2866 HK	1.01	5	1.62	60.4	2.8	7.2	n.a.	n.a.	5.0	395.0	2.5	n.m.
Oil & Gas (China)	Sinopec	386 HK	4.66	2	8	71.7	6.7	7.0	3.7	4.0	10.50	125	5.25	4.2
Pharmaceuticals and Healthcare (China)	Sihuan Pharmaceutical	SHPH SP	0.57	1	0.88	54.4	7.6	4.5	3.2	2.5	2.72	377	1.36	7.7
Power (China)	Datang International Power	991 HK	2.76	2	5.1	84.8	8.9	96.8	16.0	8.7	7.74	180	3.87	22.4
Small and Medium Caps (Hong Kong/ China)	Nine Dragons	2689 HK	1.93	4	1.20	(37.8)	4.0	4.9	4.2	3.8	4.00	107	2.00	5.1
Steel (China)	Angang Steel	347 HK	6.25	4	2.90	(54)	5.2	5.7	6.5	4.6	12.0	92	6.0	6.3
Tele-communications (China)	China Unicom	762 HK	9.81	3	14.05	43	12.9	3.6	19.4	13.5	21.1	115	10.55	20.9

Sector	Company name	Stock code	Share price* 12-Nov-08	Rating	Six-month target price*	+/- (%)	EPS growth (% YoY) 2007	2008E	2009E	2010E	Three-year target price*	Upside potential (%)	Entry price for 100% upside*	2009 PER at entry price (x)
Property (Hong Kong)	SHK Properties	16 HK	63.00	2	89.0	41.3	4.1	(10.7)	10.1	10.4	119.76	90.1	59.88	14.0

Source: Companies, Daiwa forecasts
Note: *local currency

Asia: our picks for 2009 (cont'd)

Sector	Company name	Stock code	Share price* 12-Nov-08	Rating	Six-month target price*	+/- (%)	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	Three-year target price*	Upside potential (%)	Entry price for 100% upside*	2009 PER at entry price (x)
Korea														
Automobiles and Components	Hyundai Mobis	012330 KS	78,000	2	100,000	28.2	8.6	6.7	6.8	5.8	140,000	79.5	70,000	6.1
Banks	KB Financial Group	105560 KS	32,100	2	41,300	28.7	3.9	4.8	5.1	-	71,582	123.0	35,791	5.7
Construction	GS E&C	006360 KS	61,600	2	106,000	72.1	7.9	6.5	6.4	5.7	143,000	132.1	71,500	7.4
Electronics	Samsung Electronics	005930 KS	480,500	2	540,000	12.4	11.0	12.8	15.3	10.2	780,000	62.3	390,000	12.4
Retail	Shinsegae	004170 KS	455,000	4	513,000	12.7	17.1	15.3	14.6	12.3	792,000	74.1	396,000	12.7
Securities	Samsung Securities	016360 KS	62,300	3	74,000	18.8	11.6	16.1	10.0	-	107,500	72.6	53,750	8.6
Shipbuilding	Hyundai Heavy Industries	009540 KS	164,000	4	140,000	(14.6)	7.2	6.7	7.2	6.7	300,000	82.9	150,000	6.6
Software	NHN	035420 KS	123,000	2	171,000	39.0	20.9	16.9	15.2	13.0	211,081	72	105,540	13.1
Tele-communications	LG Dacom	015940 KS	20,700	2	20,261	(2)	12.8	12.2	9.0	7.9	30,479	47	15,239	6.6
Taiwan														
Handset	HTC Corp	2498 TT	380	2	479	26.1	7.5	10.0	9.1	9.1	652.5	71.7	326.3	7.8
IC-design	MediaTek	2454 TT	238	4	267	12.18	7.4	11.4	10.7	8.8	540	127	270	12
LED	Epistar	2448 TT	31.2	5	25	(19.9)	9.2	29.0	23.7	16.0	75	140.4	37.5	28.8
PC	Acer Inc	2353 TT	47.00	3	66	40.4	8.7	9.4	9.1	8.1	65	38	32.5	6.3
Semiconductor	SPIL	2325 TT	29.90	2	36.5	22.1	5.2	9.2	9.8	7.8	59.8	100.0	29.9	9.77
TFT-LCD	AU Optronics	2409 TT	21.65	3	23.0	6.2	3.3	4.6	n.a.	19.8	50.00	131	25.00	n.a.
Tele-communications	Chunghwa Telecom	2412 TT	51.20	1	71.26	39	13.6	12.2	12.0	11.8	71.3	39	35.63	8.4
Singapore														
Banks	UOB	UOB SP	12.70	4	9.7	(23.6)	9.3	9.5	10.4	-	27.46	116.22	13.73	11.3
Conglomerates	SembCorp Marine	SMM SP	1.93	4	2.25	16.6	16.5	8.5	7.5	7.0	2.84	47.0	1.42	5.5
Electronics	Venture	VMS SP	5.03	2	8.5	69.0	4.6	5.8	5.3	5.0	10.6	110.4	5.3	4.1
Small Caps	Cacola	CCF SP	0.075	1	0.45	500.0	1.1	0.9	1.8	1.5	0.42	463.1	0.21	0.075
Australia														
Banks	ANZ Banking Group	ANZ AU	15.4	3	18.2	18.2	12.1	8.9	8.2	-	22.70	47.4	11.35	6.5

Sector	Company name	Stock code	Share price* 12-Nov-08	Rating	Six-month target price*	+/- (%)	DPU growth (% YoY) 2007	DPU growth (% YoY) 2008E	DPU growth (% YoY) 2009E	DPU growth (% YoY) 2010E	Three-year target price*	Upside potential (%)	Entry price for 100% upside*	2009 PER at entry price (x)
Singapore														
REITs	CCT	CCT SP	0.945	1	1.85	95.8	18.7	28.1	15.1	4.1	1.89	99.7	0.94	n.a.

Source: Companies, Daiwa forecasts
Note: *local currency

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Note: All share prices as of 12 November 2008

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Regional Strategy

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Sit tight

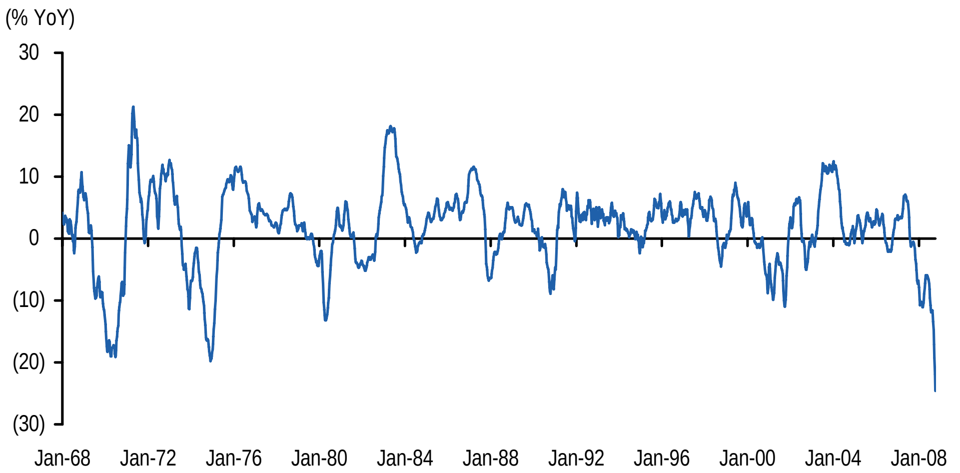
More volatility ahead …

We believe that 2009 is likely to be another difficult year for equity investors globally, with stock markets remaining volatile as fiscal reflation and monetary easing face bad economic news head-on. In the short term, we expect economic activity to dip further. The Economic Cycle Research Institute (ECRI) weekly leading indictor for the US fell to 110.9 in mid-October, its lowest level since 12 April 1996 and recorded its biggest-ever annual decline since the inception of the indicator on 31 October of 24.6% YoY.

More reflationary policies …

To counter the risk of a deepening global recession, the PRC Government announced a Rmb4tn fiscal package on 9 November 2008, and we expect other Asian economies to follow suit with additional government spending. In the developed markets, the US Government is looking to fast-track another fiscal package worth an estimated US$100bn, or 0.7% of GDP.

Weekly economic leading indicator for the US



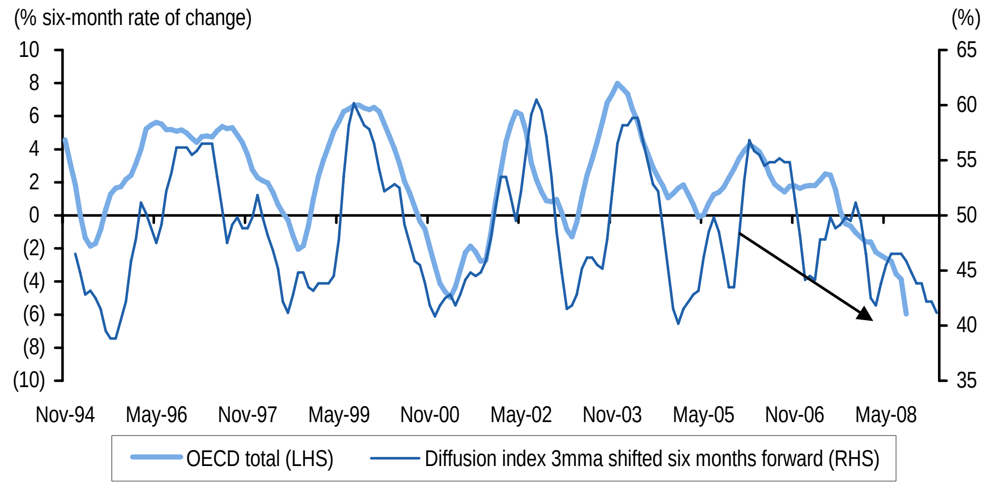
Source: ECRI

… but not out of the woods yet

In our view, such news flow will continue to have a positive impact on the market, and could set off rallies similar to the one we saw at the end of October 2008, when Asia ex-Japan equity markets rose by more than 30% within the space of less than two weeks. That said, we do not think that an end to the bear market is near. Macro fundamentals globally remain rather negative, in our view. Based on the latest data available up to September 2008, our global growth diffusion index suggests that the global growth cycle is unlikely to bottom out even by 4Q09. In our view, the chances of seeing a sustainable recovery in equity markets globally in 1H09 are very slim.

Our growth diffusion index leads the real economy by one year

Daiwa's growth diffusion index

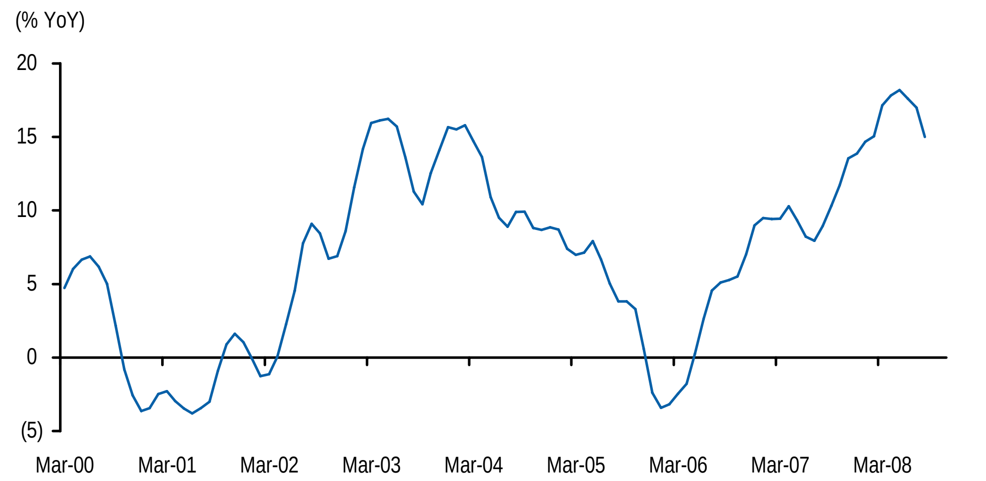


Source: OECD, Daiwa

Liquidity cycle remains on the downward leg

It is equally important to note that the de-leveraging process for the global economy does not end with a moderation in redemptions faced by investment funds. The cash injections by the various central banks at this point only serve to support the short-term funding needs of the banking system, and replace the capital that has been written off due to sub-prime-related lending. The latest survey by the Federal Reserve continues to highlight further tightening in lending conditions by the banking system. Even if the banking system were able to roll over all the existing debt that is coming to maturity, one would at best expect only flat (0% YoY) growth in bank lending next year.

Broad money supply M2 in developed markets



Source: CEIC
Note: developed markets are defined as the EU, Japan, the UK and the US

In addition, the nationalisation of major banks in the developed world, and the fact that management of these banks will now be accountable to the respective governments, suggests that credit facilities not related to any underlying transactions in the real economy are likely to be cut or reduced. Thus, we believe that not only will broad money-supply growth continue to fall, but the trading volume of cash equities will stay at a low level over the next few quarters.

Index targets for Asia ex-Japan lowered

As such, our economics team has revised down its real GDP growth forecasts further for Asia for 2009, and now forecasts Asia ex-Japan to record real GDP growth of 5.6% YoY, compared with our previous forecast of 6.7% YoY, and our projection of 7% YoY growth for 2008.

Given the downgrade to our economic growth outlook, we have also revised down our index targets for the various key markets over a six-month investment horizon. This brings our index targets into line with our expectation that sustainable ROEs will fall going forward, especially when profit margins revert toward the mean after years of easy credit conditions, which we elaborate on below.

Fair-value estimates and six-month index targets

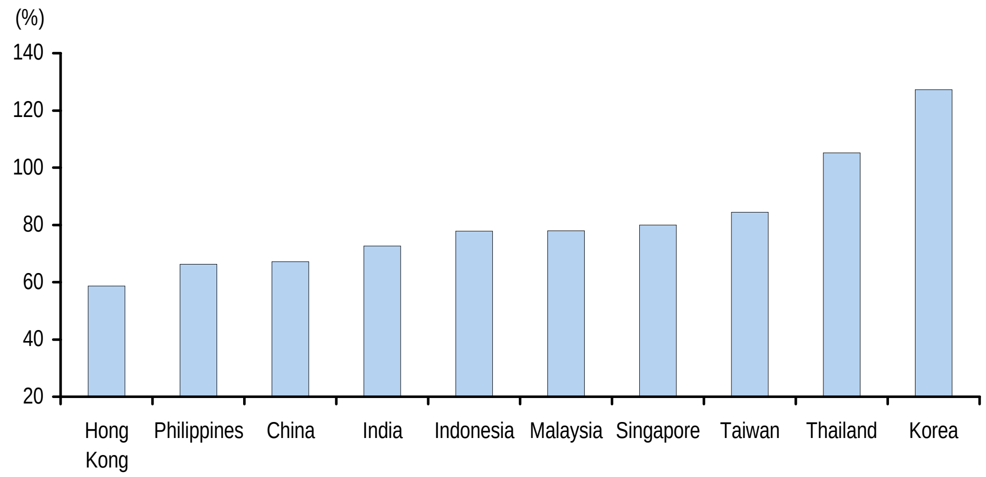
	Current PBR (x)	01-02 average PBR (x)	Implied upside (%)	Estimated fair-value PBR (x)	Implied upside (%)
China	1.64	1.73	5.5	1.90	15.9
Hong Kong	1.01	1.06	4.8	1.30	28.6
Korea	1.11	1.23	10.5	1.18	6.3
Singapore	1.22	1.39	13.8	1.24	1.6
Taiwan	1.41	1.90	34.4	1.70	20.2

	Local index equivalent	Current index level	Daiwa 6M index target
China	H-share index	7,413	8,600
Hong Kong	HSI	14,745	15,500
Korea	KOSPI	1,152	1,225
Singapore	STI	1,885	1,950
Taiwan	TAIEX	4,740	5,200

Source: MSCI, Daiwa

Taking the aforementioned factors into consideration, from a top-down perspective, we continue to prefer markets where the domestic economy enjoys strong liquidity. Such a situation ensures that the economy is able to give further legs to any monetary reflation efforts; a very crucial and necessary condition, in our view, given the global liquidity crunch. Effectively, this means low loan-to-deposit ratios in the banking system, room for further policy rate cuts, and low domestic gearing. Thus, China remains our key Overweight market in 2009.

Loan-to-deposit ratios of banking systems



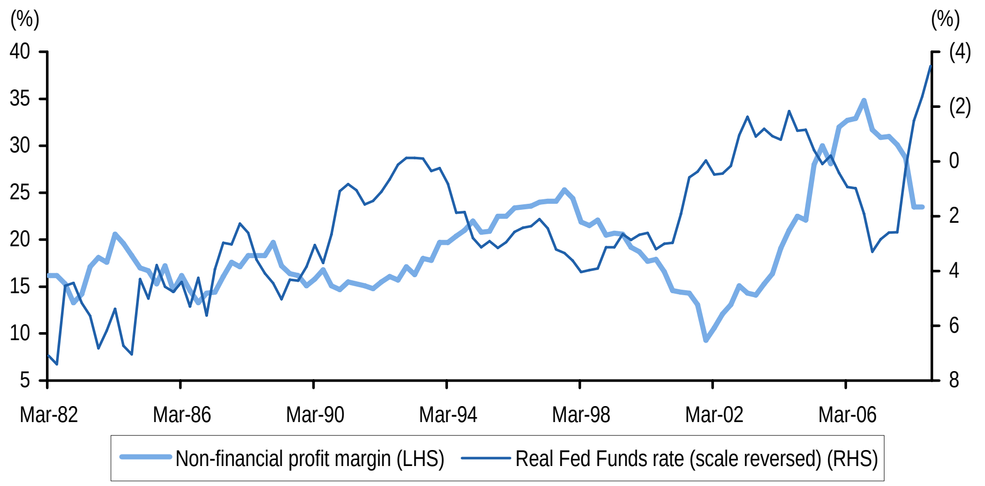
Source: CEIC

Where are margins heading?

Profit margins are reverting toward the mean

Apart from the inability to support a sustained rebound in the stock market in the near term, a period of low global liquidity growth would have strong implications for corporate performance. Over the past few years, profit margins globally have been on the rise, thanks to a period of low inflation and easy monetary policy. Of course, this has also been supported by China's increased participation in global trade following its accession to the World Trade Organization (WTO), which provided a positive labour supply shock for the global economy. However, as we can see from the following chart, the rise in the corporate profit margin has been preceded historically by a period of ultra-low real interest rates, which in our view has been the key driver of the profit-margin expansion.

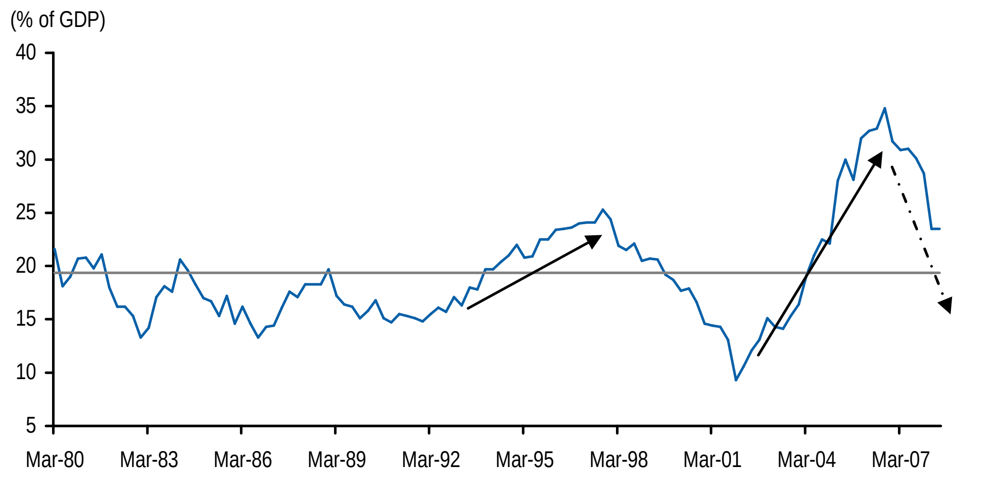
US: monetary cycle and corporate profit margin



Source: CEIC

While policy rates are being lowered now, the profit margin for the corporate sector will not turn around just yet, in our view, due to the difficulty with obtaining credit and the associated rise in lending rates offered by the banks. Thus, we believe the profit margin is likely to contract further, putting more downward pressure on profits, in addition to the impact from a contraction in sales volume.

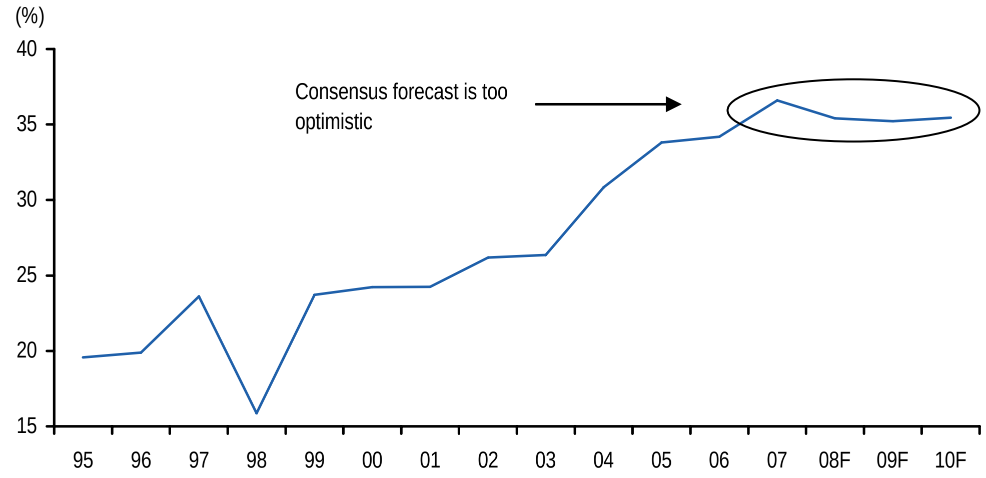
US: corporate profit margin



Source: CEIC

We believe the corporate profit margin in Asia is likely to exhibit similar behaviour, but given that it did not rise as sharply as its US counterpart, the contraction may be less severe as well. Nevertheless, this will put a cap on equity performances in Asia for the next few years, in our view.

Asia ex-Japan: EBITDA margin



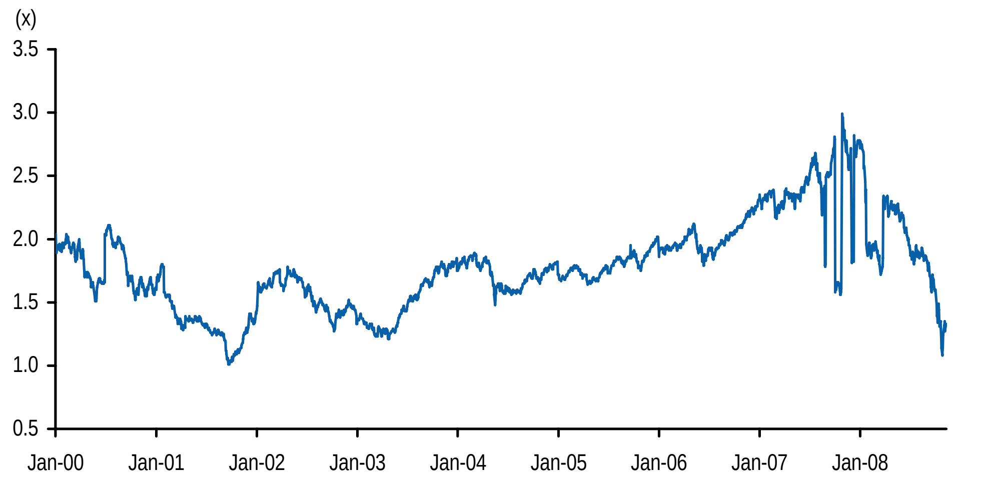
Source: Worldscope, IBES

Nevertheless, value is emerging

MSCI Asia ex-Japan touched a 1.08x PBR in October 2008

Despite the negative macro backdrop, we believe value is emerging for Asian ex-Japan equities, and that many of the negatives are starting to be priced in. At the current level, Asia ex-Japan equities are trading at a PBR of only 1.3x, after having touched a low of 1.08x at the end of October. Looking back at past cycles, that is pretty much close to a rock-bottom valuation for Asian ex-Japan markets, in the aftermath of the bursting of the Dot.com 'bubble' (1.03x), as well as the Asian financial crisis (0.84x). If investors are willing to take a longer-term view on Asia ex-Japan equities, the current correction could turn out to be a golden opportunity to invest in great Asia companies at extremely attractive valuations, in our view.

MSCI Asia ex-Japan: PBR



Source: MSCI

So where do we begin?

Looking beyond the current concerns about the credit crunch and financial dis-intermediation in the US, we expect economic growth to remain weak over the next two-to-three years, as the US corporate and household sectors repair their balance sheets. As a result, we believe demand for imports will record sub-par growth, and the US current-account deficit is likely to shrink over the next two-to-three years. This has important implications for economies and stock markets in Asia, not only from a demand perspective, but also for Asia's ability to re-liquefy its economy. Based on the data for the past two years, the US current-account deficit has been supplying liquidity to the rest of the world to the tune of close to US$800bn per year. While foreign reserves in Asia are ample at this point, the region's incremental ability to print money is dependent on its pace of foreign-reserve accumulation on the margin.

On a more positive note, we believe this crisis could impress upon Asian governments that the dependence on an export-oriented model will not ensure sustained economic growth over the long run. Given the high savings rate among Asian economies and the foreign reserves that have been amassed over the years, we believe this capital should now be re-directed toward developing domestic demand. This could come in the form of a reduction in taxation, development of the financial system to enhance returns on household savings, and reducing infrastructure bottlenecks in rural areas so that further wealth can be generated.

Although this may sound like a cliché and investors could remain sceptical about the coming of age of consumers in Asia, let us not forget that fundamentally Asia has seen a quantum improvement in its economic structure. The boom years in the early 90s were sustained on external borrowing, which led to tears eventually. However, with substantial foreign reserves, low foreign-debt levels in general, we believe Asia is in a much better position now than ever to boost its domestic economy. The very fact that intra-regional trade is now almost 60% of total exports for most Asian countries points to the structural improvement in Asian demand. While private consumption may not be the biggest growth driver for the Asian economies like in the US, at least we can say confidently that Asia is now further down the road to reducing its dependence on foreign demand.

This transformation of the Asian economy – if it succeeds – would be likely to pay dividends across many industries, from increased demand for consumer products, such as handsets, leisure travel, healthcare, insurance, to bigger-ticket items, like automobiles and housing. Thus, we believe the search for winners as the global economy rises from the ashes of the credit crisis, rests on identifying companies that are well-capitalised currently to survive and emerge as market leaders in their respective industries. This is what our *2009 Outlook* report aims to identify; never mind the near-term volatility, this is the best time to invest for the longer term, in our view.

Regional Economy

Prasenjit K. Basu *(65) 6321 3069 (p-k.basu@dir.com.sg)*

Asia economies: combating contagion with fiscal stimulus

Healthy, but affected by global contagion

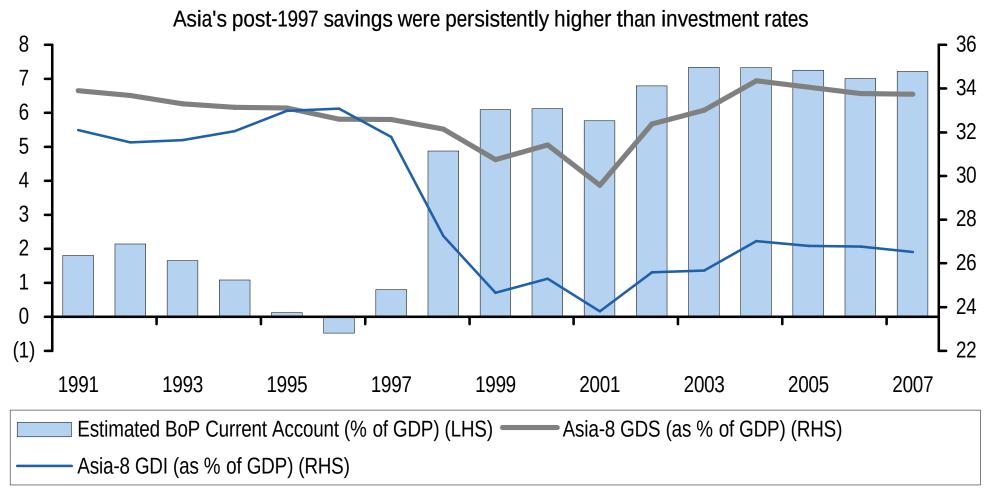
Asia is bound to be affected adversely by the worst OECD recession in half a century

The developed economies (represented in the OECD) are entering their worst recession in half a century, in our view, exacerbated by the deepest financial crisis in 75 years. Key leading indicators are already suggestive of a deepening recession, but could well get worse. Rising risk aversion has perversely affected even the emerging economies that had strong macro-economic fundamentals (large current-account surpluses backed by high savings rates, massive foreign-exchange reserves, and relatively low levels of inflation) and severely affected those with the slightest source of vulnerability. We believe that Asia, despite its strong economic fundamentals (high savings rates, a current account surplus of over 6% of GDP), is bound to succumb to the impact of the worsening global credit crunch – especially as its dynamism depends crucially on trade with the rest of the world.

Large current-account surpluses in Asia allow room for fiscal and monetary stimulus now

However, the region's high savings rates (over 50% of GDP for China, 36% for India, and averaging 34% for the other eight large non-Japan East Asian economies shown in the following chart) give it the wherewithal to boost domestic demand significantly, through a mixture of fiscal stimulus and aggressive monetary easing (as inflation moderates with the slowdown in the global economy). While China's massive Rmb4tn fiscal stimulus package (equivalent to 16% of annual GDP, and spread over 26 months) has made the headlines, several other economies (Korea, Taiwan, Malaysia and Thailand) have announced fiscal stimulus packages worth more than 1% of GDP – and all Asian central banks (apart from Malaysia and Indonesia) have begun lowering interest rates and/or banks' reserve-requirement ratios aggressively.

Large excess of savings over investment, so ample scope for policy stimulus



Source: CEIC, Daiwa

Banking systems in Asia (with the exception of Korea) are funded largely by domestic deposit bases and so should not be affected too much by global de-leveraging

Banking systems across Asia are now stable and funded largely by robust domestic deposit bases: with the sole exception of Korea, the other eight Asian economies we cover have loan-to-deposit ratios of less than 100% (unlike in the US, where it is around 105%, or Europe where it is about 130%). As shown in the following table, most Asian banking systems (with the exception of Korea, Thailand and Taiwan) have loan-to-deposit ratios of less than 80%. Consequently, we believe real GDP should rise at a much faster rate in emerging Asia than in developed economies over the medium term (the next decade or two), supported by stable banks and high savings (and investment) rates. We also think emerging Asia's share of global equity-market-capitalisation is also bound to rise substantially at the expense of the US and Japan over the next 10-15 years.

Asia: loan-to-deposit ratios (%)

	1996	2001	2007
China	94.6	78.2	67.2
Hong Kong	159.3	64.1	50.5
India	55.1	53.8	73.9
Indonesia	104.0	38.0	65.1
Korea	97.5	100.1	132.2
Malaysia	89.1	88.1	77.0
Singapore	107.4	89.3	74.1
Taiwan	107.1	90.0	87.8
Thailand	140.3	84.3	95.3

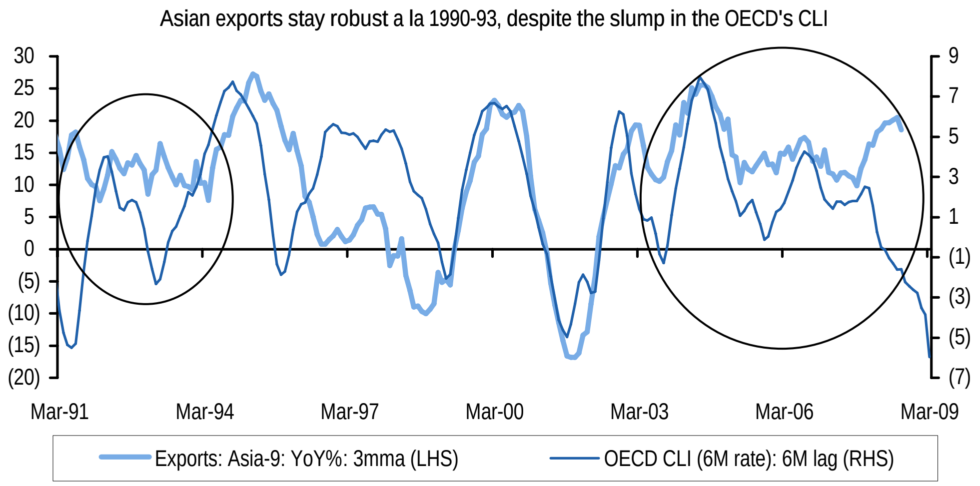
Source: CEIC, Daiwa

Structural outlook: intra-EM demand, oil and financial strength

Intra-emerging economy demand offset the slump in OECD demand in January-August 2008 …

The composite leading indicator (CLI) for the developed economies of the OECD is usually seen as a good predictor of Asian export growth. As the following chart shows, however, Asian exports have risen at a much faster rate than that predicted by the OECD CLI for the past five years (see the period circled on the right-hand side of the following chart). We think the strength of intra-emerging market (EM) demand – from within Asia as well as from Latin America, the Middle East, Africa and Russia – has helped offset the weakness in OECD demand over the past half-decade. This year, the OECD CLI was predicting a steep slump in Asian exports – which, instead, actually accelerated strongly throughout the first eight months of the year (see following chart), continuing the pattern of EM demand offsetting the slump in the OECD.

Asian exports strong despite OECD slump, aided by intra-EM demand

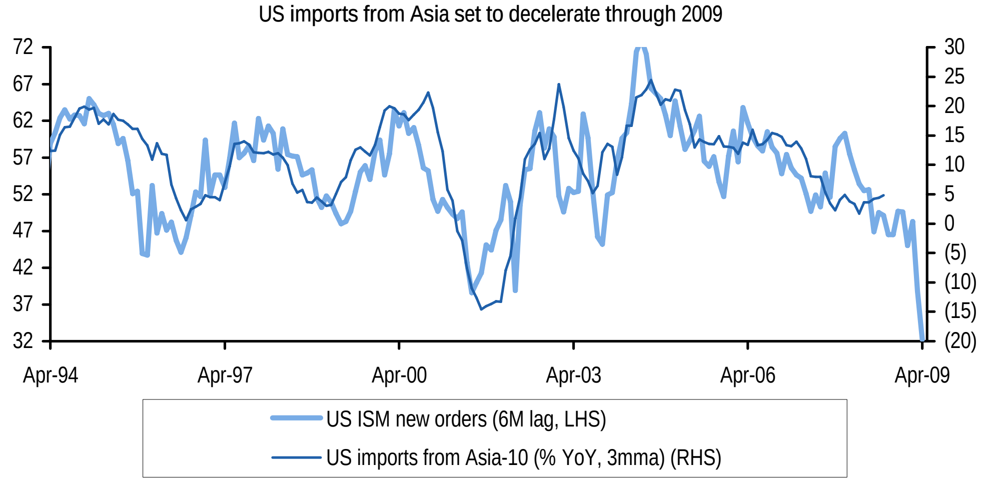


Source: CEIC, Datastream, Daiwa

… but that mitigating impact is beginning to wane now

Asia's export growth moderated in September-October (partly because of the evaporation of cross-border trade credit), but did not collapse completely. Now, with the global credit crunch spreading – and beginning to hurt the availability of even short-term trade finance – the mitigating impact of intra-EM demand is beginning to diminish. We expect Asian exports to decelerate sharply in 4Q08, and further into 2009. In particular, demand growth from the US is set to deteriorate drastically over the next six-to-eight months, as suggested by the key leading indicator.

US ISM new orders are at a 28-year low, suggesting a deep US recession



Source: CEIC, Daiwa

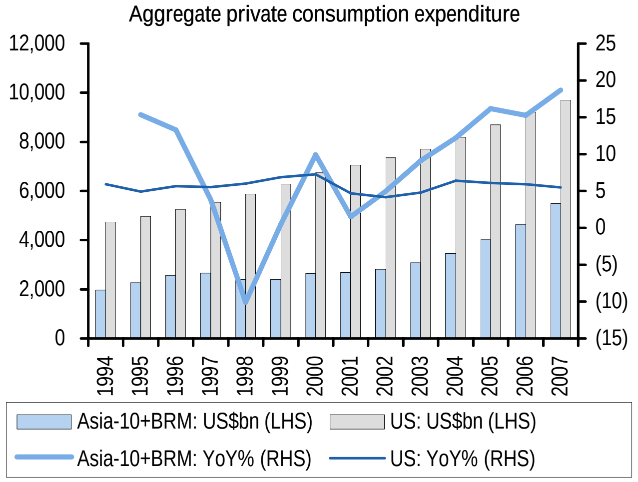
Slumping ISM new orders suggest that a deep US recession is inevitable …

With the widening of the US financial crisis, a recession in the US (and most of the OECD) is all but inevitable, in our view. The decline in the ISM index to 43.5 in September and 38.9 in October, and the collapse of the new orders index to 38.8 in September and an even more precipitous 32.2 in October, suggests that the US economy was in recession by September and would deteriorate substantially further over the next half-year. Readings of 38.8 and 32.2 for ISM new orders for the past two months suggest that US demand for Asia's exports is likely to decline quite precipitously by early-mid 2009 (see previous chart). As a heavily trade-dependent part of the world economy, Asia will undoubtedly be affected adversely by the sharper downturn in the OECD. We have maintained for more than a year now that the US is likely to face at least three years of sluggish growth à la 1990-93 (in the aftermath of the S&L crisis that preceded it), but the crisis in the US financial system is now substantially deeper than that in 1990 – and, in fact, worse than at any time in the past seven decades. The degree and duration of the downturn remains debatable (with a wide variety of outcomes possible, from mild to severe), but there is little doubt that a recession will strike over the next four-to-six quarters at least.

… and will hurt Asian exporters, albeit leavened by the strength of Asia-10+BRM consumption

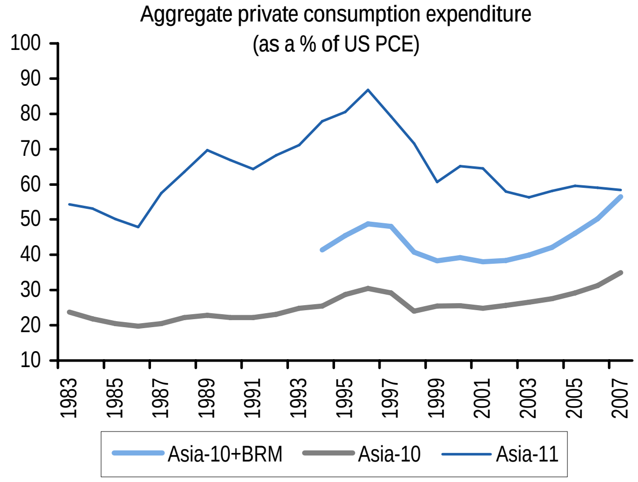
The US remains by far the largest consumer market in the world, so a US recession is bound to have some impact on the rest of the world's exporters. However, we note that private consumption expenditure (PCE) in the emerging Asian economies (Asia-10 in the following charts) plus Brazil, Russia and Mexico ('BRM' in the following charts) has increased at about twice the pace of the US over the past five years (chart left) and have continued to outpace sluggish US consumption this year substantially. The Asia10+BRM region now accounts for almost 60% of US PCE (chart right). PCE in the Asia-11 (including Japan), however, is still only 75% of its peak level in 1997 before Japan's stagnation.

EM consumption has outpaced the US since 2002



Source: CEIC, Datastream, Daiwa

PCE in Asia10+BRM is about 60% of that in the US



Source: CEIC, Datastream, Daiwa

EM consumption cannot completely replace the US slump, so Asia's growth will suffer

We believe that PCE will sustain good growth in the emerging economies (Asia10+BRM) even amid the US recession. However, this cannot replace US demand entirely, especially with limited room for expansionary policy in emerging economies that still face high inflation. Consequently, we have revised our forecasts for Asian real GDP growth in 2009 across the board, with that for China set to decelerate to 7.5% YoY, India to 6.3% YoY, and no other Asian economy expanding by more than 5% YoY.

Asia economies' main export destinations: note the declining share of the US

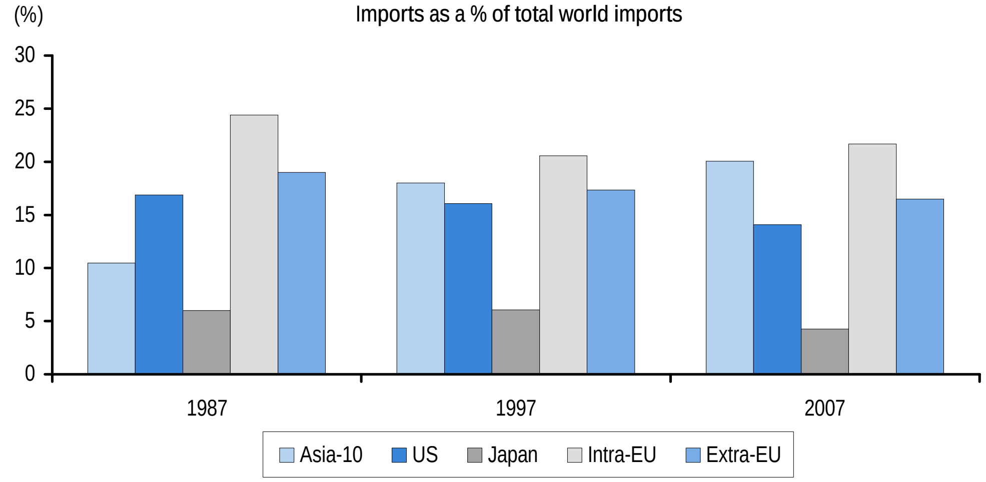
	% of total exports to US			% of total exports to Asia ex-Japan			% of total exports to Japan			% of total exports to EU		
	1997	2007	1H08	1997	2007	1H08	1997	2007	1H08	1997	2007	1H08
China	17.9	19.1	17.5	42.2	38.2	38.7	17.4	8.4	8.3	13.0	20.1	20.6
Hong Kong	21.7	13.7	12.2	47.2	61.1	62.3	6.1	4.5	4.3	14.7	13.5	13.4
India	18.4	13.8	12.1	17.2	28.2	32.4	5.3	2.2	2.4	23.9	21.6	21.4
Indonesia	13.4	10.2	9.0	36.6	46.1	49.9	23.4	20.7	19.7	16.5	11.3	10.3
Korea	15.9	12.3	11.0	38.6	45.5	46.8	10.8	7.1	6.8	12.4	14.8	14.1
Malaysia	18.4	15.6	12.9	48.3	50.1	51.8	12.6	9.1	9.9	14.7	11.7	9.9
Philippines	34.9	16.8	16.2	25.8	47.2	46.0	16.6	14.3	15.6	18.0	16.9	17.7
Singapore	18.4	8.8	7.3	52.8	64.9	65.2	7.1	4.8	5.1	14.1	10.7	10.2
Taiwan	24.2	13.0	11.3	40.8	60.1	61.3	9.6	6.5	6.4	14.4	10.9	10.8
Thailand	19.0	12.7	11.4	37.3	41.1	42.3	14.8	12.0	11.4	15.7	14.0	13.3
Asia-10	19.5	15.1	13.4	42.4	46.7	47.7	11.5	7.8	7.8	14.5	16.0	15.8
Asia-9	19.8	12.5	10.9	42.5	52.0	53.3	10.2	7.4	7.5	14.9	13.4	12.9

Source: CEIC, Daiwa

Non-China Asia is now substantially less dependent on the US

The proportion of Asian exports going to the US has declined sharply over the past decade (see previous table). The one exception to the rule is China, whose share of exports going to the US has decreased only slightly over the decade. However, for the rest of Asia's economies (aggregated as Asia-9 in the previous table), only 12.5% of their exports went to the US in 2007 – down from 19.8% in 1997 – while the share going to the rest of non-Japan Asia rose from 42.5% in 1997 to 52% in 2007. Thus, we believe stronger domestic demand across Asia (including in China) is likely to play a key role in mitigating the impact of the US downturn.

Apart from intra-EU trade, Asia is the largest importer



Source: CEIC, Datastream, Daiwa

The old-fashioned myth of the US as 'the world's importer of last resort' needs to be discarded: Asia accounts for over 20% of the world's imports now, the US just 14%

Asia now accounts for over a fifth of global imports, while the US accounts for only 14%. US import growth has underperformed all other regions over the past five years, but that sluggishness has not hurt Asia and, in our view, will continue to be mitigated by strong Asian and emerging-economy imports in the medium term. Many commentators cling to the old-fashioned notion that the US is the world's 'importer (or consumer) of last resort'. This idea stems partly from a mercantilist world view, in which net-importing countries (like the US) are seen as 'sacrificing' for the benefit of the world's net exporters (particularly Asia, including Japan). In a globalised world of relatively free trade (of the sort we now live in), we think *gross* imports rather than net imports (ie, imports minus exports) are a better measure of an economy's contribution to global demand.

Although the US is still the world's largest economy by far, its propensity to import remains low – while non-Japan Asia has a very high propensity to import, and so makes a larger contribution to the world's total imports than its share of world GDP would suggest. After two decades of rapid growth, Asia now accounts for 20.1% of total world imports, while the US only accounts for 14.1% (see previous chart). Excluding intra-EU imports, non-Japan Asia is, in fact, the world's largest importer – as its imports are larger than the EU's imports from the rest of the world. The whole of Asia (including Japan) accounts for 25% of the world's imports.

Successful bank work-outs a decade ago now position Asia well

An effective work-out is one that limits moral hazard, by ensuring that bank shareholders and management take the hit before new capital is injected

The Asian experience suggests that an effective work-out of financial-system problems (one that does not increase moral hazard) must involve the following: 1) shareholders (of a bank seeking government support) should bear the majority of the losses (ie, shareholders' equity needs to be written down largely before government support is given), 2) management needs to be changed (to serve as a salutary reminder that bad banking decisions have consequences), and 3) only after management and shareholders have taken the majority of the losses will 'taxpayers' money' be injected as capital into the bank. *The US approach – of injecting preference shares into the 10 largest banks (without diluting existing shareholders or punishing/changing managements) in October – clearly violated these principles, and actually increased moral hazard.*

Systemic banking crises

Country	Starting date for crisis	Share of NPLs at peak	Gross fiscal cost (% of GDP)	Output loss (% of GDP)	Minimum real GDP growth (%)
China	1998	20.0	18.0	36.8	7.6
Indonesia	1997	32.5	56.8	67.9	(13.1)
Japan	1997	35.0	24.0	17.6	(2.0)
Korea	1997	35.0	31.2	50.1	(6.9)
Malaysia	1997	30.0	16.4	50.0	(7.4)
Philippines	1983	19.0	3.0	60.1	(7.3)
Philippines	1997	20.0	13.2	0.0	(0.6)
Thailand	1983		0.7	9.4	4.6
Thailand	1997	33.0	43.8	97.7	(10.5)
Memo:					
Mexico	1994	18.9	19.3	4.2	(6.2)
Russia	1998	40.0	6.0	0.0	(5.3)
Sweden	1991	13.0	3.6	0.0	0.7
US (S&L)	1988	4.1	3.7	4.1	(0.2)

Source: IMF

Successful Asian examples show that the net cost to taxpayers is lowered over time as some of the initial outlay is recouped through asset sales in future calmer markets

In Korea, the Korea Asset Management Corporation (KAMCO) purchased NPLs initially from banks at about 80 cents on the dollar (in November-December 1997), quickly lost credibility, and had to be re-capitalised. Eventually, it acted to limit moral hazard, allowed foreigners to buy the weakest institutions (thereby obtaining equity from overseas) and helped cap the cost to Korea’s taxpayers. Similarly, Indonesia’s initial attempts at inducing banks to sell NPLs failed, and the government was obliged to use coercion. Asserting that bank management had committed a felony under local law by lending far more than the permitted amounts to connected parties (apart from failing to repay massive amounts of liquidity credits from the central bank), Indonesia’s IBRA nationalised virtually the whole Indonesian banking system, raising the public debt to about 100% of GDP. Over the subsequent decade, the fully-nationalised banking system was privatised gradually (starting with the sale of the largest, Bank Central Asia, to a foreign buyer), and public debt fell back to well below 50% of GDP.

The previous table shows the peak NPL levels and the gross fiscal cost of bank work-outs in various economies, the IMF’s estimate of the loss to GDP over the several years of the work-out, and the minimum level of real GDP growth during the work-out. The US S&L work-out involved a gross cost of 3.7% of GDP, but about 2.2% of GDP was clawed back when the NPLs were later sold in the market. The net cost to taxpayers is usually lower over time.

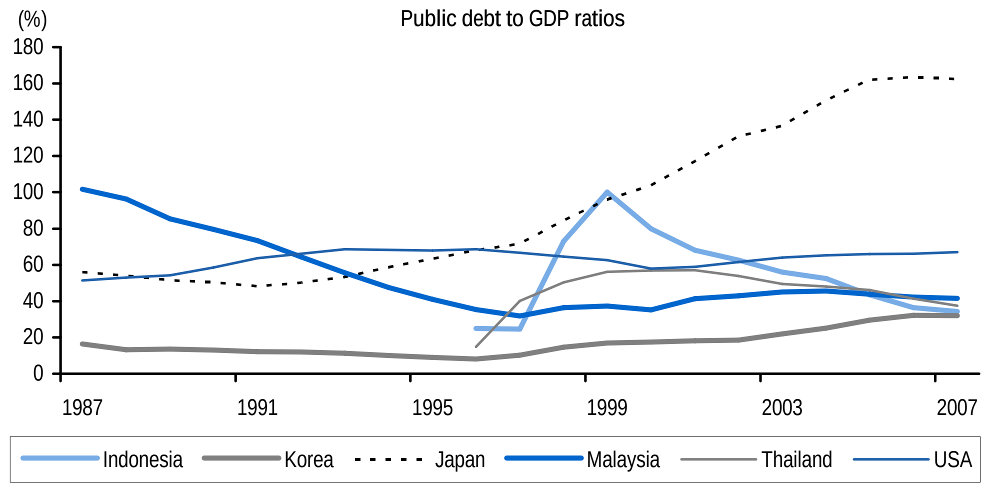
Clawing back taxpayer costs requires an early rebound in nominal GDP and an early end to asset deflation

However, ‘clawing back’ the initial costs incurred by taxpayers is only possible if nominal GDP recovers strongly within a short period of time – and asset deflation ends quickly. If asset prices continue to deflate, the costs to taxpayers can continue to rise over time (as it is then much more difficult to sell off assets in the future at a higher price), as demonstrated by Japan’s experience. In Japan, the ‘convoy’ approach was used to limit the pain inflicted on bank shareholders – by shepherding several banks into an alliance/merger. The relative sluggishness of the work-out process exacerbated the deflationary spiral of the Japanese economy.

Japan’s severe asset deflation negated attempts at corporate re-structuring, and its public debt/GDP ratio soared over the past decade

Asset deflation always has a debilitating impact on the balance sheets of debtors, as the value of their liabilities remains fixed while asset values continue to fall. Broad-based deflation (in goods and services) reduces the incentive to produce and consume – as businesses and households postpone spending decisions in anticipation of further declines in prices. Corporate restructuring is especially difficult because the goal posts keep moving: restructuring based on current prices is often rendered irrelevant when prices of assets and goods decline sharply further in the next period. The debilitating impact of asset deflation caused Japan’s public debt/GDP ratio to rise steadily from 1997 to 2005 (and to plateau since then at near the 2005 high). Japan suffered the biggest decline in asset prices in modern economic history, with share prices declining by 78% from the peak in 3Q89 to the trough in 1Q03, and prices of commercial land in Japan’s six largest cities declining by 87% from their peak.

Public debt/GDP ratios declined in ASEAN, but continued to soar in Japan



Source: CEIC, Datastream, World Bank

RTC-type entities buy assets at a time when no other buyers may exist, and later sell these assets when market conditions are more favourable

The advantage of an RTC (or Troubled Asset Relief Program [TARP]) is that it buys assets when there are no other buyers available – and can sell them at a later time when market conditions are more favourable, thereby turning a profit (on part of the portfolio) and reducing the ultimate cost to taxpayers. Currently, large segments of the credit markets resemble a 'market for lemons', where it is impossible to distinguish good banks from bad because of an 'information asymmetry' about where the toxic assets reside; as with a market for lemons, those segments of the credit market have frozen up entirely. In the absence of a TARP, the information asymmetry would cause banks' share prices to fall even further (and good banks would be sold down along with the bad). So this form of inter-temporal government intervention (tapping taxpayer funds now to limit the damage to banks, knowing that the up-front cost to taxpayers will decline over time) makes eminent sense, if the incentive structures are well designed. However, we believe *the process needs to be credible (by inflicting costs on shareholders and management), and monetary policy must avoid setting off a deflationary spiral.*

Indonesia and Thailand saw their public debt/GDP ratios soar by 1999, but have reduced them successfully since

As shown in the previous chart, south-east Asian economies (Malaysia, Indonesia and Thailand) were able to reduce their public debt/GDP ratios successfully from their post-crisis peaks (in 1999-00). The most dramatic reductions occurred in the two most hard-hit economies (Thailand and Indonesia), as both countries sought to run large primary fiscal surpluses in order to reduce their public debt – while also using the proceeds of privatising the banks that had been taken over by government during the work-out phase. Malaysia learnt from its 1985-86 experience, and limited moral hazard severely while undertaking its 1998-99 NPL carve-out, which was easily the most successful among all the Asian crisis economies of 1997. Malaysia's public debt has resumed rising in recent years because of its much larger fiscal deficits (unrelated to the bank work-out that was completed with the closure of Danaharta in 2003). Korea has never disbanded KAMCO – which remains responsible for carving out problem loans in the banking system (most recently, after the consumer-credit boom that ended in 2003) – and so has not seen its public debt/GDP ratio decline, although its absolute level is low.

Non-Japan Asia's low public debt/GDP ratio allows room for counter-cyclical fiscal stimulus

All the emerging Asian economies have substantially lower public debt/GDP ratios than Japan. For that matter, emerging Asian economies hit by the 1997-98 crisis now have public debt/GDP ratios that are between half and two-thirds the size of that of the US (even before the impact of TARP on those public debt figures). This emphasises the fact that non-Japan Asia will have ample room to use counter-cyclical fiscal policy aggressively as the US economy falls into a deeper recession – and leads the world into a more severe downturn.

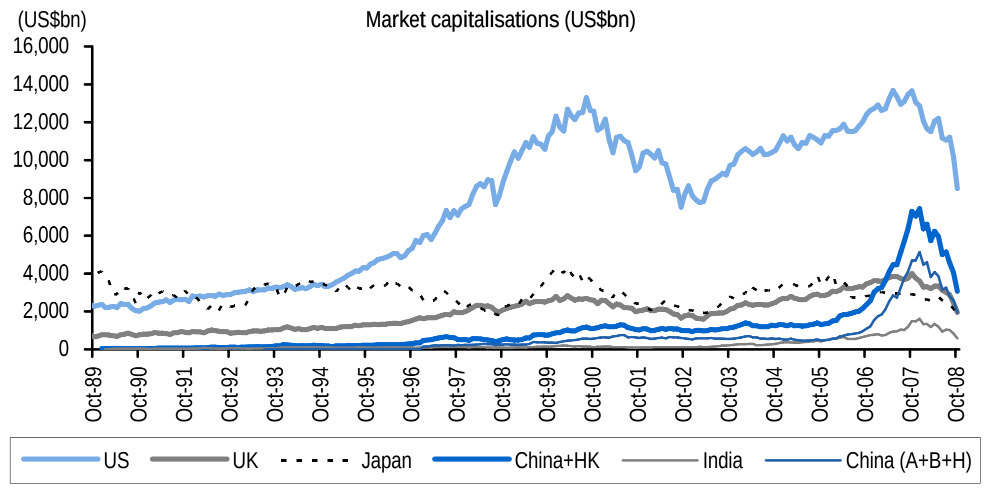
The US has thus far mirrored Japan's path almost precisely

It is worth reiterating the many similarities between the US experience in the 1991-08 period with those of Japan between 1980 and 1998 (see following chart). These include a five-fold increase in equity market capitalisation over the first decade (ending December 1989 for Japan, and August 2000 for the US), followed by a prolonged bear market in equities that culminated in a banking crisis eight years after the peak in market capitalisation (1997 for Japan, 2008 for the US), during which the fourth-largest broker-dealer went bankrupt (Yamaichi in Japan, Lehman Brothers in the US) and the third-largest (Nikko in Japan, Merrill Lynch in the US) was acquired by a commercial bank. Over the past two months, Japan's 'convoy' approach to bank mergers has also been copied by the US, and the US recapitalisation of banks without changing management or diluting shareholders also increased moral hazard.

The US needs to avoid persistent asset deflation, declining nominal GDP and any near-term fiscal austerity

The contrast with other Asian 'crisis economies' of 1997-98 is stark. Their bank work-outs curbed moral hazard by changing management and forcing large haircuts on bank shareholders before any capital injection into banks by government. This also limited the upfront costs to taxpayers. Subsequently, asset markets were allowed to clear quickly, enabling the TARP-type agencies to buy bad assets from the banks near the trough in asset prices – thereby improving the chances of those assets being sold at a higher price later, thereby recouping some of the upfront costs incurred by taxpayers in buying the assets at the outset. We stress three aspects of the Japanese experience that we believe the US should avoid: a) the persistence of asset deflation over nearly a decade, b) the absence of nominal GDP growth for a decade after the banking crisis, and c) an attempt to balance the budget (à la Hoover, and Hashimoto) amid a banking crisis and liquidity trap.

US equity market capitalisation lower than in 2000, Japan's lower than 1989

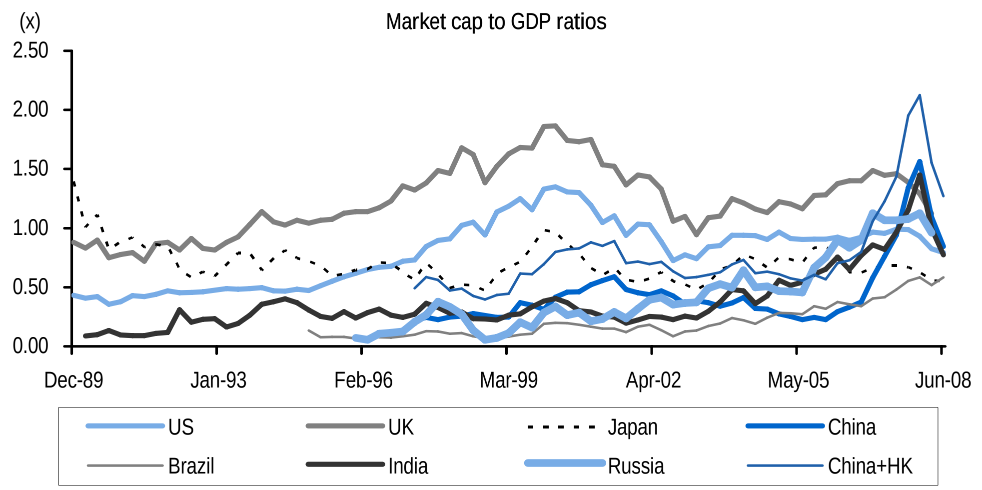


Source: CEIC, Datastream, Daiwa

At a minimum, emerging markets' market capitalisation should rise faster from current levels than developed markets' over the medium term

Given that this is uncharted territory, the future will judge the efficacy of the US policy – either enabling US market capitalisation to resume rising at a normal pace (if reform initiatives and monetary policy ensure a return to growth for companies and the economy) or following Japan into another decade of stagnating market capitalisation (if the fiscal deficit continues to balloon, asset deflation deepens, and/or the reform initiatives become mired in political gridlock). *One major difference between Japan and the US is the latter's remarkable capacity for periodic renewal through the political process: the election of President-elect Obama holds the promise of a dramatic overhaul of policy in a Rooseveltian direction – which would be entirely appropriate at a time when the US faces a liquidity trap (that is ideally countered with a large fiscal stimulus).* However, it is worth noting (see following chart) that market-capitalisation-to-GDP ratios are actually quite similar across developed and emerging markets currently. There is no particular reason for market capitalisation (a reflection of listed companies' value) to be the same as nominal GDP (the annual income earned within the country), but most of the countries shown in the following chart are now converging toward 1 (ie, market capitalisations about equal to annual GDP). Even if we were to assume that the market capitalisation to GDP ratio will converge toward 1 for most countries over time, however, the emerging economies' substantially better medium-term growth prospects should ensure that their market capitalisation will rise much faster than that of developed economies. Over the medium term, China, India, Brazil and Russia's market capitalisation is likely to close the gap with the US (aided by the fact that the GDP gap too is likely to close gradually), even if the ride from here to there is bumpy.

Market capitalisation to GDP ratios converging toward 1 across markets



Source: CEIC, Datastream, Daiwa

Given their high savings rates and stable banks, we believe emerging Asia's real GDP and market capitalisation should rise much faster than those of the US and Japan over the medium term

We think China, India and most other Asian markets still have the characteristics of emerging markets – with their underlying economies still capable of generating strong medium-term growth supported by high savings rates (over 50% of GDP for China, 36% for India, an average of 34% for the other eight Asian economies). Banking systems across Asia are now stable and funded largely by robust domestic deposit bases: with the sole exception of Korea, the other eight Asian economies we cover have loan-to-deposit ratios of less than 100%. Consequently, we believe real GDP should rise at a much faster rate in emerging Asia than in developed economies over the medium term (the next decade or two). We also think emerging Asia's share of global equity-market-capitalisation is bound to rise substantially at the expense of the US and Japan over the next 10-15 years.

The boon of declining oil prices

Oil prices have been a drag on Asian growth in 2008, but Asia would now be likely to benefit from a moderation in crude-oil prices in 2009

Crude-oil prices have had a major impact on Asian growth and inflation this year. However, the OECD recession is now causing oil prices to decline sharply (with Brent crude falling below US$60/bbl after peaking at US$147/bbl in July). Additionally, US President-elect Obama has stated publicly that he intends to use up to a tenth of the US's Strategic Petroleum Reserve (SPR) to further moderate oil prices – in contrast to the Bush administration, which added steadily to the SPR (and never released anything from it) during its entire eight-year term in office. The release of oil from the US SPR should exert further downward pressure on oil prices, especially if the US SPR is used effectively at key turning points to influence the direction of oil prices. Asian economies that would benefit most significantly from lower oil prices are major net oil importers like China, India, Korea, Taiwan and Thailand.

Estimated monthly oil imports: millions of barrels (crude-oil equivalent)	1990-99[1]	2000-07	YTD 2008[2]
China	30.0	81.9	133.7
Hong Kong	11.9	10.2	9.5
India	33.3	59.2	85.2
Indonesia	13.0	22.6	25.3
Korea	66.5	85.0	87.4
Malaysia	8.3	12.5	12.5
Philippines	8.1	7.1	6.2
Singapore	46.2	54.5	74.9
Taiwan	20.2	32.9	40.1
Thailand	19.4	28.1	30.2

Source: CEIC, Daiwa

Estimated monthly net oil imports: millions of barrels (crude-oil equivalent)	1990-99[1]	2000-07	YTD 2008[2]
China	14.6	67.7	119.9
Hong Kong	6.2	9.2	8.8
India	31.6	47.8	64.1
Indonesia	(15.6)	3.9	11.6
Korea	52.6	60.5	56.0
Malaysia	(9.1)	(5.6)	(6.0)
Philippines	7.2	6.0	5.2
Singapore	1.4	4.4	6.5
Taiwan	17.9	22.8	25.0
Thailand	16.5	21.1	20.8

Source: CEIC, Daiwa

Note: 1) Data for three countries is not available for all 10 years – China (1994-99), Hong Kong (1991-99), Malaysia (1995-99)
2) YTD data for 2008 is year-to-September for all countries except India (May), Philippines (August) and Taiwan (August)

With a crude-oil price of US$60/bbl, net oil imports would decline by 3.5%, 3%, 2.7%, 2% and 1.3% of GDP for Thailand, India, Taiwan, Korea and China, respectively, relative to 2008 imports

Assuming an average oil price of US$60/bbl for 2009 (ie, 40% lower than the average oil price of US$100/bbl this year, based on an average of US$65/bbl for November-December 2008), Korea and India would save about US$3.4bn on their monthly import bill (slightly more for India, as the volume of its oil imports is still rising, while Korea's has been stable over the past decade). For each economy, this translates into annual savings of 4% of GDP of gross oil imports – or savings on net oil imports of about 3% and 2% of GDP for India and Korea, respectively. China would save about US$4.8bn on its monthly net-oil-import bill (translating to 1.3% of GDP), Taiwan would save 2.7% of GDP and Thailand 3.5% of GDP. This would clearly switch India and Korea onto small current-account surpluses next year (from deficits of over 1% of GDP in 2008), and bolster the other economies' current-account surpluses. Our baseline forecasts are based conservatively on an assumption of only a small 10% decline in average crude-oil prices next year, but a 40-55% decline is a distinct 'risk' scenario that would give a fillip to Asian economies' current-account balances – and allow them enormous additional room to ease monetary and fiscal policy.

We expect a sharp US downturn in the current quarter and into 2009, although likely to be moderated by a massive Obama-inspired fiscal stimulus

Our US economist, Mike Moran, forecasts US real GDP to contract by about 2.5% QoQ (seasonally adjusted annualised rate) in the current quarter (4Q08). The continuing turmoil in the financial sector (likely to be worsened when the TARP begins buying assets at steep discounts to face value, crystallising losses within banks) suggests additional downside risks to global growth in 4Q08. A large fiscal stimulus (of at least US$300bn, possibly larger once President-elect Obama takes office) should ensure that US real GDP contracts by only 2-3% YoY for 2009 (a worse recession than 1991 or 1982, but well short of a Depression). The gradual move toward normalcy in interbank lending (and the successful settlement of Lehman collateralised debt securities [CDSs]) bode well for financial stability by 2Q09, in our view.

Lower growth and inflation across Asia, but a recovery by 2010

Nonetheless, we have revised down our real GDP growth forecasts for all Asian economies for 4Q08 and 2009 to reflect the deepening OECD recession (see following table). We expect most Asian economies to provide a fiscal stimulus and ease monetary policy further as inflation recedes. Already, all Asian economies have eased either monetary or fiscal policy (and China has done both). Domestic demand will be key to China's real GDP expanding by 7.5% YoY next year, India's by 6.3% YoY and Indonesia's by 4.8% YoY. The more mature, export-dependent economies will decelerate more, in our view, with Korea in particular suffering from a sharper slowdown because this year's Won depreciation will hurt the corporates and banks that participated in the US$250bn of new foreign-currency borrowing in 2005-07. As domestic demand drivers become better entrenched, we expect all Asian economies to return closer to their potentail growth rates in 2010, even as OECD growth remains sluggish.

Asia baseline forecasts

	Real GDP YoY %		CPI YoY % (year avg)		Current account (% of GDP)		Exchange rate (vs. US$) (year-end)	
	2008F	2009F	2008F	2009F	2008F	2009F	2008F	2009F
China	9.0	7.5	6.3	2.5	6.6	4.9	6.80	6.50
Hong Kong	4.5	2.6	4.5	1.9	8.0	9.4	7.80	7.80
India	7.1	6.3	8.5	4.8	(1.9)	(0.2)	51.50	48.00
Indonesia	6.1	4.8	8.9	5.8	0.9	1.0	10,200	9,300
Korea	4.1	2.1	4.9	2.4	(1.4)	(0.3)	1,300	1,240
Malaysia	5.4	3.6	5.2	3.9	16.7	15.5	3.65	3.50
Singapore	3.2	3.4	6.6	2.6	15.8	15.2	1.52	1.47
Taiwan	3.6	2.8	3.9	1.9	6.3	4.4	33.50	32.00
Thailand	4.8	3.2	6.3	2.7	0.2	0.8	35.70	34.80
Vietnam	5.8	4.2	24.5	9.5	(15.5)	(9.8)	17,550	17,100

Source: Daiwa forecasts
Note: WPI for India
For India, 2008 = FY08, April 2008 to March 2009

Hong Kong/China

Automobiles (China) – Neutral

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Sector thesis: to survive the hard times

In our view, the China auto industry will experience hard times in FY09, due to the global recession and the slowdown in the domestic economy.

Currently, weakening demand is our major concern for the passenger-vehicle segment, while we expect the commercial-vehicle segment to remain sensitive to the macro environment.

Structural outlook: three-year view

In our view, the China auto industry may start to recover from 2H09, and record mild annual revenue growth rates of 5-8% for the following few years. From a long-term perspective, we believe that the industry is still at the growth stage.

Over the long run, we expect demand to continue to rise, due to economic growth and rising personal incomes, but believe the market concentration will remain weak. Industry consolidation might be slow, in our view, due to the difficulties of co-ordinating between local governments.

China: Automobiles – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Denway Motors	203 HK	4	4	3	3	4	18	Solid support from Honda Motors and Guangzhou Auto Group.
Dongfeng Motor	489 HK	4	3	4	2	3	16	One of the three largest auto groups in China, with a strong industry background.
Geely Automobile	175 HK	3	3	2	1	3	12	A representative of Chinese original auto brands.
Brilliance China	1114 HK	3	2	1	1	2	9	Co-operates closely with BMW group.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Denway Motors

With the support of Honda Motors and Guangzhou Auto Group, all four of Guangzhou Honda's (Denway's major subsidiary) major models have established leading positions in their respective segments. We expect the company's original-brand plan be a long-term growth driver after 2010.

Worst-positioned: Brilliance China

Brilliance China's sales of original-brand products declined sharply in FY08, and this segment may record a loss for FY08, in our view.

Valuation: target and entry prices

In our view, Denway Motors' stock has the best chance of doubling in price over the next three years. We believe its growth potential, original-brand plan, capable management, and stable high dividend-payout ratio provide solid support for our view.

China: Automobiles – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Denway Motors	203 HK	1.66	4.66	180.7	2.33	5.6	Compared with other listed auto companies, Denway's growth potential is stronger, in our view.

Source: Daiwa

For a 100% return over the next three years, we calculate an entry price for Denway Motors of HK$2.33, equating to a PER of 5.6x on our FY09 EPS forecast. Denway is trading currently at a PER of 4.0x on our FY09 EPS forecast.

Top pick: Denway Motors

All four of Denway Motors' major models have established leading positions in their respective segments. We believe that the new *Fit* and *City* models will drive the company's growth over the next one-to-two years, since customers are now turning to small cars.

Original-brand vehicles will be a major growth driver for the company after 2010, in our view. Management has been working hard on this, and we believe that the products under the new *Li Nian* brand will receive a good response in the market.

Valuation and catalysts

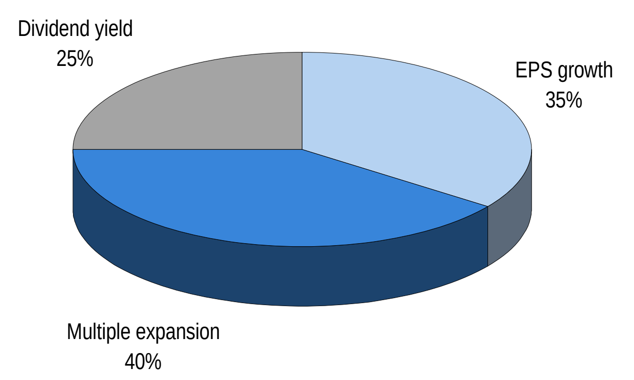
Denway Motors is trading currently at a 4.0x PER on our FY09 EPS forecast. Our recommended entry price equates to a 5.6x PER on our FY09 EPS forecast.

After the recent stock-market crash, almost all auto stocks are trading at historical-low valuation levels. We believe this is only because the market is being too pessimistic about the industry outlook. If auto sales start to recover from 2H09, as we expect, valuations should return to their normal levels of about 8-10x one-year forward PERs. Reliable EPS growth and stable dividend payouts would also boost stock prices then, in our view.

In our opinion, the major risk to our rating is the impact of the global recession. If the recovery materialises later than we expect, we believe all of the auto companies would suffer, including Denway Motors.

Source of upside

China Automobiles: Denway Motors – source of three-year total return



Source: Daiwa forecasts

China: Automobiles – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Denway Motors	203 HK	1.66	2	3.51	111.4	Dec	5.4	4.5	4.0	3.3	3.6	3.2	3.0	2.6	8.5	10.2	11.5	14.0
Dongfeng Motor	489 HK	1.83	2	4.12	125.1	Dec	3.9	3.7	3.4	3.2	2.6	2.3	2.2	2.2	2.6	2.5	2.6	2.8
Brilliance China	1114 HK	0.315	4	0.63	100.0	Dec	11.1	4.0	4.8	4.3	n.a.	n.a.	n.a.	n.a.	0.0	0.4	4.2	4.6
Geely Automobile	175 HK	0.445	3	0.49	10.1	Dec	7.0	4.1	3.7	3.2	4.0	1.4	1.1	0.9	2.7	3.4	4.5	5.6

Source: Companies, Daiwa forecasts

Aviation (Hong Kong/China) – Neutral

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Sector thesis: global slowdown to offset declining jet-fuel costs

We believe the global economic slowdown will have a negative impact on Asian airlines, and offset the benefit of declining international jet-fuel prices. Moreover, we expect many airlines to record fuel-hedging losses for 2008 because of the unexpected sharp decline in international jet-fuel prices.

We believe airlines are likely to be affected more than airports

In our view, airlines would have to absorb most of the negative impact, as they are not that flexible in terms of being able to adjust capacity within a short period of time. The airlines may be forced to undertake promotions in order to boost traffic. Therefore, with respect to the problems of weak demand and overcapacity, we believe airports would benefit at the expense of the airlines.

Structural outlook: three-year view

Fierce competition at all levels

We expect fierce competition among the Asian airlines over the next three years, due mainly to a slowdown in traffic demand and the continuous capacity expansion of airlines in the region. We think the competition would be at the aviation-hub, airline and alliance levels.

With the current credit tightening, we think many small and private airlines will face difficulties refinancing their loans. We expect more airlines to go bankrupt or be acquired, which would lead to a new wave of industry consolidation in Asia.

We expect the PRC Government to finalise its industry consolidation plan over the next three years, mainly to improve the efficiency of airlines in Mainland China.

HK/China: Aviation – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Singapore Airlines	SIA SP	5	5	4	4	4	22	Strong management; balance sheet and brand remain its unique strengths.
Cathay Pacific Airways	293 HK	5	5	4	4	3	21	Strong management, but potentially weak profitability in the short term.
TravelSky Technology	696 HK	3	5	5	3	5	21	Monopoly on aviation technology in the Mainland and strong balance sheet remain the attractions.
Beijing Capital International Airport	694 HK	4	5	4	3	4	20	Earnings pressure in the short term, but probably a good investment choice in the long term, in our view.
Air China	753 HK	4	4	4	3	2	17	Strong management team; benefits from increase in outbound and inbound traffic.
China Southern Airlines	1055 HK	4	3	4	2	1	14	Benefits most from domestic market growth.
Hainan Meilan International Airport	357 HK	3	2	2	3	4	14	Good fundamentals, but no strong and sustainable growth catalyst.
China Eastern Airlines	670 HK	3	3	3	2	1	12	Weak profitability and negative equity remain the concerns.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: TravelSky Technology (TST)

In our opinion, TST is the best-positioned company within our sector coverage in Hong Kong and China, because of its monopolistic position, healthy balance sheet and stable cash flow. We expect the company to maintain its monopoly over the next three years, and strong cash flow amid the economic downcycle. With traffic continuing to increase in the Mainland aviation market and the potential for more foreign airlines to connect to its system and new cargo-reservation systems, we believe TST's earnings growth could be enhanced further over the next three years.

Worst-positioned: China Eastern Airlines (CEA)

In our view, CEA is the worst-positioned airline within our sector coverage because of its poor profitability, reflecting the weaknesses of its management, product demand, market share and margins. We expect the airline to have negative equity from 2009, and believe it will continue to record net losses and struggle financially over the following three years.

Valuation: target and entry prices

Companies with stronger fundamentals would have better potential on any rebound

We believe Mainland aviation stocks with strong market positions, good fundamentals and stable cash flows, such as Beijing Capital International Airport (BCIA) and TST, have the strongest potential to see their share prices double over the next three years. The major reason is that the earnings of these companies were affected significantly by natural disasters (snowstorms, the earthquake in Sichuan Province), temporary restrictive policies (visa and flight controls), volatile jet-fuel prices, and the global economic slowdown in 2008. We expect the Mainland economy to continue to expand over the next three years, albeit at a reduced pace and magnitude than previously. Therefore, when the economic outlook becomes more positive, we would expect the share prices of the Mainland aviation stocks with strong fundamentals to rebound sharply.

HK/China: Aviation – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
TravelSky Technology	696 HK	2.93	6.75	130	3.38	8.9	DCF valuation from 2011.
Cathay Pacific Airways	293 HK	8.03	19.54	143	9.77	n.a.	Average forward PBR of 1.32x since 1998.
Beijing Capital International Airport	694 HK	4.89	10.14	107	5.07	90.5	DCF valuation from 2011.

Source: Daiwa

Our entry prices for Cathay Pacific Airways (CPA) and BCIA are higher than their current share prices (22% higher for CPA and 4% higher for BCIA), while that for TST is 15% higher. At our entry price, TST would trade at a PER of 8.9x, a PBR of 0.9x and an EV/EBITDA of 2.0x on our FY09 forecasts. Therefore, TST's current valuation is at an historical low, we believe reflecting the current negative sentiment toward aviation-related stocks, especially those with small market capitalisation.

Top pick: TravelSky Technology

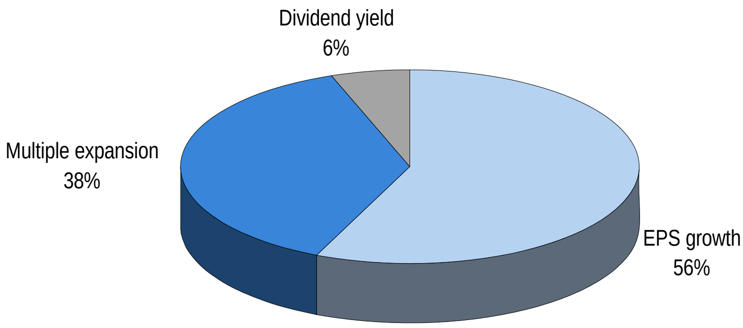
According to management, there will not be any major capital expenditure after 2010. With traffic in the Mainland aviation market increasing and new opportunities from its cargo-reservations system (which we expect to be launched in two-to-three years' time), we believe TST's current share price is very attractive. We expect the company to maintain its monopoly over the next three years.

Valuation and catalysts

Our six-month target price for TST is based on a 50% discount to our DCF valuation, to reflect the current negative sentiment toward aviation stocks, especially those with a small market capitalisation. Potential share-price catalysts would be consistent traffic growth in the domestic market, more airlines connecting to TST's system, and the successful launch of its cargo-reservation system.

Source of upside

HK/China Aviation: TravelSky Technology – source of three-year total return



Source: Daiwa forecasts

HK/China: Aviation – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	PBR (x) 2008E	PBR (x) 2009E	PBR (x) 2010E	EV/EBITDAR (x) 2008E	EV/EBITDAR (x) 2009E	EV/EBITDAR (x) 2010E	Dividend yield (x) 2008E	Dividend yield (x) 2009E	Dividend yield (x) 2010E
Travelsky Technology	696 HK	2.93	2	4.28	46.1	Dec	8.8	7.7	7.0	1.0	0.8	0.7	1.4	1.4	1.2	4.2	4.8	5.2
Hainan Meilan Intl Airport	357 HK	2.8	2	7.45	166.1	Dec	5.2	4.7	3.8	0.6	0.6	0.5	2.3	2.0	1.8	9.5	10.6	13.1
China Southern Airlines	1055 HK	1.07	3	1.09	1.9	Dec	n.a.	n.a.	n.a.	0.5	0.5	0.6	8.2	7.3	6.5	0.0	0.0	0.0
Singapore Airlines*	SIA SP	11.42	3	11.18	(2.1)	Mar	8.8	8.9	6.7	0.8	0.8	0.7	2.9	3.1	2.7	8.0	7.9	8.8
Beijing Capital Intl Airport	694 HK	4.89	5	4.71	(3.7)	Dec	n.a.	87.3	31.6	1.6	1.3	1.2	7.2	8.3	7.3	0.0	0.3	0.9
Cathay Pacific Airways	293 HK	8.03	5	6.72	(16.3)	Dec	n.a.	n.a.	42.7	0.7	0.8	0.7	21.6	18.0	7.1	0.4	0.4	1.2
China Eastern Airlines	670 HK	0.92	5	0.73	(20.7)	Dec	n.a.	n.a.	n.a.	13.3	n.a.	n.a.	18.6	15.3	13.2	0.0	0.0	0.0
Air China	753 HK	1.98	5	1.44	(27.3)	Dec	n.a.	n.a.	n.a.	0.7	0.8	0.8	9.9	14.3	13.0	0.0	0.0	0.0

Source: Companies, Daiwa forecasts
*SIA has a March year-end; headings will be 2008/09F, 2009/10F, 2010/11F; pricing data is in Singapore dollars

Banks (Hong Kong) – Neutral

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Sector thesis: China banking a key medium-term growth driver

We revised down our 2008-10 net-profit forecasts recently

Recently, we revised down our net-profit forecasts for the Hong Kong banks that we cover by 14-76% for 2008 and 4-83% for 2009. This was mainly to reflect: 1) the downward revisions to our loan-growth forecasts, 2) the pressure on the banks' NIMs, 3) downward revisions to our net fee-income forecasts, and 4) our expectation that credit costs would increase. We also revised down our BVPS forecasts for the Hong Kong banks, to reflect the fall in the value of the available-for-sale (AFS) securities they hold.

We maintain our Neutral rating for the Hong Kong banks sector

Notwithstanding the downward revisions to our net-profit forecasts, we forecast most of the Hong Kong banks that we cover to record rebounds in their 2009 net profit of more than 13% YoY. We expect most of the banks to benefit from a sharp reduction in sub-prime-related provisions, a slight recovery in net-fee income, and declines in the investment losses for their treasury operations and life-insurance businesses. However, the earnings visibility of Hong Kong banks remains low for 2009, and we therefore maintain our Neutral rating for the sector.

Structural outlook: three-year view

We expect a gradual recovery in net profit for the Hong Kong banks from 2009 onwards

We expect a gradual recovery in net profit for the Hong Kong banks from 2009 onwards, and believe they will make fewer provisions for their subprime-related securities in 2009. In addition, expected lower interest-rate volatility in 2009, compared with 2008, should help stabilise Hong Kong banks' NIMs. These factors, together with a slight recovery in net-fee income, should help to more than offset a potential rise in credit costs in 2009, based on our forecasts.

Hong Kong banks remain optimistic about the outlook for the China banking business over the next few years

While Hong Kong banks have turned more cautious about expanding their domestic-manufacturing loans and trade-financing loans in 2008, they remain optimistic about the outlook for the China banking business for the next few years. We believe the China banking business will be a key earnings driver for the Hong Kong banks over the next three years. This is because: 1) the capital markets in China are under-developed, leaving much room for growth in bank loans in the near term, 2) interest rates in China remain largely regulated, providing excellent NIMs for banks to offset credit costs, and 3) most Hong Kong banks have set up their own subsidiary banks in China since 2006, thus allowing them to tap into the Renminbi retail business.

Overall, with a low base for comparison, we expect most Hong Kong banks to maintain strong China loan growth of more than 15% a year over the next three years. We believe this, together with a potential widening of NIMs, and gradual development of the fee-income business and a comprehensive risk-management system, should help increase the net-profit contributions from the China banking businesses of Hong Kong banks over the next few years. Among all the Hong Kong banks under our coverage, Bank of East Asia (BEA) has the strongest position in the China banking businesses, and we forecast the net profit of its China banking business to account for more than 60% of the group's total net profit over the next three years.

Hong Kong: Banks – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Hang Seng Bank	11 HK	4	4	4	4	3	19	Strong management quality and dominant market share.
BOC Hong Kong	2388 HK	3	3	4	4	4	18	High market share, but a lack of innovative retail banking products.
HSBC	5 HK	4	4	3	3	2	16	Strong management quality and excellent product-innovation capability.
Bank of East Asia	23 HK	2	3	3	3	4	15	Weak management quality, but strong expertise in China banking business.
Wing Hang Bank	302HK	4	3	2	2	4	15	Good management quality and strong asset and liability management to help stabilise the NIM.
ICBC (Asia)	349 HK	3	3	3	2	3	14	Large amount of referral business from parent, but reduces its pricing power.
Dah Sing Banking Group	2356 HK	3	4	2	2	2	13	Good product innovation in the retail-banking business, but NIM is vulnerable to interest-rate volatility.
Dah Sing Financial	440 HK	3	4	2	2	2	13	Good product innovation in the life-insurance business, but investment income is vulnerable to stock-market volatility.
Fubon Bank Hong Kong	636 HK	3	4	2	2	2	13	Provides a wide range of retail banking products to customers but NIM is vulnerable to interest-rate volatility.
Chong Hing Bank	1111 HK	2	2	2	2	2	10	Conservative management and too small to have pricing power.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Hang Seng Bank

Hang Seng Bank has the best management quality and service quality among all Hong Kong listed banks, in our view

In our view, Hang Seng Bank (HSB) has the best management quality and service quality among all Hong Kong-listed banks. HSB also has an extensive branch network and strong product-manufacturing capability, which allow it to develop a comprehensive range of retail-banking services, such as wealth-management, securities-brokerage, private-banking and credit-card businesses. It is strong in residential mortgages, property lending, manufacturing loans and credit-card advances, where it had market shares of 15.9%, 12.9%, 9.3% and 17.0%, respectively, as at the end of June 2008.

HSB has a less-developed China banking business

Meanwhile, HSB has a strong customer base, which allows it to absorb low-cost savings deposits. As at the end of June 2008, savings deposits accounted for 45.8% of HSB's total customer deposits. As a result, HSB has stronger pricing power in its lending business than the small banks in Hong Kong. However, compared with its peers, HSB has a less-developed China banking business. HSB's China business accounted for just 9.4% of its total 1H08 pre-tax profit. The majority of this came from its 12.78%-owned Industrial Bank. We forecast HSB's organic China pre-tax profit contribution to remain weak at 2-3% of the group's total over the next few years.

Worst-positioned: Chong Hing Bank

We believe Chong Hing Bank has very conservative management and the lowest NIM in the sector

As a traditional family-owned bank, Chong Hing Bank (CHB) has very conservative management, in our view. It is involved mainly in less-risky but low-yield syndicated loans and residential mortgages in Hong Kong. At the same time, we believe CHB has weak asset and liability management, as it places most of its excess liquidity in the low-yield interbank market and short-term treasury bills. As such, its NIM is among the lowest in the sector. CHB also has a heavy reliance on stock-market-related fees. Securities-brokerage and wealth-management fees accounted for a total of 74.1% of CHB's gross fees for 1H08.

We think CHB will continue to suffer from NIM pressure and slow fee income growth in the coming years

As a small bank in Hong Kong, CHB has a low market share of less than 5% for most of its business. In addition, CHB has to rely heavily on time deposits as a key funding source. Time deposits accounted for about 75% of its total deposits as at the end of June 2008. As such, CHB has weak pricing power in both the lending and deposit business. Looking ahead, we think CHB will continue to suffer from NIM pressure, given the decline in interbank market activities and slow fee-income growth due to the poor stock-market sentiment. We forecast its ROE to stay at about 6.5% over the next three years.

Valuation: target and entry prices

We believe BEA has the highest chance of its share price doubling over the next three years

Among all the banks that achieved a high score in our 'structural scoreboard' table, we believe BEA has the highest chance of seeing its share price double over the next three years. We believe the recent sharp correction in BEA's share price was due mainly to the mini bank-run in September 2008 and its announcement that it would write off the whole of its US$434m CDO exposure. Indeed, BEA has been trading at or close to its historical trough PBR of 0.71x recently. We believe the market's reaction to this news was overdone.

The decision to write off the CDO exposure should remove the share price overhang for BEA, in our view

First, BEA lost only HK$6bn of its customer deposits (less than 2% of total deposits) during the mini bank-run. Even though it has had to offer slightly higher time deposit rates than its peers to restore customer confidence, we believe the negative impact on its NIM could well be offset by the widening of the NIM for its China banking business. Second, the decision to write off the CDO exposure should remove the share-price overhang, in our view, as BEA would have a limited amount of exposure after the write-offs.

Our long-term target price for BEA is HK$30.0

Our target price of HK$30.0 for BEA is derived from the Gordon Growth Model with a long-term ROE of 13% and represents a fair 2012 PBR of 1x. We believe the fair price is very conservative, as this is equivalent to a SOTP valuation giving a PBR of 1.2x for its China business and a PBR of 0.8x for its remaining businesses, based on our 2012 forecasts.

Hong Kong: Banks – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Bank of East Asia	23 HK	15.40	30.00	95	15.00	7.4	The target price is derived from our Gordon Growth Model based on a long-term ROE of 13%, and represents a fair PBR of 1x. This is equivalent to a SOTP valuation of a PBR of 1.2x for BEA's China operation and 0.8x for its Hong Kong and overseas operations. We think the current share price has yet to discount a potential profit recovery from 2009.
BOC Hong Kong	2388 HK	8.65	20.00	131	10.00	6.1	The target price is derived from our Gordon Growth Model based on a long-term ROE of 22%, and represents a fair PBR of 2.5x. We think the current share price has discounted an increase in provisions for BOC HK's mortgage-backed securities (MBS).
HSBC	5 HK	86.25	150.00	74	75.00	9.4	The target price is derived from our Gordon Growth Model based on a long-term ROE of 14% and represents a fair PBR of 1.8x. We think sentiment toward HSBC will remain bearish in the short term, as there are concerns over asset quality problems in emerging markets, and mark-to-market losses of non-subprime-related securities.
Wing Hang Bank	302 HK	40.40	70.00	73	35.00	5.9	The target price is estimated from our Gordon Growth Model based on a long-term ROE of 22% and represents a fair PBR of 1.7x. We think the current share price has discounted a negative outlook on the Macau business of WHB and further provisions for its CDO exposure.
Hang Seng Bank	11 HK	95.00	130.00	37	65.00	7.0	The target price is derived from our Gordon Growth Model based on a long-term ROE of 35% and represents a fair PBR of 3.75x. We think the current share price has largely discounted the exposure of HSB to Washington Mutual bonds.

Source: Daiwa

We believe BOC HK has an undemanding valuation at the current share price

Apart from BEA, we believe BOC HK trades at an undemanding valuation at the current share price, and that its share price has the potential to double over the next three years. The recent correction in BOC HK's share price reflected mainly concerns related to the provisions required for its US MBS holdings and provisions for the redemption of the Lehman minibonds from its customers. We believe the provisions for the Lehman minibonds should be a one-off factor in 2008.

We forecast a decline in provisions for BOC HK's US MBS in 2009

Meanwhile, with the launch of the rescue package and the injection of liquidity into the US banking sector, BOC HK saw a limited fall in the value of its MBS holdings in October 2008. As such, we forecast a decline in provisions for BOC HK's US MBS from HK$6.6bn for 2008 to HK$752m for 2009. Overall, with the parent's support on the development of Asia-Pacific syndicated loan business, we forecast BOC HK's ROE to rebound from 13.1% for 2008 to above 20% for 2009-12. Our target price of HK$20 for BOC HK was derived from the Gordon Growth Model with a long-term ROE of 22%, and represents a fair 2012 PBR of 2.5x.

Top pick: Bank of East Asia

Among the Hong Kong banks under our coverage, we like BEA the most. We believe BEA's China banking business will remain very profitable. With strong loan growth, a widening NIM, the development of new fee-income business and stringent risk management, we forecast BEA China's net profit to account for more than 60% of the group's total over the next three years. In addition, BEA has lower fee-income volatility than its peers, HSB and BOC Hong Kong (BOC HK), given its low exposure to stock-market fees. It has diversified into corporate services, loans and credit-card fees. We forecast it to maintain solid net-fee growth of more than 15% annually for the next three years. Overall, we forecast its net profit to rise at a CAGR of 20% for 2009-12.

Valuation and catalysts

BEA has been trading at, or close to, its historical trough PBR of 0.71x recently

BEA has been trading at, or close to, its historical trough PBR of 0.71x recently. We believe the market reaction to its mini bank-run in September 2008 and its announcement that it would write off all of its CDO holdings was overdone. With a strong China banking business and diversified fee-income business, we forecast its ROE to rebound to above 13% from 2010 onwards.

Our target price of HK$30.0 for BEA is derived from the Gordon Growth Model

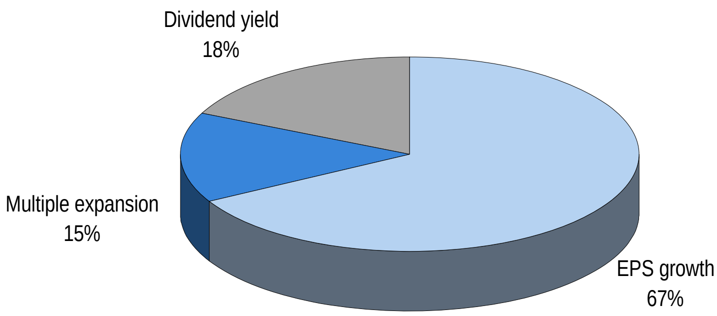
Our target price of HK$30.0 for BEA is derived from the Gordon Growth Model with a long-term ROE of 13%, and represents a fair 2012 PBR of 1x. Based on our SOTP valuation, our target price for BEA is equivalent to a 2012 PBR of 1.2x for its China business and a 2012 PBR of 0.8x for its remaining businesses (on our forecasts).

A short-term positive catalyst for BEA would be a stronger-than-expected China net profit for 2008

In our opinion, the short-term positive catalysts for BEA would include a stronger-than-expected China net profit for 2008 and a sharp rebound in 1H09 net profit for the whole BEA group. Over the next three years, if investment sentiment toward the A-share market improves, we would not exclude the possibility of BEA listing its China banking business separately on the A-share market. This would be a positive catalyst for the stock in the medium term, in our view.

Source of upside

Hong Kong Banks: Bank of East Asia – source of three-year total return



Source: Daiwa forecasts

Hong Kong: Banks – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	EPS growth (% YoY) 2007	EPS growth (% YoY) 2008E	EPS growth (% YoY) 2009E	PBR (x) 2007	PBR (x) 2008E	ROE (%) 2007	ROE (%) 2008E	Yield (% p.a.) 2007	Yield (% p.a.) 2008E
BEA	23 HK	15.40	2	18.10	18	Dec	5.8	n.m.	7.6	18.2	(100.0)	n.m.	0.8	0.8	14.4	0.0	10.8	0.0
DSF	440 HK	17.00	2	23.25	37	Dec	4.0	10.9	4.6	(24.8)	(62.9)	135.6	0.4	0.6	10.2	4.5	8.8	3.6
ICBCA	349 HK	8.09	2	10.35	28	Dec	5.7	9.8	5.4	27.1	(41.3)	82.1	0.7	0.8	12.3	7.4	10.4	6.0
BOCHK	2388 HK	8.65	2	10.50	21	Dec	5.9	8.1	5.3	10.3	(26.9)	54.1	1.0	1.2	17.4	13.1	10.5	11.1
DSB	2356 HK	4.97	2	6.00	21	Dec	5.8	8.4	4.9	(33.1)	(31.3)	72.0	0.5	0.7	8.6	6.9	8.0	4.8
WHB	302 HK	40.40	2	46.30	15	Dec	5.9	7.7	6.8	22.2	(24.0)	13.6	1.1	1.5	20.5	16.8	8.5	6.5
HSBC	5 HK	86.25	4	83.35	(3)	Dec	6.7	9.4	10.8	18.1	(28.3)	(13.7)	1.0	1.2	16.1	11.7	7.9	7.9
CHB	1111 HK	10.10	3	9.40	(7)	Dec	8.7	17.6	12.0	0.3	(50.5)	46.6	0.7	0.7	8.2	4.0	6.4	6.4
HSB	11 HK	95.00	4	87.75	(8)	Dec	10.0	12.0	10.2	51.5	(17.3)	18.5	3.2	4.2	35.3	30.2	6.6	6.6
Fubon	636 HK	2.22	4	1.80	(19)	Dec	5.6	25.5	28.8	40.9	(77.9)	(11.5)	0.6	0.8	11.4	2.8	8.6	1.9

Source: Companies, Daiwa forecasts

Banks (China) – Neutral

Sandra Cai *(852) 2848 4923 (sandra.cai@dir.com.hk)*

Sector thesis: cyclical pressure rising

The operating environment is getting tougher, in our view

The operating environment for banks has been getting tougher, in our view, as China's economic growth has eased notably this year. We believe the Hong Kong-listed China banks' 3Q08 results also highlighted the difficulty of sustaining strong growth going forward. We reiterate our Neutral rating on the sector, due to our concerns about the banks' asset-quality risk, net-interest-margin (NIM) pressure and balance-sheet growth.

Corporate banking is facing particular challenges

The corporate-banking business is facing particular challenges, in our view. We expect loan demand from better-off clients to decline due to slower corporate expansion, loan yields to drop due to interest-rate cuts and rising competition, and loan-related fee growth (eg, credit commitment fees and consultancy fees) to slow as well. At the same time, we remain cautious about the asset-quality risk, especially in the manufacturing sector (and for exporters in particular) and the east coast, due to the economic slowdown.

Structural outlook: three-year view

We believe banks will have to look proactively for alternative revenue sources

Over the next three years, we expect the banks' balance-sheet growth to slow, with the deposit mix shifting to time deposits and retail deposits, and the loan mix shifting further to long-term loans. We expects NIMs to fall back to 2006 levels, due to interest-rate cuts and the decline in banks' pricing power over better-off clients as a result of competition. Although the fiscal stimulus package announced by the central government should provide a cushion against a corporate banking slowdown in the next two years, it won't provide a sustainable driver for banks' profit growth over the medium-to-long run, in our view. We expect the large banks (Industrial and Commercial Bank of China [ICBC], China Construction Bank [CCB], and Bank of China [BOC]) to benefit more than their smaller peers from the government's policy support.

Due to the slowdown in the traditional corporate business, we believe the banks will have to look proactively for alternative revenue sources to offset the impact. These additional sources would include the retail-banking business, non-banking financial business and overseas business, in our view.

We believe 2009-11 will see significant progress in retail banking development, and that this will redefine the competitive landscape for the industry. In addition, some of the banks will be allowed to expand their presence further in non-banking financial-service areas, such as the insurance industry, thus establishing new revenue streams for the next few years. We believe banks with strong retail franchises (ICBC, CCB, China Merchants Bank [CMB]) and distribution networks will benefit most from the structural changes. In addition, we expect banks with strong capital bases to continue to expand overseas.

China: Banks – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
CCB	939 HK	5	5	5	3	4	22	Advantage in infrastructure sector and strong retail base.
ICBC	1398 HK	5	5	5	3	3	21	Defensive loan book and strong retail base, but relatively risky loan book and tight capital.
CMB	3968 HK	4	5	2	4	2	17	Strong high-end retail franchise.
BCOM	3328 HK	3	4	3	4	3	17	Synergies with HSBC are key.
CITIC	998 HK	3	4	2	4	2	15	Leveraging the group platform is key.
BOC	3988 HK	3	3	4	3	2	15	Weak domestic retail franchise and Renminbi investment product offerings.

Source: Daiwa Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: CCB

In our view, CCB's historical advantage in infrastructure lending and services will provide a buffer for its corporate-banking business against an economic slowdown, as we believe the government will increase spending in infrastructure investment as a way to boost economy. On the retail side, CCB has established a leading position in the mortgage market, which we believe is a critical factor in winning retail-banking business. Through its broad personal mortgage franchise, CCB has developed a strong and loyal retail customer base, which benefits the company in terms of cross selling its wealth-management products and attracting low-cost savings deposits over the long run.

Worst-positioned: Bank of China (BOC)

BOC has the largest exposure to foreign-currency lending and overseas investment among its peers. As a result, its earnings are subject to greater uncertainty, including an external economic slowdown, US interest-rate cuts, the speed of Renminbi appreciation, and a deterioration in the market value of its overseas investment securities, in our view. On the domestic retail side, we believe BOC has a weaker retail client base and Renminbi investment product offerings than the other large banks, due to its traditional focus on the foreign-currency business. These disadvantages will constrain the company's competitiveness in the retail-banking space, in our opinion.

Valuation: target and entry prices

We believe concerns will be removed when the economic situation stabilises

In our view, the share prices of CCB and BOC are the most likely to double over the next three years. Their share prices have been trading at a discount to those of their peers, due to their higher exposure to the domestic property sector and overseas investment, respectively. As the domestic and external economies stabilise, we expect such concerns to be removed, and these companies to be the ones most likely to be re-rated.

China: Banks – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
CCB	939 HK	4.25	8.59	102	4.30	7.4	We use a relative valuation, based on our target PBR for ICBC.
BOC	3988 HK	2.18	4.51	107	2.25	6.7	We use a relative valuation, based on a 40% discount to our target PBR for ICBC.
BCOM	3328 HK	4.64	8.97	93	4.49	6.1	We use a relative valuation, based on a 30% discount to our target PBR for ICBC.
ICBC	1398 HK	3.83	7.13	86	3.56	7.8	Based on a peak-cycle PBR of 3x.
CITIC	998 HK	3.30	5.88	78	2.94	6.3	We use a relative valuation, based on a 40% discount to our target PBR for ICBC.
CMB	3968 HK	13.80	23.84	73	11.92	6.4	We use a relative valuation, based on our target PBR for ICBC.

Source: Daiwa

CCB's current share price is 2% lower than our suggested entry price (HK$4.3) for 100% upside, which equates to a PBR of about 1.5x on our 2009 BVPS forecast. In our view, the reason CCB is trading at such a significant discount to its peers is its larger exposure to domestic property developers and the share-overhang risk due to the recent unlocking of Bank of America's stake.

Top pick: CCB

We expect CCB to benefit from aggressive investment in infrastructure by the government

We expect the PRC Government to continue to invest aggressively in infrastructure over the next two years. With its expertise in this area, we believe CCB should see strong growth in long-term loans and construction-related fee-based services. In addition, we expect its extensive branch network, broad and loyal retail client base to continue to support the company's business development in retail banking and non-banking financial areas over the long run, in our view.

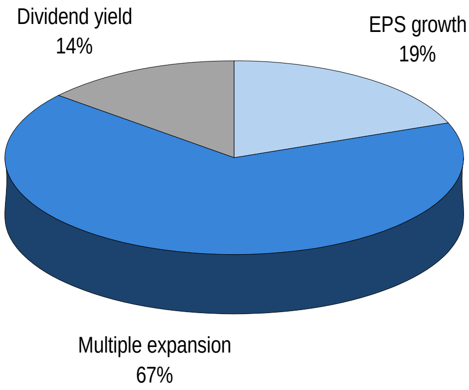
Valuation and catalysts

We expect government support to enhance the stock's investment appeal

The stock is trading at a PBR of 1.8x and a PER of 7.9x on our 2008 forecasts, and 2% below our suggested entry price (HK$4.3) for 100% upside, which equates to a PBR of 1.5x on our 2009 BVPS forecast. We expect the government's increased spending on infrastructure to enhance the company's investment appeal.

Source of upside

China Banks: CCB – source of three-year total return



Source: Daiwa forecasts

China: Banks – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	EPS growth (% YoY) 2007	EPS growth (% YoY) 2008E	EPS growth (% YoY) 2009E	PBR (x) 2007	PBR (x) 2008E	ROE (%) 2007	ROE (%) 2008E	Yield (% p.a.) 2007	Yield (% p.a.) 2008E
CCB	939 HK	4.25	2	4.70	10.6	Dec	13.2	7.9	7.3	46.1	54.8	3.7	2.2	1.8	18.4	24.0	5.0	5.7
BOC	3988 HK	2.18	3	2.50	14.7	Dec	9.2	6.5	6.5	31.3	31.5	(3.6)	1.2	1.0	14.0	16.8	4.9	6.7
ICBC	1398 HK	3.83	3	4.15	8.4	Dec	14.7	9.2	8.4	38.8	48.3	5.5	2.2	1.9	16.2	21.7	3.7	6.0
BCOM	3328 HK	4.64	3	5.00	7.8	Dec	10.5	6.6	6.3	54.4	47.5	(0.1)	1.6	1.3	18.1	21.0	2.2	5.2
CMB	3968 HK	13.80	3	13.80	0.0	Dec	12.5	7.3	7.4	96.0	58.5	(5.2)	2.8	2.1	24.7	31.5	2.4	4.1
CITIC	998 HK	3.30	2	3.10	(6.1)	Dec	14.5	7.1	7.1	71.9	91.2	(5.2)	1.5	1.2	14.4	17.9	1.7	5.7

Source: Companies, Daiwa forecasts

Coal (China) – Neutral

***Jason Li, CFA** (852) 2848 4499 (jason.li@dir.com.hk)*

Sector thesis: spot and contract prices narrowing; metcoal price is falling

Weakness led to recent downgrade

Signs of weakness in both the physical and equity markets led us to downgrade our rating for the China coal sector to Neutral from Positive recently. These signs included:

- A deterioration in demand from the export sector: 1) slowing export growth and industrial-production growth, and 2) the increasing risk of using letters of credit due to the credit crunch, thus dampening export activity.
- Demand from the construction sector has been affected negatively by the vanishing wealth effect, and loan/credit tightening toward the property sector in 2008.
- The key catalysts (heavy snowstorms in southern China, earthquake in Sichuan Province, China, and heavy rainfall in Queensland, Australia) underpinning coal's strong fundamentals are non-recurrent and will normalise, in our view.

Structural outlook: three-year view

We still believe that the China coal sector can emerge from the trough in three years for the reasons listed below:

1) Industry consolidation, leading to supply restraint:
   - We believe the emergence of mega coal miners on the back of government support means that mega state-owned enterprises (SOEs) could emerge as leaders in the consolidation game, with China Shenhua Energy (Shenhua) taking the lead (we regard recent talk in the market of Shenhua acquiring China Coal, and Shenhua acquiring small mines in Inner Mongolia as evidence of this).
   - We believe many small mines will be squeezed out of the market due to their poor safety records, air-polluting operations, and high strip ratios. In our view this implies companies such as Shenhua, with visible volume-growth potential, should gain market share, aided by both organic growth and acquisitions.
2) We expect the physical coal market to become more volatile, benefiting those companies that have integrated operations (coal and power), due to: a) global supply-chain re-balancing/re-distribution taking time to settle, b) power tariff hikes may not offer a one-time solution to enable power generators to become profitable.
3) New mining areas, such as Erdosi in Inner Mongolia are ready to be exploited. In our view, this suggests that the supply and demand situation in China is becoming increasingly unbalanced, with reserves being depleted in high-demand coastal areas, benefiting those coal miners (such as Shenhua) that have direct railway access.

China: Coal – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
China Shenhua Energy	1088 HK	4	3	4	3	3	17	We see the margin risk as low, due to volume growth and low costs.
China Coal Energy	1898 HK	3	3	3	3	2	14	We believe further market-share gains are possible due to consolidation and organic growth.
Yanzhou Coal Mining	1171 HK	2	4	1	4	2	13	High-quality coal results in higher pricing power and product demand.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Shenhua

With a score of 17 points, the highest among the group, Shenhua offers the best risk/reward profile in the group, in our view. We rate it the highest as it has:

- the lowest unit cost contributing to margin protection,
- the highest growth profile, enabling it to gain more market share,
- an integrated operation, reducing volatility (expanding power segment), and
- a balanced operating model (railway and ports).

Worst-positioned: Yanzhou Coal Mining

We are not convinced that Yanzhou Coal Mining is a better play than the other two on many metrics. It has:

- a low reserve base and issues with expansion (eg, Yushuwan impasse),
- no volume growth, and
- increasing unit mining costs.

In our view, once pricing leverage disappears in a volatile spot market, Yanzhou Coal's share price would be particularly vulnerable to the downturn. We therefore do not believe Yanzhou Coal can outperform over a two-to-three year horizon.

Valuation: target and entry prices

We believe China Shenhua has the strongest potential to see its share price double over the next three years, due to what we see as its stable growth, multiple expansion and stable dividend policy.

We forecast Shenhua to record a 2009-12 earnings CAGR of 42%, on the back of double-digit percentage annual volume growth and decent cost control. Assuming a stable dividend-payout ratio of 35%, we estimate Shenhua's dividend yield will account for 13% of the total share price upside. As we expect coal companies' valuations to reach mid-cycle levels in three years' time, we estimate Shenhua's multiple expansion will account for contribute the remaining 45%.

China: Coal – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
China Shenhua Energy	1088 HK	14.30	41.10	188	20.60	8.3	We arrived at our target price using a mid-cycle valuation.

Source: Daiwa

Our suggested entry price of HK$20.60, equal to half of our three-year target price, represents a 44% premium to the current share price of HK$14.30. The valuation at our entry price would be an 8.3x PER on our 2009 EPS forecast.

Top pick: China Shenhua Energy

We believe, over the next three years, power tariffs will rise to a reasonably high level, incentivising Chinese power producers to continue operating.

By the same token, we expect domestic contract coal prices to increase, narrowing the spread with spot prices regionally. We expect domestic spot coal prices to remain volatile.

The coal-mining companies located in the coastal regions will face higher mining costs, as their reserves get depleted and they have to mine deeper than ever, incurring higher cash costs than inland coal miners, such as Shenhua, in our view.

In our view, all of these developments benefit Shenhua, a coal-power integrated player with large contract exposure (around 80% currently), large inland reserves, and self-controlled access to ports.

Shenhua's main weakness is coal pricing, but we do not necessarily see this as a big drawback. As we expect the spot market to continue to fluctuate significantly, we think players with low ASPs should be more capable of weathering the volatility and deliver stable earnings growth.

Valuation and catalysts

Shenhua is trading currently at a 5.8x PER on our 2009 EPS forecast, representing a 4.8x PER for its coal segment. Yanzhou Coal is now trading at a PER of 2.5x on our 2009 EPS forecast (compared with a post-Asian Financial Crisis low of 3.7x in March 1999). We believe that Shenhua deserves to trade at a premium to Yanzhou Coal, given its integrated operations.

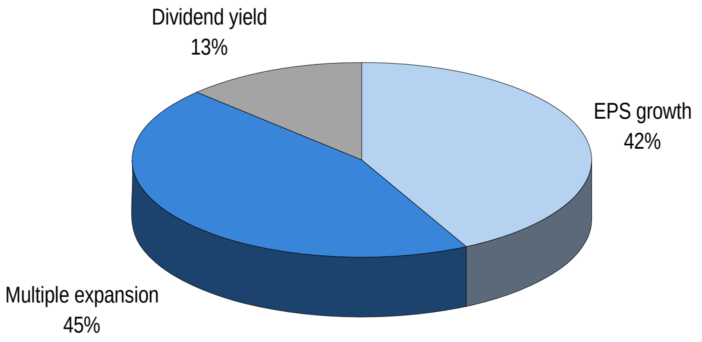
We thus believe the current share price has priced in a deep recession, implying further downside is limited. Although the share price has risen significantly over the past few days, we still believe this represents an attractive entry point.

Our suggested entry price of HK$20.60 implies an 8.3x PER on our 2009 EPS forecasts. We see the potential share-price catalysts as including:

- a domestic contract price increase,
- volume growth, aided by industry consolidation and the injection of assets by the parent company,
- power-tariff hikes, and
- the valuation moving to the mid-cycle level over the next three years.

Source of upside

China Coal: Shenhua – source of three-year total return



Source: Daiwa forecasts

China: Coal – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
China Shenhua Energy	1088 HK	14.30	2	22.69	58.7	Dec	12.9	8.1	5.8	4.0	6.7	4.8	3.7	2.9	7.7	6.1	6.1	8.7
Yanzhou Coal Mining	1171 HK	4.20	4	7.98	90.0	Dec	6.4	2.2	2.5	2.7	4.6	1.2	1.3	1.5	4.6	13.6	12.3	11.4
China Coal Energy	1898 HK	4.92	3	8.59	74.6	Dec	9.6	5.3	3.5	2.5	15.5	3.0	2.0	1.5	3.3	5.8	8.9	12.7

Source: Companies, Daiwa forecasts

Conglomerates (Hong Kong) – Neutral

Jonas Kan, CFA *(852) 2848 4439 (jonas.kan@dir.com.hk)*

Sector thesis: removal of 'nurturing discount' on 3G investment

We expect Hutchison's hidden value to unfold gradually over the next few years

We think one factor that has undermined Hutchison Whampoa's (Hutchison) valuation over the past few years is that the stock market has attached a heavy discount to it, as a result of the company's determination to nurture a large-scale start-up to break into the mobile phone industry in Western Europe.

We think this has resulted in two sources of hidden value in Hutchison. One is the neglected value creation and growth at its established businesses, whose EBIT rose at a CAGR of 13.3% from FY01 to FY07. Another is the option value in the 3 Group, as the stock market seems unwilling to assign any value to this start-up until it proves that it has become a profitable operation.

We expect the hidden value of Hutchison to unfold gradually over the next few years, and believe this would be supported by positive factors at the company level, although the pace could be affected by uncertainties related to the global economy (most of Hutchison's established businesses are global in nature) and concerns related to the outlook for Western economies (where its 3G businesses are concentrated).

Structural outlook: three-year view

The overall environment is challenging, but there is room for self-improvement

Ports – the outlook for the global port industry will inevitably be affected by the slowdown in global trade. However, we think the impact on Hutchison Port Holdings is likely to be mitigated by its progress in achieving market-share expansion through continued building of new ports in various parts of the world.

Retail – we believe the outlook for Hutchison's retail businesses will be affected by weakening consumer sentiment in the near future, although we expect margins for its retail division to improve considerably through rationalising its diverse operations. The group has acquired diverse retail operations in many countries since 2004, but has yet to extract the synergies and economies of scale that they should be able to provide. Its achieved EBIT margin from retail was still only 3.4% for FY07, and we see an improvement in the achieved margin as one main factor underpinning the growth of Hutchison's retail operation.

Property – Hutchison has built up a sizeable landbank in China amounting to more than 100m sq ft, of which over 70% is for sale, we estimate. We expect gradual completion of these projects to provide a new growth driver for the stock.

Energy, finance and investment – Cheung Kong Infrastructure is in a strong financial position with net cash and strong dividend income from Hongkong Electric, which puts it in a good position to seize new investment opportunities in the global infrastructure investment industry. While Husky will be affected by the decline in oil prices, its volume should expand significantly over time, when its oil-sands projects gradually come to fruition.

The 3 Group – The group's focus on improving customer quality since 2006 has shown up in the expanding EBITDA margin, falling CACs, and declining churn rates, which are likely to underpin its operating performance over the next few years. At the same time, mobile broadband customers have become a new growth driver for the 3 Group, and have provided it with a new revenue stream, but at small incremental cost. Provided it can keep existing customers (which are mostly postpaid and generate above industry average ARPU) and can continue to increase scale and critical mass, we think it could meet its guidance of recording full-year positive EBIT for 2009.

Hong Kong: Conglomerates – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Hutchison Whampoa	13 HK	4	4	4	3	3	18	Whether and how quickly the 'nurturing discount' attached to its 3G investments can be removed is the key, in our view.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Hutchison Whampoa

We view Hutchison as one of the few corporations in Hong Kong that has expanded successfully overseas, and established a meaningful presence in various growth sectors. While the uncertain global environment is a challenge, we think Hutchison's position will be protected by the considerable self-improvement potential of its businesses, mainly for its 3G operations and, to a lesser extent, retail.

Worst-positioned: n.a.

Valuation: target and entry prices

We see HK$42.10 or less as a good entry price

While many of Hutchison's businesses are exposed to the global environment, we think a 40% discount to its ex-3G NAV discounts the risk adequately. Based on this, we see HK$42.10 or less as good entry price for Hutchison. We also expect the 3 Group to be able to command option value over time, if it can meet the company's guidance of positive EBIT by 2009. Assuming that the discount on its ex-3G NAV narrows to 5% in three years, and that the option value of the 3 group expands to HK$13.60 (based on 20% of our estimate of its DCF value if it can become a self-sustaining business with a 20% revenue market share in the countries where it operates), this would give a target price of HK$84.27/share.

Hong Kong: Conglomerates – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Hutchison	13 HK	41	84.27	106	42.1	7.3	Exposed to the global environment, and we believe there is room for improvement at the individual business level.

Source: Daiwa

Top pick: Hutchison Whampoa

We expect the valuations of its established businesses and the 3 Group to improve

We expect Hutchison's established businesses to be able to demonstrate resilience during market downturns and believe the 3 Group will mature gradually into a start-up that can stand on its own feet. These two factors should help underpin a gradual improvement in the valuation of its established businesses and the 3 Group, in our view.

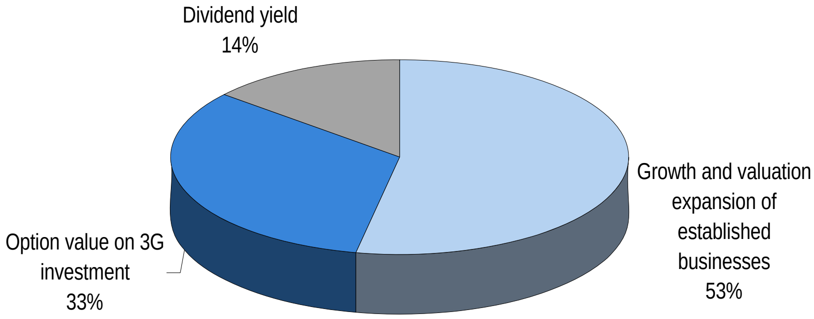
Valuation and catalysts

Results announcement and deals are potential catalysts, in our view

With the stock trading currently at a 43% discount to our ex-3G NAV estimate of HK$71.90, we think Hutchison's current valuation has discounted considerable risks related to its exposure to the global economic slowdown. We expect Hutchison's established businesses to be able to demonstrate resilience against this, and believe the 3 Group is on track to record positive EBIT by 2009, although we may need to wait for its results announcements to verify this. Its results announcement and potential deals for crystallising the value of its established and 3G businesses are likely to be the main potential share-price catalysts for the stock, in our view.

Source of upside

Hong Kong Conglomerates: Hutchison Whampoa – source of three-year total return



Source: Daiwa forecasts

Hong Kong: Conglomerates – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Hutchison	13 HK	41.00	2	71.50	74.4	Dec	5.7	9.7	7.0	3.3	4.7	3.5	3.1	2.7	4.2	4.2	4.5	4.7

Source: Company, Daiwa forecasts

Consumer (Hong Kong) – Neutral

Peter Chu, CFA *(852) 2848 4430 (peter.chu@dir.com.hk)*

Sector thesis: difficult operating environment ahead

Esprit and Li & Fung will be negatively affected by the economic downturn

In light of the global financial crisis, it is clear that Hong Kong retailers face a tough business environment in 2009. In addition, most of the companies in the sector have direct business exposure to the unexciting US and European retail markets. For example, we expect about 85% of Esprit's revenue for FY09 to be derived from Europe, while 65% of Li & Fung's turnover for 1H FY08 came from the US. As a result, we expect Esprit's and Li & Fung's earnings to be affected adversely by the economic downturn in both the US and Europe.

Hong Kong retailers' share prices have declined by 11-40% over the past month

Hong Kong retailers' share prices have declined by 11-40% over the past month. Current valuations of some companies are now much lower those seen during the past economic downturns in the US and Europe. For example, Li & Fung's prospective PER of 10.4x is below the 18.3x recorded in January 2003, when the US was in an economic downturn. As a result, we have a Neutral rating on the sector.

Structural outlook: three-year view

Improvement in overseas economic conditions would be positive for Esprit, Li & Fung and Texwinca

According to forecasts from our global economic research team, there will be a material year-on-year improvement in real GDP growth for 2010. Our economists forecast the real GDP growth rate in the US to accelerate to 2.6% YoY for 2010, from 1.4% YoY for 2009, and that for the Eurozone to accelerate to 1.5% YoY for 2010, from 1.2% YoY for 2009. An improvement in overseas market conditions would be positive for Esprit, Li & Fung, and Texwinca.

Esprit and Li & Fung are well-positioned in their respective industries

Regarding the global apparel industry, we believe Esprit is well-positioned in the casual-wear markets in Europe, due to its established brand name and extensive distribution networks. In the meantime, we believe Li & Fung will strengthen its competitive position in the outsourcing industry, and expect it to receive more outsourcing contracts in the economic slowdown. Armed with an extensive supplier and manufacturer network, Li & Fung is in a strong competitive position, in our view.

Hong Kong: Consumer – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Esprit	330 HK	4	5	3	4	5	21	We expect Esprit's products to remain popular in Europe.
Li & Fung	494 HK	5	4	4	5	3	21	Market-share gains are possible in view of the current economic downturn in overseas markets.
Texwinca	321 HK	2	3	5	3	4	17	We expect consolidation in the textile industry to lead to market-share gains and margin enhancement.
Giordano	709 HK	3	1	1	2	2	9	Mid-priced apparel products have limited pricing power in Asia markets.
Yue Yuen	551 HK	1	2	2	1	1	7	OEM company has limited pricing power and a limited chance of a margin improvement.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Li & Fung

Given the current economic slowdowns in the US and Europe, we expect Li & Fung to receive more outsourcing contracts. Despite the relatively thin profit margins of these new contracts, we would expect turnover from the new business to still have a positive impact on the company's earnings.

Worst-positioned: Yue Yuen

International sportswear brand owners, such as Nike and Adidas, have strong bargaining positions and the flexibility to outsource sports-shoe production to other OEM companies. Accordingly, we believe Yue Yuen will have very limited pricing power in the future. It is the worst-positioned stock in the sector, in our view.

Valuation: target and entry prices

Potential for share prices to double

We believe the share prices of Li & Fung and Esprit have the potential to double over the next three years. An improved economic performance in Europe and the US, and hence margin expansion, would result in strong share-price performances for these companies over the next few years, in our view.

Hong Kong: Consumer – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Li & Fung	494 HK	14.26	38.67	171.00	19.30	14.0	A DCF with a WACC of 9.2% is used to derive the three-year target price.
Esprit	330 HK	41.50	102.10	146.00	51.00	7.3	A DCF with a WACC of 10.3% is used to derive the three-year target price.

Source: Daiwa

Esprit and Li & Fung offer attractive value now, in our view

We believe both Esprit and Li & Fung offer attractive investment value, as their share prices are now below our recommended entry prices. The PERs at our three-year target prices are toward the high end of the past eight-year trading ranges. With a gradual economic recovery in both Europe and the US, we believe the earnings growth of those two companies in FY11 will exceed that for FY09. As a result, we think investors would be willing to pay a higher price than the PER level at which the two stocks trade currently.

Top pick: Li & Fung

Management quality is the best in the sector

We regard the management quality of Li & Fung as the best in the sector. In addition, with its extensive supplier network, we think Li & Fung will continue to be the leader in the global sourcing industry. We believe the company will secure more outsourcing contracts in times of economic slowdown in the US and Europe.

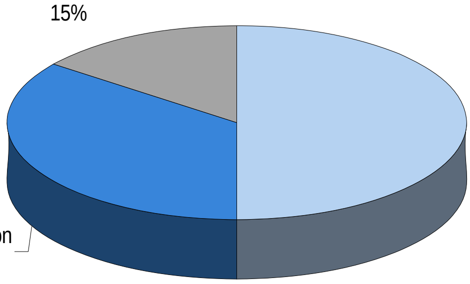
Valuation and catalysts

New outsourcing contracts and improvement in economic conditions are earnings drivers

At present, Li & Fung trades at a PER of 10.4x on our FY09 EPS forecast, lower than its valuation after ‘911’ in 2001. Our recommended target price represents a PER of 14x on our FY09 EPS forecast. We believe potential share-price catalysts would be more outsourcing contracts and margin expansion due to the emergence of operating leverage. Nevertheless, any prolonged economic slowdown in Europe and the US would undermine our positive view on the stock.

Source of upside

Hong Kong Consumer: Li & Fung – source of three-year total return



Source: Daiwa forecasts

Hong Kong: Consumer – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Li & Fung	494 HK	14.26	2	29.40	106.0	Dec	15.9	14.0	10.4	7.7	11.5	11.8	8.7	5.4	5.0	5.7	7.9	10.7
Esprit	330 HK	41.50	2	99.00	139.0	Jun	8.0	6.9	5.9	4.7	6.9	4.5	3.9	4.1	10.1	10.8	12.7	15.9
Texwinca	321 HK	3.88	2	6.67	72.0	Mar	5.6	4.7	4.0	3.3	3.7	3.3	2.7	2.3	11.1	13.2	15.7	18.8

Source: Companies, Daiwa forecasts

Department Store (China) – Positive

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Sector thesis: well-positioned in fashion-goods distribution

We favour the market leaders

We favour the leading department-store operators in China, ie, Golden Eagle Retail Group (Golden Eagle) and Parkson Retail Group (Parkson). With what we see as their good brand equity, we expect these market leaders to gain market share from their peers, even during an economic slowdown.

The major retail channel for fashion goods

Department stores are the major retail channel for mid- to high-end fashion goods. Generally, fashion merchandise accounts for more than 80% of a department store's sales. Per-capita disposable income for urban households in China was about US$1,825 for 2007. In our view, spending on fashion is likely to be more popular than on housing or vehicles in times of weakening consumer sentiment.

Superior business model

Moreover, the department-store operators in China typically are 'asset-light', which alleviates the risk of carrying inventory and allows for negative working capital. We like the leading department-store operators that we see as having good management, ie, Golden Eagle and Parkson.

Structural outlook: three-year view

We expect retail sales value growth to decelerate gradually

We expect department stores to be the major distribution channel for mid-price range fashion goods over next three-to-five years. Due to the slowdown in China's economic growth, we expect demand for fashion goods to decelerate over the next two-to-three years. We forecast China's retail-sales value to rise by 20.3% YoY, 14.0% YoY, and 15.5% YoY for 2008, 2009 and 2010, respectively.

Limited supply of department stores in existing commercial districts

We expect the expansion of department-store networks to also slow over the next two-to-three years. We believe the supply of new department stores will decrease, especially in emerging commercial districts, and that the supply of department stores in existing commercial districts will be limited. In addition, transportation will continue to be a bottleneck for discount stores or factory stores located typically on the outskirts of the major cities, in our opinion.

Arising industry consolidation opportunities

In our view, there are opportunities for industry consolidation over the next three years. However, we see the prerequisite for acquisitions as the ability to finance them from internal resources. The market leaders, ie, Parkson, Golden Eagle, and New World Department Store China (NWDS), have solid balance sheets, which we believe should enable them to seize any acquisition opportunities.

China: Department Stores – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Parkson	3368 HK	5	4	5	4	4	22	The market leader, with a nationwide department-store network.
Golden Eagle	3308 HK	5	4	4	4	4	21	An outstanding regional player in China's third most affluent province.
NWDS	825 HK	3	4	4	4	3	18	Re-focusing on the department-store business after being spun off from a property company in 2007.
Intime	1833 HK	3	4	3	3	3	16	We believe the company's aggressive expansion plan is a significant burden in the current market environment.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Parkson

In our view, Parkson is one of few department-store operators that has demonstrated the ability to run a good department-store business from tier-one cities to tier-three cities. The brand name is well known in the Mainland China market. Parkson prefers leasing stores to owning properties, which lowers the initial cost of new stores. The company plans to add four-to-five new stores per annum over the next three years, and to finance them from internal resources.

Worst-positioned: Intime

We do not regard Intime as a department-store operator, but as an investment company, in our view. We see its aggressive expansion plan as a significant burden in the current market environment. Moreover, Intime is not able to finance its expansion with internal resources. Its gearing ratio rose sharply, to 28.8% for 1H08. We expect Intime to scale back its expansion plans in the near future.

Valuation: target and entry prices

Time to accumulate Parkson and Golden Eagle, in our view

In our view, both Parkson and Golden Eagle have the potential to see their share prices double over the next three years. Both have established good brand equity in the department-store industry, which is very important for maintaining customer loyalty. Department stores with reputable brand images also inspire confidence in concessionaires. In addition, both companies have good management teams, in our view. We expect both companies to achieve balanced growth as a result of their top line, ie, same-store-sales (SSS), growth and department-store network expansion.

China: Department Store – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Parkson	3368 HK	5.80	10.68	84.1	5.34	12.1	DCF valuation model
Golden Eagle	3308 HK	4.10	6.41	56.3	3.21	8.8	DCF valuation model

Source: Daiwa

Parkson and Golden Eagle are trading at near the low end of their historical PER bands. In our view, retail companies trading at relatively high multiples are likely to see their share prices fall considerably every time the overall market falls. Currently, the average PER of department-store stocks on our FY09 forecasts is around the middle of the current PER range of our China stock universe.

Our entry prices for Parkson and Golden Eagle are about 10% and 20% lower than their current share prices, respectively. In our view, now is the time to consider accumulating the stocks of these market leaders in the China retail sector, given what we regard as their attractive valuations.

Top pick: Parkson

Balanced growth drivers

We are comfortable that Parkson will able to maintain its leading position in the nationwide market over next three years. Our forecasts for SSS growth of 8% YoY, 10% YoY, and 9% YoY for 2009, 2010 and 2011, respectively, reflect the economic slowdown in China. Meanwhile, we forecast the operating area of its self-owned department stores to increase by 17% YoY, 15% YoY, and 13% YoY for 2009, 2010 and 2011, respectively, which would translate roughly into four-to-five new department stores per annum. We forecast an EPS CAGR of 21% for 2007-10.

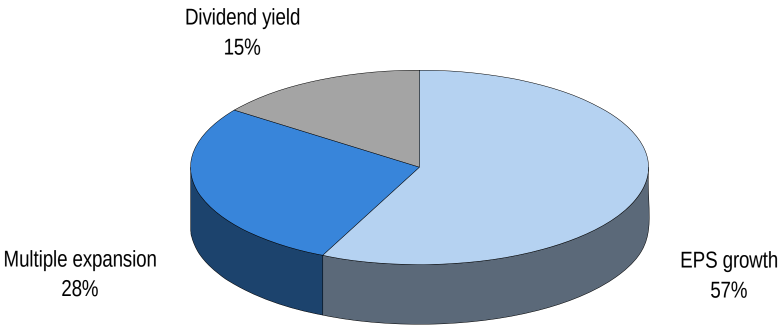
Valuation and catalysts

Trading at below our suggested entry price

Parkson is trading at a 13.1x PER on our FY09 forecasts, above the 12.1x PER on our FY09 forecasts implied by our entry price. The market is rather bearish on discretionary consumption in China. However, according to management, year-on-year SSS growth for October remained at around a mid-teens percentage. In our view, Parkson is relatively defensive in the sector for two reasons: it focuses more on mid-range fashion goods than its peers, and its chain-store network is fairly diversified geographically, from tier-one cities to tier-three cities.

Source of upside

China Department Store: Parkson – source of three-year total return



Source: Daiwa forecasts

China: Department Store – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Parkson	3368 HK	5.80	2	7.95	37.1	Dec	22.2	16.1	13.1	10.7	14.2	10.6	9.0	7.2	2.2	3.1	3.8	5.0
Golden Eagle	3308 HK	4.10	2	5.35	30.5	Dec	18.1	12.2	11.3	8.7	8.9	8.0	7.1	5.8	1.1	2.5	2.7	3.5
NWDS	825 HK	3.94	3	4.70	19.3	Jun	13.8	13.5	12.0	10.5	7.3	6.2	5.4	4.6	2.3	2.2	2.5	2.9
Intime	1833 HK	2.33	4	2.47	6.0	Dec	9.9	7.8	9.5	8.6	6.8	5.7	5.4	4.3	3.1	3.8	3.2	3.5

Source: Companies, Daiwa forecasts

Electronics (Hong Kong/China) – Neutral

Joseph Ho, CFA *(852) 2848 4443 (joseph.ho@dir.com.hk)*
Pranab Kumar Sarmah, CFA *(852) 2848 4441 (pranab@dir.com.hk)*

Sector thesis: survival of the fittest

We prefer domestic plays to export-driven stocks in the near term

In the China electronics sector, we remain cautious in the near term on export-orientated companies with highly leveraged balance sheets, such as ZTE Corp and Techtronic Industries (669 HK, HK$2.60, Not rated). We prefer the China plays, particularly telecom infrastructure stocks like China Communications Services (CCS), which generates 99% of its revenue from China. We also like BYD Electronic (BYD) and AAC Acoustic (AAC) for their strong balance sheets (net cash) and their depressed valuations (PERs of about 3.6-4.9x on our FY09 EPS forecasts). In the PC sector, Lenovo is sitting on sizeable net cash, but we think its corporate-centric overseas PC business is unlikely to offer much upside surprise in the near term.

Structural outlook: three-year view

Further market-share gain by the PRC players

Longer term, we forecast demand for PCs and handsets to resume positive year-on-year growth of 5% and 6%, respectively, for 2010. In our view, the PC sector will go through further industry consolidation, as players such as Lenovo remain proactive in seeking inorganic growth. The key question, in our view, is whether Toshiba or Fujitsu Siemens, the two obvious targets that would contribute meaningful market-share gain to Lenovo, are up for sale.

For the PRC handset-component sector, we think the two emerging PRC players, AAC and BYD, will continue to gain market share in a supply chain dominated currently by Taiwanese and Japanese players. In the telecom-equipment sector, we believe the two PRC equipment makers, ZTE and Huawei, will continue to operate more successfully than their global rivals in the developing countries, given their cost advantages and close Sino-African relationships.

HK/China: Electronics – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Suntech Power	STP US	4	5	5	3	3	20	The largest PV-module maker globally, with a strong distribution network and a virtual vertically-integrated supply chain. In terms of scale, R&D, growth rate and margins, STP is ahead of most PV-cell/module makers.
Kingboard Laminates	1888 HK	4	4	4	4	3	19	Solid track record of managing economic downturns since listing in 1993.
CCS	552 HK	3	4	4	3	3	17	Market leader in China, with virtually no foreign competition.
AAC Acoustic	2018 HK	4	3	3	3	3	16	An emerging PRC handset acoustic components maker, with a strong balance sheet to weather the downturn.
BYD Electronic	285 HK	4	3	3	2	3	15	An emerging PRC handset keypad and casing maker, with a strong balance sheet to weather the downturn.
ZTE	763 HK	3	3	4	2	3	15	A proxy for TD-SCDMA capex. Negative operating cash flow remains an issue.
Lenovo	992 HK	4	2	2	3	2	13	M&A would be the next share price catalyst, in our view.
Comba Telecom	2342 HK	3	3	3	2	2	13	Market leader in indoor network enhancement.
Skyworth	751 HK	3	3	3	2	2	13	A proxy for TV demand in tier-two and tier-three cities.
SinoCom	299 HK	3	2	2	2	2	11	High customer concentration.
SMIC	981 HK	1	3	1	2	1	8	Management lacks focus on profitability. Competition is too strong.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Kingboard Laminates (KBL)

We believe KBL is fundamentally the strongest, with market leadership in the laminate industry in China and a well-diversified customer base (no single external customer accounted for more than 3% of FY08 sales). It also has a solid and proven track record of managing economic downturns (eg, stringent credit controls and cautious capacity expansion, etc) in 1998 and 2001. We believe its market leadership will continue to improve over the next three years.

Worst-positioned: SMIC

SMIC is fundamentally the weakest, in our view, as it is nearly six quarters behind its competitors in terms of advanced process development. In addition, we think it has lost out on opportunities, as customers in need of advanced capacity already have foundry partners.

Valuation: target and entry prices

We like stocks with depressed valuations and healthy balance sheets

We believe KBL has the strongest chance of doubling its share price over the next three years, due to what we see as its: 1) depressed valuation (trading at a PER of 2.9x on our FY08 EPS forecast), and 2) generous dividend-payout policy.

HK/China: Electronics – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Kingboard Laminates	1888 HK	1.88	6.44 (inc. dividend income of HK$1.02)	243	3.22	4.56	A total return play with a portion of returns derived from dividend income.
SMIC	981 HK	0.173	0.25	44.5	0.125	n.m.	We expect SMIC to record a profit for 2010-11 and its valuation to re-rate to a PBR of 0.4x by then, from a one-year forward PBR of 0.2x currently.

Source: Daiwa

KBL's current share price is below our entry price of HK$3.22 for a 100% return, meaning it is time to start accumulating the stock on weakness, in our view.

Top pick: KBL

Solid track record of managing economic downturns

KBL is a market leader in the laminate industry in China. The industry has seen few new entrants over the past 10 years, as the barrier to entry is high, given the high capex required. It has a well-diversified customer base and a good track record of managing economic downturns. Investors would also benefit from KBL's steady and generous dividend payout (we expect its dividend-payout ratio to increase from FY10 onwards from 50% currently), which is an important source of income for the parent company (which holds a 73% stake in KBL). KBL had a moderate net gearing of 26% as at 30 June 2008, with cash on hand of HK$1.7bn versus short-term bank borrowing of HK$1.1bn, and it generated HK$0.8bn in operating cash flow for 1H08. We think KBL could survive the current credit crunch easily by scaling back on its capex.

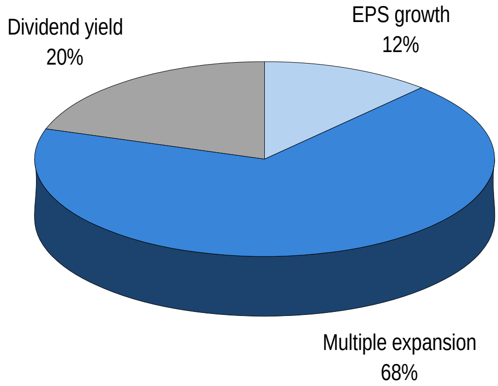
Valuation and catalysts

A potential total return of 243%, primarily from dividends and PER expansion

Trading currently at a PER of 2.9x, a PBR of 0.7x, and offering a 17.1% dividend yield on our FY08 forecasts, the stock is oversold at the current level, in our view. The share price would reach HK$5.42 (or 188% capital appreciation), based on our current FY08 EPS forecast of HK$0.643 (Bloomberg-consensus forecast: HK$0.630), and assuming a 4% EPS CAGR over the next three years and a PER of 7.5x on our FY11 EPS forecast of HK$0.723. In addition, shareholders would receive about HK$1.02 in dividends over 2008-11, if we assumed a constant 50% dividend-payout ratio. This would give a total return of 243% (HK$5.42 plus HK$1.02, divided by HK$1.88).

Source of upside

HK/China Electronics: KBL – source of three-year total return



Source: Daiwa forecasts

HK/China: Electronics – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Kingboard Laminates	1888 HK	1.88	3	6.25	232.4	Dec	3.1	2.9	2.7	2.5	2.4	2.3	2.1	1.8	16.0	17.1	18.7	20.2
Suntech	STP US	10.21*	2	36.00*	252.6	Dec	11.2	7.7	5.0	3.9	15.0	8.2	5.1	3.9	0.0	0.0	0.0	0.0
Comba Telecom	2342 HK	0.70	2	2.24	220.0	Dec	3.1	2.8	2.1	2.0	2.8	2.4	1.8	1.7	8.6	10.8	14.7	15.4
Skyworth Digital	751 HK	0.41	1	1.11	170.7	Mar	7.2	2.9	2.3	2.7	3.6	1.9	1.5	1.6	4.1	4.0	7.8	11.1
SinoCom Software	299 HK	0.60	3	1.58	163.3	Dec	6.0	5.8	5.4	4.9	1.4	1.3	1.2	1.1	9.3	9.1	9.7	10.6
ZTE	763 HK	14.40	3	26.50	84.0	Dec	14.5	10.2	7.6	6.6	8.7	6.9	5.6	5.2	1.3	2.0	2.6	3.0
CCS	552 HK	4.14	2	6.92	67.1	Dec	18.1	15.5	12.3	11.0	7.4	6.3	5.6	5.3	1.8	2.6	3.2	3.6
BYD Electronic	285 HK	2.71	2	4.51	66.4	Dec	5.1	4.8	3.6	3.0	2.8	2.5	2.0	1.8	5.9	6.3	8.2	10.1
AAC Acoustic	2018 HK	3.19	2	5.16	61.8	Dec	6.7	5.1	4.9	4.2	3.6	2.9	2.9	2.6	0.0	3.9	4.0	4.8
SMIC	981 HK	0.173	3	0.21	21.4	Dec	n.a.	n.a.	n.a.	6.1	2.1	3.1	2.4	2.0	0.0	0.0	0.0	0.0
Lenovo	992 HK	1.83	4	1.83	0.0	Mar	5.0	9.0	8.0	7.3	1.0	1.6	1.5	1.3	8.5	8.5	8.5	8.5

Source: Companies, Daiwa forecasts
*US$

Disclosure: Daiwa Institute of Research Ltd. (DIR) has a consultancy and advisory contract with Zhongxun Computer System (Beijing) Co., Ltd., SinoCom Software Group's major subsidiary in Beijing. A senior executive of DIR has been appointed as an advisor to Zhongxun Computer System (Beijing) Co., Ltd.

Insurance (China) – Positive

Steven Chan *(852) 2848 4468 (steven.chan@dir.com.hk)*

Sector thesis: time to accumulate life insurers

Life-insurance business is basically under-developed in China

The life-insurance business is basically under-developed in China, in our opinion. The life-insurance penetration rate and density are well below those in industrialised markets, as well as lower than those in some emerging markets. Indeed, only 11% of personal financial assets in China were allocated to life-insurance/pension products in 2006. Meanwhile, with the bearish sentiment toward both the stock and property markets in China, and the negative real interest rate, demand for participating and universal life-insurance products surged in 1H08.

Meanwhile, the China Insurance Regulatory Commission (CIRC) has imposed a cap of 2.5% on guaranteed-return life products since 1999. This has helped to curb severe price competition, in particular from newcomers to the life-insurance market. In our view, this should help strengthen the market-leading positions of China Life and Ping An. On the other hand, most life insurers switched from equity investments to bond investments or deposits in 1H08 to take advantage of rising bond yields. We expect total investment returns for Ping An Insurance (Ping An), China Life Insurance (China Life) and PICC Property and Casualty (PICC) to recover gradually from 2009 onwards.

Severe price competition in P&C insurance in China

Price competition in the auto-insurance industry in China has been fierce, since the CIRC relaxed the restrictions on policy terms and premium rates for auto insurance on 1 January 2003. This has resulted in underwriting losses for most property and casualty (P&C) insurers in China, including the market leader, PICC. Despite this price competition in the P&C insurance market remains severe, we maintain our Positive rating for the overall China insurance sector, with a particularly optimistic outlook for the life-insurance sector over the next few years.

Structural outlook: three-year view

We believe China Life and Ping An should be able to maintain their market-leading positions in China's life-insurance sector

With low penetration rates and a potential fall in time-deposit rates in China, and the increased product diversification and channel proliferation among China life insurers, we forecast strong rises in gross life premiums of more than 15% per year over the next few years. Meanwhile, given their dominant position in terms of sales forces and distribution outlets and high solvency margin ratios, we believe China Life and Ping An will remain market leaders in the life-insurance industry in China. We forecast total written premiums for the life-insurance businesses of both Ping An and China Life to increase by 15-20% per annum over the next three years.

We see limited downside risk for equity investment in China Life and Ping An, as the 2008 PERs of both the Hong Kong and China markets are near their 2003-07 lows. Rather, we believe the shift toward bond investments will help to revive their net-investment returns and total-investment returns slightly from 2009 onwards. Overall, we forecast China Life and Ping An to maintain strong net-profit growth of more than 20% per year over the next three years.

We expect total gross P&C premiums to increase at a slower rate than life premiums

Meanwhile, with the possibility of a slowdown in auto sales and a decline in premium rates for auto insurance, as well as continued weak demand for commercial-property insurance in China, we expect total gross P&C premiums to increase at a slower rate than life premiums, at about 13-15% per year over the next three years. We believe that this, together with severe price competition in the market, could result in continued underwriting losses for PICC over the next few years, based on our forecasts.

China: Insurance – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Ping An	2318 HK	4	4	3	4	3	18	Strong management and product-innovation capabilities, but volume growth for life premiums is slower than that of China Life.
China Life	2628 HK	3	3	4	4	3	17	Conservative management style, with a higher proportion of low-margin life products.
PICC	2328 HK	2	2	4	2	2	12	Weak management and business strategy. Market deregulation makes it difficult to maintain pricing power.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Ping An

Ping An has the best management and service quality among all the China insurers, in our opinion

Ping An has the best management and service quality among all China insurers, in our view. The company has focused on expanding its high-margin life products and hence, it has a very strong product-innovation capability. Although Ping An's share of the life-insurance market is not as large as that of China Life, and it is not as strong as PICC or China Pacific Insurance in the P&C insurance industry, it has a larger market share than the other companies. Meanwhile, the regulated life-insurance industry in China has made it difficult for Ping An to compete with its peers through price competition. As a result, the company plans to offer competitive dividend payouts to participating and universal policy holders in order to maintain its share of the life-insurance market. We forecast Ping An's new business margin to decline from 24.0% for 2007 to 21.0% from 2008 onward, given the poor investment returns for the company in 2008.

Worst-positioned: PICC

PICC has lost market share consistently in the P&C insurance and had a low solvency margin ratio

As a result of the price deregulation in auto insurance since 1 January 2003, PICC has lost market share consistently in P&C insurance, while the small domestic players have gained share in recent years. Meanwhile, PICC had a low solvency margin ratio of 120% as at the end of June 2008, very close to the minimum requirement of 100% set by the CIRC. This may make it difficult to compete with other players in the P&C market through price competition. Meanwhile, we believe PICC has weaker management quality and product innovation capability than its peers.

Valuation: target and entry prices

We believe Ping An has the highest chance of seeing its share price double over the next three years

Among all the insurance companies on our 'structural scoreboard' table, we believe Ping An has the highest chance of seeing its share price double over the next three years. We believe the recent sharp correction in Ping An's share price was due mainly to the company's decision to write off the loss on its investment in Fortis shares in the profit and loss account. We view the market reaction to this news as having been overdone, as we estimate that the complete write-off of the Fortis investment would reduce Ping An's EV by only HK$3.25, or by 15.9% based on the reported EV at the end of 2007.

Our long-term target price for Ping An is HK$65.00

As Ping An is a financial conglomerate, we calculate its fair value by means of a sum-of-the-parts (SOTP) valuation, estimating the EV and AV of its life-insurance business, and a fair PBR for its P&C, banking and other businesses. Our three-year target price of HK$65.00 for Ping An is based on 1x our appraisal value (AV) forecast for 2012, plus a PBR of 1x on our 2012 forecasts for its P&C insurance and banking businesses, and a PBR of 0.5x on our 2012 forecasts for the rest of the group.

China: Insurance – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Ping An	2318 HK	34.00	65.00	91	32.50	10.1	Our target price is based on a SOTP valuation methodology. The current share price has penalised management for investing in Fortis.
China Life	2628 HK	21.25	40.00	88	20.00	11.8	Our target price is based on AV methodology. The current share price has discounted the poor stock-market sentiment in 2H08, in our view.

Source: Daiwa

We believe China Life trades at an undemanding valuation at the current share price

Apart from Ping An, we believe China Life trades at an undemanding valuation at the current share price, and has a high chance of seeing its share price double over the next three years. The recent correction in China Life's share price reflected mainly concerns in the market about its equity investment returns. However, as the group has switched gradually from equity investment to bond investment, we forecast its total investment return to recover gradually from 4.3% for 2008 to 5.7% for 2009. Our three-year target price of HK$40.00 for China Life is derived from our 2012 AV forecast for the group.

Top pick: Ping An

Ping An is our top pick among the China insurers

Among the China insurers under our coverage, Ping An is our top pick. We like Ping An for three reasons: 1) its focus on expanding its range of high-profit-margin life-insurance products, 2) its competitive edge in the P&C insurance business, achieved by building up its distribution network and expanding its low-cost sales channels, such as telemarketing and cross-selling, and 3) as a financial conglomerate, Ping An emphasises cross-selling to customers of the different business units within the group. It aims to create revenue synergies between the P&C insurance, corporate annuity and banking businesses. We forecast total written premiums to rise by 15-20% per year over the next three years, and for its net profit to increase at a CAGR of about 22% between 2009 and 2012.

Valuation and catalysts

We believe the market reaction to Ping An's Fortis investment is overdone

Ping An has been trading at or close to its historical trough PEV of 1.35x (ie, about HK$24.50) recently. We believe the market reaction to its Fortis investment has been overdone, as a complete write-off of the Fortis investment would reduce Ping An's EV by only HK$3.25, or by 15.9% based on the reported EV at the end of 2007.

Our target price of HK$65.00 for Ping An is derived from a SOTP valuation

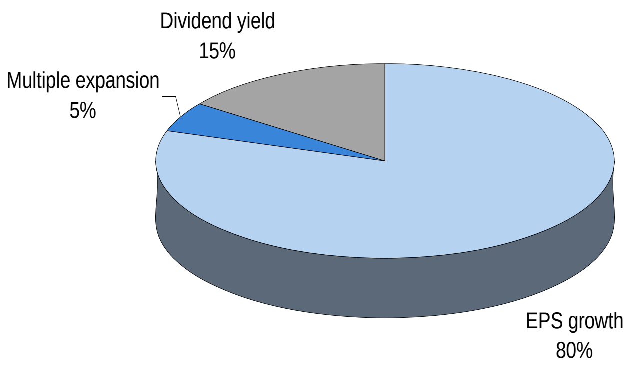
Our three-year target price of HK$65.00 for Ping An is derived from a SOTP valuation. In estimating the appraisal value of Ping An Life, we have assumed increases in first-year new life premiums and deposits of 15% per year for 2011-12, 11% per year between 2012 and 2017, a terminal growth rate of 6% per year from 2018 onward, and a discount rate of 11.5%. We also project a fair PBR for the P&C insurance and banking businesses of Ping An of 1x on our 2012 forecasts. For the rest of Ping An, we project a fair PBR of 0.5x on our 2012 forecasts.

A positive short-term catalyst for Ping An would be continued strong life and P&C premium growth in 4Q08

We see the short-term positive catalysts for Ping An as continued strong life and P&C premium growth in 4Q08, and potential recoveries in the stock markets in both Hong Kong and Mainland China. Another positive catalyst over the next three years would be the amount of revenue synergies generated by Ping An through increased cross-selling activity within the group.

Source of upside

China Insurance: Ping An – source of three-year total return



Source: Daiwa forecasts

China: Insurance – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	EPS growth (% YoY) 2007	EPS growth (% YoY) 2008E	EPS growth (% YoY) 2009E	PBR (x) 2007	PBR (x) 2008E	ROE (%) 2007	ROE (%) 2008E	Yield (% p.a.) 2007	Yield (% p.a.) 2008E
Ping An	2318 HK	34.00	1	62.41	84	Dec	12.2	33.6	10.5	107	(66)	205	2.1	2.5	23.6	6.5	2.2	2.4
China Life	2628 HK	21.25	2	30.20	42	Dec	14.5	22.2	12.6	85	(39)	69	2.7	3.2	22.5	12.8	2.1	2.3
PICC	2328 HK	2.68	5	2.85	6	Dec	9.3	n.a.	21.2	44	n.a.	n.a.	1.1	1.3	12.8	(0.2)	3.6	0.0

Source: Companies, Daiwa forecasts

Marine (Hong Kong/China) – Negative

Geoffrey Cheng *(852) 2848 4024 (geoffrey.cheng@dir.com.hk)*

Sector thesis: demand destruction

Rapid destruction of demand

The rapid deceleration of global economic growth has weighed on demand for shipping services. The outlook for demand, for both container-shipping and bulk-shipping services, is bleak, with shipping consultants forecasting growth rates to retrench to low levels – 2-3% for bulk shipping and 7-8% for container shipping – for the next two years at least.

Risk of oversupply

Meanwhile, we believe shipping-capacity supply will continue to increase. The orderbook for the newbuildings to be delivered over the next few years stands at about 47.7% and 71.5% of the global container fleet and global bulk-carrier fleet, respectively. Although the tight credit market could result in some contracts being cancelled or delayed in terms of delivery, the current orderbook still spells oversupply trouble at this point in time, in our view.

Structural outlook: three-year view

Market balance to be restored gradually, in our view

We believe the current downcycle and demand destruction will shake up the industry again, in terms of wiping out those companies with weak balance sheets that are unable to remain solvent.

Meanwhile, we believe the zeal for ordering newbuildings (as we have seen over the past two years) will cool rapidly over the next 12-18 months. This would limit orderbook growth, as well as future supply in about three years from now. Moreover, we think the much-needed scrapping of old vessels could increase amid a low freight-rate environment.

With the global economy taking about two-to-three years to start looking healthy again, the earnings outlook for the shipping market should become stronger from 2011, in our view.

HK/China: Marine – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
OOIL	316 HK	5	3	3	4	4	19	A stalwart container-shipping company that has survived numerous cycles.
Pacific Basin	2343 HK	5	4	3	2	3	17	A bulk-shipping company with shrewd management, in our view.
CSCL	2866 HK	4	3	3	2	3	15	A rapidly rising container-shipping company with a high-beta business model.
COSCO Pacific	1199 HK	4	3	3	2	3	15	Leasing business could be a drag due to the shipping cycle.
China Merchants	144 HK	3	3	3	2	4	15	A port conglomerate with asset concentration in Shenzhen/Shanghai.
China COSCO	1919 HK	4	2	3	2	3	14	A world-class shipping conglomerate with occasional high-risk investments.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Orient Overseas International (OOIL)

OOIL has survived many shipping cycles before and it has been very prudent in its expansion plan, in our opinion. It has recorded higher-than-industry-average margins consistently, due, we believe, to its focus on quality customers, quality customer services from its superior IT infrastructure, and its emphasis on high-yield cargo, such as refrigerated products.

Worst-positioned: China COSCO

In terms of management, we believe China COSCO is a quality company with the ambition of becoming a leading shipping-based logistics provider globally. However, the size of its current orderbook, both for container vessels and bulk carriers, is huge and raises concerns about its financial burdens ahead.

Valuation: target and entry prices

Buy cyclicals for the cycle and beta

Buying cyclicals is to play the cycle, as well as the stock beta. We argue that China Shipping Container Lines (CSCL) could be the stock to see rapid share-price appreciation when the cycle starts to pick up, given its high operating leverage and our expectation that its earnings would improve rapidly. Moreover, within the same container-shipping segment, we believe OOIL could see a significant share-price uptick with the cyclical upturn. Its quality management and more robust earnings base than its peers' would be the main attractions for investors, in our view.

HK/China: Marine – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
CSCL	2866 HK	1.01	5.00	395.0	2.50	n.m. (loss expected)	Our target price is equivalent to the average PBR in 2004, the upturn of the last shipping cycle.
OOIL	316 HK	15.50	50.00	222.6	25.00	13	Our target price is equivalent to the average PBR in 2004, the upturn of the last shipping cycle.

Source: Daiwa

Our entry price for CSCL of HK$2.5 is 147.5% higher than its latest closing price of HK$1.01. At our entry price, CSCL would trade at a PBR of 0.75x on our FY09 BVPS forecast. We think the current share price has factored in a further decline in earnings for CSCL over the next 12 months.

Our entry price for OOIL of HK$25.0 is 61.3% higher that the stock's latest closing price of HK$15.50. At our entry price, OOIL would trade at a PER of 13x on our FY09 EPS forecast. We think the current share price has probably factored in a further decline in earnings for OOIL over the next 12 months.

Top pick: CSCL

A small orderbook and a healthy balance sheet to survive the downcycle

We believe CSCL will survive the current downcycle, as it has one of the smallest orderbooks outstanding among the shipping companies we cover. As one of China's three leading national shipping companies, CSCL has a good customer base in China that could underpin its recovery in the next cyclical upturn, in our view. We think CSCL's small orderbook would help it to preserve valuable cash resources during the tough times ahead.

Valuation and catalysts

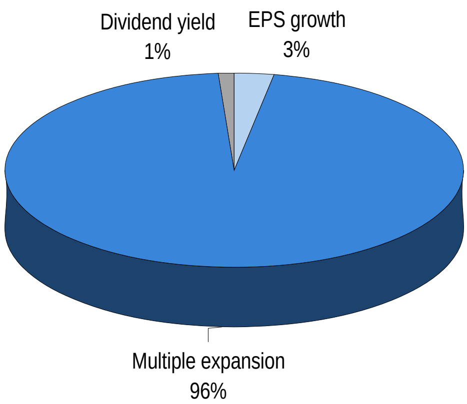
A cyclical upturn would be the most important catalyst

CSCL is trading currently at a PBR of 0.3x on our FY09 BVPS forecast. Our entry price for CSCL is equivalent to about a PBR of 0.75x on our FY09 BVPS forecast.

We believe a cyclical upturn in the container-shipping industry would be the key catalyst for both CSCL and OOIL to outperform. As OOIL is also engaged in the China property-development market, a recovery in that market would be a positive catalyst for the share price, in our view.

Source of upside

HK/China Marine: CSCL – source of three-year total return



Source: Daiwa forecasts

HK/China: Marine – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
China Shipping Container Lines	2866 HK	1.01	5	1.62	60.4	Dec	2.8	7.2	n.a.	n.a.	1.6	2.5	85.2	47.4	4.2	2.8	0.0	0.0
China COSCO	1919 HK	4.30	2	31.7	637.2	Dec	1.8	1.5	1.6	4.5	0.7	0.6	0.6	2.3	4.5	16.1	15.9	5.6
Pacific Basin Shipping	2343 HK	3.79	1	15.00	295.8	Dec	1.4	1.3	1.6	2.8	0.7	0.5	0.7	1.0	31.7	46.1	31.3	17.9
Sinotrans Shipping	368 HK	1.83	2	4.60	151.4	Dec	4.6	2.9	3.0	3.5	n.a.	n.a.	n.a.	n.a.	0.0	10.4	10.1	8.6
Xiamen International Port	3378 HK	0.73	4	1.52	108.2	Dec	5.0	6.0	5.1	4.2	2.4	2.6	2.3	2.1	8.3	6.7	7.8	9.4
China Merchants	144 HK	15.50	4	22.2	43.2	Dec	10.4	9.3	8.7	7.9	20.1	13.4	12.8	11.9	4.2	4.3	4.6	5.1
Orient Overseas Intl	316 HK	15.50	4	17.2	11.0	Dec	0.5	4.2	8.1	8.5	3.0	4.2	5.1	4.9	51.8	5.9	3.1	2.9
COSCO Pacific	1199 HK	6.19	5	6.60	6.6	Dec	4.2	5.8	6.2	5.9	15.2	11.0	10.3	9.6	11.9	8.7	8.1	8.4

Source: Companies, Daiwa forecasts

Oil & Gas (China) – Neutral

***Andrew Chan** (852) 2848 4964 (andrew.chan@dir.com.hk)*

Sector thesis: Neutral

We prefer downstream to upstream in the near term

We prefer downstream players (refining) to upstream players (E&P) over the next six months. We expect Sinopec Corp to record positive margins and earnings growth for FY09. There may still be near-term downside risk for oil prices, and this would put pressure on CNOOC's share price, in our view.

Oil still has some safe-haven attributes

Despite softer oil prices, we believe the sector's robust balance sheets and strong cash generation still offer some appeal as a safe haven during times of market turbulence. However, the oil sector is not normally associated with leading a market recovery, and therefore, we think a Neutral view appears the appropriate stance at present for China's oil sector.

Structural outlook: three-year view

Semi-deregulated market for refiners

In three years' time, we expect a semi-deregulated market for refining, whereby ex-factory refining product prices will be determined more by market factors than by the government, as is the case currently. We expect domestic refiners to no longer record losses and this should lead to a re-rating by the market, as previously the market viewed refining as a drag on the earnings and NAV of the oil companies.

Medium-to-high-single-digit-percentage oil-product demand growth

Using a simple bottom-up analysis for the three-largest refined products, China's oil-product demand outlook remains positive for the next three years, as we still expect medium-to-high single-digit-percentage growth, as long as China's GDP also rises at a similar rate. In our opinion, the industrialisation of inner China and the modernisation of the agricultural sector will drive demand for diesel; the low penetration rate of car ownership will support demand for gasoline; and new ethylene crackers coming on stream in the next three years (about 40% of existing capacity) will underwrite demand for naphtha.

Recovery in oil prices, recovery in multiples

With a potential recovery in the economy in three years' time, we would also see a recovery in oil prices, and ultimately a recovery in the PERs of the China oil companies. We expect the China oil companies to move from their trough valuation multiples to mid-cycle multiples.

China: Oil & Gas – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Sinopec Corp	386 HK	3	5	5	3	3	19	Better pricing power and margin outlook than the other two, as Sinopec is leveraged downstream rather than upstream.
CNOOC	883 HK	3	5	5	1	1	15	Pricing power and margin outlook depend on international crude-oil prices, over which CNOOC has no control.
PetroChina	857 HK	3	5	5	1	1	15	Pricing power and margin outlook depend on international crude-oil prices, over which PetroChina has no control.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Sinopec Corp

We believe Sinopec is best-positioned among the China oil companies in a falling oil-price environment, as it has more highly leveraged downstream operations than its peers. We also expect incremental deregulation of the refining industry in China over the next three years, which we believe would lubricate refiners' profits.

Worst-positioned: CNOOC

We believe CNOOC is worst-positioned among the China oil companies in a falling oil-price environment, as it is a pure upstream company. Even if oil prices stabilised at a certain level, earnings growth would remain flat, and we think CNOOC is likely to trade at trough valuations over the next three years until oil prices recover.

Valuation: target and entry prices

The share prices of China's oil companies have a good chance of doubling

In our view, the share prices of all China's oil companies have a good chance of doubling over the next three years based on two key factors: 1) incremental deregulation of the refining industry, and 2) a recovery in oil prices. Sinopec would be most leveraged to the first factor, while CNOOC would be leveraged to the second.

China: Oil & Gas – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Sinopec Corp	386 HK	4.66	10.50	125	5.25	4.2	Target price based on SOTP using DCF for E&P and a long-term oil price of US$50/bbl, a 1x PBR for refining and chemicals, a 10x PER for marketing.
PetroChina	857 HK	5.98	9.00	51	4.50	4.2	Target price based on EPS of HK$1/sh, a US$75/bbl oil price and 9x historical average PER.
CNOOC	883 HK	6.07	8.55	41	4.28	3.2	Target price based on EPS of HK$0.95/sh, a US$75/bbl oil price and 9x historical average PER.

Source: Daiwa
Note: FY09 PER is based on there being no change in domestic product prices and a WTI oil price of US$105/bbl

Accumulate Sinopec at current levels

As Sinopec benefits from falling oil prices, we suggest accumulating the shares at the current share-price level. Based on our worst-case scenario of: 1) an average WTI oil price of US$60/bbl, and 2) a net refining margin of US$2/bbl fixed by the PRC Government, we estimate Sinopec's EPS at about HK$0.70, implying a potential trough valuation of HK$4.20, a PER of 6x. Currently, Sinopec's net refining margin is more than US$20/bbl, but this could be affected by potential price cuts in the near term.

We believe Sinopec is unlikely to return to its historical trough valuation of a PER of 5x (a discount to its peers' PER of 6x due to its refining losses), as we believe its refining division will be profitable going forward.

Accumulate CNOOC starting at HK$4.28

For CNOOC, even though we see long-term value, we think its share price will remain under short-term pressure due to the falling oil-price environment. We view HK$4.28 as a good entry price to accumulate the stock for 100% upside potential, as the risk/reward profile would be more favourable. At HK$4.28, CNOOC would be factoring in an average FY09 WTI oil price of US$58/bbl, and trade at a PER of 6x on trough earnings.

Top pick: Sinopec Corp

No more refining losses; positive re-rating warranted

Sinopec's refining division has been loss-making since FY05 due to price caps, yet we believe strongly that going forward it will be profitable due to: 1) the fall in oil prices – which should lead to a significant year-on-year earnings rebound for FY09, and 2) incremental deregulation – which should lead to a positive re-rating of its refining assets.

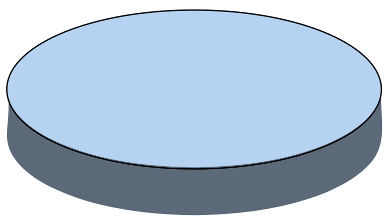
Previously, the market did not like Sinopec due to the earnings drag from refining, and this led to its share price underperforming those of its peers, PetroChina and CNOOC, during the rising oil-price environment. We expect this trend to reverse over the next three years, as we think oil prices are likely to remain subdued.

Valuation and catalysts

Assuming product prices remain unchanged, and based on our house forecast of an average WTI oil price of US$105/bbl for FY09, Sinopec is trading currently at a PER of 3.7x on our FY09 EPS forecast. In our view, the potential positive catalysts would be: 1) a smaller-than-expected product-price cut, or 2) a new product-pricing mechanism allowing satisfactory refining margins. We believe the key investment risks would be: 1) negative government policy, and 2) near-term market volatility.

Source of upside

China Oil & Gas: Sinopec Corp – source of three-year total



Source: Daiwa forecasts

China: Oil & Gas – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Sinopec	386 HK	4.66	2	8.00	71.7	Dec	6.7	7.0	3.7	4.0	3.9	4.1	2.7	2.8	3.8	3.2	6.0	5.7
PetroChina	857 HK	5.98	2	9.00	50.5	Dec	7.0	7.1	5.7	4.8	3.8	4.0	3.5	3.1	6.5	5.7	7.1	8.4
CNOOC	883 HK	6.07	3	8.10	33.4	Dec	7.9	4.8	4.7	4.5	4.6	3.1	3.0	3.0	4.9	7.2	7.5	7.8

Source: Companies, Daiwa forecasts

Pharmaceuticals and Healthcare (China) – Positive

Soo Kee Ang *(65) 6329 2133 (sookee@dir.com.sg)*

Sector thesis: unstoppable growth

Positive on the China Pharmaceuticals sector

We have a Positive rating on the China Pharmaceuticals sector, as we believe it is resilient to the current economic environment due to its defensive qualities, and is also poised for continued strong growth, on the back of improving affordability, tighter regulations, and government support for healthcare in the PRC.

Improving operating environment with rising demand and less intense competition

We expect demand for pharmaceutical products in the PRC to rise going forward with the rise in per-capita income, as well as the widening coverage of national healthcare insurance (especially to rural areas), and increased government spending on healthcare infrastructure. Multiple growth drivers, coupled with demand inelasticity for pharmaceutical products (especially related to critical illnesses), lead us to believe that this sector will continue expanding even amid the economic downturn. We also expect the operating environment to be more regulated, and for this to result in fairer and less-intense competition, as well as provide room for existing players to progress steadily.

Sector has emerged stronger from recent transition

As highlighted in our sector report published on 29 July (*The top-100 listed PRC pharmaceutical companies*), the top-100 listed PRC pharmaceutical companies (top-100) recorded a 52.7% YoY jump in their combined operating profit for 2007, up from 0.3% YoY for 2006. In our view, this is a clear indication that the sector has emerged from its recent transition. The Bloomberg consensus forecasts year-on-year increases of 35.4% and 24.4%, respectively, in the 2008 and 2009 combined net profit of the top-100, which reinforces our positive outlook on the sector.

Structural outlook: three-year view

Product innovation and consolidation likely to reshape the sector

In three years, we expect the China pharmaceuticals sector to be a bigger market with fewer players. In our view, product innovation and consolidation will be the key factors reshaping this sector. Recent policy changes by the government are aimed at raising overall standards in the industry, by: 1) limiting excessive competition, 2) improving product quality and safety standards, and 3) encouraging the R&D of new drugs.

Potential winners should have proprietary products, strong R&D, and solid balance sheets

As a result, we expect the weaker players with poor R&D capabilities to be phased out, and the stronger players to consolidate their market positions through mergers and acquisitions. In our view, the sector remains relatively fragmented compared with developed markets, and there is a need for further consolidation to create more competitive entities. The companies that we expect to emerge as winners are those with proprietary products, strong R&D capabilities, and solid balance sheets (to support new acquisitions).

Higher weightings in key stock indices to drive a positive re-rating

We also expect the sector to command higher weightings in key stock indices, as its companies become bigger through mergers and/or strong organic growth, and believe this will drive a positive re-rating of the sector. At the moment, the market value for Jiangsu Hengrui (the largest listed PRC pharmaceutical company by market value) is about 0.8% of PetroChina (the largest listed PRC company by market value), and 1.3% of ICBC (the largest listed PRC bank by market value). In comparison, Pfizer's market value amounts to about 31% of ExxonMobil and 79% of JP Morgan Chase in the US. As a result, we see room for the market value of the PRC pharmaceutical companies to expand exponentially, as the China market becomes more developed.

China: Pharmaceuticals and Healthcare – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Sihuan	SHPH SP	4	5	5	5	5	24	*Kelinao* is protected from competition for at least the next two-to-three years.
AsiaPharm	APHM SP	3	3	3	3	3	15	Mixture of promising and mature products.
C&O	COPT SP	3	3	4	2	3	15	C&O continues to rely on *Amoxycillin* for income.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Sihuan Pharmaceutical

***Forward-looking management and protected product in* Kelinao**

In our view, Sihuan is best-positioned to emerge as a winner in three years. We believe it has forward-looking management that has developed strong in-house R&D capabilities to ride on the structural changes in the industry. It also has a champion product in *Kelinao*, which is a proven peripheral vasodilation drug with good efficacy and minimal side effects, and is protected by a patent for its raw medicine. *Kelinao* is currently the best-selling peripheral vasodilation drug in China, and consequently Sihuan ranks high for its market share, pricing power, and margin outlook.

Worst-positioned: C&O Pharmaceutical

***Weakness in pricing power and volatile product margin for core product* Amoxycillin**

We expect C&O to continue relying on *Amoxycillin* as its key income earner. While we expect demand for *Amoxycillin*, a widely-used antibiotic, to remain stable, and for C&O to maintain its market leadership for this product, we have observed some weakness in its pricing power and volatility in its product margin in recent quarters. As C&O is only a distributor for *Amoxycillin*, it is exposed to fluctuating antibiotic prices, and sales of *Amoxycillin* were also affected by government controls on the sale of prescription drugs at pharmacies before and during the *Beijing Olympics*.

Valuation: target and entry prices

Sihuan offers the best chance of doubling in three years, in our view

In our view, Sihuan's share price has the best chance of doubling in three years. With continued strong earnings growth and PERs at cyclical lows, we see the prospect of a multi-fold increase in its share price. Assuming the stock reverts to the mid-cycle PER for the sector in three years, this would result in a 377% jump from the current share price to our three-year target price of S$2.72, which is based on the mid-cycle PER of 11.2x on our earnings forecasts for FY11.

China: Pharmaceutical and Healthcare – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (S$)	Three-year target price (S$)	Upside potential (%)	Entry price for 100% upside (S$)	2009 PER at entry price (x)	Comment
Sihuan	SHPH SP	0.57	2.72	377	1.36	7.7	Reverting to sector mid-cycle mean PER of 11.2x.
C&O	COPT SP	0.165	0.62	276	0.31	9.1	Reverting to sector mid-cycle mean PER of 11.2x.
AsiaPharm	APHM SP	0.40	1.08	170	0.54	10.7	Reverting to sector mid-cycle mean PER of 11.2x.

Source: Daiwa
Note: Sector mid-cycle PER of 11.2x is derived from the average of the mid-cycle PERs for AsiaPharm (13.5x), C&O (11.5x) and Sihuan (8.6x)

AsiaPharm's current share price is artificially high and offers limited upside, in our view

We believe that AsiaPharm's share price is supported artificially by the prospect of another privatisation attempt in 2009. As a result, we think it offers limited upside potential in the longer term if the privatisation does not materialise and the company continues to be listed.

We think C&O's upside is dependent on its ability to regain its growth momentum

C&O offers 276% upside potential to our three-year target price, but two-thirds of the upside could be attributed to the change in PER. We think that for the stock to revert to the sector mid-cycle PER, it has to regain its growth momentum and deliver on its new products and growth plans.

Top pick: Sihuan Pharmaceutical

We expect Sihuan's net profit to almost double between 2008 and 2011

Our top pick in the sector is Sihuan Pharmaceutical. We forecast its net profit to almost double to Rmb505.6m for 2011, from our forecast of Rmb260.5m for 2008, backed by the increasing penetration of *Kelinao* in southern China and rural areas (the product already has a strong presence in Beijing and northern China). Sales of *Kelinao* and its sister product, *Anjieli,* have risen by 78% YoY over the past 12 months, with no signs of slowing. The product is protected by a patent for its raw medicine until 2024.

Potential surprises from new products and R&D sales

We also look to potential surprises from its new products and R&D sales. Sihuan launched *GM-1* recently, one of the few available drugs in the PRC used to repair and recover damaged brain cells, and has a number of Category I drugs scheduled for introduction from 2010 (Category I drugs are drugs that are not yet marketed by any manufacturer around the world). Its R&D arm, which is strong in *Me-Too-Me-Better* drug research (which involves the development of new drug variations with similar or improved therapeutic benefits), is targeting its first patent sale in 2009.

Valuation and catalysts

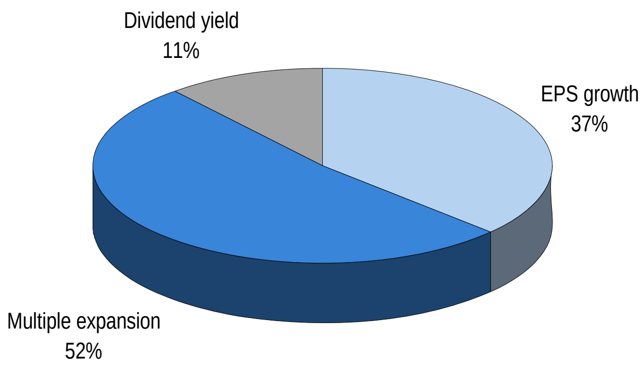
Stock trades at 4.5x and 3.2x our forecasts for FY08 and FY09, respectively

Sihuan is trading at PERs of 4.5x and 3.2x on our earnings forecasts for FY08 and FY09, respectively. We see earnings growth as the primary catalyst for a positive re-rating, but believe positive news flow from the sector, or a surprise patent sale, could also drive up the share price. On the downside, we see asset impairment from the unsuccessful R&D of new products as the most likely negative catalyst.

Source of upside

The upside potential to our three-year target price is based on a 105% increase in EPS (adjusted for changes in the Rmb/S$ exchange rate) to FY11 from FY08, an expansion of the PER to 11.2x from 4.5x (for FY08), and a dividend yield arising from a payout of 34% (similar to FY07) on the net profit for FY08, FY09 and FY10.

China Pharmaceuticals and Healthcare: Sihuan Pharmaceutical – source of three-year total return



Source: Daiwa forecasts

China: Pharmaceutical and Healthcare – valuation summary

Company name	Stock code	Share price 12-Nov-08 (S$)	Rating	Six-month target price (S$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Sihuan Pharm.	SHPH SP	0.57	1	0.88	54.4	Dec	7.6	4.5	3.2	2.5	5.5	2.6	2.0	0.6	4.5	7.5	10.5	13.4
AsiaPharm Group	APHM SP	0.40	3	0.48	20.0	Dec	16.8	11.0	8.0	5.9	9.2	6.7	5.2	3.4	1.4	2.1	2.9	3.9
C&O Pharmaceutical	COPT SP	0.165	3	0.17	3.0	Jun	7.6	5.1	4.8	4.3	4.0	3.3	2.7	2.3	0.0	4.7	4.9	5.6

Source: Companies, Daiwa forecasts

Disclosure: The research analyst who prepared this report has a financial interest in the securities of Sihuan Pharmaceutical.

Power (China) – Neutral

***Alan Chan** (852) 2848 4483 (alan.chan@dir.com.hk)*

Sector thesis: coal prices trending down, but so is demand

Significant margin compression for 2008

We maintain our Neutral rating on the China power sector. As we expect coal prices to continue to decline gradually, we see the key roadblock ahead for the sector as a slowdown in power demand. Over the past year, high coal prices have been an overhang for the sector, leading to significant margin erosion for major independent power producers (IPPs). According to the National Development and Reform Commission (NDRC), coal-fired plants recorded a net loss of about Rmb21.6bn for the first eight months of 2008, a drastic decline when compared with the 8M07 net profit of Rmb45.5bn.

We expect the decline in coal prices and a prospective tariff hike to alleviate cost pressure

As spot prices of coal began to trend down in October 2008, we believe the cost pressure on China's IPPs will be alleviated and profit margins will recover at a gradual pace. We also believe the PRC Government will impose tariff hikes (short-term) and restructure tariff mechanisms (medium-term) to enable the IPPs to avoid recording further losses and margin erosion.

Slowdown in demand has become another overhang

However, as we believe the global economy is decelerating, demand for power in China will be negatively affected. Looking ahead, we believe the performance of China's IPPs will hinge on how quickly China's industrial players (which account for about 75% of power consumption) recover from the current slowdown.

Structural outlook: three-year view

Tariff structure should change over the next three years

We believe the next three years could be an inflection point for the power sector. We expect the government to undertake structural reform of the current tariff-mechanism, enabling power companies to fully, or at least partially, pass on fuel-price increments to end-users. As such, we think IPPs' profitability and margins will be more stable than they have been over the past two years.

We expect demand growth to dip in 2009

Demand growth for electricity is likely to slow in 2009, but we believe it will pick up again in 2010, following the trend of GDP growth. We expect the government to further clamp down on the capacity expansion of power companies, thereby stabilising the decline in power-plant utilisation in the country.

Integration with coal mines to become an industry trend

Over the next three years, we also expect IPPs to continue to integrate upstream by acquiring or investing in coal mines. Among the companies we cover, China Resources Power and Datang International Power announced their pursuit of such vertical-integration strategies back in 2007, with scheduled commissioning dates set for 2010, while the remaining three indicated their intentions to assess investment opportunities in 2008.

China: Power – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
China Resources Power	836 HK	5	3	4	1	5	18	Strong strategy execution and lean operation, offering a defensive margin.
Datang International Power	991 HK	4	3	4	1	3	15	Coal downstream ventures will begin to contribute in late 2010 and 2011.
Huaneng Power International	902 HK	4	3	5	1	2	15	Traditionally well-managed, but unable to contain fuel-cost increases.
China Power International	2380 HK	3	3	2	1	2	11	Poor track record of expansion through greenfield investments and acquisitions.
Huadian Power International	1071 HK	3	3	3	1	1	11	High operating and financial leverage, making it unattractive for the long term.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: China Resources Power (CRP)

In our view, CRP's management has a very strong track record in strategy execution, which has enabled the company to expand organically and through acquisitions over the past few years. With power assets located in areas with high demand or rapid economic growth, CRP should record better top-line growth than some of its peers going forward, in our view. Furthermore, we think the company's lean operation and low operating leverage (relative to its peers) should enable it to maintain a more competitive margin than its peers.

Worst-positioned: Huadian Power International (HDP)

In our view, HDP's high operating and financial leverage makes the company an unattractive investment choice for investors with a long-term view, particularly in a high-cost environment (2008) and low-demand situation (which we expect in 2009). We believe the company's profit margin is the most at risk in the current operating environment, where fuel costs are high and power demand is likely to run low in the medium term. Furthermore, the company's balance sheet is already stretched, while it continues to pursue its aggressive expansion plan to double its generating capacity, adding additional risks to investing in HDP.

Valuation: target and entry prices

Both DTP and CRP offer sizeable upside potential over the next three years, we believe

Within our sector coverage, we believe the share prices of Datang International Power (DTP) and CRP are the most likely to double over the next three years. We select DTP because of the contribution from its downstream coal ventures, which we expect to commence operation in 2011, bolstering the company's earnings growth significantly. We believe CRP will continue with its solid strategy execution of capacity expansion through greenfield investment and acquisition activity, while obtaining a stable supply of coal from its own coal mine in Inner Mongolia (commissioning scheduled for 2011).

China: Power – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Datang International Power	991 HK	2.76	7.74	180	3.87	22.4	Three-year target price based on a DCF valuation as at 2011.
China Resources Power	836 HK	12.22	31.76	160	15.88	12.9	Three-year target price based on a DCF valuation as at 2011.
Huaneng Power International	902 HK	3.71	5.61	51	2.81	8.7	Three-year target price based on a DCF valuation as at 2011.

Source: Daiwa

Among the IPPs under our coverage, we believe DTP has the greatest upside potential over the next three years. We base our three-year target price of HK$7.97 on a DCF valuation as at the end of 2011, and our entry price is half of this target price. Based on the latest share price (as of 12 November), we believe the stock offers 189% upside potential. In our view, the market is discounting the share price due to several key factors, including the slowdown in power demand, uncertainty about the development of DTP's downstream coal ventures, and the company's large debt position.

We also estimate CRP offers 160% upside potential from its current share price, with our three-year target price of HK$31.76 determined by a DCF valuation as at the end of 2011. CRP's current share price is lower than our estimated entry price of HK$15.88, which implies a PER of 12.9x on our 2009 EPS forecast. We believe the market is discounting the uncertainty of China's power demand and the development of CRP's coal mine in Inner Mongolia.

Top pick: Datang International Power

Power generation provides a steady income source for DTP

According to our forecasts, DTP has a large power-generation portfolio, with a total capacity of about 25,500MW as at the end of 2008, and increasing at a CAGR of 11% by the end of 2011. We believe this would provide a stable income source for the company. Furthermore, we expect about 17% of DTP's generating capacity by 2011 to be in the form of non-coal-fired generation (eg, wind and hydro-electric power), thereby mitigating somewhat the risks associated with fuel-cost increases.

Downstream coal ventures will contribute starting in 2011

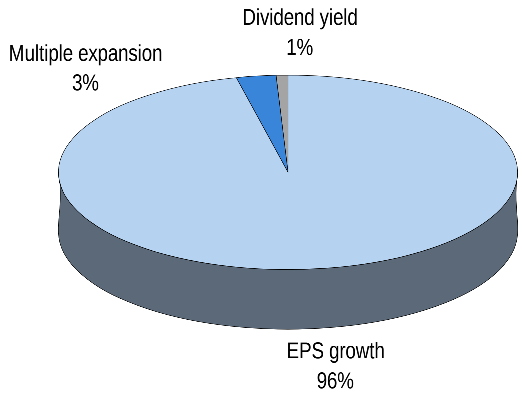
Apart from developing power-generation projects, DTP is investing in the supply chain for coal in order to secure its coal supply (eg, coal-mining and transportation projects) and in coal-downstream ventures (ie, coal-chemical and coal-gas projects), with commissioning scheduled for 2011. We believe these projects will offer an income stream that complements DTP's earnings from power generation in the medium term. We think the market is concerned about the commercial viability of the coal-chemical project, which has yet to produce on an industrial scale. In our view, DTP's new business model is to move away from the pure IPP model and transform itself into an energy enterprise. It is a relatively risky move, but we think the reward will be worth the effort, especially under the difficult operating environment for power generation.

Valuation and catalysts

DTP is trading currently at a PER of 16.0x on our 2009 EPS forecast, while the implied PER at our entry price is about 22.4x. We believe medium-term catalysts for the power sector will be tariff hikes and structural reform of the tariff mechanism, and company-specific catalysts will include achievements of key milestones for its coal-downstream projects (eg, successful equipment installation and pilot testing), which we expect to occur in mid-2009.

Source of upside

China Power: DTP – source of three-year total return



Source: Daiwa forecasts

China: Power – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x)				EV/EBITDA (x)				Dividend yield (%)			
							2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E
Datang International Power	991 HK	2.76	2	5.10	84.8	Dec	8.9	96.8	16.0	8.7	7.9	13.8	9.5	7.2	4.6	0.4	2.5	4.6
China Resources Power	836 HK	12.22	1	24.48	100.3	Dec	15.7	15.7	9.9	8.4	12.0	9.8	6.6	5.0	2.0	2.0	3.1	3.7
China Power International	2380 HK	1.26	3	2.01	59.5	Dec	7.2	10.7	4.9	6.0	12.5	9.0	5.3	5.5	4.6	3.3	7.2	5.8
Huadian Power International	1071 HK	1.26	5	1.82	44.4	Dec	5.9	n.a.	12.0	6.5	6.8	9.8	5.7	4.9	5.3	0.0	2.5	4.6
Huaneng Power International	902 HK	3.71	5	4.66	25.6	Dec	6.8	60.3	11.4	7.4	6.2	9.7	6.8	5.8	8.6	0.9	4.8	7.4

Source: Companies, Daiwa forecasts

Property (Hong Kong) – Positive

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Sector thesis: strong financial resources to weather the crisis

Developers have emerged financially stronger from the previous downturn

We think one consequence of the six-year downturn in the Hong Kong property market from 4Q97 to 2Q03 was that the property industry has consolidated further, with a handful of major players dominating and controlling most of the forthcoming supply. At the same time, Hong Kong developers' continued investment in expanding their rental portfolios and recurrent income bases throughout the past decade has started to pay off, with the four major developers' recurrent income bases now being 95% higher than they were in 1997, on our estimates.

Meanwhile, the industry trend to focus more on 'achieved margin' rather than 'volume' has resulted in good achieved property-sales margins for the developers over the past few years, and has also reduced their required investment in Hong Kong landbank. This has afforded them considerable financial resources to build a long-term presence in the mainland, in our view.

Structural outlook: three-year view

Solid recurrent income base

We estimate that current passing rents in the developers' rental portfolios are still 20-50% below the market level, and believe they will continue to complete new properties over the next few years. These factors, together with the generally above-average quality of their rental portfolios, should cushion them against a correction in overall commercial property rents, in our view. During the previous downcycle in 1998-03, the four major developers' aggregate gross rental income was broadly sustained (in the worst year, they recorded a 9.4% decline from the 1998 peak level), despite an up to 70% correction in overall office rents and about a 30% correction in overall retail rents. We believe that such factors will continue to work this time, and believe their solid recurrent income bases should provide downside protection to developers' financial strength.

Potential upswing in Hong Kong residential property and China in three years

Meanwhile, we see the potential for an upturn in both the residential-property market in Hong Kong and the China property sector. In Hong Kong, we think residential unit completions over the next two-to-three years will remain modest, and believe there is no lack of potential demand for residential properties in Hong Kong, especially as mortgage rates currently are among the lowest on record, and given that positive carry in the residential property sector is likely to continue for quite some time.

As for China property, we think there is currently a lack of quality commercial properties in major cities, and believe this is an area where Hong Kong developers could have some competitive advantages over their Mainland counterparts. We value Hong Kong developers' China investments at their estimated book cost currently, and see room for upward revisions to this in three years' time, if the Mainland sustains its GDP growth rate despite the adverse global environment.

Hong Kong: Property – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
SHKP	16 HK	4	4	4	4	4	20	Owns high-quality property assets and possesses a strong brand name.
Cheung Kong	1 HK	4	3	4	3	4	18	Strong development pipeline underpins continued market-share expansion.
Henderson Land	12 HK	3	3	3	3	4	16	Whether it can achieve progress in agricultural land conversion is the key.
Sino Land	83 HK	3	3	3	3	3	15	Has gradually exhausted the low-cost land acquired before 2002.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: SHK Properties

We think SHK Properties' massive investment in four major commercial property projects – *IFC, ICC, Millennium City* and *Shanghai IFC* – are starting to pay off, and forecast this to drive its annual gross rental income to more than HK$10bn by FY10, which would be the highest in the sector. Strong financial resources, together with its quality low-cost landbank and large agricultural landbank, should ensure that the company is well-positioned to benefit the most from the real-estate opportunities in Hong Kong.

Worst-positioned: Sino Land

While Sino Land has made considerable progress over the past few years, there is still a gap between it and the big-three in terms of recurrent income base and financial resources. It is close to using up its low-cost land acquired before 2002, and it will have to rely mainly on bidding at open auctions and tenders to replenish its landbank, which means that it faces a more challenging environment compared with the big-three developers, in our view.

Valuation: target and entry prices

Current valuations of the developers have discounted considerable risks already, in our view

We think the stock market has already discounted a 60-70% price-correction scenario for Hong Kong property, which we think is excessive given that a 70% correction is the worst Hong Kong has experienced in past crises, and in terms of both supply and demand, we believe the industry is in a better situation than during previous crises in many respects. We expect the discount that has been attached to developers' valuations to be removed or reduced significantly when the market gradually focuses on the recovery prospects of the sector.

In our opinion, quality always commands a premium in property, and the fact that SHK Properties owns and has built some of the most prime office, retail and residential property assets in Hong Kong and Shanghai makes it a good play on the potential cyclical upswing in these sectors in three years' time.

Hong Kong: Property – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
SHKP	16 HK	63.00	119.76	90.1	59.88	14.0	Owns and has built some of the most prime property assets in Hong Kong and Shanghai.
Cheung Kong	1 HK	69.90	124.60	78.3	62.30	6.6	Mainly a residential developer; does not own many prime commercial property assets.
Henderson Land	12 HK	27.55	47.77	73.4	23.89	9.9	Progress in agricultural land conversion is the key.
Sino Land	83 HK	6.38	10.86	70.3	5.43	5.0	Whether it can secure a low-cost landbank for the next stage of growth is the key.

Source: Daiwa

We see HK$59.88 as an attractive entry price for SHK Properties, as this would represent a 42% discount to our 2009 year-end forward NAV estimate, which is based on a 40% price-correction scenario.

Top pick: SHK Properties

Asset quality and recurrent income base likely to improve over next few years

We expect SHK Properties' asset backing and recurrent income to improve notably over the next few years, due to the completion of several high-quality properties in Hong Kong and Shanghai. At the same time, it is also on schedule to roll out some key projects, such as the *Cullinan* and *Peak One*, on which we believe the market is likely to focus.

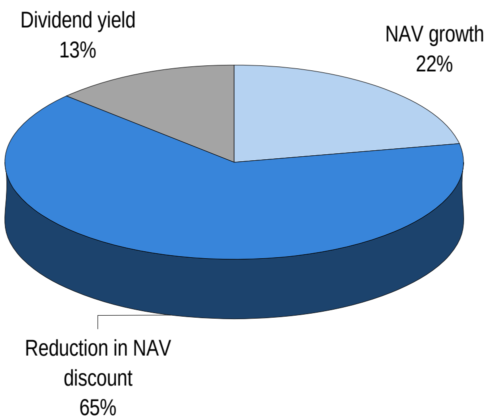
Valuation and catalysts

Sector outlook and execution of key projects are the key

With the stock trading currently at a 54% discount to our current NAV estimate, and at a 32% discount to adjusted BVPS (after adding back deferred tax) of HK$92.87 (versus an average PBR of 1.3x since 1990), we think the current valuation of SHK Properties has already discounted many concerns. We expect the outlook for the sector and execution of key projects to be the major potential share-price catalysts for the stock.

Source of upside

Hong Kong Property: SHK Properties – source of three-year total return



Source: Daiwa forecasts

Hong Kong: Property – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	EPS growth (% YoY) 2008	2009E	2010E	2011E	Dividend yield (% p.a.) 2008	2009E	2010E	2011E	P/NAV (x) 2008	2009E	P/BVPS (x) 2008	2009E
SHKP	16 HK	63.00	2	89.00	41.3	Jun	4.1	(10.7)	10.1	10.4	4.0	4.0	4.1	4.4	0.4	0.5	0.7	0.7
Henderson Land	12 HK	27.55	2	39.10	41.9	Jun	(10.6)	(13.3)	4.9	11.0	4.0	4.0	4.0	4.4	0.3	0.4	0.5	0.5
Sino Land	83 HK	6.38	2	8.60	34.8	Jun	(18.0)	55.3	(10.9)	11.2	6.3	6.7	6.7	6.9	0.3	0.3	0.5	0.5
Cheung Kong	1 HK	69.90	2	91.3	30.6	Dec	60.0	(26.6)	17.0	35.2	3.5	3.7	3.7	4.0	0.5	0.7	0.7	0.7

Source: Companies, Daiwa forecasts
*Cheung Kong's year-end date is December and is different from other developers. Hence, its 08 figures in the table refer to its actual reported figures for FY07 while the FY09-11 forecast figures for other developers correspond to our forecast for it from FY08-10.

Small and Medium Caps (Hong Kong/China) – Negative

Kevin Leung *(852) 2848 4489 (kevin.leung@dir.com.hk)*

Sector thesis: favourable long term, but too early to enter now

A bear market is not an ideal time to enter the sector, in our view

Small and mid caps tend not to outperform in a bear market, especially with larger caps also at compressed valuations. In addition, their comparatively lower trading liquidity also makes them less attractive than the larger caps in a volatile environment.

However, we believe a bear market is also the ideal time to cherry-pick small and mid-cap stocks with good value. Given the substantial 66% year-to-date correction in the Hang Seng Small-Cap Index and 50% correction in the HSI, share prices of many stocks have also fallen by similar levels, resulting in a high number of quality stocks, including industry leaders, trading at historical lows and trough valuations.

With no clear direction in the market at present, we would underweight the sector on a six-to-12 month view. However, if investing on a three-year horizon, we would suggest that investors begin accumulating individual quality stocks, most of which are now trading at what we regard as undemanding valuations.

Structural outlook: three-year view

Best time to enter with a three-year view is when the market starts to turn

Valuations for most of stocks, including the large caps, have come down significantly, and they are trading at near historical troughs. Most are also trading at below book value. Industrials, a sector with a large number of small caps, are a prime example.

While the reasons for the battered valuations could be justified by concerns related to a combination of factors such as high net gearing, cash-flow/refinancing issues, demand slowdown, margin compression, and losses from investments, we believe most of these negatives have been priced in. While it is likely that on a six-to-12-month view, companies will continue to be plagued by these concerns, we believe there are reasons to be more optimistic on a three-year view.

We note that many industries in the PRC are also undergoing consolidation. What this means is that when the economy recovers, industry leaders may face the prospect of less competition and better pricing power. As a result, we believe now is a good time to start looking at industrial leaders, with the view that they will emerge as industry winners in three years' time.

HK/China: Small and Medium Caps – structural scoreboard (Note: Only ND and LMP under formal coverage. Other stocks included recently visited with coverage potential)

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Nine Dragons	2689 HK	4	4	5	5	3	21	Market leader in a consolidating industry, but high net debt and margin pressure are concerns.
Huabao International	336 HK	4	4	5	4	4	21	Increasing market share in both tobacco and food flavouring.
Lee & Man Paper	2314 HK	4	4	4	5	3	20	Profile similar to Nine Dragons. Also concerns about high net debt.
Hengan International	1044 HK	3	4	5	4	3	19	Leader in PRC in sanitary product sales. Acquired an F&B business recently. High valuation is a concern.
Kingboard Chemical	148 HK	4	3	5	4	3	19	Market leader in laminate, PCB production. Aiming for large-scale expansion in chemicals, but now cutting ASPs; concerns about demand.
Sinofert Holdings	297 HK	3	4	5	3	3	18	Leader in PRC fertilizer sales. Favourable industry but pricing controlled by potash import prices.
Hop Fung Group	2320 HK	4	3	3	3	3	16	Mid-sized containerboard and downstream manufacturer.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Nine Dragons

Even though we think Nine Dragons' management has been somewhat misguided in the past by being too bullish, it has adapted by taking a more proactive and hands-on approach to the business. In terms of product demand, Nine Dragons' containerboard business is low-end and domestic-oriented, hence is less affected than the businesses of those companies that focus on high-end exports. Industry consolidation would benefit the company in terms of pricing power and market share, where it is already the leader in the PRC by a large margin. While the margin outlook is likely to continue to remain poor over the next 12-24 months, significant and sustainable declines in raw-material prices could lead to an earlier-than-expected margin recovery, in our view.

Worst-positioned: high net-debt companies

We do not have a specific stock pick here. However, we would identify worst-positioned stocks as the ones that might not make it out of the current financial crisis. Recent high-profile failings, such as Peace Mark, U-Right, and Tai Lin, all had one thing in common: a lack of short-term liquidity. We believe there are still a number of SMEs, both listed and non-listed, facing similar issues, ie, high net debt, low cash levels, negative and declining operating cash flow. In our view, such companies, especially non-market leaders in fragmented industries, are the ones to avoid.

Valuation: target and entry prices

Current share prices are already at attractive long-term entry levels, in our view

We believe Nine Dragons and Lee & Man Paper could see their share prices double over the next three years given: 1) they are market leaders in the containerboard-manufacturing industry, 2) industry consolidation, 3) their moves upstream and to diversify their product ranges, and 4) what we regard as their undemanding valuations.

HK/China: Small and Medium Caps – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Nine Dragons	2689 HK	1.93	4.00	107	2.00	5.1	Current share price is already lower than our entry price.
Lee & Man Paper	2314 HK	3.61	7.30	102	3.65	4.7	Current share price is already lower than our entry price.

Source: Daiwa

For Nine Dragons, by applying conservative margin and revenue assumptions, then an undemanding PER of 6x on our FY12 EPS forecast, we derive a target price of HK$4.0, equivalent to a FY12 PBR of 0.7x, which is below its book valuation. Our entry price of HK$2.0, 4% above the current price, is equivalent to a PER of 5.1x and a PBR 0.5x on our FY09 forecasts. We believe Nine Dragons' current valuation has factored in a high possibility that the company would go bankrupt.

For Lee & Man Paper, by applying a PER of 5.5x on our FY12 EPS forecast and a 10% valuation discount to Nine Dragons', we derive a target price of HK$7.30, equivalent to a PBR of 0.74x on our FY12 BVPS forecast. Our entry price of HK$3.65, 1% above the current price, represents a June 2009 PER of 4.7x and a June 2009 PBR of 0.5x. We believe that the scenario for the current valuation of Lee & Man Paper is similar to that of Nine Dragons, ie, the valuation has factored in a high possibility that the company would go bankrupt.

Top pick: Nine Dragons

Nine Dragons is our top long-term pick

Comparing Nine Dragons and Lee & Man Paper, we have a slight preference for Nine Dragons, as we think it has the edge in terms of size and trading liquidity, and the fact that it is a PRC private enterprise supported by the PRC Government. As for the outlook, while revenue growth over the next two years is likely to be much slower than in the past few years, we believe the company will emerge as a long-term winner as the industry goes through consolidation. We think it is likely that when the economy recovers, Nine Dragons will be in pole position to benefit in the containerboard industry, a key manufacturing segment in the PRC.

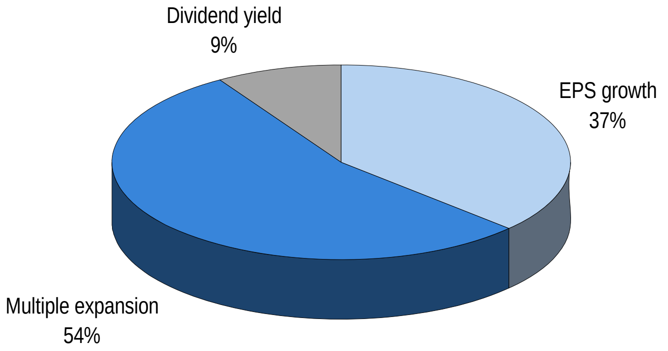
Valuation and catalysts

Nine Dragons is an attractive three-year investment at the current valuation, in our view

Nine Dragons is trading currently at a PER of 4.9x on our FY09 EPS forecast and at a PBR of 0.5x on our FY09 BVPS forecast, already an attractive level to accumulate on a long-term view. In our opinion, the share-price overhangs include the stock's high net gearing, debt profile, and margin concerns. While the company has cut capex to lower its gearing and net debt, we think current valuations suggest a high probability of bankruptcy, which could happen theoretically, but is highly unlikely, in our view. As for margins, we believe there will be continued pressure with a slowdown in the economy (hence less pricing power) and a rise in production costs. The upside risk is that if raw-material prices see a rapid and sustainable drop, a margin recovery could occur earlier than we expect.

Source of upside

HK/China: Small and Medium Caps: Nine Dragons – source of three-year total return



Source: Daiwa forecasts

HK/China: Small and Medium Caps – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2008	PER (x) 2009E	PER (x) 2010E	PER (x) 2011E	EV/EBITDA (x) 2008	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	EV/EBITDA (x) 2011E	Dividend yield (%) 2008	Dividend yield (%) 2009E	Dividend yield (%) 2010E	Dividend yield (%) 2011E
Nine Dragons	2689 HK	1.93	4	1.20	(37.8)	Jun	4.0	4.9	4.2	3.8	7.8	7.4	6.6	6.3	3.1	2.0	2.4	2.6
Lee & Man Paper	2314 HK	3.61	4	2.28	(36.8)	Mar	2.9	4.7	4.4	3.8	7.7	7.3	6.7	6.2	7.2	3.2	3.3	3.9

Source: Companies, Daiwa forecasts

Steel (China) – Negative

Helen Lau *(86) 21 5840 1138 (helen.lau@dirsh.com.cn)*

Sector thesis: demand contraction and margin squeeze

We have a Negative rating on the sector due to the poor economic outlook for FY09

We recommend that investors underweight the China steel sector over a six-month investment horizon. We are of the view that diminishing consumer confidence in China and the decelerating GDP growth outlook for FY09 in both the Mainland and the rest of the world could result in an extended contraction in demand for steel products, weak steel prices, and an extended inventory destocking cycle by steel traders and end users.

Margin squeeze on the back of continuous cost pressure, especially for large steel companies

In addition, we think the large steel companies will continue to experience significant cost pressure until 1Q09, because their iron-ore prices have all been locked in at annual FOB contract prices, and most of their freight rates have also been locked in on contracts of affreightment. Therefore, large steel companies that are reliant on imported iron ore would not benefit from the decline in domestic spot iron-ore prices and freight rates.

Furthermore, our base-line forecast for contract FOB iron-ore prices calls for a 10% YoY decline for JFY09 (the Japanese financial year). Contract FOB iron-ore prices are subject to annual negotiations between iron-ore suppliers and steel companies. We believe iron-ore producers' production-cut initiatives and bargaining power (ie, China's imported iron ore accounts for half of its annual consumption, and Japan is 100% dependent on imported iron ore) would limit the downside for iron-ore contract prices. Therefore, we think margin pressure as well as a demand contraction are the current themes in the sector. We expect China steel companies to mostly record negative earnings growth for FY09.

Structural outlook: three-year view

Demand recovery

However, three years from now, we expect a strong recovery in demand following an across-the-board increase in demand in the domestic and global markets, and as a result of the effectiveness of the PRC Government's stimulus measures, including increased infrastructure expenditure and monetary easing policies.

Large steel companies are increasing their market share

We also expect the medium-to-large steel companies' market shares to improve substantially, from the current 36% to 60% by 2012, due mainly to an industry shakeout and continuing efforts by the government to mop up obsolete production capacity at small and medium-sized steel companies.

Large companies are getting bigger and more profitable

Therefore, by 2012, we believe large steel companies will have become even more competitive and profitable than ever, due to their continuous expansion into high-end value-added products, improved operational efficiency and capacity expansion through parent asset injections or acquisitions, against the backdrop of an economic upturn. We think the peak of the cycle could occur in 2011 and last until 2012.

China: Steel – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Angang	347 HK	4	5	4	5	5	23	Product market share is distributed more evenly among various sectors and could benefit from an across-the-board rebound in demand.
Baosteel	600019 CH	4	4	5	5	4	22	Baosteel would benefit the most from a recovery in demand for the auto and home-appliance sectors where it had 50% and 36% market shares, respectively, as of FY07. However, the stainless-steel business remains a drag on margins in view of its lack of experience in raw-material inventory management, we believe.
China Nickel Resources	2889 HK	4	4	4	4	5	21	Has strong cost competitiveness and hence a positive margin outlook. A recovery in the stainless-steel sector in FY10 would boost its earnings.
China Oriental Group	581 HK	5	5	3	3	4	20	May maintain top market share in H beams, but still has less pricing power than its peers, and its other products are still low-end, eg, strips and billets.
Maanshan	323 HK	4	4	3	3	4	18	Poor product mix and relatively less operational experience in producing cold-rolled steel products would make it less competitive than other large steel companies, in our view.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Angang Steel

Angang is the most profitable

Angang's product applications are distributed evenly among various sectors and would benefit from an across-the-board recovery in demand, in our view. Historically, its gross-profit margin has been on average five-to-10 percentage points higher than those of Baosteel and Maanshan due, we believe, to its optimal product mix.

Worst-positioned: Maanshan

Maanshan is less competitive and hence may face more competition in the mid-to-high-end markets, in our view

Around 50% of Maanshan's products are used in construction, therefore the company would benefit from a revival in construction/infrastructure activity. However, a lack of experience in high-end flat-steel production would make it hard for Manashan to increase its market share and pricing power, in our view. Hence, we do not expect significant margin expansion going forward. In addition, Maanshan lacks a capacity-expansion plan, which we believe will lower its earnings visibility going forward.

Valuation: target and entry prices

We think the share prices of Angang and Baosteel have the potential to rise by 92% and 130%, respectively, in three years' time, on the back of a recovery in demand. China Nickel Resources' share price, meanwhile, has 300% upside potential over three years, on our estimates, on the back of a demand recovery, with the potential for strong earnings growth driven by capacity expansion and reduced uncertainty.

China: Steel – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (x)	Comment
Angang	347 HK	6.25	12.00	92	6.00	6.3	Demand recovery and mid-cycle valuation.
China Nickel Resources	2889 HK	0.75	3.00	300	1.50	1.3	Demand recovery, completion of new projects, capacity expansion and less risk.
Baosteel	600019 CH	5.22*	12.00*	130	6.00*	7.2	Demand recovery and mid-cycle valuation.

Source: Daiwa
Note: *Rmb

For Angang, our entry price is HK$6.00, some 4% lower than the current share price, equivalent to a PBR of 0.6x on our FY09 BVPS forecast.

Top pick: Angang

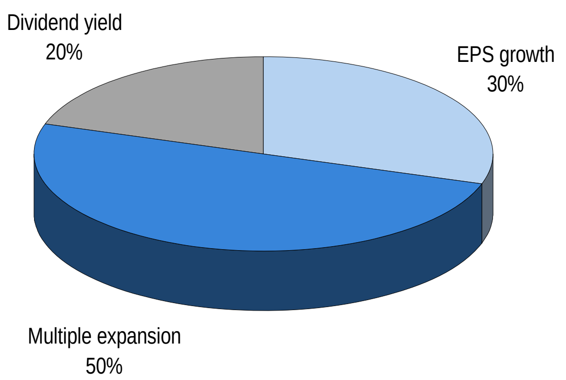
We think Angang may be the most profitable steel company in three years, in light of its experience in producing high-end flat-steel products. We believe an across-the-board demand recovery would strengthen its market share. Also, its newly commissioned Yingkou plant will be a strong earnings generator going forward, in our view. A parent asset injection (such as Bengang) would raise its capacity and underpin solid earnings growth, in our opinion.

Valuation and catalysts

The stock is trading currently at the low end of its trough valuation because of the pessimistic economic outlook, and the fact that demand has still not shown signs of recovering. By mid FY09 or towards the end of FY09, we expect the signs of an economic recovery to be evident and demand to have also recovered. By then, we expect the share price to be firmer, at about HK$6.00, equivalent to a PBR of 0.6x on our FY09 BVPS forecast, a starting point for a confirmed rally from mid cycle to peak cycle over three years, in our view.

Source of upside

China Steel: Angang – source of three-year total return



Source: Daiwa forecasts

China: Steel – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Angang Steel	347 HK	6.25	4	2.90	(54)	Dec	5.2	5.7	6.5	4.6	3.6	3.9	4.0	3.3	9.4	5.3	4.6	6.6
China Oriental	581 HK	1.18	2	5.50	366	Dec	2.8	1.9	1.2	1.0	1.4	0.9	0.7	0.6	9.9	14.3	22.0	27.9
China Nickel Resources	2889 HK	0.75	1	3.40	353	Dec	3.2	3.0	0.6	0.4	0.7	0.4	0.1	0.1	8.7	4.9	23.9	33.8
Baosteel	600019 CH	5.22*	4	4.60*	(12)	Dec	7.2	5.6	6.3	4.6	3.1	2.8	2.9	2.4	6.7	8.5	7.7	10.4
Maanshan Iron	323 HK	2.27	4	1.24	(45)	Dec	6.1	5.5	7.7	4.6	5.2	3.8	3.9	3.1	6.1	6.7	4.8	8.0

Source: Companies, Daiwa forecasts
Note: *Rmb

Telecommunications (China) – Neutral

Marvin Lo *(852) 2848 4465 (marvin.lo@dir.com.hk)*

Sector thesis: structural slowdown

Less revenue, but higher costs

The significant slowdown in revenue growth for the telecoms industry since 2Q08 is a sign of a structural slowdown, in our view, as we suspect that telecom services have penetrated the low- and mid-end segments of the rural market, where consumers are price-sensitive, but demand is less elastic than in the urban market, leading to lower ARPU and higher acquisition costs.

Restructuring has come at a bad time

Intensifying competition triggered by industry restructuring is likely to amplify the profit erosion for the telecoms operators, despite the number of players in the market being reduced to three from four.

Structural outlook: three-year view

A three-player market

In our view, asymmetric regulations are unlikely to affect China Mobile's (CM) market share in any significant way in three years' time, as the network quality of China Unicom (CU) and China Telecom (CT) are very much behind it. We forecast CM to account for a 69% market share by 2010, 22% for CU gets and 9% for CT.

China: Telecommunications – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
China Mobile	941 HK	5	4	5	4	4	22	Aggressive asymmetric regulation could reduce its total score.
China Unicom	762 HK	3	3	3	2	3	14	We view management quality as the weakest among the three despite it having the best mobile technologies (GSM + WCDMA).
China Telecom	728 HK	4	2	2	2	2	12	Chairman Wang has a good knowledge of mobile operations, but CDMA is not the most popular technology in China or in the rest of the world.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: China Mobile

We believe its strong brand name, good economies of scale and high-quality management are likely to help CM maintain its dominant position in the telecom market. Asymmetric regulations may erode its superiority, but not in any significant way over the next three years, in our opinion.

Worst-positioned: China Telecom

CT has been forced to use CDMA, the minority technology in China as well as the rest of the world. The handset bottleneck issue is unlikely to be resolved in the short term. An increase in subscriber acquisition costs is likely to keep the CDMA operation in the red for the next two years, on our estimates.

Valuation: target and entry prices

CU has the greatest potential to improve

CU is trading at a trough valuation (1x PBR) but with the best mobile technology (GSM + WCDMA), which leads us to expect double-digit-percentage earnings growth in 2010. We think this stock has the highest potential to double its share price in three years' time.

China: Telecommunications – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (HK$)	Three-year target price (HK$)	Upside potential (%)	Entry price for 100% upside (HK$)	2009 PER at entry price (HK$)	Comment
China Unicom	762 HK	9.81	21.1	115	10.55	20.9	Target price is based on a DCF valuation of our best-case scenario assuming the company can improve its GSM operation significantly. Entry price resembles its last trough valuation of 1x PBR in 2002.
China Mobile	941 HK	68.8	137.9	100	68.95	9.3	Target price is based on a DCF valuation. CM's share price had dropped to our entry price before at one point.
China Telecom	728 HK	2.85	4.44	56	2.22	8.1	Target price is based on a DCF valuation of our best-case scenario assuming the company can improve its CDMA operation significantly. Entry price resembles its last trough valuation of 0.7x PBR in 2002.

Source: Daiwa

All three Chinese telecoms companies have touched our entry prices, in October 2008, when the HSI was down at the 10,000-point level. CU is the only stock that has not rebounded yet due, we believe, to the disappointing financial performance of its GSM business in 3Q08.

Top pick: China Unicom

Earnings growth to surpass CM by 2010, on our estimates

In our opinion, CU is a good long-term play due to: 1) our expectation that earnings growth will return to a double-digit percentage starting in 2010, assuming GSM growth picks up and the synergies of merging with CN kick in, and 2) it having the best technology combination, GSM/WCDMA, versus the GSM/TD-SCDMA of CM and CDMA/CDMA2000 of CT. We believe the recent announcement of weak 3Q08 GSM results provides a good opportunity to accumulate the stock.

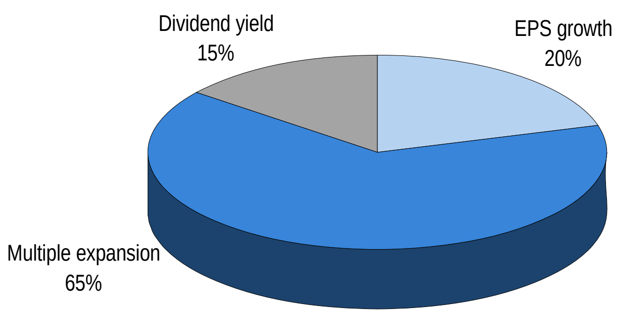
Valuation and catalysts

PBR maybe a better valuation yardstick in the current market environment

All three telecoms companies are trading at about the estimated DCF values of our worst-case scenarios, but slightly above the previous trough valuations (in terms of PBR) in 2002. The low earnings visibility (especially of CT and CU in the post-restructuring era) and deteriorating economy, however, could easily push their share prices down to below our entry levels.

Source of upside

China Telecommunications: China Unicom – source of three-year total return



Source: Daiwa forecasts

China: Telecommunications – valuation summary

Company name	Stock code	Share price 12-Nov-08 (HK$)	Rating	Six-month target price (HK$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
China Unicom	762 HK	9.81	3	14.05	43	Dec	12.9	3.6	19.4	13.5	6.7	3.0	3.0	2.8	2.3	3.5	2.1	3.0
China Mobile	941 HK	68.80	2	107.51	56	Dec	14.8	10.7	9.3	8.3	5.2	4.6	4.2	3.9	3.1	4.0	4.6	5.2
China Telecom	728 HK	2.85	4	1.98	(31)	Dec	10.6	9.3	10.4	9.9	3.8	3.7	3.8	3.8	2.9	3.1	3.1	3.2

Source: Companies, Daiwa forecasts

Korea

Automobiles and Components – Positive

***Sung Yop Chung** (82) 2 787 9157 (sychung@daiwasmbc.co.kr)*

Sector thesis: well-positioned for a cyclical downturn in 2009

We expect global auto sales for 2009 to record their biggest decline since 1990

While we forecast global auto sales to drop significantly, by 10% YoY to 59.4m units for 2009 (which would be the largest year-on-year drop since 1990), following the aftermath of the global financial crisis, we continue to expect Korean automakers' global unit sales growth to outstrip that of their global peers. For the first nine months of 2008, Hyundai Motor's (HMC) and Kia Motors' (Kia) global retail unit sales were up 10% YoY and 14.5% YoY, respectively, versus the global auto industry's retail unit sales decline of 0.6% YoY.

We expect Korean automakers' global auto sales to outstrip those of their peers in 2009

In our opinion, Korean automakers': 1) well-balanced global market portfolios, 2) second-highest exposure (17% market share for small-sized cars globally) to small-sized cars (A, B and C segments) among global automakers, and 3) stronger price competitiveness amid the weaker Won versus the US dollar, Euro and Yen, should continue to enable them to expand their global market shares, even during what we expect would be a very challenging year for the global auto industry in 2009.

Structural outlook: three-year view

Cyclical OEMs may not be safe investments over the long term, in our view

While we think Korean automakers would be relatively well-positioned for the cyclical downturn in 2009, we do not think they are safe investments over the long term.

After all, not a single automaker in the world would be immune from a cyclical downturn in the global economy. For instance, according to the market's forecasts, even Toyota Motors' profit would fall by more than 40% YoY for 2008.

Since 2005, the share prices of HMC and Kia have not even increased by two-fold, but rather have dropped by nearly 50%. Once again, this underpins our view that auto stocks can be very cyclical over a long-term investment horizon. As a result, we would rather focus on stocks with higher earnings visibility and more defensive business natures than the original equipment manufacturers (OEMs) over the next three years.

We recommend Mobis as a long-term stock pick

In our opinion, Hyundai Mobis (Mobis) would be a strong candidate to consider if we had to invest in a stock with a three-year investment horizon, given its higher earnings visibility and more defensive nature versus HMC and Kia. Currently, 40-45% of Mobis's overall revenue and 60% of its overall operating profit come from the after-sales parts business.

After-sales parts are perceived as a cash-cow business, and the margins for this are higher than for new car sales. Global automakers have therefore kept this business to themselves, as a hedge against cyclical auto sales.

Furthermore, automakers can have substantial pricing power over after-sales parts, as they are often the sole distributors of these products. Typically, sales of after-sales parts lag auto sales by two-to-three years, and continue to generate stable cash flow until a vehicle is discontinued. Consequently, automakers focus on the after-sales market to optimise profitability and establish a closer relationship with end consumers.

Since 2004, the number of Hyundai/Kia cars on the road in overseas markets has increased by 24%. In our opinion, this rapid increase should result not only in strong revenue growth for Mobis's after-sales parts division, but also boost its profitability, as exports of after-sales parts tend to have margins that are twice as high as those for domestic products.

Korea: Automobiles and Components – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Hyundai Mobis	012330 KS	2	4	4	5	5	20	Higher earnings visibility and defensive nature versus OEMs.
Hyundai Motor	005380 KS	2	2	4	2	3	13	Moving up the value ladder, but still a cyclical stock.
Kia Motors	000270 KS	2	2	3	1	2	10	More cyclical than HMC due to its weaker brand equity.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Mobis

In the above structural scoreboard, Mobis scores the highest out of the three names within our auto universe. While we have only given it a 2 for its management (the same as for the other two companies, as they are all affiliates of Hyundai Motor Group), Mobis scored the highest out of all the stocks under our universe, given it is the sole distributor for HMC and Kia's after-sales parts globally, with higher earnings visibility and a more defensive nature than the Korean OEMs.

We forecast Mobis's revenue to increase by at least 10% every year over the next five years, and forecast a sustainable operating-profit margin of 10%, which would be significantly higher than the average revenue growth of 5% per year and sustainable operating-profit margin of 5% each for HMC and Kia Motors (on our forecasts) over the next five years.

Worst-positioned: Kia Motors

Despite our view that Kia is an earnings-turnaround story with the potential to record strong earnings growth for 2009, we equally think its business prospects could be more volatile than HMC's due to its weaker brand equity.

Valuation: target and entry prices

We think Mobis's share price could double over the next three years

We derive a three-year target price of W140,000 for Mobis, based on our DCF valuation. As such, the entry price for 100% upside would be W70,000, which is 10.3% lower than the prevailing share price.

Korea: Automobiles and Components – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
Hyundai Mobis	012330 KS	78,000	140,000	79.5	70,000	6.1	Our three-year target price is based on a three-year DCF valuation.

Source: Daiwa

Top pick: Mobis

Mobis is our top pick in the sector

Given the cyclical nature of the auto industry, we would accumulate Mobis on a three-year investment horizon, given its higher earnings visibility and more defensive nature than the Korean OEMs.

Valuation and catalysts

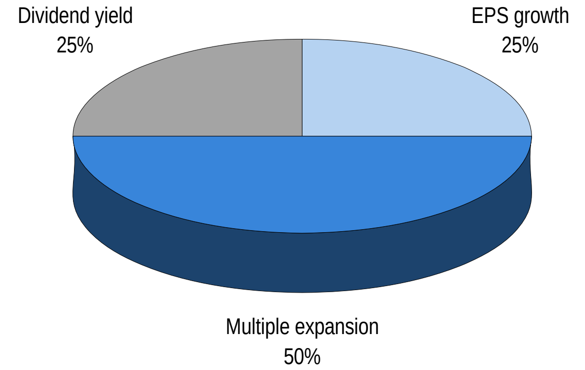
An entry point of W70,000 looks attractive, in our view

In our opinion, an entry point of W70,000 (10.3% lower than the current share price) looks attractive. We think the negative catalyst over the short term could be the possible cancellation of the planned merger between Mobis and Hyundai Autonet. Mobis announced the merger with Hyundai Autonet on 31 October 2008.

The merger ratio between Mobis and Autonet would be 1:0.03971. As a result, an additional 9.2m shares (equating to 10.6% of its total shares) would have to be issued by Mobis in February 2009. Shareholders opposed to this merger have the option to sell their shares in Mobis back for W83,019 and those in Autonet for W3,360. However, if the value of appraisal rights of dissenting shareholders exceeds W300bn, the planned merger could be cancelled.

Source of upside

Korea Automobiles and Components: Mobis – source of three-year total return



Source: Daiwa forecasts

Korea: Automobiles and Components – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Hyundai Motor	005380 KS	49,700	2	73,000	46.9	Dec	8.4	7.8	7.2	6.5	2.6	2.4	2.5	2.4	2.0	2.4	4.0	4.0
Kia Motors	000270 KS	9,800	2	13,000	32.7	Dec	n.a.	18.6	7.0	4.5	10.4	5.6	5.7	4.6	0.0	0.0	3.1	6.1
Hyundai Mobis	012330 KS	78,000	2	100,000	28.2	Dec	8.6	6.7	6.8	5.8	6.9	5.3	4.8	4.5	1.9	2.2	2.2	2.6

Source: Companies, Daiwa forecasts

Banks – Positive

__Chang H. Lee__ (82) 2 787 9177 (chlee@daiwasmbc.co.kr)

Sector thesis: Santa is coming to town

Mounting reasons to be cautious

The unprecedented scale of the financial fiasco in the global financial markets currently has rippled over to Korea, particularly after Lehman Brothers' downfall. As a consequence, Korean banks' share prices have nose-dived to an oversold level, due to concerns about foreign-currency liquidity, construction-sector risk, and fears about declines in real-estate prices, etc. All are legitimate reasons to be cautious on banks, in our view. In our view, the banks' 3Q08 results – which were below the market's forecasts due to the rise in credit costs – mostly confirmed investors' concerns.

We have a positive view over the next six months

The banking-business environment has been deteriorating since the beginning of 2H08. We believe 2009 and even 2010 could be very challenging years. Therefore, we are cautious about the mid-term outlook. However, over a six-month horizon, we take a more positive view, as we think the series of government measures to combat the various challenges could offer a sense of safety. Therefore, we expect bank stocks to rebound within six months.

Structural outlook: three-year view

Hoarding capital is a survival strategy

Depending on the severity of challenges over the next couple of years, Korea's banking-industry outlook may differ significantly in three years' time compared with now. However, we think banks with a better capital buffer could not only weather the challenges better, but also become beneficiaries through M&As amid favourable conditions, from a long-term perspective. Banks with shallow capital bases may end up inviting the government to become a shareholder and possibly be used as credit-amplifying vehicles to save the economy.

We expect the challenges to come to an end in three years at the most

As we believe we are at an early stage of the wrong side of the credit cycle, banks' share prices in the medium term could be weak (after rebounding as we expect). However, we believe difficult times would not last for more than a couple of years at the most, since lasting for more than two years would force us to question whether we are heading for a long-term deflationary spiral, where only cash has any value. As of now, we have not assumed a future economic downturn would usher us into a long-term deflationary phase. Therefore, we take the view that the economy and banking business environment would normalise within three years.

Korea: Banks – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
KB Financial Group	105560 KS	4	4	5	3	2	18	Sufficient capital buffer and large treasury stock.
Daegu Bank	005270 KS	4	2	3	3	3	15	Smart regional bank.
Pusan Bank	005280 KS	3	2	3	3	3	14	Small capital buffer (tier-1 capital).
Industrial Bank of Korea	024110 KS	3	3	4	2	2	14	Government-owned SME-focused bank.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: KB Financial Group

KB Financial could take advantage of opportunities amid the downturn, in our view

Given that the major purpose of Kookmin Bank (Not listed), after transforming into KB Financial Group (KB Financial), was to seek growth through acquisitions, we believe the economic downturn would bring good opportunities for growth to the company within three years, backed by its strong capital base and 20.7% holding of treasury stocks.

Worst-positioned: Industrial Bank of Korea (IBK)

IBK has been given the job of offering a national service by saving the small- and medium-sized enterprise (SME) sector in its role as a government-owned bank amid the current economic difficulties.

Valuation: target and entry prices

Once the perceived risk level reduces, the upside potential would be sizable, in our view

Along with banks' 3Q08 earnings results, we have reflected the rising risk level of the banking business environment (for a couple of years at the most) by revising up our cost-of-equity assumptions mostly by 3.4 percentage points, and by revising down our long-term growth assumptions to zero. However, within a three-year time frame, we believe that the reasons for our assumption changes would be mitigated significantly. To reflect this, we have undone our assumption changes by revising down our cost-of-equity assumptions by 3.4 percentage points and revising up our long-term growth assumptions to 3.0% (using the Gordon Growth Model). Except for IBK, we believe the share prices of the other three banks could double, even from their current levels.

Korea: Banks – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
KB Financial Group	105560 KS	32,100	71,582	123.0	35,791	5.7	Three-year target price derived using the Gordon Growth Model.
Daegu Bank	005270 KS	7,060	15,825	124.2	7,913	4.2	Three-year target price derived using the Gordon Growth Model.
Pusan Bank	005280 KS	6,770	14,784	118.4	7,392	4.0	Three-year target price derived using the Gordon Growth Model.
Industrial Bank of Korea	024110 KS	6,750	11,225	66.3	5,613	3.6	Three-year target price derived using the Gordon Growth Model.

Source: Daiwa

We estimate that KB Financial's entry price for 100% upside after three years is about its current price, which is equivalent to a PBR of 0.67x and a PER of 5.7x on our FY09 BVPS and EPS forecasts, respectively. This implies that the market is more concerned about the uncomfortable uncertainties of the immediate economic downturn, rather than focusing on the long-term perspective, in our view.

Top pick: KB Financial

We expect KB Financial to expand through M&As

In difficult times, companies with large capital buffers could seek growth through acquisitions. We believe that would be the case for KB Financial. Therefore, it is our top pick in the sector.

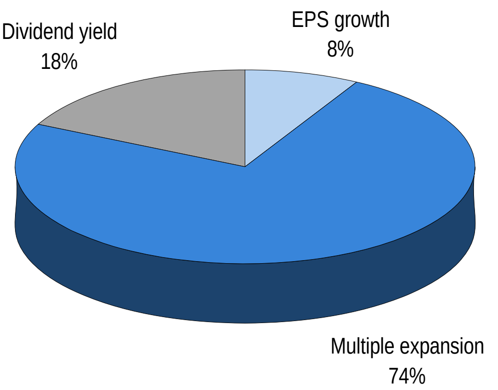
Valuation and catalysts

Raising more cash could be a share-price catalyst, in our view

The shares are trading currently at a PBR of 0.6x and a PER of 4.8x on our FY08 BVPS and EPS forecasts, respectively. We think raising cash by selling its treasury stocks to strategic investors and its stake in ING Life Korea to ING Group could offer a share-price catalyst.

Source of upside

Korea Banks: KB Financial – source of three-year total return



Source: Daiwa forecasts

Korea: Banks – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	EPS growth (% YoY) 2007	EPS growth (% YoY) 2008E	EPS growth (% YoY) 2009E	PBR (x) 2007	PBR (x) 2008E	ROE (%) 2007	ROE (%) 2008E	Yield (% p.a.) 2007	Yield (% p.a.) 2008E
KB Financial Group	105560 KS	32,100	2	41,300	28.7	Dec	3.9	4.8	5.1	12.2	(19.3)	(6.3)	0.7	0.6	17.8	16.1	7.6	7.4
Pusan Bank	005280 KS	6,770	2	10,000	47.7	Dec	3.7	3.5	3.7	47.2	5.0	(5.7)	0.7	0.6	19.7	18.7	8.4	7.4
Daegu Bank	005270 KS	7,060	2	10,200	44.5	Dec	3.6	3.5	3.8	8.4	1.2	(5.9)	0.7	0.6	19.4	18.1	8.5	8.6
Industrial Bank of Korea	024110 KS	6,750	2	8,400	24.4	Dec	2.6	3.0	4.3	10.9	(10.7)	(31.2)	0.5	0.4	18.6	15.1	8.5	8.1

Source: Companies, Daiwa forecasts

Construction – Positive

Hyo S. Yim *(82) 2 787 9179 (hsyim@daiwasmbc.co.kr)*

Sector thesis: housing-market recovery is the key

Wary view of the industry …

We advise discretion in approaching the Korea construction sector, as we believe the housing market is in a prolonged downturn, which, in addition to the current global financial turmoil, could trigger a liquidity crisis for domestic constructors that rely significantly on apartment construction.

… but positive on the top constructors

However, we are positive on the top constructors, as we believe they will be relatively cushioned from the domestic construction market slowdown, due to their large housing order backlogs and exposure to booming overseas orders. Accordingly, we expect the top constructors to be in a better position than other relatively smaller construction companies, and sustain their earnings momentum into 2009 despite a decline in margins due to higher raw-material prices.

Depressed housing market likely to affect 2010 earnings

Nevertheless, we expect to see slower earnings growth than we had anticipated originally, as we do not expect housing prices or transactions to pick up in the near term, continuing to delay a recovery in the residential market in 2009. Accordingly, we expect new housing supply by domestic homebuilders to be at minimal levels next year, which would, in turn, have an impact on their earnings going into 2010.

Structural outlook: three-year view

Housing market to begin a gradual recovery in late-2010/early-2011

From a longer-term perspective, we expect the construction industry to begin to recovery slowly as early as late-2010 or early-2011, as new housing supply is increased in line with what we expect, as the property market shows signs of life with housing demand picking up gradually centering around the greater Seoul region. However, we expect competition for public civil engineering projects to intensify, thereby eroding margins in this sector.

Contribution from overseas works to expand

We also expect earnings contributions from overseas construction works to expand the business portfolios of the major constructors, accounting for almost a third of their top-line revenue in three years' time. Furthermore, an increasing number of construction companies plan to expand into the overseas markets, especially south-east Asia and natural-resource-rich developing economies, to sustain their growth in a crowded and competitive domestic market.

Korea: Construction – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
GS E&C	006360 KS	5	4	5	4	3	21	Diversified business portfolio.
Hyundai E&C	000720 KS	4	4	5	4	4	21	Fundamentals on a recovery path.
Daelim Industrial	000210 KS	3	4	4	4	4	19	Rising debt levels.
Hyundai Dev	012630 KS	3	3	2	5	5	18	Higher margins as developer.
Daewoo E&C	047040 KS	2	3	4	3	2	14	Highest exposure to housing.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: GS Engineering & Construction (GS E&C)

Diversified portfolio, sound financials and active expansion strategy

In our view, GS E&C is in the best structural position to take a leading place in the market, as it has the most diversified business portfolio among its peers to minimise risks in individual sectors of the construction industry. In addition, the company's sound financial health and active expansion into new overseas markets strategically should put GS E&C in front of the competition, in our opinion.

Worst-positioned: Daewoo Engineering & Construction (Daewoo E&C)

High exposure to provincial housing and smaller overseas markets

As we expect the housing market to be in the initial stages of a recovery in 2011, Daewoo E&C's relatively larger exposure to the housing and, in particular, provincial markets than its peers should take a higher toll on the company's margins. In addition, its higher presence in smaller overseas markets, as opposed to the Middle East, will also lead to lower overseas margins and slower growth in overseas business compared with its peers, in our view.

Valuation: target and entry prices

Upside based on high overseas exposure, stable earnings and attractive valuation

We believe the current valuations of GS E&C and Daelim Industrial offer the greatest upside potential on a three-year horizon based on their: 1) higher exposure to booming overseas petrochemical plant orders from the Middle East, 2) relatively stable operating earnings and margins, and 3) excessive share-price falls year-to-date compared with their fundamentals.

Korea: Construction – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
GS E&C	006360 KS	61,600	143,000	132.1	71,500	7.4	2009 PER at current price: 6.4x.
Daelim Industrial	000210 KS	38,350	93,000	142.5	46,500	3.7	2009 PER at current price: 3.0x.
Hyundai Dev	012630 KS	30,400	59,000	94.1	29,500	8.9	2009 PER at current price: 9.2x.
Daewoo E&C	047040 KS	10,050	16,000	59.2	8,000	8.1	2009 PER at current price: 10.2x.
Hyundai E&C	000720 KS	51,100	64,000	25.2	32,000	7.0	2009 PER at current price: 11.1x.

Source: Daiwa

Based on our DCF model, we believe favourable entry points for GS E&C and Daelim Industrial would be W71,500 and W46,500, respectively, as calculated by their implied share prices that provide 100% upside to our three-year forward target prices. However, their share prices as of 12 November remain 13.8% and 17.5% lower than our estimated entry prices, respectively, due we believe to the excessive share-price falls year-to-date on the back of unwarranted talk in the market of a potential liquidity crunch and bankruptcy. Based on our 2009 EPS forecasts, GS E&C and Daelim are trading currently at the lowest levels among our stock coverage, at 2009 PERs of 6.4x and 3.0x, respectively.

Top pick: GS Engineering & Construction

Higher growth than peers, increasing overseas contributions and less severe slowdown in orders

Among the constructors under our coverage, GS E&C is our top pick, on the back of: 1) its highest earnings growth among its peers (we forecast a sales CAGR of 11.3% for 2008-11), 2) its higher contributions from surging overseas orders beginning in early 2007 expected to take full effect starting in 2009 (we forecast a top-line contribution of 27% for 2011 from 19.7% for 2008), and 3) a relatively minor slowdown in new orders and, compared with its peers, the lesser impact on its earnings from rising costs.

Valuation and catalysts

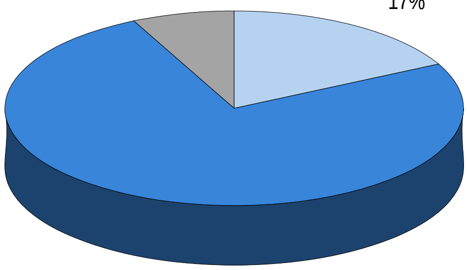
The stock trades at a PER of 6.4x with an implied target PER of 7.4x

Currently, GS E&C is trading at a PER of 6.4x and a PBR of 1.1x based on our 2009 EPS and BVPS forecasts, respectively. Our entry price of W71,500 implies a PER of 7.4x, which offers an attractive buying opportunity at current valuations, as we believe share prices have been beaten down excessively by the selling frenzy by both institutions and foreign investors. Accordingly, the current price provides additional 16.1% upside to our entry price for our three-year forward 100% return target price.

With the extensive set of deregulation measures announced by the government on 3 November, we expect share prices to bounce back to our entry-price levels on the back of excessive share-price declines.

Source of upside

Korea Construction: GS Engineering & Construction – source of three-year total return



Source: Daiwa forecasts

Korea: Construction – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
GS E&C	006360 KS	61,600	2	106,000	72.1	Dec	7.9	6.5	6.4	5.7	6.9	5.6	5.3	4.7	2.5	2.9	3.2	3.2
Daelim Industrial	000210 KS	38,350	3	45,000	17.3	Dec	3.0	3.4	3.0	3.0	4.3	5.3	4.8	4.7	6.3	5.7	6.8	8.1
Hyundai Dev	012630 KS	30,400	3	31,000	2.0	Dec	6.4	10.6	9.2	8.7	7.5	11.4	8.7	8.2	3.0	2.3	3.0	3.0
Hyundai E&C	000720 KS	51,100	2	49,000	(4.1)	Dec	20.4	12.5	11.1	10.1	17.4	10.6	9.9	9.1	0.5	0.5	0.5	1.0
Daewoo E&C	047040 KS	10,050	3	8,400	(16.4)	Dec	3.6	11.4	10.2	8.9	4.9	11.1	10.5	10.0	5.0	5.0	7.5	7.5

Source: Companies, Daiwa forecasts

Electronics – Neutral

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Sector thesis: not secure from the slowdown in demand

We expect earnings momentum to remain weak until 1H09

Given our expectation that consumer spending on key IT products, such as PCs, handsets and flat-panel TVs, will decline going forward, we are cautious on the outlook for the Korea electronics sector. For 2009, we have revised down our global forecasts for PC and handset demand to reflect the ongoing economic slowdown, and now forecast PC shipments to decline by 2.5% YoY and mobile handset shipments to decline by 4.1% YoY for 2009, the first drop in volume since 2001.

Although the major Korean IT hardware companies may benefit from favourable foreign-exchange-rate trends in the near term, we are more concerned about the slowdown in demand for IT products going forward, as over 80% of the major electronics companies' revenue comes from exports. Several companies' profit has already been hammered by the sharp declines in memory-chip and LCD-panel prices since 3Q08, and we expect earnings momentum for these companies to remain weak, at least until 1H09.

Structural outlook: three-year view

Eventual consolidation in the DRAM industry

Despite several announcements of fab closures (mostly eight-inch production lines), memory-chip prices continue to slide, and we believe the next sensible step would be a temporary or permanent shutdown of 12-inch production lines. As the outlook for chip prices remains grim until 1H09, and given that losses are mounting, we believe the industry is headed for consolidation; and we expect a fewer number of players over the next three years, as the number of DRAM companies declined to about 15 in the late-1990s, from 30 in the late-1980s.

LCD-panel prices have tumbled from their peak in 2Q08, due to lower-than-expected demand, and panel makers' profitability has started to deteriorate. However, we do not believe that the worst is over, as capacity increases by Korean and Taiwanese panel makers in 2009 will continue to put pressure on panel prices. As there is no strong demand driver in the current cycle, and given that a slew of next-generation fabs will start to ramp up in 1H09, we believe a substantial earnings recovery would only be achievable in 2H10.

An increasing presence in green energy

Over the next three years, we expect Samsung Electronics and LG Electronics to increase their presence in the solar-cell market. LG Electronics plans to start solar-cell and module production from 2010, utilising old plasma-display-panel (PDP) lines, while Samsung Electronics has set up a task force to develop both crystalline and thin-film PV cells. Meanwhile, Samsung SDI has formed a joint venture with a German auto-parts maker to produce rechargeable batteries for electric vehicles from 2010. Although sky-high oil prices have slipped substantially from their peak in July, we believe that demand for green energy will continue to expand, due to environmental concerns and as cost-reduction efforts reduce the payback period for these alternative energy sources.

Korea: Electronics – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Samsung Electronics	005930 KS	4	3	5	5	4	21	Best at improving cost competitiveness.
LG Display	034220 KS	3	3	4	4	4	18	Improving customer base for IT and TV panels.
LG Electronics	066570 KS	3	3	4	4	3	17	More focused on value than volume.
Samsung SDI	006400 KS	3	4	3	3	3	16	Rising exposure to rechargeable batteries.
Samsung Electro-M	009150 KS	3	3	3	3	2	14	Pricing pressure from set makers.
Hynix Semiconductor	000660 KS	3	2	3	3	2	13	Likely to lose competitiveness in NAND flash.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Samsung Electronics

Although its profit has been battered recently by sharp declines in core component prices, we believe Samsung Electronics can enhance its leading position in the industry when the market recovers. The company has plenty of cash on hand, while its competitors in the memory-chip industry are hemorrhaging cash as chip prices have fallen below cash costs. While the business outlook may now be more challenging, if it is bad for Samsung Electronics, it could be much worse for its competitors, in our view.

Worst-positioned: Hynix Semiconductor

Due to continuous memory-chip price erosion, we expect Hynix to record losses for the next several quarters. In addition, we believe Hynix is becoming less competitive in NAND flash, while its cash flow will not be sufficient to reduce the technological gap with the industry leaders, in our view. Although we do not expect Hynix to face liquidity issues in the near term, potential difficulties with rolling over existing loans could limit its investment capability further going forward.

Valuation: target and entry prices

Large valuation gap between the peak and trough of the cycle

Since memory chips and LCD are both highly cyclical industries, the PBR valuation gap is relatively wide between the peak and trough of the cycle. In our view, companies like Samsung Electronics and LG Display have a better chance than their peers of seeing their share prices double their over the next three years.

Korea: Electronics – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
Samsung Electronics	005930 KS	480,500	780,000	62.3	390,000	12.4	Mid-cycle PBR.
LG Display	034220 KS	22,600	45,000	99.1	22,500	61.7	Mid-cycle PBR.
LG Electronics	066570 KS	85,800	130,000	51.5	65,000	11.1	Mid-cycle PBR.

Source: Daiwa

In late October, Samsung Electronics' share price fell to a low of W400,000, from a peak of W764,000 in mid-May, while LG Display's dropped to mid-W10,000, from W50,600 over the same period. Applying a mid-cycle PBR multiple of 2.2x, we derive a three-year target price of W780,000 for Samsung Electronics; and applying a mid-cycle PBR multiple of 1.7x, we derive a three-year target price of W45,000 for LG Display.

Top pick: Samsung Electronics

Well-positioned to widen its competitiveness during the downturn

Despite the grim macro-economic outlook, we believe Samsung Electronics is well-positioned to improve its competitiveness during the industry downturn. In memory chips, Samsung Electronics was the only company to record a profit for 3Q08, while it enjoyed the highest profitability among the LCD-panel makers. The company has more than W8tn in cash, which will be used to further improve its competitiveness.

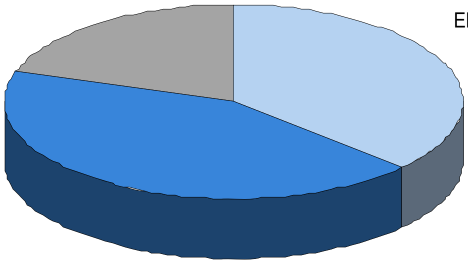
Valuation and catalysts

Entry price of W390,000 assumes a PBR of 1.0x on our 2009 BVPS forecast

Historically, the PBR lows for Samsung Electronics shares were during the Asian financial crisis (1998), with the PBR hitting a low of 0.7-1.0x, and after the bursting of the dot.com 'bubble' (2001), at 1.3x. Our entry price of W390,000 assumes a PBR of 1.0x on our 2009 BVPS forecast. Should demand for memory chips and LCD panels become more challenging, we believe the shares could test this level. However, with plenty of cash on hand, we believe the company is better-off now than it was 10 years ago, and that eventual consolidation in DRAM industry could be a positive catalyst for the share price.

Source of upside

Korea Electronics: Samsung Electronics – source of three-year total return



Source: Daiwa forecasts

Korea: Electronics – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Samsung Electronics	005930 KS	480,500	2	540,000	12.4	Dec	11.0	12.8	15.3	10.2	5.4	5.5	5.9	4.7	1.7	1.7	1.7	2.1
Samsung SDI	006400 KS	69,000	3	77,000	11.6	Dec	n.a.	30.7	23.6	17.3	n.a.	7.7	6.5	6.5	0.0	0.0	0.7	0.9
LG Electronics	066570 KS	85,800	3	95,000	10.7	Dec	11.4	10.7	14.6	9.6	11.3	5.5	7.1	7.1	1.0	1.0	0.9	1.2
LG Display	034220 KS	22,600	3	22,000	(2.7)	Dec	6.0	5.9	62.0	7.9	2.3	1.7	2.9	2.9	3.3	3.3	0.0	3.3
Hynix Semiconductor	000660 KS	10,500	4	10,000	(4.8)	Dec	14.7	n.a.	n.a.	17.2	3.2	47.2	12.9	12.9	0.0	0.0	0.0	0.0
Samsung Electro-M	009150 KS	39,150	3	34,000	(13.2)	Dec	26.9	48.4	34.3	24.6	n.a.	10.8	9.7	9.7	1.3	1.3	1.3	1.5

Source: Companies, Daiwa forecasts

Retail – Neutral

Jun Koh *(82) 2 787 9125 (jun.koh@daiwasmbc.co.kr)*

Sector thesis: play defensive

Cautious on the sector

We are cautious on the Korea retail sector, due mainly to what we see as the unfavourable macro outlook for Korea in FY09. Major retailers' sales have slowed recently as a result of negative consumer sentiment, which is unlikely to improve in the near term, in our view.

Discount stores look more defensive

By retail format, we expect the major offline retail formats (ie, department and discount stores) to be better off than the major home-shopping companies in terms of sales and earnings growth, given home-shopping companies' less-diversified target clients and high profit dependency on a single-product category. Among the major offline retail formats, sales of the department stores appear to have been affected more adversely than those of the discount stores, due mainly to the more cyclical nature of their business. In addition, we believe discount-store operators will have a better chance of improving their margins than the department stores by raising the sales contribution of their private-label products, which are more profitable than other products and likely to retain solid demand during the cyclical downturn in consumption.

Structural outlook: three-year view

Top tiers will further expand their market shares in their existing retail formats

While we expect new retail formats, including drug stores, to emerge and expand their market shares over the next three years, we believe the current major retail formats, like discount stores, will largely maintain their shares in the domestic retail market. Among the existing major retail formats, we expect top-tier companies to expand their market shares further through aggressive store expansion and/or small-scale acquisitions.

Success of overseas business will be a key variable for long-term growth

In addition, besides major retailers' efforts to diversify their business portfolios, we believe they will focus more on overseas expansion over the next three years. As a result, we expect the profit contributions from their overseas businesses to either expand or start in three years from now, and believe the success of their overseas businesses will affect their long-term growth significantly.

Korea: Retail – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Shinsegae	004170	4	5	4	4	4	21	Good management and overseas expansion.
Lotte Shopping	023530	3	4	3	4	2	16	Weak margin and overseas expansion.
Hyundai Department Store	069960	3	4	3	3	3	16	Resume new store additions.
Hanssem	009240	2	4	4	2	4	16	New store additions.
CJ Home Shopping	035760	3	3	3	3	3	15	Overseas expansion in Asia.
GS Home Shopping	028150	3	3	3	3	3	15	Overseas expansion in Asia.
Gwangju Shinsegae	037710	2	4	3	4	2	15	Lack of long-term growth potential.
Hyundai DSF	016510	2	4	3	3	3	15	Lack of long-term growth potential.
Daegu Dept Store	006370	1	4	2	3	3	13	Fierce competition to continue.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Shinsegae

Based on its broader distribution network in the domestic discount-store segment, Shinsegae differentiates itself from its peers with its wider range of private-brand (PB) product line-ups. Its aggressive store-addition plan in China will contribute to the company's bottom-line growth going forward, in our view.

Worst-positioned: Daegu Dept Store

Given that major department stores plan to add new stores in the region, we think Daegu Dept Store will endure further market-share losses.

Valuation: target and entry prices

Shinsegae has significant upside potential

We think Shinsegae's share price has significant upside potential over the next three years, on the back of: 1) its stable earnings growth outlook, 2) widening market-share gaps with its peers, and 3) potential profit contributions from its overseas business in China.

Korea: Retail – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
Shinsegae	004170 KS	455,000	792,000	74.1	396,000	12.7	Gordon Growth Model.
Hyundai Department Store	069960 KS	55,000	113,000	105.5	56,500	7.1	Gordon Growth Model.
Lotte Shopping	023530 KS	189,000	278,000	47.1	139,000	6.8	Gordon Growth Model.

Source: Daiwa

Our entry price for Shinsegae is W396,000

Our entry price for Shinsegae is W396,000, based on our Gordon Growth Model, which is 13% lower than the current share price. This equates to an FY09 PBR of 1.7x. In our view, the market is currently discounting a possible slowdown in earnings-growth momentum in the near term, reflecting the downturn in the consumption cycle.

Top pick: Shinsegae

Shinsegae is our top pick

Shinsegae is a key beneficiary of the polarisation of consumption spending in Korea, and enjoys strong demand for its PB products, which we believe will result in further market-share expansion in the domestic discount-store segment. Along with Shinsegae's enhancing market position in Korea, the turnaround of its overseas business would lead to the stock being re-rated over the long term, in our view.

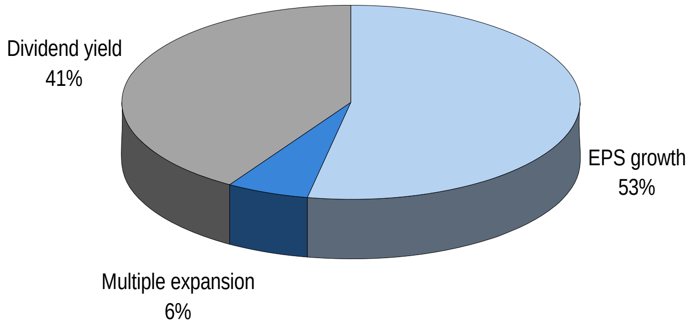
Valuation and catalysts

Negative catalyst in the near-term may offer a good chance to buy Shinsegae

Shinsegae's shares are trading currently at a PER of 14.6x and a PBR of 1.9x on our FY09 forecasts, which are near the low ends of its one-year forward PER/PBR bands over the past three years. We think there may be a chance for the current valuation to drop to a level (FY09 PBR of 1.7x) equal to our suggested entry price over the next six months, as we expect the market to be negatively surprised by a sharp decline in its earnings for 1Q09, on the back of an increase in the cost burden relating to the opening costs for its new department store in March 2009.

Source of upside

Korea Retail: Shinsegae – source of three-year total return



Source: Daiwa forecasts

Korea: Retail – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Shinsegae	004170 KS	455,000	4	513,000	12.7	Dec	17.1	15.3	14.6	12.3	11.7	11.5	10.2	8.9	0.3	0.3	0.4	0.4
Daegu Dept Store	006370 KS	7,780	3	14,000	79.9	Mar	3.8	4.0	3.8	4.2	1.6	n.a.	n.a.	n.a.	5.1	5.1	5.1	5.1
Gwangju Shinsegae	037710 KS	99,000	2	148,000	49.5	Dec	5.8	5.3	5.4	4.9	2.1	1.5	1.5	1.5	1.3	1.4	1.5	1.5
Hanssem	009240 KS	7,050	2	10,000	41.8	Dec	10.5	6.3	5.5	4.0	4.5	2.1	1.9	1.4	4.3	5.7	7.1	9.9
Hyundai DSF	016510 KS	6,390	2	8,200	28.3	Dec	3.9	3.6	4.2	4.2	2.2	1.5	1.8	1.9	3.1	3.1	3.1	3.1
Hyundai Dept Store	069960 KS	55,000	3	61,000	10.9	Dec	6.8	6.1	6.9	6.3	7.8	7.1	7.4	7.1	1.1	1.3	1.5	1.5
GS Home Shopping	028150 KS	45,600	3	43,000	(5.7)	Dec	6.3	5.5	6.6	5.2	2.0	1.9	2.3	2.0	6.6	6.6	6.6	6.6
Lotte Shopping	023530 KS	189,000	3	167,000	(11.6)	Dec	8.0	8.0	9.2	8.0	4.8	5.4	5.2	4.5	0.7	0.7	0.7	0.7
CJ Home Shopping	035760 KS	39,400	4	30,000	(23.9)	Dec	13.7	6.7	9.5	7.1	7.2	5.7	6.6	6.0	3.8	3.8	3.8	5.1

Source: Companies, Daiwa forecasts

Securities – Neutral

Eric Min *(82) 2 787 9176 (ysmin@daiwasmbc.co.kr)*

Sector thesis: focus on the long-term growth potential

Cautious on the near-term earnings outlook

We are cautious on the near-term earnings outlook for the sector, due mainly to the effect of the US credit crunch – the decline in market trading value, the slowdown in money inflows to the fund market, and unstable market interest rates. As long as fears of a global economic recession remain in the market, we cannot rule out the possibility of further declines in the earnings of securities companies in 2009.

Focus on the long-term growth potential

Therefore, we think we should focus more on the long-term growth potential than on a short-term earnings recovery. We believe that large companies with more diversified earnings structures and higher potential to develop diverse new products should be valued higher than their peers. Assuming there are a few more dips in the stock market in 2009, we recommend that investors utilise these dips to buy these companies at a bargain.

Structural outlook: three-year view

Brokerage business may experience a negative impact from competition, in our view

We believe that competition in the sector would intensify going forward, as new players in the industry are likely to be aggressive about expanding their businesses. We expect the competition to centre on the brokerage business first, as this is where it is considered relatively easy for a new participant to catch up with existing players. Therefore, companies with less competitive commission rates would have difficulties maintaining their current margin levels, in our view.

CMIA *would help expand the product mix*

On the other hand, as the *Capital Market Integration Act* (*CMIA*) is scheduled to come into force in February 2009, we expect companies with strength in product development to have more opportunities to expand their product mixes and business scope, going forward.

Korea: Securities – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Samsung	016360 KS	4	3	4	3	3	17	Stable growth in asset management.
MAS	037620 KS	3	3	4	3	2	15	No.1 M/S in fund sales among brokers.
WIS	005940 KS	4	3	3	2	2	14	Diversified business structure.
Daewoo	006800 KS	3	3	3	2	2	13	Benefits from KDB to be key variable.
Kiwoom	039490 KS	3	2	5	1	1	12	Leading online discount broker.
Hyundai	003450 KS	3	2	3	1	1	10	Highly dependent on equity brokerage.
Daishin	003540 KS	3	2	2	1	1	9	Highly dependent on equity brokerage.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Samsung Securities (Samsung)

We expect Samsung to lead its peers in developing new financial products going forward, given its expertise, manpower, sufficient capital and potential support from the financial affiliates in Samsung Group.

Worst-positioned: Daishin Securities (Daishin)

As Daishin depends relatively heavily on its equity-brokerage business compared with its peers, we expect the company's earnings to remain volatile. As it is an independent brokerage firm, we cannot expect any support from affiliates.

Valuation: target and entry prices

Samsung has the most upside potential, in our view

Considering that the development of a diverse range of new products would bring further diversified earnings sources and, thus, would be one of the key valuation factors, in our view, we believe that Samsung's shares should be valued higher than those of its peers, when we look at a three-year time frame.

Korea: Securities – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
Samsung	016360 KS	62,300	107,500	72.6	53,750	8.6	Gordon Growth Model.
MAS	037620 KS	60,000	102,000	70.0	51,000	7.9	Gordon Growth Model.
WIS	005940 KS	11,000	15,750	43.2	7,875	4.5	Gordon Growth Model.

Source: Daiwa

For Samsung, our three-year target price of W107,500 implies a PBR of 2.0x based on our BVPS forecast for FY11 (ending in March 2012), while our entry price represents a PBR of 1.3x on our FY09 BVPS forecast. The entry price of W53,750 is 13.7% lower than the current share price.

Top pick: Samsung

Samsung is the best-positioned to benefit from the CMIA, in our view

We believe Samsung is the best-positioned to benefit from the favourable regulatory change. Although the near-term earnings outlook for the sector is not positive currently, and therefore we expect potential further drops in the share price, we expect Samsung to utilise the economic downturn to prepare for the future by focusing its efforts on product development and business diversification.

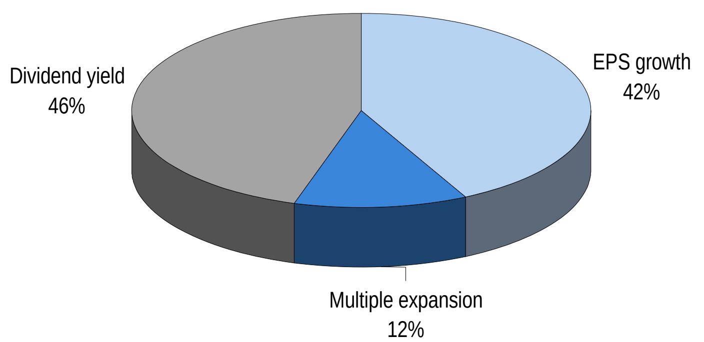
Valuation and catalysts

We think any dip in the share price would offer a buying opportunity

The stock is trading currently at a PBR of 1.6x on our FY09 BVPS forecast. If we assume a few more dips in the stock market over the next six months and a further decline in market trading value (from 6.7tn for October 2008), we think the PBR would decline to 1.3x on our FY09 BVPS forecast, which would be equivalent to our entry price.

Source of upside

Korea Securities: Samsung – source of three-year total return



Source: Daiwa forecasts

Korea: Securities – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2008	PER (x) 2009E	PER (x) 2010E	EPS growth (% YoY) 2008	EPS growth (% YoY) 2009E	EPS growth (% YoY) 2010E	PBR (x) 2009E	PBR (x) 2010E	ROE (%) 2009E	ROE (%) 2010E	Yield (% p.a.) 2009E	Yield (% p.a.) 2010E
Samsung	016360 KS	62,300	3	74,000	18.8	Mar	11.6	16.1	10.0	75.4	(28.0)	61.5	1.8	1.6	11.1	16.5	1.7	2.8
WIS	005940 KS	11,000	3	14,650	33.2	Mar	5.1	8.1	6.3	52.4	(37.1)	29.3	0.7	0.7	8.7	11.2	6.4	8.2
MAS	037620 KS	60,000	3	76,500	27.5	Mar	8.5	11.9	9.2	69.9	(28.5)	28.6	1.4	1.2	12.2	14.3	1.3	1.6
Daewoo	006800 KS	11,250	4	12,500	11.1	Mar	6.8	14.2	7.1	(24.5)	(51.8)	99.4	0.9	0.9	6.7	12.6	1.8	3.6
Hyundai	003450 KS	7,850	4	7,870	0.3	Mar	6.4	12.4	6.9	50.0	(48.4)	80.3	0.6	0.6	4.8	8.5	3.2	6.0
Daishin	003540 KS	13,100	4	12,300	(6.1)	Mar	6.0	12.1	7.6	69.0	(50.7)	59.9	0.7	0.7	5.6	9.2	5.0	8.4
KIWOOM	039490 KS	37,000	3	28,850	(22.0)	Mar	6.2	12.7	11.1	68.0	(51.6)	14.6	1.6	1.4	12.7	13.7	0.8	1.1

Source: Companies, Daiwa forecasts
Note*: 2008 represents the fiscal year that ended in March 2008 (or FY07)

Shipbuilding – Negative

Sung Yop Chung *(82) 2 787 9157 (sychung@daiwasmbc.co.kr)*

Sector thesis: bracing for a cyclical downturn

We now expect the BDI to remain weak

In the wake of the global credit crunch, the Baltic Dry Index (BDI) fell sharply to 824 points on 12 November 2008, from an all-time high of 11,771 points on 21 May 2008.

As the global credit crunch is affecting the daily business operation of commodity trading, we think that spot buyers of commodities are likely to take a wait-and-see attitude for the remainder of the year, which we believe is likely to have a negative impact on dry-bulk shipping, as well as commodity prices.

We expect ship-financing volumes to drop further in 2009 …

Meanwhile, ship-financing volumes globally dropped significantly on a year-on-year basis for the first nine months of this year. In our opinion, this was due mainly to historical-high order-book-to-fleet ratios for all vessels, but, more importantly, to the aftermath of the global credit crunch.

In view of a longer-than-expected credit crunch in financial markets globally, we expect ship financing globally to deteriorate further in 2009.

… posing further downside for second-hand bulk-carrier prices

Based on our expectation of the BDI not staging a meaningful rebound over the short term, and global ship-financing volumes dropping further in 2009, we now forecast secondhand prices of bulk carriers to decline further heading into 2009.

As a result, we expect new shipbuilding prices to drop further

Given that secondhand prices of bulk carriers have been a leading indicator for new shipbuilding prices (a key share-price driver for Korean shipyards) since 2003, we expect Clarkson's new shipbuilding price index to drop further from the current level of 186 points.

It is worth noting that the new shipbuilding price index contracted by 3% in the third week of October (on a week-on-week basis), representing its biggest weekly decline since 2007.

We have revised down our global order forecasts for 2008 and 2009

Recently, we revised down our new order volume assumptions by 12% to 52.0m CGT (down 40.1% YoY) for 2008 and 10% to 41.3m CGT (down 20.6% YoY) for 2009. Our assumption that new orders will decline reflects the increasing financing difficulties facing the major shipping/charter companies, rising concerns about a severe global economic slowdown, and the uncertain outlook for long-term shipping freight rates.

Structural outlook: three-year view

Uncertain outlook for the industry

Even taking a three-year view for the global shipbuilding industry, we believe the outlook still looks somewhat uncertain, considering that the global economy has just started to enter a recession. With slower economic growth ahead, we think it would be more rational to take a conservative approach to the global shipbuilding industry.

Industry consolidation is likely to take place over the next two years, in our view

In view of our expectation of a continuous slowdown in new shipbuilding orders globally over the next couple of years, we expect industry consolidation to take place, especially with less established yards (greenfield yards and yards that have not delivered big ships) already commanding 45% of the world's total capacity of 31.6m CGT.

We expect the slippage rate for greenfield yards to increase significantly from 2011 …

… resulting in rapid industry consolidation

As of September 2008, the global order book amounted to US$545.1bn. According to Clarkson research, 12% of the current global order book is scheduled to be delivered in 2009, 31% in 2010, and the remaining 57% between 2011 and 2012. Given our expectation of: 1) greenfield yards (those that didn't deliver any ships up to 2007, with weaker financials, and lacking skilled labour and shipbuilding components) accounting for nearly 30% of deliveries between 2011 and 2012, and 2) our forecast of a significant slippage rate of more than 20% between 2011 and 2012 for greenfield yards, we expect 70% of them to go bankrupt, resulting in more rapid industry consolidation from 2011.

Focus on HHI, with a three-year investment horizon

Although we maintain our cautious stance toward the global shipbuilding sector over the next six months, we expect Korean shipyards to benefit from what we see as industry consolidation taking place within the global shipbuilding industry over the next three years. This stems mainly from our expectation of less-established yards' unproven track records and weaker financial positions compared with the more-established shipyards.

As a result, we think the world's largest shipyard, HHI, could be a safer option over the next three years, due to what we see as its: 1) strong net cash position, 2) economies of scale, 3) vertically-integrated business structure, and 4) diversified business portfolio.

Korea: Shipbuilding – structural score board

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Hyundai Heavy Industries	009540 KS	1	4	4	5	5	19	Worst management, in our view, yet the undisputable market leader.
Samsung Heavy Industries	010140 KS	2	3	3	3	3	14	Competitive advantage in offshore vessels, but all dependent on oil prices.
Daewoo Shipbuilding & Marine Engineering	042660 KS	2	3	2	2	2	11	Weaker productivity and post-merger integration could be painful, in our view.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: HHI

Over the next three years, we expect HHI to emerge as a major beneficiary of consolidation within the global shipbuilding industry, due mainly to its undisputable market dominance.

Worst-positioned: Daewoo Shipbuilding & Marine Engineering (DSME)

On the other hand, DSME appears to be the worst-positioned shipyard under our coverage, due to its lower productivity among top-tier shipyards. Furthermore, we think the post-merger integration with Hanwha Group (selected as the preferred bidder on 24 October 2008) could be rather painful.

Valuation: target and entry prices

We believe HHI's share price could double over the next three years

We have a three-year target price of W300,000 for HHI, based on a post-2005 average annual PBR of 3.4x on our 2012 BVPS forecast. As such, the entry price for a 100% upside would be W150,000, 8.5% lower than the latest closing price.

Korea Shipbuilding: Hyundai Heavy Industries – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
Hyundai Heavy Industries	009540 KS	164,000	300,000	82.9	150,000	6.6	Our three-year target price is based on a PBR valuation.

Source: Daiwa

Top pick: HHI

HHI is our top pick

Given the uncertain outlook for the global shipbuilding industry, coupled with industry consolidation occurring ever more rapidly, we would accumulate HHI with a three-year investment horizon, as we expect it to emerge as a major beneficiary of consolidation within the global shipbuilding industry.

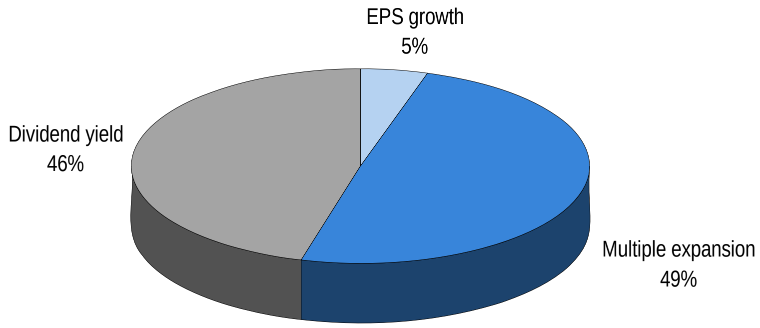
Valuation and catalysts

An entry point of W150,000 looks attractive to us

In our opinion, an entry point of W150,000 looks attractive. This is 8.5% lower than the latest closing price. We see potential negative catalysts over the short term as further declines in the BDI and new shipbuilding prices (a key-share price driver for Korean shipyards), and weaker 4Q08 earnings.

Source of upside

Korea Shipbuilding: HHI – source of three-year total return



Source: Daiwa forecasts

Korea: Shipbuilding – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
HHI	009540 KS	164,000	4	140,000	(14.6)	Dec	7.2	6.7	7.2	6.7	4.6	3.1	3.5	3.3	4.6	4.9	5.2	7.3
DSME	042660 KS	14,800	4	14,000	(5.4)	Dec	8.8	6.8	5.9	5.8	1.4	0.5	0.4	n.m.	2.9	5.4	8.1	10.1
SHI	010140 KS	19,700	4	18,000	(8.6)	Dec	9.4	9.4	7.2	6.4	4.0	1.6	1.2	0.8	2.5	3.0	3.6	3.6

Source: Companies, Daiwa forecasts

Software – Positive

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Sector thesis: the Internet is truly recession-proof

Accelerating channel shift to online

We are positive on the Korea Internet and on-line game sector, as we believe the market leaders will manage to thrive during the economic downturn. On-line platforms will be key to users' daily living, as the young generation depends increasingly on web searches and on-line entertainment. We think continuous user migration to on-line would help the companies weather the recession and record robust revenue growth.

Cannibalisation of market share

During downturns, businesses typically cut large-scale capital expenses, but on-line spending is less sensitive to an overall slowdown in consumption due to the lower average selling prices (ASP) and diversified user base. We think on-line services will continue to take market share away from offline competitors, on the back of competitive pricing, better accessibility, wider selections, and enhancing brand equity.

Structural outlook: three-year view

The Internet is a starting point for daily living

As more and more young people go on-line and increase their spending on-line, we expect huge opportunities for on-line advertising, e-commerce, distance learning, and web-content publishing. We think companies will focus on user monetisation to restore growth momentum by introducing new revenue models, expanding vertical markets, and diversifying service platform and service regions.

Top-site history likely to continue

We expect industry consolidation to accelerate from 2009, due to the economic downturn and rapid cash-burn. However, we do not expect drastic changes in the competitive landscape, given the big lead the top players have in terms of service quality, brand and user base. We forecast sales of on-line advertising and e-learning to increase at a CAGR of 12.3% and 19%, respectively, for 2007-12.

Korea: Software – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
NHN	035420 KS	4	4	5	4	4	21	Number-one search-portal in Korea.
Megastudy	072870 KS	3	4	4	3	4	18	Dominant on-line educator.
CJ Internet	037150 KS	3	3	3	3	3	15	Well-diversified game portfolio.
Daum	035720 KS	2	3	3	3	3	14	Ramping up new online services.
NCsoft	036570 KS	2	3	3	4	2	14	Struggling to add new revenue stream.
Webzen	069080 KS	2	2	1	1	3	9	Hard to gain share through new games.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: NHN

NHN has a proven revenue model, based on on-line ads, digital entertainment, and e-commerce. We expect NHN to maintain its high profitability and successfully defend its dominant position, helped by its brand power and wide range of content.

Worst-positioned: Webzen

Due to its weak game portfolio in 2009-12, we believe Webzen will face difficulties gaining market share and rebuilding its growth momentum. We are also sceptical about its potential business synergies with NHN Games (Not listed).

Valuation: target and entry prices

Which sector will benefit from the next upturn?

We recommend investors focus on the on-line ads and on-line education segments, due to low on-line penetration into the total off-line market and increasing demand from the younger generation. However, we are concerned about the medium-term growth prospects of on-line game stocks, due mainly to the rising competition, low return on investment, volatile margins, and widespread free-to-play (FTP) game services.

Korea: Software – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
NHN	035420 KS	123,000	211,081	72	105,540	13.1	Weak 3Q results likely to show this entry price level.
CJ Internet	037150 KS	9,910	15,626	58	7,813	6.1	Weaker-than-expected 3Q results will be key driver.
Daum Communications	035720 KS	27,250	36,469	34	18,234	8.2	Losing market-share will provide good opportunity.
Megastudy	072870 KS	160,000	214,536	34	107,268	9.4	Soft seasonal demand for 4Q will lead to this price level.
NCsoft	036570 KS	44,050	54,490	24	27,245	8.4	*Aion* game will send the stock to this price level.
Webzen	069080 KS	4,795	5,797	21	2,899	8.0	Earnings turnaround story will help the stock to hit this level.

Source: Daiwa

For NHN, we derive an entry price of W105,540 to ensure 100% upside for 2011, implying a PER of 13.1x on our 2009 EPS forecast. This valuation indicates that investors are currently overlooking NHN's strong fundamentals and growth potential in the overseas markets. For our peer comparison, we applied a target PER of 15x and target EV/EBITDA of 10x to our 2011 and 2012 earnings forecasts.

Top pick: NHN

Still expanding amidst the downturn

We forecast NHN's revenue to expand at a CAGR of 16.4% for 2007-12, while its EPS increases at a CAGR of 16.2% during the same period. By leveraging its dominant position in web searches and on-line game services, we believe NHN's management could identify huge business opportunities from new media platforms, such as Internet protocol television (IPTV), mobile, and other portable devices.

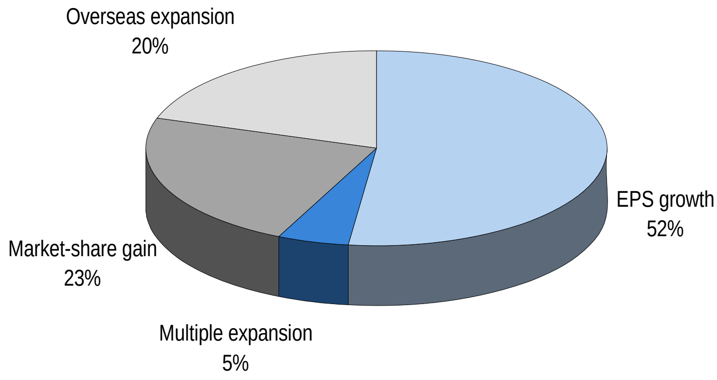
Valuation and catalysts

Positive outlook amid the slowing economy

The stock is trading at a PER of 15.2x on our 2009 EPS forecast, an all-time low, compared with its PER valuation range (36.5-20.5x) for 2006-07. Over the next six months, we expect the share price to perform strongly, on the back of a steep recovery in *Hangame* sales, as well as year-end seasonal demand for on-line advertising and e-commerce.

Source of upside

Korea Software: NHN – source of three-year total return



Source: Daiwa forecasts
Note: overseas expansion – % of overseas sales. Market-share gain – % of NHN ad sales to total market.

Korea: Software – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x)				EV/EBITDA (x)				Dividend yield (%)			
							2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E
NHN	035420 KS	123,000	2	171,000	39.0	Dec	20.9	16.9	15.2	13.0	14.0	10.7	10.0	8.7	0.0	0.0	0.0	0.0
CJ Internet	037150 KS	9,910	2	13,000	31.2	Dec	8.7	8.3	7.7	7.1	2.2	1.7	1.6	1.6	1.5	1.5	1.5	1.5
Megastudy	072870 KS	160,000	2	205,000	28.1	Dec	21.9	18.1	14.0	11.4	15.5	12.5	9.6	7.9	1.1	1.1	1.1	1.1
Daum	035720 KS	27,250	3	30,500	11.9	Dec	22.2	6.6	12.3	10.7	5.2	5.9	5.6	5.2	0.0	0.0	0.0	0.0
Webzen	069080 KS	4,795	3	5,300	11.0	Dec	n.a.	n.a.	13.2	11.0	1.2	1.9	n.a.	n.a.	0.0	0.0	0.0	0.0
NCsoft	036570 KS	44,050	3	41,000	(6.9)	Dec	20.0	28.1	13.7	9.6	11.5	10.5	7.2	6.0	0.0	2.3	2.3	2.3

Source: Companies, Daiwa forecasts

Telecommunications – Neutral

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Sector thesis: rotation into a safe haven

The mobile sector has become a temporary safe haven

Competition among the mobile operators started to ease in mid-July when competition to lock in subscribers through long-term contracts (24 months) resulted in significant losses for 2Q08. In light of the economic downturn, we expect the competitive environment for mobile operators to remain stable over the next 12 months, which would increase the defensiveness of the Korean mobile companies.

The risks for fixed-line players are rising

In contrast, another round of competition in the fixed-line segment has just started. As we expect VoIP-PSTN number portability to be introduced in 4Q08, fixed-line operators with a significant reliance on the traditional PSTN businesses will be hurt.

Structural outlook: three-year view

Nothing changes, except profitability

Despite many years of aggressive competition among the mobile operators, there has been little change in their market shares. SK Telecom (SKT) maintains its market share at around 50%, followed by KT Freetel (KTF) at 32% and LG Telecom (LGT) at 18%. The same applies to the fixed-line operators. We do not expect any drastic changes for them over the next three years.

Korea: Telecommunications – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
LG Dacom	015940 KS	4	4	3	3	4	18	Major beneficiary of VOIP-PSTN number portability. Break-even of VOIP would improve earnings growth in 2009.
SK Telecom	017670 KS	4	3	4	3	4	18	SKT did not engage deeply in fierce mobile competition in 2Q08. However, its handset installment programme could become an overhang if subscribers default.
KT Freetel	032390 KS	4	3	3	3	4	17	Strong earnings rebound from fierce competition in 2Q08.
LG Telecom	032640 KS	4	3	3	3	4	17	Lacklustre subscriber growth of EVDO Rev A compared with WCDMA of KTF and SKT remains our major concern.
KT Corp	030200 KS	4	3	4	3	3	17	PSTN business is deteriorating due to mobile on-net discount and VOIP-PSTN number portability.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: LG Dacom

A focus on VOIP subscriber growth during the investment phase of 2007-08 weighed on Dacom's profitability. However, we expect the investment to pay off over the next three years, on the back of VoIP-PSTN number portability (which we expect to be implemented in 4Q08).

Worst-positioned: KT Corp

KT Corp is a pure fixed-line operator suffering from mobile substitution. Mobile on-net discount packages (which will continue to drive fixed-to-mobile substitution) and VoIP-PSTN number portability are the major overhangs for KT, in our view.

Valuation: target and entry prices

We cannot identify any long-term plays with the potential to double their share prices

Similar to the Taiwan telecom sector, Korean telecom companies are low-beta stocks. However, their earnings are relatively volatile compared with those of their telecom peers in Asia, on the back of aggressive periodic competition for market share. Instead of returning excess cash to shareholders, Korean telecom companies prefer to invest in overseas projects. Unfortunately, most of these foreign investments have not been very profitable, and eventually become overhangs for the companies. As a result, the Korean telecom plays are valued at single-digit to low-teens PERs.

Korea: Telecommunications – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (W)	Three-year target price (W)	Upside potential (%)	Entry price for 100% upside (W)	2009 PER at entry price (x)	Comment
LG Dacom	015940 KS	20,700	30,479	47	15,239	6.6	Target price is based on SOTP valuation, of which W7,600 comes from Powercom using 4.5x EV/EBITDA and the rest is the DCF value of Dacom.
KT Freetel	032390 KS	27,000	34,667	28	17,334	8.1	Target price is based on DCF valuation. KTF's balance sheet is the weakest among the five listed Korean telecom companies in terms of cash/short-term debt.
SK Telecom	017670 KS	223,500	283,208	27	141,604	7.2	Target price is based on a DCF valuation. However, downside risk from the various affiliates (in Korea and overseas) in terms of profitability and unclear overseas acquisition strategy remain concerns for investors, in our view.
KT Corp	030200 KS	36,500	45,832	26	22,916	4.0	Target price is based on a DCF valuation. We see significant downside risk over next two years, as its PSTN business is likely to be affected by VOIP-PSTN number portability to be introduced in 4Q08.
LG Telecom	032640 KS	10,300	12,269	19	6,135	5.3	Target price is based on DCF valuation. LGT is likely to register slow earnings growth, as the near-term earnings impact from the *OZ* brand service will be limited.

Source: Daiwa

Therefore, we do not foresee any Korean telecom company having the potential to double its share price in three years' time, unless their share prices drop by 26-40% in 2009, which we think could be rather unrealistic given the lack of catalysts.

Top pick: LG Dacom

Potential IPO of Powercom would facilitate the merger with Dacom

In our opinion, LG Dacom is a key beneficiary of VoIP-PSTN number portability, which helped the company accelerate its subscriber take-up to reach the break-even point in 1H09 with 2m subscribers. We expect the breaking even of VoIP would lead to an improvement in earnings growth for FY09, on the back of cost savings on marketing. In our view, Dacom deserves to trade at a premium, due to Powercom's IPO (Dacom owns a 45.4% stake) in November 2008, which would facilitate the merger of the two companies, creating more synergies, as Dacom focuses mainly on the corporate business, while Powercom focuses on retail.

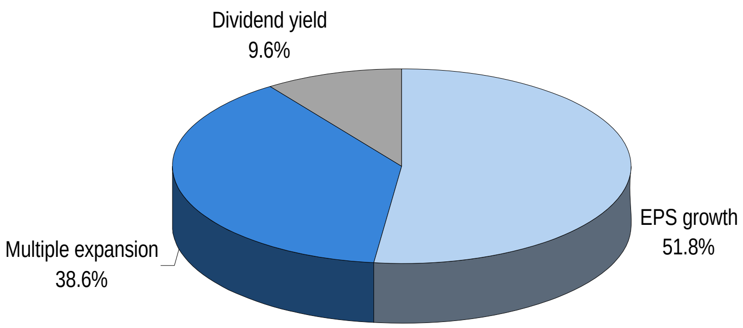
Valuation and catalysts

Earnings growth driven by cost cutting is not a strong reason to buy, in our view

The five listed telecom companies are trading at around their past three-year PER averages (except KT Freetel, which is trading at an historical high PER, as the company was engaged heavily in mobile competition during 2Q08, resulting in low earnings for FY08). We expect EPS growth to be high as competition eases in 4Q08 and 2009. In our view, earnings growth driven by cost cutting is not a strong reason to buy the Korea telcos, especially with the Korea economy in a rather shaky state.

Source of upside

Korea Telecommunications: LG Dacom – source of three-year total return



Source: Daiwa forecasts

Korea: Telecommunications – valuation summary

Company name	Stock code	Share price 12-Nov-08 (W)	Rating	Six-month target price (W)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
LG Dacom	015940 KS	20,700	2	20,261	(2)	Dec	12.8	12.2	9.0	7.9	5.3	5.8	4.8	4.4	2.3	2.5	3.3	3.8
KT Corp	030200 KS	36,500	3	42,046	15	Dec	7.0	11.2	6.3	5.1	2.8	2.9	2.6	2.5	5.5	4.5	7.9	9.7
KT Freetel	032390 KS	27,000	3	25,896	(4)	Dec	21.4	98.3	12.7	8.1	4.0	4.7	4.0	3.8	2.2	0.5	3.9	6.1
SK Telecom	017670 KS	223,500	3	198,329	(11)	Dec	11.1	13.8	11.4	10.4	4.8	4.9	4.6	4.4	4.2	4.2	4.2	4.3
LG Telecom	032640 KS	10,300	3	9,079	(12)	Dec	10.4	9.2	8.9	8.7	5.3	4.5	4.3	4.2	2.9	3.3	3.4	3.5

Source: Companies, Daiwa forecasts

Taiwan

Electronics (Handset) – Neutral

Andrew Chang *(886) 2 8789 5341 (andrew.chang@dirtpe.com.tw)*

Sector thesis: industry downturn hurts components and ODMs

The handset slowdown could extend the lead of Nokia, Samsung and LG Electronics

Potential negative shipment growth in the global handset industry for 2009 would widen the gap between the winners and the losers in handset global original equipment manufacturers (OEMs), in our view. We expect Nokia (NOK1V FH, €10.33, Not rated), Samsung Electronics (Samsung) and LG Electronics to be the winners during the industry downturn and their overall global market shares to increase. On the other hand, we think Motorola (MOT US, US$4.58, Not rated) and Sony Ericsson (Not listed) may experience deeper losses and see further market-share declines due to their weaker product portfolios.

Convergence-device segment continues to thrive under subsidies

The only bright spot remaining in the handset sector is the convergence-device segment, which we forecast to still record shipment growth of 20% YoY for 2009, despite potential negative growth in global handset shipments. We forecast that, by 2010, convergence devices may replace most of the high-end feature phones and account for close to 20% of overall handset shipments globally. We believe continuing subsidies by the cash-rich global telecom service providers hoping to raise the overall data usage across their networks through the promotion of mobile internet devices will allow the smartphone OEM companies, such as Apple (AAPL US, US$96.44, Not rated), Research-In-Motion (RIM) (RIMM US, US$43.08, Not rated) and HTC Corp to continue strengthening their industry positions with creative devices and continue to see market-share gains for 2009. We have a **2** (*Outperform*) rating on HTC.

We dislike Silitech and Compal Comm

We believe the slowdown of the global handset industry will have an adverse impact on the profitability of the handset-component and handset ODM companies in Taiwan in 2009. We have a **Neutral** rating on Taiwan's handset sector. We now have **3** (*Hold*) ratings on Largan and Merry Electronics (Merry), a **4** (*Underperform*) rating on Silitech, and a **5** (*Sell*) rating on Compal Communications (Compal Comm). We are more negative on the latter two companies due to our concerns about their declining profitability and industry positions during the handset industry downturn.

Structural outlook: three-year view

We expect the industry to consolidate over the next three years

Global handset growth continues to slow due to the saturation of subscription rates in the developed markets. We expect 2009 to be a difficult year for volume growth in the emerging-market countries during the economic downturn, but think growth momentum should recover in 2010. Going forward, we expect leading handset-component suppliers to expand their market-share leads and squeeze out the second-tier suppliers. We expect to see component consolidation in handset PCBs, small-sized TFT-LCD panels, touchscreen panels, and passive components. In addition, we expect handset ODMs to move further into vertical integration to protect their margins against the EMS competitors. We expect *3.5G* convergence devices to become a mainstream high-end platform beyond 2010, and face price erosion and margin contraction as all the handset OEM makers join the battlefield.

We think wafer-level optics and touchscreens may encroach on the market of lens modules and keypads

On the technology front, further progress with semiconductor foundry wafer level optics may be a threat to existing handset lens module suppliers and the camera module assemblers once the video quality improves, in our view. Further progress in touchscreens as the primary input device in high-end handsets and smartphones may limit the growth of regular keypads. Improving handset system-on-chip (SOC) would further reduce the number of PCB layers and passive components in demand.

We think the continuing consolidation of antenna and RF transceiver devices would also squeeze out some of component suppliers in the long term.

Taiwan: Electronics (Handset) – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
HTC Corp	2498 TT	5	5	3	3	3	19	Leads in smartphones using OS *Win CE* & *Android* operating systems.
Largan Precision	3008 TT	4	4	4	2	3	17	Long-term technology overhang due to wafer-level optics.
Silitech Technology	3311 TT	3	3	4	2	2	14	Further market-share gain limited, new business takes time.
Merry Electronics	2439 TT	2	3	2	2	2	11	Cross-selling strategy still cannot defend against pricing.
Compal Comm	8078 TT	3	3	1	1	1	9	ODM business model does not compete well against EMS.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: HTC Corp (HTC)

HTC set to outshine the others, in our view

HTC aims to maintain its position as the best alternative smartphone OEM after Apple. HTC has increased its telecom service provider customisation efforts to over 50 countries globally. Its strength comes from providing the best design in using *Win CE* and *Android* operating systems blended with Qualcomm's *MSM* multimedia *3.5G* chipsets and TI's *OMAP* application processors. In addition, HTC has established extensive testing capabilities with all the major *3.5G* infrastructure networks globally to pass protocol and on-site testing characteristics. If HTC expands its brand name successfully with the success of the *Android*-based Google phone HTC *Dream* series products, we think we could see the stock being re-rated closer to Apple going forward.

Worst-positioned: Compal Comm

Compal Comm suffers from the market-share losses of Motorola and a lack of diversification

We do not expect Compal Comm to see significant shipment and global market-share growth due to the lingering weakness of its major ODM customer, Motorola. We believe other ODM projects received from Nokia and LG Electronics will not be the mainstream models. In our view, global OEM customers may find it easier for quality control and cost competitiveness to outsource to the EMS suppliers for multiple models under the same in-house design platforms. Compal Comm's gains in smartphone ODM are still too small in scale to generate a positive contribution to its overall profitability.

Valuation: target and entry prices

HTC is the most likely candidate for a strong share-price rebound, in our view

HTC is now trading at its trough valuation over the past three years. We believe its current success stems from the fact that it is fully supporting the customisation efforts of the telecom-service providers. In our view, HTC could increase its pricing power successfully with the telecom service providers with more aggressive advertising to match Nokia and Samsung. In addition, HTC could create a better user experience by expanding its software applications' R&D staff to generate more unique on-line games and on-line services. Once the brand-name value increases through rising market share, we think its share price could double over the next three years.

Taiwan: Electronics (Handset) – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
HTC Corp	2498 TT	380	652.5	71.7	326.3	7.8	Long-term re-rating depends on the *HTC Dream* series' success and branding.
Largan	3008 TT	295	536	81.7	268	9.8	Growth depends on new product launches and slower growth of wafer level optics.

Source: Daiwa

Top pick: HTC

HTC is increasing its overall competitiveness

We believe HTC will continue to record shipment growth over the next three years, driven by mobile Internet devices capturing market share from the high-end feature phones. HTC's commitment toward the future comes from its determination to expand its production facility in Shanghai, China, and its decision to embark on a new software R&D centre in Taipei. Management is fully committed to engaging in creating a technological edge, as well as product differentiation by establishing an industry design lab to create innovative devices.

An improved overall brand value could result in a re-rating, in our view

Currently, HTC is viewed as the best alternative customisation supporter for global telecom service providers. Going forward, we expect HTC to spend more on product advertising and strengthening its channels in the emerging markets to improve its overall brand-name awareness. We think the successful launch of the HTC *Dream* should improve consumer awareness of HTC's capability to launch top-notch devices, capable of competing head-to-head with those of the giants, Apple and RIM.

Valuation and catalysts

HTC has a number of long-term positive catalysts

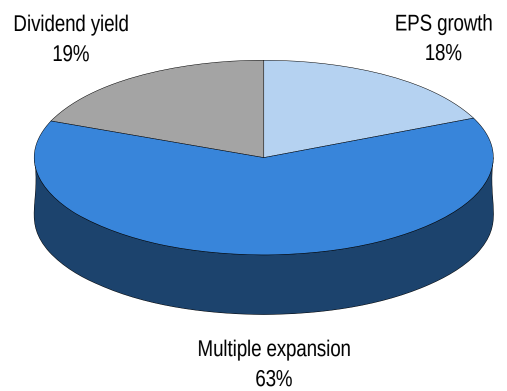
Our three-year target price of NT$652.5 is based on the assumption of an EPS CAGR of 4.5% over 2008-11, followed by a re-rating back to the forward PER of 15x on our 2012 EPS forecast of NT$43.5. This target PER is at the top half of HTC's historical PER band of 8-20x over 2006-08, which we think is achievable once the handset industry resumes its growth momentum. We expect further upside catalysts to come from the better-than-expected sell-through of the *Android*-based HTC *Dream* with multiple telecom service providers, and the ongoing strong shipment-growth momentum in *Win CE*-based convergence devices.

Near-term negative: a worse-than-expected inventory correction during 1Q09

Our long-term entry price of NT$326.3 is 14.1% lower than the current share price and equivalent to a PER of 7.8x on our current 2009 EPS forecast. We believe HTC's current share-price weakness is due to a heavy impact from the foreign redemption pressure on the TAIEX. Foreign institutions hold 51.5% of HTC stock currently, and it remains one of the key targets for redemption. If a worse-than-expected inventory correction occurs in 1Q09, after the initial product pull-in is completed for HTC's *Touch Diamond* series derivative models, we expect to see share-price weakness occur around this time.

Source of upside

Taiwan Electronics (Handset): HTC – source of three-year total return



Source: Daiwa forecasts

Taiwan: Electronics (Handset) – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
HTC Corp	2498 TT	380	2	479	26.1	Dec	7.5	10.0	9.1	9.1	6.8	7.1	6.3	6.2	8.9	6.5	7.1	7.2
Compal Communications	8078 TT	21.85	5	32	46.5	Dec	3.1	8.4	6.4	5.6	n.a.	n.a.	n.a.	n.a.	18.3	6.9	9.0	10.4
Largan Precision	3008 TT	295	3	348	18.0	Dec	14.4	11.3	10.7	9.5	9.8	8.2	7.6	6.8	3.3	4.4	4.7	5.5
Merry Electronics	2439 TT	29.55	3	33	11.7	Dec	5.3	6.3	6.3	6.1	3.3	3.9	3.4	3.3	14.5	11.2	11.2	11.4
Silitech Technology	3311 TT	62.4	4	61	(2.2)	Dec	7.3	9.0	9.4	8.4	4.4	4.6	4.6	4.2	7.0	5.5	5.3	6.0

Source: Companies, Daiwa forecasts

Electronics (IC-design) – Neutral

***Aaron Jeng, CFA** (886) 2 8780 1469 (aaron.jeng@dirtpe.com.tw)*

Sector thesis: entry point is critical, even for the industry winner

Neutral rating on the Taiwan IC-design sector

We are Neutral on the Taiwan IC-design sector. Although sector valuations have almost retreated to historical trough levels, the uncertain demand outlook presents downside risk for the sector, in our view, particularly when we are heading into the 1H09 slow season.

Structural outlook: three-year view

Industry consolidation is on the way

The Taiwan IC-design sector entered a consolidation period in 2008. With demand for electronic products shrinking quickly, we believe many small or poorly managed IC-design companies will be acquired or closed during the consolidation period. After this downturn, we believe the winners will be able to expand the technological gap with the laggards, and generate more profit than their competitors.

Taiwan: Electronics (IC-design) – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
MediaTek	2454 TT	5	4	5	5	4	23	The best IC-design house in Asia, in our view.
Richtek	6286 TT	4	3	5	2	3	17	A market-share improvement would make it outstanding among peers.
Realtek	2379 TT	4	3	3	2	3	15	No significantly new product to lead to a strong upswing after the downturn.
Novatek	3034 TT	4	2	1	3	3	13	Losing market share is the biggest problem.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: MediaTek

In our view, MediaTek is the best IC-design company in Taiwan. Its technology gap with laggards, scale of sales, and market share have all improved over the past few years. Given its dominant positions in the major sub-sectors it covers (eg, PC OSD, consumer DVD, mobile handset and TV), we are confident that it will be one of a few Taiwan IC-design companies able to gain further market share (ie, particularly mobile and TV) and improve its gross-profit margin after the downturn.

Worst-positioned: Novatek

Novatek is a worldwide top-three display-driver IC (DDI) company, and one of the best DDI companies in the world from a technological point of view. However, it is encountering unfavourable industry trends, including multi-channel technology migration and panel makers' intention to develop in-house DDI suppliers. In addition, we are not optimistic about the company's ambition to diversify its product lines, due to its relatively weak technology in the non-DDI space.

Valuation: target and entry prices

MediaTek and Richtek are long-term winners, in our view

As far as we are concerned, industry leaders, such as MediaTek (in the digital IC space) and Richtek (in the analog IC space), will become stronger companies with bigger market shares after the downturn. We believe they both have the most talented people in Taiwan, solid product roadmaps, and good execution.

However, given our view that demand visibility is highly uncertain and the 1H09 slow season is just ahead, we would advise long-term investors to only accumulate these quality names should better entry points emerge over the next three-to-six months.

Our three-year target price for MediaTek is NT$540, equivalent to a PER of 20x on our 2010 EPS forecast. The entry price is about 13% higher than the current share price. However, we expect a lower entry price to emerge over the next three-to-six months, due to the weak demand outlook and propensity of IC-design companies' share prices to be volatile.

Our three-year target price for Richtek is NT$280, equivalent to a PER of 20x on our 2010 EPS forecast. The entry price is about 2% higher than the current share price. However, we expect a lower entry price in the next three-to-six months, due to the weak demand outlook and propensity of IC-design companies' share prices to be volatile.

Taiwan: Electronics (IC-design) – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
MediaTek	2454 TT	238	540	127	270	12	We derive our three-year target price using a 20x PER on our 2010 EPS forecasts. We expect a better entry point to emerge at the NT$200-250 level (ie, a 10x FY09 EPS) in 4Q08 or 1H09.
Richtek	6286 TT	137	280	104	140	13	We derive our three-year target price using a 20x PER on our 2010 EPS forecast. We expect a better entry point to emerge at the NT$110-130 level (ie, a 10x FY09 EPS) in 4Q08 or 1H09.

Source: Daiwa

Top pick: MediaTek

MediaTek is our top pick, but be patient for a better entry point

Over a three-to-six month period, we see downside potential for MediaTek's share price, as we believe the market's 4Q08/1Q09 sales and 2009 EPS forecasts are too optimistic. We forecast MediaTek's 4Q08 and 1Q09 sales to fall by 15% YoY and 17% YoY, respectively (below consensus) and its EPS to rise by about 6% YoY only for 2009 (below the consensus forecasts of a 10-20% rise).

However, we would advise long-term investors to accumulate the stock on any share-price correction in 4Q08 or 1Q09, and after our concerns are well understood by the market, as we believe MediaTek will be able to expand its market share successfully after the downturn (particularly in handsets and TV applications).

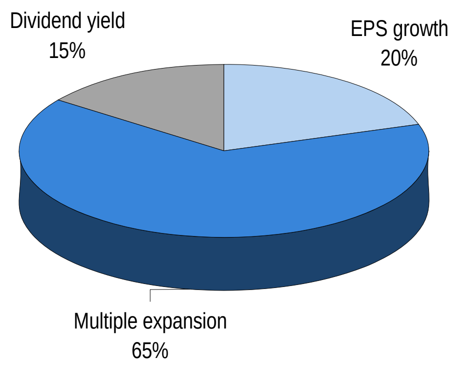
Valuation and catalysts

We think a better entry point could emerge in 4Q08 or 1Q09

The shares are trading currently at a PER of 10.7x on our 2009 EPS forecast. We expect a decline in the market's optimism to lead to a better entry point for the share price in 4Q08 or 1Q09 (ie, a PER of 10-12x on our 2009 EPS forecast).

Source of upside

Taiwan Electronics (IC-design): MediaTek – source of three-year total return



Source: Daiwa forecasts

Taiwan: Electronics (IC-design) – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
MediaTek	2454 TT	238	4	267	12.18	Dec	7.4	11.4	10.7	8.8	6.9	6.0	5.9	4.5	6.3	8.0	5.3	5.3
Richtek	6286 TT	137	3	185	35.04	Dec	9.2	13.0	12.5	10.0	9.2	9.7	9.6	7.0	3.6	6.2	5.4	5.1
Realtek	2379 TT	39.85	4	47	17.94	Dec	9.6	12.5	8.4	8.0	4.3	3.9	4.2	5.4	8.8	7.5	7.2	10.4
Novatek	3034 TT	31.8	3	35	10.06	Dec	2.3	4.8	6.4	6.6	2.3	2.4	3.3	2.9	25.2	28.3	15.3	11.4

Source: Companies, Daiwa forecasts

Electronics (LED) – Neutral

Andrew Chang *(886) 2 8789 5341 (andrew.chang@dirtpe.com.tw)*

Sector thesis: chip oversupply continues during the slowdown

We expect the current LED-chip oversupply situation to last into 1H09

The weak economy has led to a slowdown in demand for consumer electronics devices and handsets. Following aggressive panel-price cuts in mid-2Q08, panel-module assemblers have started to lower their inventory of LED chips. LED wafer/chip suppliers expanded their capacity aggressively between 2H07 and 1H08, so the LED industry is now faced with excess capacity. The LED-chip suppliers have cut down or delayed their MOCVD reactor orders from 3Q08. We now expect the LED industry to continue to digest inventory before new demand reverses this situation.

New demand for notebook LED backlights and special lighting will benefit the Taiwan LED suppliers

We expect new demand for LEDs to come from two areas: notebook LED backlights and special-lighting applications. The adoption of slightly thicker light-guiding plates by the panel makers, in order to raise overall LED backlight module yields, has led to many new notebook models in 2009 adopting LED backlights. We forecast the LED backlight penetration rate of notebooks to expand from 10% for 2008 to 33% for 2009. Another major growth area for Taiwan LED demand is in special-lighting applications, mainly from the increase in architectural, outdoor display/signage and consumer-related applications, where IP barriers and reliability issues are not so critical. Typically, we expect the Taiwan LED supply chain to benefit strongly from the increase in demand in China.

We prefer Everlight to Epistar during the LED industry downturn

We expect Taiwan LED chipmakers' expansion into the notebook business to be capped by patent overhangs and rising competition from global leaders, Nichia and Cree (CREE US, US$18.8, Not rated). On the other hand, we expect vertically integrated LED suppliers of the panel makers to be the most aggressive about ramping up LED capacity in order to seize market share. We have a Neutral rating on the LED sector, and prefer downstream LED packager Everlight to Epistar during the current LED industry downturn, because it has a more stable margin trend, smaller capex, lower inventory days and higher positive free cash flow per share to support its balance sheet during the downturn.

Structural outlook: three-year view

Industry consolidation is likely to occur during the downturn in 2009

We expect the current economic slowdown to have a negative impact on the LED industry, as LEDs remain a light source for handsets, notebooks and lighting applications. We expect some of the second-tier LED chip makers and packagers in Taiwan and China to experience a tightening of credit during the slowdown, leading to some going out of business in 2009. In the long run, we believe adoption of LEDs in notebooks, and eventually LCD monitors, as well as LCD TVs after 2010, will ease the oversupply situation. In addition, the opening up of the general lighting market to LEDs, once the luminous efficiency surpasses 150 lumens per watt, will add further momentum to the industry. Our outlook for the secular growth of, and long-term demand for, LED chips remains intact.

US and China to announce guidelines for LED street lighting in 2009-10

We expect the US Department of Energy and the PRC Government to issue initial LED street-lighting guidelines and specifications some time in 2009-10, and believe this will be followed by similar guidelines in other countries. We also expect to see more LED light bulbs replacing the incandescent light bulbs in retail stores in 2009, raising people's awareness of the advantages of LEDs as an energy-saving light source.

Margin contraction and ASP cuts are inevitable

We expect the continued expansion of vertically integrated LED suppliers to cap the margin expansion of the independent LED suppliers in TFT-LCD backlights from 2009. As the LCD-panel makers are eager to achieve their cost-reduction targets in order to raise their overall loading rates, we now expect contractions in average selling prices to be the norm going forward.

Taiwan: Electronics (LED) – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Epistar	2448 TT	4	4	3	1	2	14	We expect the near-term inventory correction to result in low capacity utilisation. Over the long run, we expect demand for LEDs to continue to trend upward.
Everlight	2393 TT	4	4	2	2	2	14	Has a broader customer portfolio than Epistar, ranging from handsets, to consumer electronics, and automotive and lighting applications.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Epistar

Epistar scores higher than Everlight on the structural scoreboard

We are pessimistic on the near-term outlook for Epistar, due to our expectation that the oversupply of LED chips will continue into 1H09. Historically, Epistar's share price has been very volatile, due mainly to the volatility and unpredictability of its earnings. Epistar has poor pricing power and its firm order visibility does not extend beyond one month. During periods of LED-chip shortages, Epistar experiences margin expansion and earnings growth, as all of its MOCVD reactors operate at peak capacity to output the best product mix.

Back in the phase of rapid LED adoption in handset keypads of 2003, and the China handset backlight and digital photoframe booms of 2007, Epistar's share price rose significantly. However, during industry downturns, such as those in 2004 and 2008-09, Epistar's share price plummeted to below its book value, as concerns about potential losses loomed large. We expect a similar rebound in Epistar's share price following the end of this current inventory correction phase, when its ODM strategy starts to benefit from an increase in demand for LED-TV backlights, and the general lighting-related business starts to see more significant volume growth.

Worst-positioned: Everlight

Everlight scores lower due to its slower profit growth during an industry upturn

We expect Everlight to remain the most defensive company in the Taiwan LED sector during the LED industry downturn, due to what we see as its continued leadership in overall profitability, strong balance sheet, and comprehensive customer portfolio. With diversified product offerings, Everlight's gross-profit margin is more resilient to the overall erosion of LED prices than Epistar's, in our view. Everlight is a key supplier of handset keypads, backlights and flash for Nokia, Motorola, Sony Ericsson and Apple.

We believe Everlight will benefit from the popularity of smartphones and demand for LEDs from Apple, HTC Corp (HTC), and Research in Motion (RIM), as well as increased demand from the special-lighting market. Everlight can circumvent potential patent-infringement issues by sourcing high-power LED chips from Cree to package into various special-lighting products. However, during periods of rapid LED replacement growth, Everlight's overall earnings tend to rise more moderately than Epistar's. We thus foresee greater long-term upside potential for Epistar, when overall shipments of LCD-TV backlights and general lighting orders for LED chips start to take off.

Valuation: target and entry prices

Epistar's OEM and ODM relationships should allow it to enter the notebook, LCD-TV and lighting markets

We believe that in 4Q08 and 1Q09 Epistar will struggle to find orders to fill up its expanded capacity and stay profitable. However, we still think it has the better opportunity to see its share price double over the next two years. Epistar has formed various OEM and ODM relationships with global leaders Nichia (Not listed), Toyoda Gosei (7282 JP, ¥1,231, 3), Osram Opto, Philips, and Samsung Electronics to bypass the IP barriers and enter the high-growth notebook, LCD-TV and lighting markets. We believe that once the economic slowdown causing the weakness in demand for consumer electronics and handsets comes to an end in 2H09, its share price will rebound.

Taiwan: Electronics (LED) – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
Epistar	2448 TT	31.2	75	140.4	37.5	28.8	Growth depends on a sufficient penetration growth rate of LEDs in the notebook, LCD monitor, LCD-TV and lighting markets.
Everlight	2393 TT	45.0	82.5	83.3	41.25	7.9	Less share-price downside in the near-term and less upside potential in the long run.

Source: Daiwa

Top pick: Epistar

Epistar's large MOCVD capacity will help it win orders from global LED makers during the industry upturn

We believe Epistar will gain access gradually to the high-growth area of notebook backlights through its ODM relationship with Toyoda Gosei, and believe it will access the LED-TV backlight business through its relationships with Samsung Electronics and AU Optronics. We expect Epistar's nitride LED-chip brightness to exceed 2,000mcd in 2009, and its high-power LEDs' luminous efficiency to reach over 80 lumens per watt. Epistar's CEO, Mr. Lee, has emphasised that the company is striving to become the best second-source supplier for the large global LED companies, in order to maximise its production capability and leverage across various applications.

We expect Epistar's large MOCVD capacity to give it the advantage (versus other tier-two Asia based suppliers) to win orders from the global LED leaders during the next LED industry upturn.

Valuation and catalysts

We set our three-year long-term share price target at NT$75

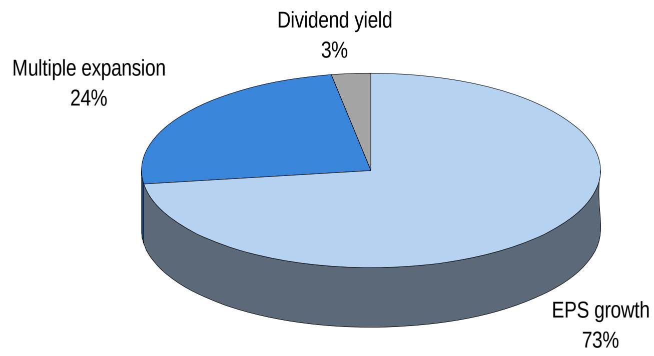
Our three-year target price of NT$75 assumes the share price re-rates back to a forward PER of 30x on our 2012 EPS forecast of NT$2.5. This target price is at the low end of the stock's PER range of 25-60x over the past three years, and is near a PBR of 2x on our 2012 BVPS forecast. This target PBR is referenced to the historical peak PBR cycle of AUO in the previous four years.

Epistar's share price is near our entry point, but still has near-term downside

Our long-term entry price of NT$37.5 is 20% above the current share price of NT$31.2, and equivalent to a PER of 28.8x on our 2009 EPS forecast. We believe this entry point is still demanding, taking into account the rapid recent de-rating of the Taiwanese electronics component stocks down to an average PER of 9x, on the Bloomberg-consensus EPS forecasts for 2009. We believe there are still near-term share-price downside risks, due to Epistar's low utilisation of only 50-60% in 4Q08 and 1Q09. However, we expect Epistar's share price to rebound after 1H09, due to what we see as an easing of the LED oversupply situation and a rapid turnaround in its overall earnings-growth momentum.

Source of upside

Taiwan Electronics (LED): Epistar – source of three-year total return



Source: Daiwa forecasts

Taiwan: Electronics (LED) – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Epistar	2448 TT	31.2	5	25	(19.9)	Dec	9.2	29.0	23.7	16.0	4.5	7.0	6.6	5.3	7.7	2.4	2.9	4.4
Everlight	2393 TT	45.0	3	60	33.3	Dec	6.9	9.4	8.6	7.7	4.7	5.5	5.0	4.3	9.0	7.5	8.3	9.4

Source: Companies, Daiwa forecasts

Electronics (PC) – Negative

Calvin Huang *(886) 2 2758 8805 (calvin.huang@dirtpe.com.tw)*

Sector thesis: the netbook is not just creating demand

We expect notebook shipments to keep rising but overall value growth to slow in 2009

We expect notebook shipments to continue to increase in 2009, driven by the notebook-replacing-desktop trend and the boost from the netbook. However, we think overall notebook value growth will slow due to the negative impact of the netbook. We believe the netbook is not just creating demand. In our view, it will accelerate the price erosion of regular notebooks and trigger inevitable competition with regular notebooks, due to the vague specification boundary between the two.

Structural outlook: three-year view

Notebook companies need to focus on margin improvement and cost reduction to survive

Competition among Taiwanese notebook companies has intensified. Given their low bargaining power and low margins, we think notebook companies need to transfer the focus from market-share gains to margin improvement in order to sustain their profit. Also, creating new products to stimulate demand and catch up with the latest technology is essential for companies. The vertical integration trend has been another main goal for companies to reduce their costs.

Taiwan: Electronics (PC) – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Acer Inc	2353 TT	5	4	5	4	5	23	A pure brand and distribution company taking advantage of the supply chain.
Hon Hai Precision	2317 TT	3	4	4	4	3	18	Business model of vertical integration causes more margin contraction in the downturn than for its peers.
Quanta Computer	2382 TT	4	4	4	3	4	19	Customer concentration remains the biggest business risk, in our view.
Compal Electronics	2324 TT	3	4	4	3	4	18	Burden from non-core investments remains the major overhang.
Wistron Corp	3231 TT	3	4	4	3	4	18	Foray into the display business brought more business risk than for other hardware makers.
ASUSTeK Computer	2357 TT	3	3	4	3	3	16	Stuck in the transition of separating its businesses; needs more time to excel in the mass market.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Acer Inc

In our view, the synergies from the Gateway and Packard Bell acquisitions show Acer's efficient execution ability. Acer merged with Gateway in October 2007. During the integration, Acer's notebook market share kept rising. Also, Acer's operating margin rose from 2.1% for 1Q08 to 2.8% for 3Q08, due to solid cost management and restructuring. We believe Acer will benefit from its multi-brand strategy going forward, and broaden its addressable market by changing its brand image. Given its solid global distribution channel, merger synergies, and cost-management ability, we believe Acer is in a relatively strong position among its peers.

Worst-positioned: ASUSTeK

ASUSTeK is stuck in a transition. We believe the company needs more time to transform itself from a product company into a distribution company to excel in the mass market. In our view, ASUSTeK is a great product company with a strong track record in the premium segment. However, after introducing the *Eee PC* to the mass market, ASUSTeK retained its product strategy, which we believe is not suitable for the mass/commodity market. Also, ASUSTeK has not come out with any specific plan to separate the business with Pegatron. Given the status quo, both ASUSTeK and Pegatron are going nowhere, in our view. ASUSTeK cannot get support from tier-1 ODMs to reduce costs, and Pegatron cannot land orders from tier-1 brands due to the conflict of interest. We would have to see a more specific plan for the Pegatron share release to turn more aggressive on the stock.

Valuation: target and entry prices

In our view, Acer's share price has greater upside potential over the next three years. We believe Acer, with its global distribution channel and diversified geographical exposure, can benefit from an economic boom and become defensive during a recession. Also, the integration with Gateway and Packard Bell has increased its market share in Europe and the US. We believe the successful launch of the *Aspire One* was attributable to great industrial design and strong channel relationship. We believe Acer will narrow its market-share gap with Dell and HP in three years, and may surpass Dell in becoming the second-largest notebook vendor globally.

Taiwan: Electronics (PC) – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
Acer Inc	2353 TT	47.0	65	38	32.5	6.3	Remains our top pick in the hardware space.
Compal Electronics	2324 TT	20.2	30	49	15.0	4.6	Will expand in line with notebook growth.
ASUSTeK Computer	2357 TT	42.2	60	42	30.0	4.3	The transition should be over in 2010.
Wistron Corp	3231 TT	24.6	35	42	17.5	3.4	New drivers to hold up business growth.
Hon Hai Precision	2317 TT	67.5	95	41	47.5	4.5	Business will recover with the macro economy.
Quanta Computer	2382 TT	37.3	45	21	22.5	4.5	Continues to ride on the notebook growth.

Source: Daiwa

Top pick: Acer Inc

Acer is less vulnerable during a downturn, in our view

Acer's 3Q results were impressive, in our view. Its operating-profit margin improved further, which led to many bears in the market upgrading the stock. Acer remains our top pick in the whole sector. We downgraded our rating previously due to our concerns about the netbook, which we believe have been well supported by the recent fundamental changes.

Our concerns about price erosion and cannibalisation were realised with the 3Q data. As a key player in the PC industry, Acer will not be able to avoid the mega-trend toward netbooks. However, we like Acer's relative position in the industry.

A value brand, like Walmart, is better suited to the downturn, when consumers are looking for bargains and value. A real international brand, like HP, with a more balanced geographical exposure, will be more defensive than companies depending too much on single markets (like Dell on the US and Lenovo on China).

Acer is a consumer notebook play, less affected by the slowdown in corporate spending than its peers. The notebook remains a penetration story. Notebook demand is driven by new demand, unlike handset demand, which is driven mainly by replacement demand.

Valuation and catalysts

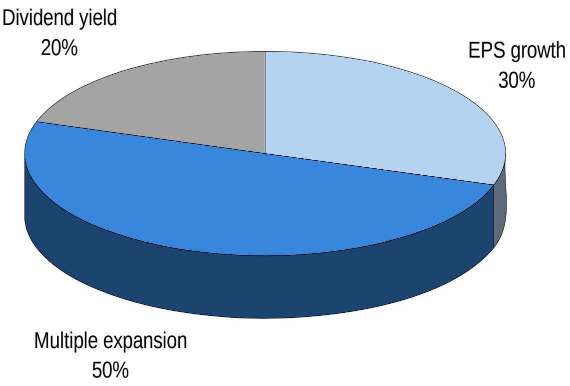
We suggest that investors revisit Acer and other hardware companies after February 2009

We believe Acer deserves to trade in line with its peers like Dell and HP, which trade currently at PERs of around 7-9x based on the Bloomberg-consensus EPS forecasts for 2009. Acer trades currently at a PER of 8x on our FY09 recurring EPS forecast. However, we suggest that investors revisit Acer and other hardware names after February 2009.

First of all, as those companies tend to move along with seasonality, we would not suggest buying them as the high season was over in October. Also, Acer, like other hardware names in Taiwan, is being sold by foreign investors in a redemption sell-off. As a result, we expect the share price to remain bumpy until the end of the year. We do not expect to have a better picture of next year until 1H09. Share prices tend to be weaker during the low season in the first half of the year, and the issue related to inventory adjustments will be gone after February 2009. We do not think it's worth the risk buying Acer at the moment.

Source of upside

Taiwan Electronics (PC): Acer Inc – source of three-year total return



Source: Daiwa forecasts

Taiwan: Electronics (PC) – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Acer Inc	2353 TT	47.00	3	66	40.4	Dec	8.7	9.4	9.1	8.1	11.6	10.1	8.6	7.8	8.2	7.7	7.1	7.3
Hon Hai Precision	2317 TT	67.50	5	127	88.1	Dec	5.5	6.8	6.4	5.3	3.4	4.3	4.0	3.3	4.4	3.8	3.6	3.8
ASUSTeK Comp	2357 TT	42.20	5	71	68.2	Dec	5.7	6.9	6.0	5.5	5.1	6.0	5.1	4.7	4.1	4.1	3.9	4.4
Wistron Corp	3231 TT	24.60	5	41	66.7	Dec	5.1	5.2	4.8	4.6	5.0	3.9	3.3	2.9	8.9	9.8	10.9	11.8
Compal Electronics	2324 TT	20.20	5	27	33.7	Dec	5.7	6.2	5.8	5.6	3.7	5.0	4.5	4.8	8.4	11.9	11.1	11.8
Quanta Computer	2382 TT	37.30	5	40	7.2	Dec	7.2	7.7	7.5	7.1	5.2	5.7	5.4	5.0	6.7	9.4	8.5	8.8

Source: Companies, Daiwa forecasts

Electronics (Semiconductor) – Neutral

***Pranab Kumar Sarmah, CFA** (852) 2848 4441 (pranab@dir.com.hk)*

Sector thesis: the strong will become stronger

Stick with the winners

We have a Neutral rating on the capital-intensive semiconductor sector in Taiwan because we believe no individual company will be left unscathed by the current downcycle exacerbated by the credit crisis, in our view. We expect global semiconductor revenue and shipments to decline for 2009, and, on a quarterly basis, we think the sector will recover only from late 2009. We think lower revenue bases and utilisation rates will also have an impact on companies' 2009 profit margins.

If the credit crisis deepens further, the recovery phase could be delayed to 2010. We believe companies with strong financial resources and the right strategies will become stronger in the next upcycle and, therefore, we intend to stay with the industry leaders that have solid financial muscle.

Structural outlook: three-year view

We do not expect the foundry sector to start to recover until late 2009

The foundry industry has been slowing down rapidly from 4Q08 due to slowing demand and channel inventory cuts. We forecast the industry to record -9% YoY revenue growth for 2009, but to recover strongly to above 15% YoY revenue growth for 2010. We also expect more outsourcing from integrated device manufacturers (IDMs) at advanced 45nm process technology to be reflected in the foundry industry's revenue from 4Q09. There is a polarisation effect within the foundry industry, where Taiwan Semiconductor Manufacturing (TSMC) is superior to United Microelectronics (UMC) and its other peers on all techno-commercial and financial matrices. We expect this structural difference to continue over the next three years. We expect the semiconductor and foundry cycle to be in a recovery phase in 2010, after bottoming out in late 2009.

Recovery of memory sector would be possible only after major industry consolidation

Currently, the memory sector is going through its toughest period since 1996. Capacity build over the past two years and slowing demand have created acute oversupply. We do not expect demand/supply to balance in 2009. Moreover, Taiwanese DRAM makers lack their own technology and have limited exposure to non-commodity memory products. Financially, they are also fragile. In this downturn, we think the competitive gap with industry leader Samsung will expand. Only a major industry consolidation and recapitalisation of Taiwanese memory companies could save them in the medium term, in our view.

We think the semiconductor assembly and test sector is structurally sound

The semiconductor assembly and test sector has also slowed from 4Q08, in line with the declining semiconductor cycle. Structurally, leading companies in the sector are sound and have been maintaining capex discipline since 2005. Entry barriers to the high-end assembly/test business are also high. We expect some pricing pressure for 2009 due to low utilisation rates. Volatile gold prices are also affecting these companies' profit margins.

Taiwan: Electronics (Semiconductor) – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
TSMC	2330 TT	5	3	5	4	4	21	A well-managed company, in our view, with a solid track record of delivering on long-term commitments in both up/down cycles.
SPIL	2325 TT	5	3	4	3	4	19	Strong management and solid control over cost and execution. Despite being number three in the industry, SPIL has been generating the highest profit in the industry consistently for years.
Motech	6244 TT	3	5	3	2	3	16	One of the oldest solar cell makers in Taiwan, but management is less aggressive than its peers in expanding. Motech is a price taker in the commodity PV-cell market.
UMC	2303 TT	2	3	3	2	3	13	We think frequently changing strategy and management confuses customers and investors. Competition is too strong.
Nanya	2408 TT	1	2	2	1	1	7	Management's financial planning is in question, in our view. Unlikely to improve design capability and diversify effectively outside commodity DRAM. We expect commodity DRAM oversupply to continue until 1H09.
Powerchip	5346 TT	1	2	2	1	1	7	Unlikely to improve design capability and diversify effectively outside commodity DRAM. We expect commodity DRAM oversupply to continue until 1H09.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: TSMC

We expect its rising cash to be a drag on ROE

TSMC scores the best because we think it is way ahead of the competition in terms of market share, profitability, technological capability, financial resources, and management strength, etc. However, we believe the company has limited room for growth, and we expect its rising cash pile to be a drag on its ROE.

Worst-positioned: Powerchip

Stuck in the middle

Both DRAM companies (Powerchip and Nanya) score the least in our structural scoreboard, due mainly to their delicate financial positions, lack of own technology, and overall weak industry outlooks for 2009. Nanya has a fall-back option with its parent Formosa Group in case of an extreme financial crisis, but Powerchip does not.

Valuation: target and entry prices

Potential double-baggers on our list

We believe Motech and Siliconware Precision (SPIL) (including cash bonuses) have the potential to double over the next three years. Despite TSMC being the strongest on our scoreboard, we do not expect its share price to double, as the stock is well supported at a relatively high level during the current downturn. We think Motech has the most to gain from capital appreciation, while SPIL's upside would come from capital appreciation, as well as cash dividends.

Taiwan: Electronics (Semiconductor) – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
SPIL	2325 TT	29.90	59.8	100.0	29.9	9.77	We derived our three-year target price based on a PER of 13.5x on our 2011 forecast, which is a slight premium to its past three-year average PER of 12.5x.
Motech	6244 TT	74.30	182.3	145.3	91.1	5.54	We derived our three-year target price based on a PER of 8x on our FY11, at a discount to STP's valuation. We think the solar sector's valuations will be de-rated once the industry's growth rate slows.
Powerchip	5346 TT	3.35	5.5	64.2	2.75	n.m.	We derived our three-year target price based on a PBR of 2x or a PER of 5x on our 2011 forecasts.
TSMC	2330 TT	43.40	71.0	63.5	35.5	11.63	We derived our three-year target price based on our 2011 ROE adjusted PBR of 3x, which translates into a PER of 15x on our FY11 forecast.
UMC	2303 TT	8.10	11.9	46.3	5.93	41.85	We derived our three-year target price based on our 2011 ROE PBR of 0.75x, which is a 20% premium to its current forward PBR.
Nanya	2408 TT	4.96	7.0	41.1	3.5	n.m.	We derived our three-year target price based on a PBR of 2x or a PER of 7x on our 2011 forecasts.

Source: Daiwa

For SPIL, we recommend investors buy the stock below NT$30, ie, below a PER of 10x on our FY09 forecast. Another stock we like from the list is Motech, and we forecast a close to 150% share-price appreciation over the next three years. We think its entry price should be below NT$100 or a PER of 6x on our FY09 forecast.

Top pick: SPIL

Likely to be a winner in the sector in this downturn, in our view

We expect SPIL's competitive position to strengthen during the downturn, due to what we see as its quality leadership, healthy balance sheet (NT$10bn net cash), free cash flow and continuous investment in R&D. Over the medium term, we think SPIL will be able to save on production costs by gradually ramping up its production facility in China. Although we forecast a 6% YoY decline in earnings for 2009, we think SPIL will record earnings growth from 2010.

Valuation and catalysts

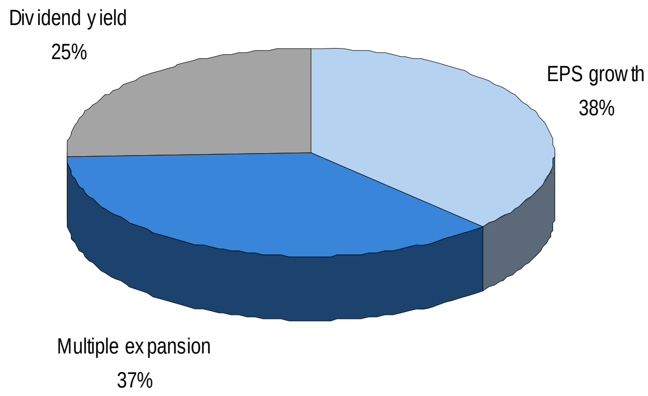
We think its valuation is reasonable

After reaching a near-term low in October 2008, the stock has recovered so far in November and is now trading at a PER of 9.8x on our 2009 forecast, lower than its three-year average of 12x. In the near term, we think weak demand from its largest customer, MediaTek, could affect its share price. We recommend investors buy the stock below NT$30.

The next major company-specific share-price drivers would be SPIL's progress with penetrating the Qualcomm account, and the impact on its 1Q09 profit margin from falling gold prices, in our view.

Source of upside

Taiwan Electronics (Semiconductor): SPIL – source of three-year total return



Source: Daiwa forecasts

Taiwan: Electronics (Semiconductor) – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
SPIL	2325 TT	29.90	2	36.50	22.1	Dec	5.2	9.2	9.8	7.8	2.8	4.0	4.0	3.5	11.5	15.1	8.3	7.8
Motech	6244 TT	74.30	2	162.00	118.0	Dec	7.1	6.9	4.5	3.8	6.8	5.3	3.4	2.7	8.0	7.8	9.4	15.5
TSMC	2330 TT	43.40	2	54.00	24.4	Dec	10.5	11.1	14.2	9.9	4.8	5.0	5.7	4.7	6.9	6.9	6.9	6.3
Powerchip	5346 TT	3.35	4	3.10	(7.5)	Dec	n.a.	n.a.	n.a.	n.a.	6.1	n.a.	98.8	6.1	40.7	0.0	0.0	0.0
UMC	2303 TT	8.10	4	7.30	(9.9)	Dec	5.9	n.a.	57.2	7.5	1.4	2.2	2.3	1.8	8.6	9.3	0.0	1.4
Nanya	2408 TT	4.96	4	4.40	(11.3)	Dec	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	7.3	66.5	0.0	0.0	0.0

Source: Companies, Daiwa forecasts

Electronics (TFT-LCD) – Neutral

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Sector thesis: gloomy outlook for 2009 factored in

We think the outlook for 2009 is gloomy

The TFT-LCD sector entered a downcycle in late 2Q08. Given that six new fabs are scheduled to commence mass production in 2009 and demand has started to slow, we do not think the balance of supply and demand for LCD panels will improve substantially before 2H10. We forecast Taiwan's two-largest LCD makers to record net losses for 2009, due to panel-price declines and lower utilisation rates.

Limited room for share-price downside

Although we are negative on the sector's fundamentals, we remain Neutral on the sector, because we think a loss-making outlook for 2009 has been factored into share prices already, and so believe there is limited room for share-price downside. AU Optronics' (AUO) and Chi Mei Optoelectronics' (CMO) current PBRs are as low as 0.6x and 0.4x, respectively, on a reported BVPS basis, and we expect the sector to recover from 2H10, supported by rising LCD-TV penetration in emerging countries.

Structural outlook: three-year view

We think panel supply and demand will improve substantially from 2H10

We think the LCD sector will move into the next upcycle from 2H10 to 2H11. In our view, recent cutbacks in capex will result in slower capacity expansion for 2010-11. We also expect the rising penetration of LCD TVs in emerging countries to support LCD-panel demand. New displays, such as AMOLED, will not replace LCD TVs over the next three years, due to high prices and technological challenges, in our view. In addition, we think huge capex and continuous panel-price declines would prevent new players from entering the market.

Any changes in the TV supply chain would have an impact on panel makers' shipments

Another point to look at would be any changes in the TV-supply chain. We think there is a possibility of industry consolidation in the LCD-TV space, and believe this would have an impact on panel makers' market shares. Any changes of strategy by the major TV brands would also be a swing factor for panel makers, in our view.

Taiwan: Electronics (TFT-LCD) – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
AU Optronics	2409 TT	4	4	5	3	4	20	Management has a good track record for M&As and timing for capex.
Chi Mei Optoelectronics	3009 TT	3	4	4	3	3	17	Aggressive capacity expansion has resulted in weaker financial health.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: AUO

We think AUO's management has made the right decisions in terms of M&As and capex over the past few years, enabling it to maintain better financial health and margins than its peers.

Worst-positioned: CMO

Although CMO is good at marketing, the timing of its capex has not been right, in our view. We think its aggressive capex has had a negative impact on its financial health.

Valuation: target and entry prices

Target PBR of 1.5x for AUO

We think both AUO's and CMO's share prices could double over the next three years. We expect the sector to move into an upcycle from 2H10 to 2H11. For upside potential, we have applied a target PBR of 1.5x for AUO, based on our 2010 BVPS forecast. AUO's mean PBR during the previous upcycle (1H08) was 1.5x. For CMO, we think the valuation gap with AUO would remain the same, given its weaker financial health.

Taiwan: Electronics (TFT-LCD) – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
AU Optronics	2409 TT	21.65	50.00	131	25.00	n.a.	We forecast AUO's share price to trade at a PBR of 1.5x during the next upcycle – its mean PBR during the previous upcycle (1H08).
Chi Mei Optoelectronics	3009 TT	10.70	25.00	134	12.50	n.a.	We have assumed CMO's 30% discount to AUO will remain, due to its weaker financial health.

Source: Daiwa

Top pick: AUO

Return to profitability for 2010, after recording a loss for 2009

We expect AUO to record net losses between 4Q08 and 2Q10. We think it will return to profitability in 3Q10, on the back of a potential recovery in LCD-panel prices, and also record a net profit for 2010. We believe AUO will continue to be the frontrunner in the Taiwan LCD sector.

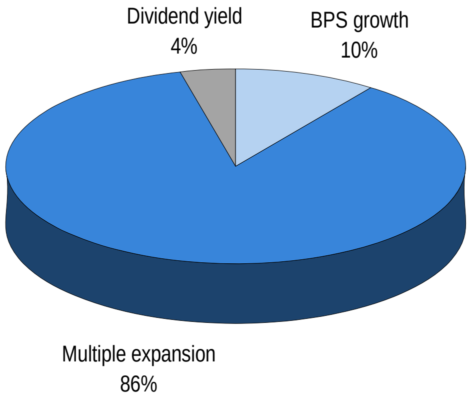
Valuation and catalysts

The time to enter would be early 2010, in our view

On our assumptions, AUO would be able to achieve a 100% return over the next three years from its current share price. However, we think it is still too early to enter. Historically, LCD makers' share prices have not moved upward substantially while panel prices have trended downward. The best entry timing would be slightly before panel prices turn around, in our view. Currently, we expect LCD-panel prices to rebound from sometime in 2Q10.

Source of upside

Taiwan Electronics (TFT-LCD): AUO – source of three-year total return



Source: Daiwa forecasts

Taiwan: Electronics (TFT-LCD) – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
AU Optronics	2409 TT	21.65	3	23.0	6.2	Dec	3.3	4.6	n.a.	19.8	1.9	2.2	4.0	2.7	9.2	7.9	0.0	1.4
Chi Mei Optoelectronics	3009 TT	10.7	3	13.0	21.5	Dec	2.2	5.7	n.a.	43.4	2.7	2.9	5.1	2.8	13.0	4.7	0.0	0.9

Source: Companies, Daiwa forecasts

Telecommunications – Positive

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Sector thesis: a shelter in tough times

Immune from the financial tsunami, in our view

In our view, the Taiwan telecom sector offers investors the perfect shelter within the export-orientated Taiwan market from the current downturn triggered by the financial tsunami. At the same time, we have identified three positive catalysts – capital reductions, digital convergence and the *Three Links* concept (direct postal, transportation and trade links between Mainland China and Taiwan) – that we think would help the sector to outperform for 2009.

The highest dividend yield in the Greater China region

High dividend yields (7-10%) and a stable operating environment are the key attractions of Taiwanese telecom companies, and we do not foresee any significant changes over the next two years.

Structural outlook: three-year view

A three-player market

We think it would still be a three-player market, dominated by Chunghwa Telecom (CHT), Taiwan Mobile (TWM) and Far EasTone (FET) capturing about a third of the mobile market each. However, we think the broadband Internet market could be less concentrated by the end of 2010, when the six WiMax licencees have secured footholds after operating for two years.

Taiwan: Telecommunications – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Chunghwa Telecom	2412 TT	4	4	4	3	4	19	Investment in foreign-exchange derivative products in 2007 affected investors' perception of management's quality.
Taiwan Mobile	3045 TT	4	4	3	3	3	17	The potential expansion of its cable operation is a long-term catalyst.
Far EasTone	4904 TT	4	3	3	3	2	15	Lack of catalysts. Its fixed-line operation remains small and loss-making, making it inferior to CHT and TWM in terms of product-bundling power.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: CHT

A dominant position in various segments of the telecom industry (eg, fixed-line, mobile, Internet, IPTV) affords CHT first-mover advantage over its competitors in rolling out convergence products. Its strong net-cash position makes capital reduction a recurrent exercise, leading to high cash yields.

Worst-positioned: FET

FET is virtually a pure mobile play, as its fixed-line operation is small and loss-making. As a result, it is more vulnerable to intensifying competition in the mobile market, while CHT and TWM could minimise the negative impact through product bundling.

Valuation: target and entry prices

Low-beta characteristics mean 100% increases in share prices unlikely

Taiwan telecom companies are low-beta stocks, offering high yield options to investors that are risk-averse. A steady organic income pattern (± within 10% YoY), with minimal overseas investments, would make it rather difficult for the share prices to double in three years' time. The historical data for the past eight years shows that the share prices of Taiwanese telecom plays never move beyond ±20%.

Our entry prices imply that the Taiwanese telecom companies' share prices would have to fall by 15-31% in 2009, which may not be that realistic, in our opinion. In fact, we do not foresee any negative catalysts that would make this happen.

Taiwan: Telecommunications – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (NT$)	Three-year target price (NT$)	Upside potential (%)	Entry price for 100% upside (NT$)	2009 PER at entry price (x)	Comment
Chunghwa Telecom	2412 TT	51.2	71.3	39	35.63	8.4	Our three-year target price is based on our sum-of-the-parts (SOTP) valuation, of which NT$12.86 comes from property-redevelopment potential and the rest is the DCF value of its telecoms operation.
Taiwan Mobile	3045 TT	42.55	67.0	57	33.48	7.0	Our three-year target price is based on our SOTP valuation, of which NT$10.62 is the treasury share value and the rest is the DCF value of its telecoms operation.
Far EasTone	4904 TT	32.05	50.3	57	25.13	7.1	Our three-year target price is based on our DCF valuation. However, FET is likely to deliver a lower DPS for 2008 amid the losses of its fixed-line arm.

Source: Daiwa

Top pick: CHT

Cash is king

Unwinding the foreign-exchange contract removes the major overhang for CHT and makes it truly defensive, in our view. We believe its dominant market position in the mobile, fixed-line and Internet market segments will help CHT to weather the negative impact of the economic downturn. We expect CHT to be the only Taiwanese telecom company to conduct a capital reduction in 2009, which would boost its total cash yield to 10.5%. It has the highest cash-to-market cap ratio (16%) among its peers, on the back of our forecast NT$90bn net cash for 2008.

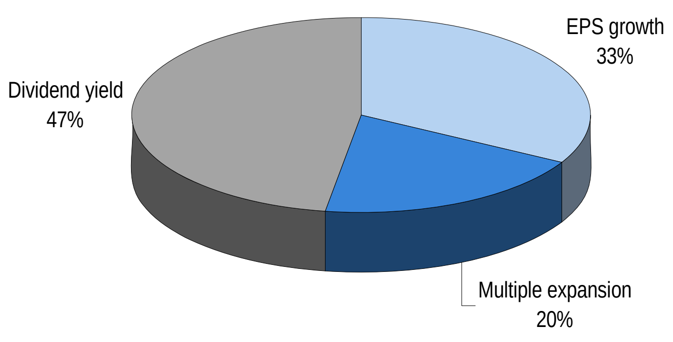
Valuation and catalysts

The* Three Links *concept benefits CHT more, in our view

Dividend yield (including capital reduction) is the biggest source of return and the major reason for investors to buy into Taiwanese telecom companies, in our view. We expect EPS growth and multiple expansion to be minimal, given that the Taiwan telecom market is quite mature. Apart from capital reductions, we think the *Three Links* concept that could benefit the property sector would be a positive catalyst for CHT, given that 18% of its SOTP value is related to its property-redevelopment potential.

Source of upside

Taiwan Telecommunications: CHT – source of three-year total return



Source: Daiwa forecasts

Taiwan: Telecommunications – valuation summary

Company name	Stock code	Share price 12-Nov-08 (NT$)	Rating	Six-month target price (NT$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Chunghwa Telecom	2412 TT	51.20	1	71.26	39	Dec	13.6	12.2	12.0	11.8	5.0	5.0	4.9	4.8	7.0	7.3	7.4	7.7
Taiwan Mobile	3045 TT	42.55	2	66.95	57	Dec	25.3	10.2	8.8	8.7	5.7	5.6	5.7	5.6	6.0	9.9	11.2	11.4
Far EasTone	4904 TT	32.05	2	50.26	57	Dec	10.7	11.3	9.0	8.6	3.7	3.8	3.7	3.6	9.7	7.8	8.8	9.3

Source: Companies, Daiwa forecasts

Singapore

Banks – Negative

***David Lum, CFA** (65) 6329 2102 (david_lum@dir.com.sg)*

Sector thesis: three lost years

Earnings forecasts have not come down enough

We believe the global financial crisis will wipe out about three years (2008-10) of earnings growth for the Singapore banks, and that core EPS will exceed 2007 levels only in 2011. The magnitude of the earnings decline will depend on how high NPLs will rise. Our forecasts assume that after bottoming at 1.4% for 2008, a region-wide slowdown will raise the aggregate NPL ratio for the three Singapore banks to 2.4% for 2009 and 3.1% for 2010, resulting in average annual charge-off ratios (or credit costs) of 70 basis points for 2009 and 2010. We do not believe our forecasts are particularly aggressive (charge-offs during the Asia financial crisis and dotcom bust recessions were far worse), yet our earnings forecasts for 2009 and 2010 appear to be well below those of the consensus.

Structural outlook: three-year view

Singapore banks will be the survivors

By 2011-12, we expect Asia and Singapore to be in some stage of economic recovery depending on the actual severity of the global financial crisis-induced recession. We have little doubt that Singapore banks will emerge as survivors, having weathered several severe recessions over the past decade.

Back to financial intermediation, but at good margins

With the government's guarantee of all bank deposits in Singapore lifted by the end of 2010, we expect business as usual in Singapore as the industry resumes growth mode. The difference this time around, in our opinion, is the return of financial intermediation, with corporates, large and small, relying more than ever on bilateral bank loans, which we suspect would suit the banks fine, since their business models never relied heavily on securitisation.

As they resume growth mode, the Singapore bank with the best prospects, in our view, would be the one that will have made a transformational acquisition (ideally of a bank in a major Asian market at a bargain price) in 2009-10. However, it is almost impossible to identify the winner (if any) at this time.

Singapore: Banks – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
UOB	UOB SP	4	4	4	3	3	18	Management competence and stability, regional exposure advantage.
OCBC	OCBC SP	3	3	3	3	3	15	Trying desperately to differentiate itself, possibly through Great Eastern.
DBS Group	DBS SP	2	2	4	3	3	14	Unproven management, reputational damage could linger for a long time.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: United Overseas Bank (UOB)

We believe UOB has the advantage of regional presence, the next best thing to landing a major acquisition, with its banking operations in Malaysia, Thailand, Indonesia, and footholds in Vietnam and China. We also believe it will be the local winner by default, along with Oversea-Chinese Banking Corporation (OCBC), for wealth-management sales from its branches with the reputational damage suffered by DBS's ill-fated sales of its Lehmann Brothers-linked High Notes structured products. With the new DBS management team still unproven (in our opinion) and OCBC experiencing some senior staff turnover (though CEO David Conner remains a steady fixture, in our view), we believe UOB's overall management team is a paragon of competence and stability.

Worst-positioned: DBS Group

It is probably still early, but Richard Stanley, DBS's new CEO who joined in May 2008, has made almost no impact, in our opinion, compared with previous new CEOs (who were completely new to the organisation), such as Alex Au and David Conner. Moreover, Stanley faces the most daunting, in our view, challenges in his first year at the helm, with the global financial crisis wreaking havoc, the DBS balance sheet losing value fast (with marked-to-market losses and negative fair-value adjustments directly to equity), and disgruntled investors (many of whom are core customers) clamouring for compensation after suffering severe losses in their structured-product investments sold by DBS. Of course, Stanley could turn it around eventually, but so far, there is little sign, in our opinion, that the company is even headed in the right direction.

Valuation: target and entry prices

Trough to mid-cycle

We believe moving from current near-trough valuations to mid-cycle valuations would provide a solid basis for a doubling of the share price over the next three years, assuming a return to normal economic growth by then from the current recessionary outlook.

Singapore: Banks – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (S$)	Three-year target price (S$)	Upside potential (%)	Entry price for 100% upside (S$)	2009 PER at entry price (x)	Comment
UOB	UOB SP	12.70	27.46	116.22	13.73	11.3	Mid-cycle PER of 15x applied to estimated 2012 core EPS of S$1.83.

Source: Daiwa

UOB's share price is already below our entry price for 100% upside (on a three-year view). We believe the shares will underperform on a six-month period, as we expect market earnings forecasts to be revised down and further signs of localised economic distress to gain traction. However, looking past the current downturn, we believe PER expansion to a (historical) normalised level of 15x for UOB, with the most solid underlying fundamentals in the sector, in our view, is a realistic expectation for long-term investors.

Top pick: UOB

Resilient and abound with regional opportunities

We expect UOB to be one of the most resilient (asset quality and earnings impairment) banks during this downturn. Unless one of its local competitors strikes gold with a major overseas acquisition on the cheap (highly unlikely, in our opinion), UOB's ongoing development of its banking subsidiaries in Southeast Asia will provide a valuable source of growth outside of Singapore for the next upcycle.

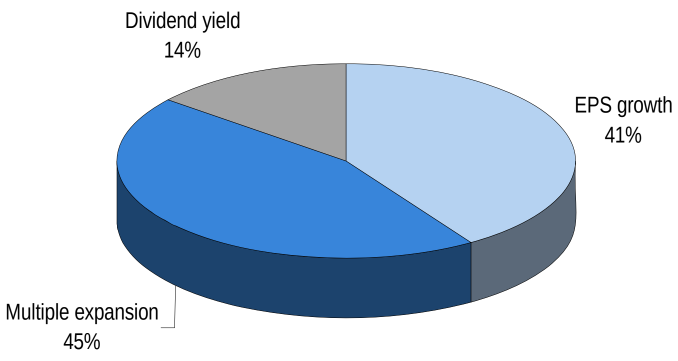
Valuation and catalysts

Still above previous troughs

We estimate that UOB's shares are still trading above the previous PBR troughs of 0.5x for 1998 and 1.1x for 2003. It would also be a blow to investor perceptions if UOB comes out of the downturn worse-off (NPLs, provisions, or earnings growth) than either DBS or OCBC, since the market already expects, in our opinion, that UOB would be the most defensive bank.

Source of upside

Singapore Banks: UOB – source of three-year total return



Source: Daiwa forecasts

Singapore: Banks – valuation summary

Company name	Stock code	Share price 12-Nov-08 (S$)	Rating	Six-month target price (S$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	EPS growth (% YoY) 2007	EPS growth (% YoY) 2008E	EPS growth (% YoY) 2009E	PBR (x) 2007	PBR (x) 2008E	ROE (%) 2007	ROE (%) 2008E	Yield (% p.a.) 2007	Yield (% p.a.) 2008E
UOB	UOB SP	12.70	4	9.70	(23.6)	Dec	9.3	9.5	10.4	(17.5)	(1.6)	(9.1)	1.2	1.2	13.0	13.0	6.3	5.4
DBS	DBS SP	10.66	3	10.30	(3.4)	Dec	7.4	7.0	8.6	(0.6)	5.4	(17.9)	0.8	0.8	11.6	11.6	7.5	7.5
OCBC	OCBC SP	4.92	4	3.98	(19.1)	Dec	7.5	8.5	10.0	4.0	(12.4)	(15.1)	1.0	1.0	14.9	12.5	5.7	5.7

Source: Companies, Daiwa forecasts

Conglomerates – Neutral

Chris Sanda, CFA (65) 6321 3085 (csanda@dir.com.sg)

Sector thesis: the return of peak-oil concerns

Keppel and SCI trade in line with crude-oil prices

The key stocks that we cover in the Singapore conglomerates sector are SembCorp Industries (SCI), Keppel Corp and SCI's key subsidiary, SembCorp Marine (SembMarine). While these stocks are fundamentally defensive, due to their long order books and relatively strong balance sheets, they tend to trade in line with crude-oil prices. In our view, an investment in Keppel or SCI is a de-facto investment in crude oil.

Structural outlook: three-year view

We believe in the peak-oil theory

While the current six-month outlook has us concerned about global over-supply of crude oil in the face of worldwide decelerating economies, the key thesis is that the cycle will rebound within three years. In this event, we project that the world will once again be facing the same fundamentals that drove crude-oil prices to nearly US$150/bbl in July 2008. That is, energy demand tends to rise in association with global GDP, global energy companies are struggling to replace their depleting reserves, new energy reserves are structurally more expensive than existing ones, and there is a dearth of excess capacity that can come into production. Singapore's conglomerates should be key beneficiaries, as they have sizeable global market shares in global rig building.

Singapore: Conglomerates – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
SembMarine	SMM SP	2	5	4	3	3	17	Key beneficiary of rising oil prices.
Keppel Corp	KEP SP	2	4	4	3	3	16	Key beneficiary of rising oil prices.
SembCorp Industries	SCI SP	2	4	3	3	3	15	Key beneficiary of rising oil prices.
ST Engineering	STE SP	2	2	2	1	2	9	Diverse portfolio; smooth earnings growth.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: SembMarine

This stock is a pure offshore rig-building company, which gives it direct exposure to the peak-oil theory. We believe it should benefit from the trend of depleting reserves and the need to explore and produce from new energy fields.

Worst-positioned: ST Engineering

Of the Singapore conglomerate stocks that we cover, ST Engineering is a true conglomerate with a balance of businesses from a diverse range of industries. Some are in government-linked businesses (eg, communication systems, defence systems), some are counter-cyclical and some are cyclical. As a result, ST Engineering's net earnings tend to rise by a low-teens percentage during good economic times and record zero growth during weak economic times. We see ST Engineering as a defensive stock, but not one for large capital appreciation.

Valuation: target and entry prices

Energy-related conglomerate stocks could rebound with oil prices

We forecast the fundamental equilibrium value for Brent crude oil to be US$109/bbl for FY10. In the event that crude-oil prices rebound to these levels, then we believe the energy-linked conglomerates could rebound significantly.

Singapore: Conglomerates – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (S$)	Three-year target price (S$)	Upside potential (%)	Entry price for 100% upside (S$)	2009 PER at entry price (x)	Comment
SembMarine	SMM SP	1.93	2.84	47.0	1.42	5.5	13x PER, which is the historical PER-band floor

Source: Daiwa

SembMarine trades typically within a fairly 'expensive PER' band of 13-30x. The stock collapsed below this band recently, so is in new territory. Implicitly, we believe the market is factoring in some sort of collapse in rig-contract prices and/or volumes. While we think there could be some moderation, a systemic collapse would be unlikely over the next three years, in our view.

Top pick: SembMarine

Key way to play sector – via its subsidiary

Technically, SembMarine is not a conglomerate, but is the key subsidiary of SembCorp Industries. SembMarine offers pure offshore exposure, whereas the parent company and Keppel Corp have less exposure through virtue of being conglomerates. If we were to recommend Keppel Corp or SembCorp Industries over each other, we would prefer Keppel Corp, due to its larger exposure to deep-water rigs and lower earnings valuation.

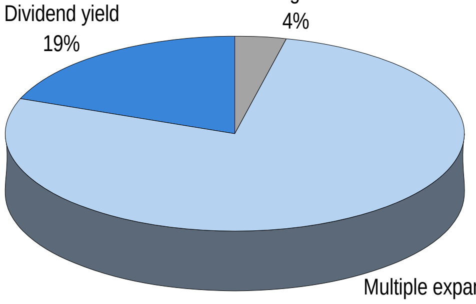
Valuation and catalysts

Trades with oil

In our view, where oil goes, so goes SembMarine (and for that matter, also Keppel Corp and SCI). We believe that oil prices are fickle, based partly on fundamentals, partly on liquidity flows, partly on expectation theory, and partly on US-dollar policy. We believe that the extreme bearishness of crude oil will pass within the next three years, and expect crude-oil prices to rebound sharply.

Source of upside

Singapore Conglomerates: SembMarine – source of three-year total return



Source: Daiwa forecasts

Singapore: Conglomerates – valuation summary

Company name	Stock code	Share price 12-Nov-08 (S$)	Rating	Six-month target price (S$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
SembMarine	SMM SP	1.93	4	2.25	16.6	Dec	16.5	8.5	7.5	7.0	5.1	4.2	3.6	3.4	4.5	5.5	6.3	6.7
ST Engineering	STE SP	2.40	3	2.85	25.0	Dec	13.9	14.7	14.4	12.7	10.1	10.5	10.0	8.9	2.9	7.5	7.0	7.9
Keppel Corp	KEP SP	4.88	4	5.31	8.8	Dec	6.9	7.0	7.1	6.7	7.8	7.2	6.9	6.7	13.1	8.7	8.5	9.1
SembCorp Industries	SCI SP	2.46	4	2.57	4.5	Dec	8.4	8.3	7.7	7.3	3.5	3.0	2.7	2.5	17.8	6.7	7.2	7.7

Source: Companies, Daiwa forecasts

Electronics – Neutral

Pranab Kumar Sarmah, CFA *(852) 2848 4441 (pranab@dir.com.hk)*

Sector thesis: losing competitiveness

Unexciting sector

In the year-to-date, the MSCI Singapore IT Index has underperformed the STI by 24.9%. Despite this underperformance, we do not expect the MSCI Singapore IT Index to outperform in the near future, due to what we regard as the declining competitiveness of the Singapore electronics sector. We therefore maintain our Neutral rating on the sector.

However, we expect niche product makers with high design content to remain in business over the next three-to-five years.

Structural outlook: three-year view

Niche players to remain in business

The Singapore electronics sector has been losing momentum since 2001, and we expect the sector to experience a structural slowdown over next three years, due mainly to increased competition for high value-added activities, such as design and semiconductor manufacturing, from Taiwan, China and Malaysia. Due to intense competition for high-volume contracts from Taiwanese EMS/ODM companies and large US-listed EMS companies, a few small Singapore-based EMS companies are focusing on niche (high-end product mix and high engineering content) products. Venture and Hi-P are successful examples of this strategy, in our view. However, growth opportunities in niche-product areas are limited.

Singapore is also home to a cluster of hard-disk-drive (HDD) and plastic-component makers. With the growth rate in the HDD industry slowing, we expect further consolidation among component makers, in line with the consolidation of HDD makers over the next few years. Plastic-component makers are facing severe competition from Taiwanese and large EMS companies, and we expect this situation to continue. Falling crude-oil prices may help the industry to lower its costs, but only marginally. The actual benefits are likely to be much lower than we expected, as many contracts are based on a 'cost-plus' arrangement.

Singapore: Electronics – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Venture	VMS SP	4	3	2	3	4	16	Strong design capability to command a decent profit margin. Strong cash generation capability.
CSM	CSM SP	4	3	2	2	1	12	Competition is too strong. Weak track record for profitability.
Elec & Eltek	ELEC SP	3	2	2	2	3	12	Solid track record in managing economic downturns since listing in 1994.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Venture

Design capability and financial health are Venture's key strengths

Venture's cash-flow generation capability is strong, in our view, and we do not see any liquidity issues for the company over the next few years. Venture focuses on niche products with high engineering content that are ignored by large Taiwanese and US-based EMS/ODM companies. It has strong design capability and many intellectual-property rights to defend its profit margins.

Worst-positioned: Chartered Semiconductor (CSM)

Weak financial health and strong competitor

CSM is one of the worst positioned in our structural scoreboard, due to its weak financials and strong competition from the industry leader, Taiwan Semiconductor Manufacturing (TSMC). CSM has nearly US$800m of debt maturing in 2010, which may force the company to sell new shares in the market or to offer a rights issue. Due to its smaller scale, higher R&D burden and less cost-effective manufacturing process than TSMC, we forecast CSM's gross-profit margins to lag those of TSMC by 15-20 percentage points for the foreseeable future. We do not believe its technology gap with TSMC will narrow over the next three years without any significant capital injection.

Valuation: target and entry prices

Venture's share price has the potential to double over the next three years, in our view

Venture has the potential to double its share price in the next three years at an entry price below S$5.30, in our view. We think CSM's situation is a little fragile. We believe it may also double, but only if it is acquired by a strategic company (key shareholder Temasek has a plan to divest its stake in CSM) and successfully re-finances its long-term loans without hurting the current shareholders.

Singapore: Electronics – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (S$)	Three-year target price (S$)	Upside potential (%)	Entry price for 100% upside (S$)	2009 PER at entry price (x)	Comment
Venture	VMS SP	5.03	10.60	110.4	5.30	4.1	Our three-year target price is based on a PER of 8x on our FY11 forecast, at a 40% discount to its previous three-year average PER due to slowing growth.
CSM	CSM SP	0.225	0.40	77.8	0.20	n.m.	We expect CSM to record a profit for 2010-11 and the company's valuation to re-rate to a PBR of 0.5x by then, from its one-year forward PBR of 0.35x currently.

Source: Daiwa

Top pick: Venture

Moderate growth, strong cash flow

We think Venture is oversold on concerns over collateralised debt obligations (CDOs) and impairment charges for its investments. We expect the CDO saga to be over by December 2009, and believe most of the face value would be recovered by then. Venture's business is also resilient, especially during a slowing economic environment, in our view. We also expect the company to record single-digit-percentage revenue growth for 2009 backed by new orders from Intermec. Venture has more than 130 customers across various applications, which lowers its operating earnings volatility. Venture's cash generation capability is strong (industry-high margin and low capex) and, therefore, we forecast its S$0.50 annual dividend to continue over the next three years.

Valuation and catalysts

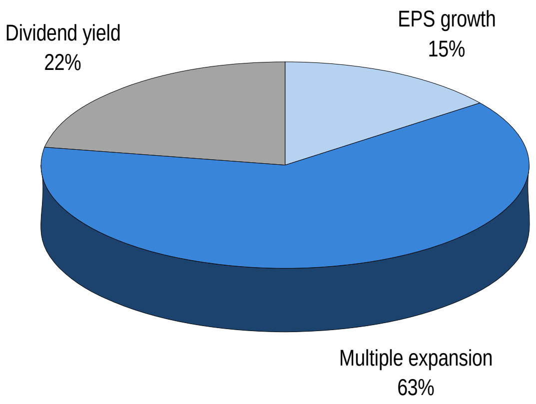
At a depressed valuation now, in our view

The stock is trading currently at a PER of 5.3x on our 2009 forecast, significantly below its three-year historical average PER of 13x. We recommend long-term investors buy the stock below a PER of 7x on our FY09 forecast (or below S$5.30).

In our opinion, a negative share-price catalyst at the end of this year would be impairment losses on long-term investments, while key share-price drivers next year would include a valuation re-rating and year-on-year revenue growth from 2H09 backed by new customer orders. We think Venture could also be an acquisition target due to its ODM capability.

Source of upside

Singapore Electronics: Venture – source of three-year total return



Source: Daiwa forecasts

Singapore: Electronics – valuation summary

Company name	Stock code	Share price 12-Nov-08 (S$)	Rating	Six-month target price (S$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Venture	VMS SP	5.030	2	8.50	69.0	Dec	4.6	5.8	5.3	5.0	3.5	4.2	4.0	3.8	9.9	9.9	9.9	10.9
Elec & Eltek	Elec SP	0.910	2	2.44	168.1	Dec	4.7	3.4	3.3	3.2	2.9	2.6	2.3	2.2	22.5	24.7	21.2	22.0
CSM	CSM SP	0.225	3	0.28	24.4	Dec	4.0	n.a.	n.a.	7.2	3.3	3.1	3.3	2.2	0.0	0.0	0.0	0.0

Source: Companies, Daiwa forecasts

S-REITs – Positive

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Sector thesis: the Great Singapore Firesale

Already pricing in a worst-case scenario

We believe the commercial physical-property market will correct inevitably from the peak in 2Q08, but with unit prices trading at (median) discounts to book of over 60%, the stock market is already discounting a severe correction (median asset-price declines of over 40%, by our estimates), and even an outright collapse in some segments (office and industrial) to their lowest-ever capital values. We believe the selling, triggered also by refinancing concerns, is overdone.

Highly attractive distressed yields

One indicator of how far prices have over-corrected, in our opinion, is that distressed yields, obtained by imposing worst-case assumptions for market rentals (throughout the entire portfolio) and financing costs, are all above 6% (based on our estimates), higher than the current FSSTI dividend yield, which we believe would collapse if these worst-case assumptions were ever to be realised.

Structural outlook: three-year view

Closer to the bottom of another recovery

We believe that in three years we will be closer to the next property-market bottom than the most recent peak in 2Q08. Investor interest will start to return to the S-REIT sector (if it still has not by then), but we reckon that investors will be more cautious about ramping unit prices above NAVs, even when NAVs will inevitably rise again during the physical-market recovery stage. We also believe S-REIT managers will be more cautious toward debt and equity finance when they resume acquisitions. They will certainly not take the capital markets for granted and will be highly disciplined (and selective) on acquisitions, in our view.

The equity market has been obsessed, in our opinion, with oversupply issues in the face of the global financial crisis. However, with the government suspending its land-sale programme from 2009 (announced on 31 October), which could be prolonged for several years depending on the state of the property market, there is a rising risk, in our opinion, that we might face another shortage in the office market by 2012.

Singapore: REITs – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
CapitaMall Trust	CT SP	5	5	5	4	5	24	Strong in all areas.
Ascendas REIT	AREIT SP	5	5	4	3	4	21	Dominant in the industrial segment.
Frasers Centrepoint Trust	FCT SP	4	5	3	4	5	21	Smaller version of CapitaMall, with a suburban focus.
Ascott Residence Trust	ART SP	4	4	5	3	3	19	Strong franchise in the industry, Asia.
CapitaCommercial Trust	CCT SP	4	4	3	3	3	17	Sound management, quality assets in commoditised markets.
CDL Hospitality Trusts	CDREIT SP	4	3	4	2	3	16	Solid niche in Singapore.
Macquarie Prime REIT	MMP SP	2	4	2	3	4	15	YTL might help to improve the low scores.
Mapletree Logistics Trust	MLT SP	2	4	3	3	3	15	Dilutive equity fund raising, acquisition-growth on hold.
Suntec REIT	SUN SP	3	4	2	3	3	15	Dual assets (*Suntec City* and *ORQ*), but high quality.
CapitaRetail China Trust	CRCT SP	4	4	1	2	3	14	Singapore-managed mall space in China.
K-REIT Asia	KREIT SP	2	3	1	3	3	12	Lacks scale; limited free float; dilutive equity fund raising.
Cambridge Industrial Trust	CREIT SP	2	3	1	1	3	10	No sponsor; manager has no track record.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: CapitaMall Trust (CMT)

CMT's dominance in the Singapore shopping-mall space rests in its portfolio of quality assets, its scale advantage and domain knowledge, and proven ability to extract further value from its assets on an ongoing basis through its strong asset-enhancement skills. We believe these competitive strengths will not vanish overnight, and CMT will even be more formidable during the next recovery, in our view.

Worst-positioned: Cambridge Industrial Trust (Cambridge)

Even though it tries hard, Cambridge lacks the scale and sponsor of its major competitors. For its survival, the manager must successfully refinance nearly all of its debt by February 2009.

Valuation: target and entry prices

Partial recovery in NAVs on the way back up

Many quality (in our view) S-REITs have been sold down such that a recovery to September 2008 NAV in three years would be more than enough to double the unit price. Not all property segments would recover back to current NAVs so quickly, so we have applied a discount to NAV depending on the perceived risk of the asset class. For office and hospitality, we assume a 40% discount to NAV (similar to the market's implied-asset discount). For industrial, we assume a 15% discount. For retail, we assume zero discount since we believe the sector will remain the most resilient.

Singapore: REITs – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (S$)	Three-year target price (S$)	Upside potential (%)	Entry price for 100% upside (S$)	2009 PER at entry price (x)	Comment
CapitaCommercial Trust	CCT SP	0.945	1.89	99.7	0.94	n.a.	40% discount to latest Sep 08 NAV.
Frasers Centrepoint Trust	FCT SP	0.70	1.24	77.7	0.62	n.a.	Sep 08 NAV.
Ascott Residence Trust	ART SP	0.595	0.95	59.4	0.47	n.a.	40% discount to Sep 08 NAV.
CapitaMall Trust	CT SP	1.85	2.43	31.3	1.21	n.a.	Sep 08 NAV.
Ascendas REIT	AREIT SP	1.50	1.57	4.7	0.79	n.a.	15% discount to Sep 08 NAV.

Source: Daiwa

We believe CapitaCommercial Trust (CCT) (office), Frasers Centrepoint Trust (FCT) (retail), and Ascott Residence Trust (ART) (hospitality) are among the standouts (in terms of depressed valuation), with the potential to more than double the unit prices if their NAVs recover even partially to their recent values.

Top pick: CapitaCommercial Trust

Best office S-REIT

CCT is the biggest, most diversified and best-managed, in our opinion, office S-REIT. It has remained largely disciplined in terms of acquisitions when there was a buying frenzy of Singapore office assets in 2006-07. We believe its latest acquisition of *1 George Street* is low-risk, given the income support from its sponsor.

Valuation and catalysts

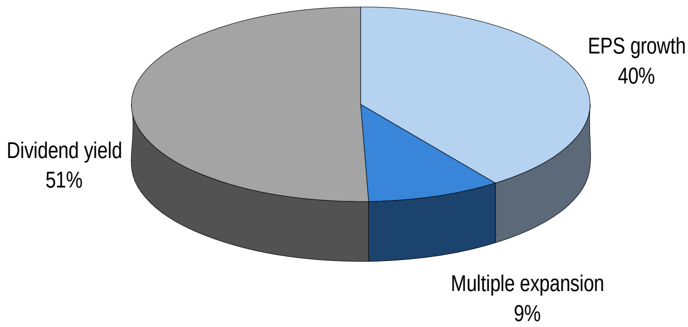
Entry-price yields, NAV discount highly attractive

CCT already trades at a steep discount to book. At our entry price of S$0.94, CCT's 12-month forward yield would be 13.3% (based on our DPU estimates), and price to latest NAV of 0.3x.

Fears of an office oversupply could recede rapidly in several years if the supply pipeline that will peak in 2010 is reduced sharply (from 2011), with the government's suspension of land-sales programmes and lifting of its moratorium on redeveloping existing office buildings. Assuming that economic growth can resume its typical 5-7% annual growth, the outlook in three years could be another severe office-supply shortage, in our opinion.

Source of upside

Singapore REITs: CCT – source of three-year total return



Source: Daiwa forecasts

Singapore: REITs – valuation summary

Company name	Stock code	Share price 12-Nov-08 (S$)	Rating	Six-month target price (S$)	+/- (%)	Year end	DPU growth (% YoY)				DPU yield (% p.a.)				PBR (x)		Loan to value (%)	
							2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2007	2008E
CapitaCommercial Trust	CCT SP	0.945	1	1.85	95.8	Dec	18.7	28.1	15.1	4.1	9.2	11.8	13.6	14.1	0.33	0.30	23.9	36.0
Cambridge Industrial Trust	CREIT SP	0.265	1	0.57	115.1	Dec	n.a	(0.1)	(17.7)	4.5	23.6	23.6	19.4	20.3	0.35	0.34	35.1	40.5
Macquarie Prime REIT	MMP SP	0.545	2	1.00	83.5	Dec	6.9	22.0	1.9	(5.3)	11.4	13.9	14.1	13.4	0.34	0.36	29.0	29.8
K-REIT Asia	KREIT SP	0.75	1	1.32	76.0	Dec	90.5	38.8	(22.8)	18.9	11.8	16.3	12.6	15.0	0.20	0.33	54.2	27.8
Suntec REIT	SUN SP	0.67	2	1.17	74.6	Sep	13.0	30.0	6.6	(5.0)	10.6	13.8	14.7	14.0	0.30	0.30	24.5	34.8
Mapletree Logistics Trust	MLT SP	0.42	2	0.68	61.9	Dec	29.8	3.7	(15.3)	1.4	15.6	16.2	13.7	13.9	0.45	0.48	53.0	36.1
Frasers Centrepoint Trust	FCT SP	0.7	1	1.05	50.0	Sep	n.a.	11.3	2.4	3.7	9.4	10.4	10.7	11.1	0.60	0.56	29.1	28.2
CapitaMall Trust	CT SP	1.85	1	2.53	36.8	Dec	14.1	14.0	4.1	4.4	7.2	8.2	8.6	8.9	0.83	0.76	34.4	41.9
Ascendas REIT	AREIT SP	1.5	2	1.91	27.3	Mar	10.8	12.3	8.1	2.9	9.4	10.6	11.4	11.8	0.82	0.82	38.0	42.8
Ascott Residence Trust	ART SP	0.595	1	0.75	26.1	Dec	59.8	20.8	(31.9)	(9.4)	12.9	15.6	10.7	9.6	0.37	0.37	32.2	33.8
CapitaRetail China Trust	CRCT SP	0.595	2	0.70	17.6	Dec	n.a.	10.5	6.8	6.7	11.3	12.5	13.3	14.2	0.59	0.51	28.6	31.4
CDL Hospitality Trusts	CDREIT SP	0.67	2	0.74	10.4	Dec	n.a.	25.3	(13.8)	(20.9)	13.4	16.8	14.5	11.5	0.42	0.40	18.7	18.5

Source: Companies, Daiwa forecasts

Small Caps – Negative

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Sector thesis: be very selective

Underweight the sector for the next three years

It is our observation that small-cap stocks tend to be 'late-cycle' investments, outperforming when the economy is the hottest and valuations become the most stretched. Assuming that economic recovery will still be the macro-economic theme, we do not think small caps is the sector in which to be investing heavily. We prefer large-cap stocks. If one does invest in small-cap stocks, we would prefer stocks that have been unfairly penalised with apparent excessively low valuations.

Structural outlook: three-year view

Small caps may not do as well as large caps

We expect small-cap stocks to generally underperform over the next three years compared with their large-cap cousins, which tend to be stronger, better capitalised, have more disciplined managements, and are less vulnerable to small risks.

Singapore: Small Caps – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
Oceanus	OCNUS SP	4	5	3	3	2	17	Super niche-player.
Jasper	JASP SP	2	5	1	1	3	12	Pure deep-water driller.
KS Energy	KST SP	2	4	1	1	3	11	Shallow-water driller.
Cacola	CCF SP	2	2	1	3	3	11	Stable margins due to cost-plus pricing.
CWT	CWT SP	3	3	1	1	3	11	Warehouse developer, which has few competitors.
China Zaino	CZAI SP	2	3	3	1	2	11	No. 1 domestic brand of backpacks in China.
China Essence	CESS SP	2	2	4	1	1	10	Dominates the China potato-starch industry.
Koda	KODA SP	2	3	1	1	3	10	Major supplier for US furniture specialty retailers.
Man Wah	MWH SP	3	3	1	1	2	10	Large exposure to US furniture market.
Tat Hong	TAT SP	2	1	3	2	1	9	Big player in mobile cranes.
Sunvic	SVC SP	2	1	1	1	3	8	Looking for cyclical rebound of key chemical product.
Best World	BEST SP	2	2	1	1	2	8	Direct marketing company's fortunes hoping for big PRC entry.
China Lifestyle F&B	CLF SP	2	3	1	1	1	8	No. 2 jelly-dessert brand in China.
China Kangda	CKANG SP	2	2	1	2	1	8	Pricing power helps control frozen rabbit prices to EU.
SMB United	SMB SP	2	1	1	1	2	7	Exposed to Singapore property development market.
Lorenzo	LOREN SP	2	1	1	1	1	6	Niche furniture product not expected to dominate.
HTL	HWA SP	2	1	1	1	1	6	Structural problems.
Sitra	SITRA SP	2	1	1	1	1	6	Still trying to find new business model.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Oceanus

This stock is an abalone farmer. Abalone takes years to grow to full commercial size. In three years, Oceanus should have a huge number of abalone that are ready to sell and should generate significant free cash flow for the company, given that it costs close to nothing to grow abalone.

Worst-positioned: Tat Hong

The company has very long lead-times. That is, it takes time for property developers to look at industry fundamentals, plan for new property development, engineer plans and break ground. We believe Tat Hong should record strong earnings until 1H10, whereupon the last of the property developments from the bull markets of 2003-07 would have been built and the company's orderbook would have dried up.

Valuation: target and entry prices

We advise investors to pick stocks that have a good chance of riding out the cyclical downturn well

In our view, low valuation projections either mean that forecasts are far too optimistic or the stock has been unfairly sold down. We would invest in stocks that we believe have the best chance of riding out the cyclical downturn intact, if not stronger. We base our target price on the assumption that multiples regress a bit back toward the mean, but at PERs of 3-6x, we are far from expecting overly aggressive valuation levels.

Singapore: Small Caps – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (S$)	Three-year target price (S$)	Upside potential (%)	Entry price for 100% upside (S$)	2009 PER at entry price (x)	Comment
Cacola	CCF SP	0.075	0.42	463.1	0.21	0.075	Based on 3x FY10 PER.
Oceanus	OCNUS SP	0.16	0.50	212.5	0.25	0.16	Based on 4x FY10 PER.
Man Wah	MWH SP	0.17	0.51	200.0	0.255	0.17	Based on 5x FY11 (Mar FYE).
Jasper	JASP SP	0.205	0.52	155.4	0.26	0.205	Based on 6x FY11 (Mar FYE).
KS Energy	KST SP	0.655	1.59	142.5	0.795	0.655	Based on 6x FY10 PER.

Source: Daiwa

There are many small-cap stocks that we think have been oversold (eg, negative enterprise values and PERs of less than 1.0x). We assume that a cyclical reversion would cause some re-inflation of multiples back upward.

Top pick: Cacola

Cacola is very inexpensive, in our view

Assuming that China's economy does not suffer from a hard landing, then Cacola trades at what we believe are extremely low valuations. The stock trades currently at a PER of 0.9x on our FY08 EPS forecast, has a negative enterprise value, generated nearly a 50% ROE for FY07, has a dividend yield of nearly 100% for the combined next three years, has stable margins through cost-plus pricing policy, and strong free cash flow.

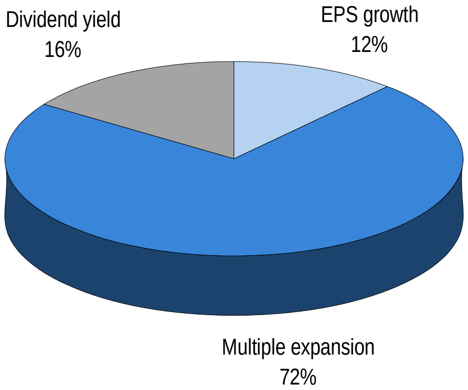
Valuation and catalysts

Either we have to be wrong or the stock should appreciate strongly

Cacola is a key example of a stock that we do not think can stay indefinitely cheap. That is, either we must be wrong about Cacola's prospects, or the stock must appreciate in value. If the stock remains at such attractive levels, we would not be surprised if the company were acquired.

Source of upside

Singapore Small Caps: Cacola – source of three-year total return



Source: Daiwa forecasts

Singapore: Small Caps – valuation summary

Company name	Stock code	Share price 12-Nov-08 (S$)	Rating	Six-month target price (S$)	+/- (%)	Year end	PER (x) 2007	PER (x) 2008E	PER (x) 2009E	PER (x) 2010E	EV/EBITDA (x) 2007	EV/EBITDA (x) 2008E	EV/EBITDA (x) 2009E	EV/EBITDA (x) 2010E	Dividend yield (%) 2007	Dividend yield (%) 2008E	Dividend yield (%) 2009E	Dividend yield (%) 2010E
Cacola	CCF SP	0.075	1	0.45	500.0	Dec	1.1	0.9	1.8	1.5	(1.1)	(1.0)	(1.8)	(1.4)	18.8	23.8	12.1	15.4
KS Energy	KST SP	0.655	2	2.35	258.8	Dec	2.1	3.3	2.5	2.5	6.4	3.9	2.7	2.4	13.7	9.2	9.2	9.2
Oceanus	OCNUS SP	0.16	1	0.535	234.4	Dec	9.5	3.6	1.5	1.3	6.5	2.8	1.1	0.9	0.0	0.0	14.1	15.9
China Zaino	CZAI SP	0.24	2	0.68	183.3	Dec	3.8	2.5	1.6	1.4	0.6	0.4	0.3	0.2	0.0	7.9	12.4	14.7
China Essence	CES SP	0.305	2	0.75	145.9	Mar	4.2	2.6	2.6	2.0	2.9	1.7	1.6	1.2	2.6	5.1	5.2	6.0
Man Wah	MWH SP	0.17	1	0.29	70.6	Mar	6.7	3.1	2.7	2.3	5.5	2.6	2.1	1.8	3.4	4.3	5.5	6.7
Jasper	JASP SP	0.205	2	0.345	68.3	Mar	27.9	n.a.	3.8	4.0	n.m.	n.m.	3.0	2.5	0.0	0.0	0.0	0.0
China Lifestyle F&B	CLF SP	0.18	5	0.22	33.3	Dec	5.2	4.5	3.8	3.2	2.3	2.0	1.7	1.5	5.5	6.2	6.3	6.4
CWT	CWT SP	0.345	4	0.46	33.3	Dec	5.1	3.1	4.0	4.7	5.1	2.7	4.0	4.5	5.8	8.7	8.7	8.7
HTL	HWA SP	0.09	5	0.12	33.3	Dec	3.7	n.a.	10.4	5.5	2.8	4.1	4.3	3.7	7.1	0.0	2.4	4.7
Lorenzo	LORENSP	0.075	2	0.09	20.0	Dec	2.3	3.6	4.0	2.7	3.2	3.3	3.3	2.8	11.3	11.3	11.3	11.3
Best World	BEST SP	0.215	4	0.24	11.6	Dec	3.3	3.4	3.3	4.1	1.2	1.3	1.3	1.4	9.3	9.3	9.3	7.4
Tat Hong	TAT SP	0.585	4	0.52	(11.1)	Mar	3.4	3.3	3.2	3.3	3.2	2.4	2.5	2.4	7.7	11.6	12.5	12.0
Sitra	SITRA SP	0.08	5	0.07	(12.5)	Dec	12.5	29.8	17.9	6.8	9.5	13.8	11.5	6.3	1.3	1.6	0.8	1.1
Koda	KODA SP	0.185	5	0.14	(24.3)	Jun	2.4	3.9	6.5	4.8	1.3	1.9	2.8	2.2	11.7	8.2	4.8	7.0
Sunvic	SVC SP	0.155	5	0.11	(29.0)	Dec	5.2	1.8	3.6	3.7	3.6	1.5	1.9	1.8	1.6	5.8	5.8	6.0

Source: Companies, Daiwa forecasts
Note: The FY08 figures are actual, rather than forecasts, for companies with non-December fiscal year ends.

Australia

Banks/Insurance – Positive

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Sector thesis: well-positioned to deal with challenges ahead

The Australian financial sector is well-positioned, in our view

We believe the Australian financial sector is well-placed to deal with the financial volatility that we expect to continue over the next 12 months, as the global financial crisis starts to have a larger impact on the local Australian economy.

We expect top-line performance to remain reasonable

The FY08 reporting season for the banks showed solid momentum in the core Australian banking business in the second half, as funding conditions eased. As a result, FY08 operating income was up 8.7% YoY. For FY09, we forecast a 5.2% YoY uplift in operating income. We expect cost growth to track above inflation, at 4.2% YoY for FY09, compared with 5.4% YoY for FY08. This would result in a lower operating leverage of one percentage point for FY09 and 0.9 of a percentage point for FY10, compared with 3.2 percentage points for FY08.

The key, in terms of profit development, will be the level of provisioning, in our view. The four major Australian banks recorded a provisioning ratio of 51 basis points for FY08 (defined as loan-loss provisioning over average gross loans) and we forecast some improvement for FY09 to 42 basis points, as we expect no repetition of the large single-name company exposure in FY09. As such, the provisioning will reflect a more broad-based deterioration in loan books as the Australian economy slows down.

Strong capital position more important than cash-EPS growth

The strong tier-1 capital-adequacy ratios of the Australian banks, of 8.0% as per FY08, position them well to deal with more challenging economic conditions, in our view. Maintaining the FY08 dividend is the basis, we believe, as banks will seek to strengthen their capital through further underwriting of their dividend-reinvestment plans above and beyond the 1H FY09 interim dividend, resulting in more earnings dilution going forward.

Structural outlook: three-year view

Major banks increasing their market share

In our view, the four major Australian banks will emerge stronger from the financial and economic crisis and be able to capture a greater part of the loan and deposit growth than their smaller counterparts, ie, the regional banks. This flight to quality will result in lower competition, as some mid-sized banks are about to be acquired by the major banks. CBA reached an agreement with HBOS regarding the acquisition of BankWest – the sixth-largest bank in Australia by gross loans – whereas Westpac is about to acquire St George – the fifth-largest bank by gross loans in November 2008. As a result, the concentration ratio will increase from 70% to 79%, based on gross loans (according to September 2008 data from the Australian Prudential Regulatory Authority).

In the insurance sector, we believe QBE might look for further opportunities to enhance its position in Australia, in particular in personal lines. Depending on the successful execution of the portfolio change of IAG under its new CEO, Michael Wilkins, we do not rule out that QBE will show renewed interest in IAG.

Australia: Banks/Insurance – structural scoreboard

Stock name	Stock code	Mgt	Product demand	Market share	Pricing power	Margin outlook	Total	Comment
CBA	CBA AU	4	4	5	5	3	21	Defensive play, strong management and sector consolidator.
Westpac	WBC AU	5	4	4	5	3	21	Defensive play, strong management and sector consolidator.
ANZ	ANZ AU	4	4	4	5	3	20	In a transition stage, with restructuring of its institutional division.
IAG	IAG AU	3	4	5	5	3	20	Portfolio changes under new management (CEO) take time.
NAB	NAB AU	4	4	4	5	3	20	Changeover of CEO could result in a different strategic direction.
QBE	QBE AU	5	4	4	4	3	20	Strong track record, management succession, and strategy are key.

Source: Daiwa
Note: rating scale of 1 to 5, with 5 being the highest

Best-positioned: Westpac

In our opinion, Westpac is the best-positioned among the Australian financials for four reasons:

1) Strong management team, with Mrs. Gail Kelly in a strong position to successfully lead the integration of St George, having been the CEO of St George for five years, prior to joining Westpac as CEO in February 2008.
2) High-quality loan book, with balanced exposure to consumer and business customers.
3) Strong risk-management framework.
4) Focus on Australia and New Zealand, and on superannuation, which offers a more defensive growth profile.

Worst-positioned: IAG

Among the less strongly positioned stocks, we believe IAG ranks the least favourably. This is because of its business mix, with exposure to the UK and commercial lines in Australia, which we believe are fundamentally high-risk, low-return franchises compared with the personal lines in Australia.

Valuation: target and entry prices

We do not expect share prices to double

Although we believe the Australian banking stocks are relatively attractive, trading at a 22% discount to their 10-year historical PER, we do not see any catalysts that could warrant a doubling of share prices over the next three years. In our opinion, the volatility in banking stocks will continue throughout FY09 and into the first half of FY10, as the global economic crisis affects banks' performances, not only through increasing bad debt, but also through lower top-line growth. Despite the fact that the Australian banks are well-placed in an international context in terms of their earnings mix, capital position and lending portfolios, they are affected by short-term negative sentiment surrounding the financial stocks.

Australia: Banks/Insurance – target and entry prices

Stock name	Stock code	Share price 12-Nov-08 (A$)	Three-year target price (A$)	Upside potential (%)	Entry price for 100% upside (A$)	2009 PER at entry price (x)	Comment
ANZ	ANZ AU	15.40	22.70	47.4	11.35	6.5	Warranted equity valuation.
NAB	NAB AU	19.93	29.30	47.0	14.65	5.6	Warranted equity valuation.
Westpac	WBC AU	19.10	26.10	36.6	13.05	6.5	Warranted equity valuation.
CBA	CBA AU	35.10	45.60	29.9	22.80	6.7	Warranted equity valuation.
QBE	QBE AU	27.29	31.10	14.0	15.55	7.8	PV insurance result and NTA.
IAG	IAG AU	4.04	4.60	13.9	2.30	9.5	PV insurance result and NTA.

Source: Daiwa

Top pick: ANZ

We think ANZ has the most share-price upside potential

Our top pick within the financial sector is ANZ, which offers upside potential of 47.4% from the current share price. The stock has been weighed down heavily over the past six-to-12 months due to an almost four-fold increase in loan-loss provisioning, reflecting the higher single-name exposure of ANZ, as well as its involvement in margin lending. In our opinion, the company will show stronger growth than its peers on a three-year time frame due to: 1) to a sharp decline in provisioning ratios, 2) an earnings pick-up in the institutional division following the restructuring, 3) the New Zealand economy recovering from its recession, and 4) stronger growth from Asia.

Valuation and catalysts

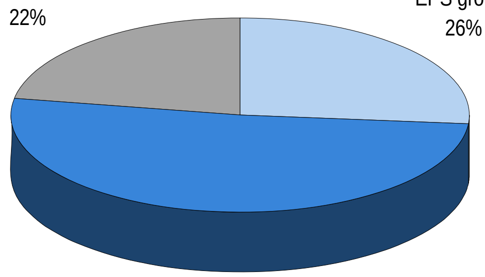
Hard to find any catalysts

Over the past ten years the major Australian banks have traded at an average PER of 13.7x. With the same banks trading now at 9.1x on average, the sector has clearly suffered a major setback amidst a more gloomy global outlook for financial stocks. To arrive at the entry price for 100% upside, the Australian banking stocks would need to fall to an average PER of 6.3x, or by about 30%.

In our opinion, there will be continued high volatility for the next 12-to-18 months for the Australian banks coupled with increasing uncertainty surrounding loan-loss provisioning charges and capital adequacy. As such, we see no real positive catalysts for the sector at large in the short-to-medium term. From a valuation-point-of-view and taking a longer-term view, current levels look relatively attractive with many uncertainties priced in. However, the global financial crisis has only just started to have an impact on the Australian banking sector and the future looks more uncertain than ever before.

Source of upside

Australia Banks: ANZ – source of three-year total return



Source: Daiwa estimates

Australia: Banks/Insurance – valuation summary

Company name	Stock code	Share price 12-Nov-08 (A$)	Rating	Six-month target price (A$)	+/- (%)	Year end	PER (x) 2008	PER (x) 2009E	PER (x) 2010E	EPS growth (% YoY) 2008	EPS growth (% YoY) 2009E	EPS growth (% YoY) 2010E	PBR (x) 2008	PBR (x) 2009E	ROE (%) 2008	ROE (%) 2009E	Yield (% p.a.) 2008	Yield (% p.a.) 2009E
ANZ	ANZ AU	15.4	3	18.2	18.2	Sep	12.1	8.9	8.2	(26.2)	11.9	8.8	1.5	1.2	14.6	15.2	7.3	8.8
NAB	NAB AU	19.93	3	25.2	26.4	Sep	10.2	7.6	7.0	(11.8)	9.6	9.4	1.5	1.2	14.3	13.2	8.0	9.7
Westpac	WBC AU	19.1	2	23.9	25.1	Sep	10.8	9.5	9.0	4.7	1.9	5.1	2.3	1.8	22.3	20.4	6.6	7.6
CBA	CBA AU	35.1	3	42.7	21.7	Jun	11.3	10.3	9.5	2.8	(4.1)	8.2	2.2	1.7	18.5	16.9	6.6	7.6
QBE	QBE AU	27.29	1	28.9	5.9	Dec	14.5	13.8	13.3	(16.5)	5.2	3.3	2.6	2.5	18.9	18.5	4.5	4.5
IAG	IAG AU	4.04	4	4.2	4.0	Jun	n.a.	16.8	17.0	n.a.	n.a.	(1.2)	1.6	1.8	(4.5)	10.7	6.5	4.7

Source: Companies, Daiwa estimates
Note: 2008 data are based on Daiwa forecasts for QBE, all others are actual.

Appendix I

Economic statistics

Real GDP (% YoY)

		Taiwan	Korea	Hong Kong*	Singapore	Thailand	Malaysia	Indonesia	Philippines	China	India	Australia	Japan#	US#
	1998	4.5	(6.9)	(6.0)	(1.4)	(10.5)	(7.4)	(13.1)	(0.6)	7.8	6.0	5.1	(2.1)	4.2
	1999	5.7	9.5	2.6	7.2	4.4	6.1	0.8	3.4	7.6	7.1	4.3	(0.1)	4.5
	2000	5.8	8.5	8.0	10.1	4.8	8.9	4.9	6.0	8.4	4.0	3.5	2.9	3.7
	2001	(2.2)	3.8	0.5	(2.4)	2.2	0.5	3.6	1.8	8.3	5.2	2.1	0.2	0.8
	2002	4.6	7.0	1.8	4.2	5.3	5.4	4.5	4.4	9.1	3.8	4.2	0.3	1.6
	2003	3.5	3.1	3.0	3.5	7.0	5.8	4.8	4.9	10.0	8.4	3.0	1.4	2.5
	2004	6.2	4.7	8.5	9.0	6.2	6.8	5.1	6.4	10.1	8.3	3.9	2.7	3.6
	2005	4.2	4.2	7.1	7.3	4.5	5.3	5.6	4.9	10.4	9.2	2.8	1.9	2.9
	2006	4.9	5.1	7.0	8.2	5.0	5.8	5.5	5.4	11.6	9.7	2.7	2.4	2.8
	2007	5.7	5.0	6.3	7.7	4.8	6.3	6.3	7.3	11.9	9.0	4.2	2.2	2.0
2004	1Q	8.0	5.4	7.7	9.1	6.7	8.2	4.1	7.2	10.4	8.9	4.4	4.5	3.0
	2Q	9.2	5.7	12.0	12.6	6.4	8.0	4.4	7.1	11.4	8.3	4.8	(1.0)	3.5
	3Q	5.4	4.7	6.6	7.6	6.3	6.4	4.6	5.6	9.7	8.6	3.9	2.0	3.6
	4Q	2.5	3.3	7.9	7.0	5.3	4.9	7.1	5.8	8.9	6.1	2.4	(1.0)	2.6
2005	1Q	2.2	2.7	6.2	4.2	3.2	5.4	6.3	4.5	10.5	10.3	2.2	2.6	3.0
	2Q	3.1	3.2	7.1	6.9	4.6	4.3	5.6	5.1	10.5	8.9	2.9	4.3	2.6
	3Q	4.4	4.5	8.1	8.9	5.4	5.6	5.6	4.7	10.2	8.3	2.8	2.7	3.9
	4Q	6.9	5.3	7.0	9.1	4.7	5.9	4.9	5.4	10.4	9.0	3.3	2.0	1.3
2006	1Q	5.1	6.3	9.0	10.4	6.1	6.1	5.0	5.6	11.4	10.6	3.3	1.7	4.8
	2Q	5.1	5.1	6.2	8.2	5.0	6.0	5.0	5.5	12.6	8.0	2.4	3.0	2.7
	3Q	5.3	4.6	6.4	7.4	4.7	5.9	5.5	5.1	11.4	10.9	2.6	1.8	0.8
	4Q	4.1	4.0	6.6	7.0	4.2	5.4	6.1	5.5	11.0	9.6	2.7	3.7	1.5
2007	1Q	4.2	4.0	5.5	7.0	4.3	5.5	6.1	7.0	11.7	10.3	3.8	3.5	0.1
	2Q	5.2	5.0	6.2	9.1	4.4	5.7	6.4	8.3	12.7	9.2	4.2	(1.2)	4.8
	3Q	6.9	5.2	6.8	9.5	4.9	6.8	6.5	7.1	12.2	9.2	4.5	2.3	4.8
	4Q	6.5	5.7	6.9	5.4	5.7	7.3	6.3	6.4	11.0	8.9	4.2	1.8	(0.2)
2008	1Q	6.3	5.8	7.3	6.9	6.1	7.1	6.3	4.7	10.6	8.8	3.3	2.5	0.9
	2Q	4.3	4.8	4.2	2.1	5.3	6.3	6.4	4.6	10.2	7.9	2.7	(3.7)	2.8
	3Q		3.9	1.7				6.1		8.9			(0.4)	(0.3)
	4Q													

Source: CEIC, Daiwa, Datastream, Bloomberg
Annualised QoQ (seasonally adjusted)
* Figures from 2001 have been revised to incorporate the new data released by the Hong Kong Tourism Board on destination consumption expenditure of incoming visitors and travellers

CPI (% YoY)

		Taiwan	Korea	Hong Kong	Singapore	Thailand	Malaysia	Indonesia	Philippines	China	India	Australia	Japan	US#
	1998	1.7	7.5	2.9	(0.3)	8.1	5.1	58.0	9.7	(0.8)	13.1	0.9	0.7	1.5
	1999	0.2	0.8	(3.9)	0.0	0.3	2.8	20.7	6.7	(1.4)	3.4	1.5	(0.3)	2.2
	2000	1.3	2.3	(3.7)	1.3	1.6	1.6	3.8	4.3	0.4	3.8	4.5	(0.7)	3.4
	2001	0.0	4.1	(1.6)	1.0	1.7	1.4	11.5	6.1	0.7	4.3	4.4	(0.8)	2.8
	2002	(0.2)	2.8	(3.0)	(0.4)	0.6	1.8	11.9	2.9	(0.8)	4.0	3.0	(0.9)	1.6
	2003	(0.3)	3.5	(2.6)	0.5	1.8	1.1	6.8	3.5	1.2	3.9	2.8	(0.2)	2.3
	2004	1.6	3.6	(0.4)	1.7	2.8	1.4	6.1	6.0	3.9	3.8	2.3	0.0	2.7
	2005	2.3	2.8	0.9	0.5	4.5	3.1	10.5	7.7	1.8	4.0	2.7	(0.3)	3.4
	2006	0.6	2.3	2.0	1.0	4.6	3.6	13.1	6.3	1.5	6.3	3.5	0.2	3.2
	2007	1.8	2.5	2.0	2.1	2.2	2.0	6.4	2.8	4.8	6.4	2.3	0.1	2.9
2004	1Q	0.5	3.2	(1.8)	1.2	1.9	0.9	4.8	4.1	2.8	4.0	2.0	(0.1)	1.8
	2Q	1.2	3.4	(0.9)	1.9	2.7	1.2	6.4	4.7	4.4	2.7	2.5	(0.3)	2.8
	3Q	2.9	4.3	0.8	1.9	3.3	1.5	6.7	6.9	5.3	4.2	2.3	(0.1)	2.7
	4Q	1.8	3.4	0.4	1.7	3.2	2.1	6.3	8.1	3.2	4.2	2.6	0.5	3.4
2005	1Q	1.6	3.1	0.4	0.3	2.8	2.4	7.8	8.5	2.8	4.2	2.4	0.0	3.0
	2Q	2.1	3.0	0.7	0.1	3.7	3.0	7.6	8.2	1.7	4.0	2.5	(0.1)	2.9
	3Q	3.0	2.4	1.2	0.5	5.6	3.4	8.4	7.1	1.3	3.7	3.0	(0.3)	3.8
	4Q	2.5	2.5	1.3	1.1	6.0	3.4	17.8	6.9	1.4	5.0	2.8	(0.7)	3.8
2006	1Q	1.3	2.4	1.6	1.4	5.7	3.7	16.9	7.3	1.2	5.0	3.0	(0.1)	3.7
	2Q	1.5	2.3	2.1	1.2	6.0	4.1	15.5	6.9	1.4	6.4	4.0	0.2	3.9
	3Q	(0.3)	2.5	2.3	0.7	3.6	3.6	14.9	6.1	1.3	6.6	3.9	0.6	3.3
	4Q	(0.1)	2.1	2.1	0.6	3.3	3.0	6.1	4.8	2.0	7.0	3.3	0.3	2.0
2007	1Q	1.0	2.0	1.7	0.5	2.5	2.6	6.4	2.9	2.7	7.0	2.4	(0.1)	2.4
	2Q	0.3	2.5	1.3	1.0	1.9	1.5	6.0	2.4	3.6	6.3	2.1	(0.1)	2.6
	3Q	1.5	2.3	1.6	2.7	1.6	1.8	6.5	2.5	6.1	6.7	1.9	(0.1)	2.4
	4Q	4.5	3.4	3.5	4.1	2.9	2.2	6.7	3.3	6.6	5.5	3.0	0.5	4.0
2008	1Q	3.6	3.8	4.6	6.6	5.0	2.6	7.6	5.5	8.0	6.3	4.2	1.0	4.2
	2Q	4.2	4.9	5.7	7.5	7.6	4.9	10.1	9.8	7.8	7.8	4.5	1.4	4.3
	3Q	4.5	5.5	4.6	6.6	7.2	8.4	12.0	12.2	5.3	9.1	5.0	2.2	5.3
	4Q													

Source: CEIC, Datastream, Daiwa
Seasonally adjusted

Unemployment rates (%)

		Taiwan	Korea	Hong Kong	Singapore*	Thailand	Malaysia	Indonesia	Philippines	China	Australia
	1998	2.7	7.0	4.4	2.5	4.4	3.2	5.5	10.3	3.1	7.7
	1999	2.9	5.2	6.3	2.8	4.2	3.4	6.4	9.9	3.1	6.9
	2000	3.0	4.4	5.1	2.7	3.6	3.0	6.1	11.7	3.1	6.3
	2001	4.6	4.0	4.9	2.7	3.3	3.5	8.1	10.9	3.6	6.8
	2002	5.2	3.3	7.2	3.6	2.4	3.5	9.1	11.5	4.0	6.4
	2003	5.0	3.6	7.9	4.0	2.2	3.6	9.5	11.5	4.3	5.9
	2004	4.4	3.7	6.9	3.4	2.1	3.5	9.9	11.9	4.2	5.4
	2005	4.1	3.7	5.7	3.1	1.9	3.5	11.2	11.2	4.2	5.1
	2006	3.9	3.5	4.8	2.7	1.5	3.3	10.3	9.7	4.1	4.8
	2007	3.9	3.3	4.1	2.1	1.4	3.2	9.1	7.3	4.0	4.4
2004	1Q	4.5	4.1	7.3	4.5	2.8	3.8		13.7		5.7
	2Q	4.4	3.5	6.9	3.6	2.5	3.7		11.7		5.6
	3Q	4.6	3.6	6.7	3.0	1.6	3.4		10.9		5.6
	4Q	4.2	3.6	6.7	3.0	1.5	3.3		11.3		5.2
2005	1Q	4.2	4.2	6.2	3.3	2.6	3.5		12.7		5.1
	2Q	4.1	3.6	5.8	3.4	2.0	3.1		10.9		5.1
	3Q	4.3	3.6	5.6	2.9	1.4	3.8		10.3		5.0
	4Q	4.0	3.5	5.3	2.6	1.5	3.8		10.7		5.2
2006	1Q	3.9	3.9	5.1	2.2	1.9	3.8		11.8		5.2
	2Q	3.9	3.4	4.9	3.4	1.7	3.4		11.7		5.0
	3Q	4.0	3.3	4.8	2.4	1.2	3.1		8.0		4.8
	4Q	3.9	3.3	4.5	2.6	1.3	3.0		7.3		4.6
2007	1Q	3.8	3.6	4.3	2.5	1.6	3.4		7.8		4.5
	2Q	3.9	3.3	4.3	2.9	1.6	3.4		7.4		4.3
	3Q	4.0	3.1	4.1	1.5	1.2	3.1		7.8		4.3
	4Q	3.9	3.0	3.6	1.6	1.1	3.0		6.3		4.4
2008	1Q	3.9	3.4	3.4	1.8	1.6	3.6		7.4		4.0
	2Q	3.9	3.1	3.3	2.8	1.4	3.5		8.0		4.3
	3Q	4.2	3.1	3.5	1.9				7.4		4.2
	4Q										

Source: CEIC, Datastream, Daiwa
* Seasonally adjusted

External balance I

		Taiwan			Korea			Hong Kong*		
		Current account (US$m)	Export % YoY	Import	Current account (US$m)	Export % YoY	Import	Current account (US$m)	Export % YoY	Import
	1998	3,436	(9.4)	(8.5)	40,371	(2.8)	(35.5)	2,507	(7.5)	(11.5)
	1999	7,993	10.0	5.8	24,522	8.6	28.4	10,250	0.0	(2.7)
	2000	8,899	22.0	26.5	12,251	19.9	34.0	6,993	16.1	18.6
	2001	18,936	(17.2)	(23.4)	8,033	(12.7)	(12.1)	9,784	(5.9)	(5.4)
	2002	26,357	6.3	4.9	5,394	8.0	7.8	12,411	5.4	3.3
	2003	30,504	10.4	13.1	11,950	19.3	17.6	16,468	11.8	11.8
	2004	19,728	20.7	31.9	28,174	31.0	25.5	15,729	15.8	16.7
	2005	17,578	8.8	8.2	14,981	12.0	16.4	20,178	11.6	10.5
	2006	26,300	12.5	11.0	5,385	14.4	18.4	22,936	9.4	11.6
	2007	32,979	10.3	8.3	5,955	14.2	15.3	28,037	8.8	10.0
2004	1Q	6,147	22.3	31.2	6,418	37.8	19.4	1,172	13.3	16.1
	2Q	5,865	28.8	39.7	6,857	38.9	32.5	578	17.7	22.0
	3Q	5,669	21.5	31.9	7,565	28.9	27.3	6,526	17.0	18.1
	4Q	2,047	11.9	26.1	7,333	21.2	23.6	7,454	14.9	11.4
2005	1Q	4,700	7.8	12.6	5,264	12.7	14.8	5,236	10.3	7.8
	2Q	2,026	6.0	10.6	2,352	9.0	15.2	4,481	12.6	10.2
	3Q	1,293	7.1	9.8	2,198	15.4	21.1	4,557	13.0	11.9
	4Q	9,559	14.2	0.9	5,167	11.4	14.6	5,907	10.4	11.6
2006	1Q	5,898	11.8	9.3	(1,978)	10.6	19.7	5,628	12.8	14.3
	2Q	4,944	13.7	9.8	235	16.9	19.9	2,404	5.6	8.2
	3Q	6,643	17.9	14.9	1,017	16.4	21.2	7,730	8.2	10.5
	4Q	8,815	7.2	9.9	6,111	14.4	13.1	7,165	11.5	13.6
2007	1Q	9,410	8.2	3.0	(1,662)	14.8	13.1	8,249	8.3	8.3
	2Q	5,265	6.6	7.2	34	14.2	14.3	3,297	11.1	12.1
	3Q	6,015	10.0	9.0	4,430	9.6	7.0	8,351	7.8	9.0
	4Q	11,183	15.8	13.3	3,152	18.2	25.8	8,149	8.3	10.6
2008	1Q	8,495	17.8	26.2	(5,213)	17.4	28.8	6,640	10.7	11.8
	2Q	5,265	19.1	19.3	(134)	23.2	30.5	4,405	8.2	9.4
	3Q		8.0	20.3	(8,449)	27.3	43.0		5.6	6.9
	4Q									

Source: CEIC, Daiwa
Note: YoY % change: US$ base
* The Census and Statistics Department has compiled and disseminated the Current Account of Hong Kong starting from the reference year of 1997

External balance II

		Singapore			Thailand*			Malaysia		
		Current account (US$m)	Export % YoY	Import % YoY	Current account (US$m)	Export % YoY	Import % YoY	Current account (US$m)	Export % YoY	Import % YoY
	1998	18,301	(11.9)	(23.2)	14,291	(6.8)	(33.0)	9,552	(6.9)	(26.2)
	1999	14,361	4.3	9.2	12,466	7.4	17.7	12,604	15.6	12.3
	2000	10,721	20.1	21.1	9,328	19.3	24.6	8,487	16.1	25.4
	2001	10,700	(11.7)	(13.8)	5,114	(6.6)	(0.7)	7,286	(10.4)	(10.0)
	2002	11,153	2.9	0.4	4,685	4.6	4.0	8,025	6.9	8.2
	2003	21,579	27.8	17.0	4,784	17.4	16.8	13,322	11.3	4.4
	2004	18,250	24.2	27.4	2,767	20.6	25.3	15,080	21.0	26.3
	2005	22,244	15.6	15.3	(7,642)	15.0	25.7	20,690	11.3	9.0
	2006	29,798	18.4	19.4	2,315	16.9	9.0	25,525	14.0	14.5
	2007	39,073	10.1	10.3	14,049	17.3	8.7	29,256	9.7	12.1
2004	1Q	3,515	18.2	22.1	1,123	19.2	25.8	3,933	17.7	23.1
	2Q	3,971	27.6	31.6	(428)	21.8	33.7	3,373	22.7	32.4
	3Q	5,474	28.5	32.9	264	23.2	27.5	4,149	27.8	31.7
	4Q	5,289	22.6	23.3	1,808	18.3	15.9	3,624	15.9	18.7
2005	1Q	4,100	15.5	15.9	(2,361)	12.7	28.1	6,029	13.5	10.6
	2Q	5,411	13.9	13.3	(5,431)	13.6	34.2	4,896	10.4	8.1
	3Q	6,968	14.5	14.3	189	22.1	20.9	5,057	8.2	9.0
	4Q	5,765	18.4	17.5	(39)	11.4	20.0	4,709	13.5	8.5
2006	1Q	7,100	23.0	19.8	753	16.7	6.7	5,457	13.7	15.9
	2Q	7,172	22.4	23.5	(2,273)	15.7	3.3	4,941	14.2	16.3
	3Q	7,413	19.0	21.8	1,240	15.7	13.4	7,448	17.1	14.6
	4Q	8,114	10.5	12.9	2,595	19.5	12.7	7,678	11.2	11.4
2007	1Q	9,731	9.8	8.7	4,306	17.2	3.7	5,609	7.7	12.5
	2Q	9,807	7.2	6.6	788	17.7	7.3	7,316	7.7	8.2
	3Q	12,043	8.5	4.8	2,777	11.3	7.9	8,482	6.9	8.1
	4Q	7,492	14.9	20.8	6,177	23.0	15.4	7,849	16.0	19.7
2008	1Q	7,050	21.3	32.1	2,689	20.9	38.1	7,376	19.2	15.8
	2Q	6,236	26.4	35.5	(1,016)	25.2	29.7	11,544	28.9	17.3
	3Q		21.0	32.7	(2,461)	25.2	39.9		21.3	14.5
	4Q									

Source: CEIC, Daiwa
Note: YoY % change: US$ base
* Customs basis for both exports and imports

External balance III

		Indonesia			China			India			Australia*		
		Current account (US$m)	Export % YoY	Import % YoY	Current account (US$m)	Export % YoY	Import % YoY	Current account (US$m)	Export % YoY	Import % YoY	Current account (US$m)	Export % YoY	Import % YoY
	1998	4,097	(8.6)	(34.4)	29,324	0.5	(1.5)	(4,038)	(5.1)	2.4	(17,569)	(10.4)	(0.9)
	1999	5,783	(0.4)	(12.2)	15,667	6.1	18.2	(4,698)	10.9	17.2	(21,292)	0.0	7.5
	2000	7,992	27.7	39.6	20,519	27.9	35.8	(2,666)	19.5	0.8	(14,837)	13.2	2.7
	2001	6,900	(9.3)	(7.6)	17,405	7.0	8.2	3,400	(0.8)	1.3	(7,098)	(0.9)	(10.2)
	2002	7,823	1.5	1.1	35,422	22.1	21.2	6,345	17.6	18.6	(15,720)	3.6	15.2
	2003	8,105	6.8	4.0	45,875	34.6	39.9	14,083	22.5	27.6	(28,950)	8.8	22.5
	2004	1,564	17.2	42.9	68,659	35.4	35.8	(2,470)	26.2	38.8	(38,541)	22.8	22.3
	2005	277	19.7	24.0	160,818	28.4	17.7	(9,902)	29.9	39.9	(41,364)	21.9	13.8
	2006	10,835	17.7	5.8	249,866	27.2	19.9	(9,766)	21.8	20.0	(40,340)	17.1	12.5
	2007	10,402	13.1	21.8	371,833	25.7	20.8	(17,403)	23.5	31.1	(56,485)	14.2	18.5
2004	1Q	(1,992)	(0.7)	21.8		34.1	42.1	7,357	38.3	34.9	(8,824)	17.0	23.3
	2Q	973	9.7	40.8		37.1	42.9	3,608	35.6	36.6	(8,175)	23.8	16.8
	3Q	2,038	27.7	55.8		34.7	30.1	(4,430)	29.1	39.8	(9,875)	25.5	24.0
	4Q	544	32.1	53.5		35.6	30.4	(5,754)	24.5	35.6	(11,667)	22.8	22.7
2005	1Q	209	32.2	33.1		34.7	12.2	4,106	19.4	42.9	(11,704)	16.8	34.0
	2Q	436	24.2	38.3		30.9	16.0	(4,794)	34.7	55.1	(9,209)	27.2	29.0
	3Q	(1,165)	12.0	22.8		29.1	19.6	(4,684)	33.4	52.9	(10,109)	24.0	19.3
	4Q	797	13.9	6.3		21.7	22.1	(4,913)	23.2	27.7	(10,343)	18.6	5.3
2006	1Q	2,949	12.9	(1.9)		26.5	24.9	4,489	29.5	29.2	(9,316)	17.5	(5.6)
	2Q	1,959	17.2	4.8		24.0	18.5	(4,065)	23.3	12.4	(9,789)	15.4	6.8
	3Q	3,772	21.0	8.5		28.7	22.0	(6,275)	30.2	24.1	(9,579)	18.7	5.3
	4Q	2,155	18.2	10.7		28.9	15.5	(3,678)	20.1	32.1	(11,656)	18.4	17.4
2007	1Q	2,597	13.9	17.0		27.9	18.2	4,252	15.1	12.5	(11,947)	17.4	16.6
	2Q	2,274	15.6	16.1		27.4	18.2	(6,301)	20.7	38.2	(13,793)	13.6	14.1
	3Q	2,142	9.4	19.6		26.2	20.7	(4,944)	17.5	19.6	(14,195)	12.6	20.3
	4Q	3,389	14.1	34.7		22.2	25.4	(5,117)	33.0	27.7	(16,549)	14.6	23.7
2008	1Q	2,328	31.9	49.3		21.4	28.6	(1,041)	31.5	48.0	(18,340)	23.3	31.9
	2Q	(1,477)	29.6	59.3		22.4	32.4	(10,724)	31.9	34.6	(12,148)	40.0	34.2
	3Q		27.8	50.5		23.0	25.7		22.9	47.7		43.0	24.9
	4Q												

Source: CEIC, Datastream, Daiwa
Note: YoY % change: US$ base
* Exports (FOB) and imports (FOB)

Stock-market indices

		Taiwan TWSE	Korea KOSPI	Hong Kong HSI	Singapore STI	Thailand SET	Malaysia KLCI	Indonesia JCI	Philippines PCOMP	China SHASHR	India SENSEX	Australia ASX200
	1998	6,418.4	562.5	10,048.6	1,392.7	355.8	586.1	398.0	1,968.8	1,219.6	3,740.0	2,717.6
	1999	8,448.8	1,028.1	16,962.1	2,479.6	481.9	812.3	676.9	2,143.0	1,451.9	5,001.3	3,117.7
	2000	4,739.1	504.6	15,095.5	1,926.8	269.2	679.6	416.3	1,494.5	2,192.4	3,604.4	3,206.2
	2001	5,551.2	693.7	11,397.2	1,623.6	303.9	696.1	392.0	1,168.1	1,712.5	3,469.4	3,422.3
	2002	4,452.5	627.6	9,321.3	1,341.1	356.5	646.3	425.0	1,018.4	1,419.1	3,048.7	3,046.0
	2003	5,890.7	810.7	12,575.9	1,764.5	772.2	793.9	691.9	1,442.4	1,569.1	5,590.6	3,299.8
	2004	6,139.7	895.9	14,230.1	2,066.1	668.1	907.4	1,000.2	1,822.8	1,330.2	6,492.8	4,050.6
	2005	6,548.3	1,379.4	14,876.4	2,347.3	713.7	899.8	1,162.6	2,096.0	1,220.9	11,280.0	4,763.4
	2006	7,823.7	1,434.5	19,964.7	2,985.8	679.8	1,096.2	1,805.5	2,982.5	2,815.1	13,072.1	5,669.9
	2007	8,506.3	1,897.1	27,812.7	3,482.3	858.1	1,445.0	2,745.8	3,621.6	5,521.5	20,287.0	6,339.8
2004	1Q	6,522.2	880.5	12,681.7	1,858.9	647.3	901.9	735.7	1,424.3	1,826.5	5,590.6	3,415.3
	2Q	5,839.4	785.8	12,285.8	1,838.0	646.6	819.9	732.4	1,579.4	1,468.8	4,795.5	3,532.9
	3Q	5,845.7	835.1	13,120.0	1,984.7	644.7	850.0	820.1	1,761.6	1,465.2	5,583.6	3,665.0
	4Q	6,139.7	895.9	14,230.1	2,066.1	668.1	907.4	1,000.2	1,822.8	1,330.2	6,602.7	4,050.6
2005	1Q	6,005.9	965.7	13,516.9	2,141.4	681.5	871.4	1,080.2	1,954.7	1,239.3	6,492.8	4,109.9
	2Q	6,241.9	1,008.2	14,201.1	2,212.7	675.5	888.3	1,122.4	1,924.2	1,135.1	7,193.9	4,277.5
	3Q	6,118.6	1,221.0	15,428.5	2,305.1	723.2	927.5	1,079.3	1,942.1	1,214.0	8,634.5	4,641.2
	4Q	6,548.3	1,379.4	14,876.4	2,347.3	713.7	899.8	1,162.6	2,096.0	1,220.9	9,397.9	4,763.4
2006	1Q	6,614.0	1,359.6	15,805.0	2,533.4	733.3	926.6	1,323.0	2,196.0	1,361.3	11,280.0	5,129.7
	2Q	6,704.4	1,295.2	16,267.6	2,435.4	678.1	914.7	1,310.3	2,178.8	1,758.1	10,609.3	5,073.9
	3Q	6,883.1	1,371.4	17,543.1	2,568.9	686.1	967.6	1,534.6	2,556.7	1,840.3	12,454.4	5,154.1
	4Q	7,823.7	1,434.5	19,964.7	2,985.8	679.8	1,096.2	1,805.5	2,982.5	2,815.1	13,786.9	5,669.9
2007	1Q	7,884.4	1,452.6	19,800.9	3,231.2	673.7	1,246.9	1,830.9	3,203.6	3,346.4	13,072.1	5,995.0
	2Q	8,883.2	1,743.6	21,772.7	3,548.2	777.7	1,354.4	2,139.3	3,665.2	4,010.0	14,650.5	6,274.9
	3Q	9,476.5	1,946.5	27,142.5	3,706.2	845.5	1,336.3	2,359.2	3,572.9	5,827.7	17,291.1	6,567.8
	4Q	8,506.3	1,897.1	27,812.7	3,482.3	858.1	1,445.0	2,745.8	3,621.6	5,521.5	20,287.0	6,339.8
2008	1Q	8,572.6	1,704.0	22,849.2	3,007.4	817.0	1,247.5	2,447.3	2,984.7	3,643.2	15,644.4	5,355.7
	2Q	7,523.5	1,674.9	22,102.0	2,947.5	768.6	1,186.6	2,349.1	2,460.0	2,869.9	13,461.6	5,215.3
	3Q	5,719.3	1,448.1	18,016.2	2,358.9	596.5	1,018.7	1,832.5	2,569.7	2,408.9	12,860.4	4,600.5
	4Q											

Source: CEIC, Daiwa

Interest rates (%)

		Taiwan Re-discount rate	Korea Base rate	Hong Kong Interbank 3 mth	Singapore Interbank 3 mth	Thailand Re-purchasing rate (14day)	Malaysia Overnight policy rate*	Indonesia SBI rate 30 days	Philippines Interbank 3 mth	China Base rate 1 year	India Repo rate	Australia Official cash rate
	1998	4.75		5.06	1.88	4.00	5.41	38.44	15.69	6.39		4.75
	1999	4.50	4.75	5.69	2.75	1.25	2.52	12.51	11.00	5.85		5.00
	2000	4.63	5.25	5.75	2.81	1.50	2.82	14.53	16.70	5.85	10.00	6.25
	2001	2.13	4.00	1.88	1.31	2.25	2.76	17.62	13.05	5.85	8.50	4.25
	2002	1.63	4.25	1.41	0.81	1.75	2.79	12.93	6.99	5.31	7.50	4.75
	2003	1.38	3.75	0.07	0.75	1.25	2.71	8.31	8.09	5.31	7.00	5.25
	2004	1.75	3.25	0.28	1.44	2.00	2.70	7.43	7.47	5.58	6.00	5.25
	2005	2.25	3.75	4.16	3.25	4.00	3.00	12.75	7.76	5.58	6.25	5.50
	2006	2.75	4.50	3.84	3.44	5.00	3.50	9.75	6.56	6.12	7.25	6.25
	2007	3.38	5.00	3.31	2.38	3.25	3.50	8.00	6.62	7.47	7.75	6.75
2004	1Q	1.38	3.75	0.07	0.75	1.25	2.70	7.42	8.69	5.31	6.00	5.25
	2Q	1.38	3.75	0.41	0.75	1.25	2.70	7.34	7.84	5.31	6.00	5.25
	3Q	1.38	3.50	1.06	1.44	1.50	2.70	7.39	7.43	5.31	6.00	5.25
	4Q	1.75	3.25	0.28	1.44	2.00	2.70	7.43	7.47	5.58	6.00	5.25
2005	1Q	1.88	3.25	2.66	2.13	2.25	2.70	7.44	6.12	5.58	6.00	5.50
	2Q	1.88	3.25	3.31	2.06	2.50	2.70	8.25	6.28	5.58	6.00	5.50
	3Q	2.13	3.25	4.13	2.38	3.25	2.70	10.00	8.38	5.58	6.00	5.50
	4Q	2.25	3.75	4.16	3.25	4.00	3.00	12.75	7.76	5.58	6.25	5.50
2006	1Q	2.38	4.00	4.41	3.44	4.50	3.25	12.75	7.18	5.58	6.50	5.50
	2Q	2.50	4.25	4.49	3.56	5.00	3.50	12.50	8.02	5.85	6.75	5.75
	3Q	2.63	4.50	4.12	3.44	5.00	3.50	11.25	7.35	6.12	7.00	6.00
	4Q	2.75	4.50	3.84	3.44	5.00	3.50	9.75	6.56	6.12	7.25	6.25
2007	1Q	2.88	4.50	4.12	2.94	4.50	3.50	9.00	5.44	6.39	7.50	6.25
	2Q	3.13	4.50	4.42	2.50	3.50	3.50	8.50	6.29	6.57	7.75	6.25
	3Q	3.25	5.00	5.06	2.50	3.25	3.50	8.25	7.00	7.29	7.75	6.50
	4Q	3.38	5.00	3.31	2.38	3.25	3.50	8.00	6.62	7.47	7.75	6.75
2008	1Q	3.50	5.00	1.90	1.38	3.25	3.50	7.96	6.48	7.47	7.75	7.25
	2Q	3.63	5.00	2.15	1.25	3.25	3.50	8.73	6.51	7.47	8.50	7.25
	3Q	3.50	5.25	3.50	2.00	3.75	3.50	9.71	4.14	7.20	9.00	7.00
	4Q											

Source: CEIC, Reserve Bank of Australia (RBA), Daiwa
* Prior to 2004, the policy rate was the Overnight interbank rate
Note: All interest rates are end-of-period values

Exchange rate per US$

		Taiwan (NT$)	Korea (W)	Hong Kong (HK$)	Singapore (S$)	Thailand (Bt)	Malaysia (RM)	Indonesia (Rp)	Philippines (P)	China (Rmb)	India (Rs)	Australia[#] (A$)	Japan (¥)
	1998	32.22	1,214	7.748	1.6605	36.28	3.800	8,025	39.06	8.279	42.48	0.6133	113.08
	1999	31.40	1,138	7.774	1.6660	38.26	3.800	7,100	40.31	8.279	43.49	0.6544	102.16
	2000	32.99	1,214	7.800	1.7315	43.25	3.800	9,595	50.00	8.278	46.75	0.5557	114.35
	2001	35.00	1,290	7.798	1.8510	43.95	3.800	10,400	51.40	8.277	48.18	0.5119	131.04
	2002	34.75	1,209	7.799	1.7365	43.32	3.800	8,940	53.10	8.277	48.03	0.5631	118.75
	2003	33.98	1,193	7.764	1.7008	39.75	3.800	8,465	55.57	8.277	45.61	0.7535	107.13
	2004	31.92	1,051	7.772	1.6338	39.18	3.800	9,290	56.27	8.277	43.58	0.7839	102.68
	2005	32.85	1,024	7.753	1.6642	41.08	3.779	9,830	53.07	8.070	45.07	0.7336	117.88
	2006	32.60	926	7.777	1.5336	35.69	3.527	9,020	49.13	7.805	44.23	0.7882	119.02
	2007	32.44	930	7.798	1.4412	30.16	3.306	9,419	41.40	7.304	39.41	0.8780	111.71
2004	1Q	33.02	1,166	7.793	1.6790	39.47	3.800	8,587	56.36	8.277	43.39	0.7635	104.18
	2Q	33.78	1,159	7.800	1.7163	40.83	3.800	9,415	56.18	8.277	45.98	0.6966	109.43
	3Q	33.98	1,148	7.798	1.6908	41.47	3.800	9,170	56.34	8.277	45.94	0.7244	110.20
	4Q	31.92	1,051	7.772	1.6338	39.18	3.800	9,290	56.27	8.277	43.58	0.7839	102.68
2005	1Q	31.53	1,007	7.799	1.6498	38.59	3.800	9,480	54.79	8.276	43.75	0.7736	107.22
	2Q	31.62	1,011	7.773	1.6832	40.92	3.800	9,713	55.92	8.277	43.51	0.7623	110.82
	3Q	33.19	1,029	7.757	1.6891	41.04	3.769	10,310	56.06	8.092	43.99	0.7637	113.29
	4Q	32.85	1,024	7.753	1.6642	41.08	3.779	9,830	53.07	8.070	45.07	0.7336	117.88
2006	1Q	32.46	975	7.760	1.6183	38.95	3.682	9,075	51.28	8.017	44.61	0.7131	117.48
	2Q	32.40	955	7.767	1.5894	38.35	3.673	9,300	53.59	7.996	46.08	0.7429	114.51
	3Q	33.10	954	7.791	1.5869	37.43	3.685	9,235	50.39	7.908	45.96	0.7463	117.99
	4Q	32.60	926	7.777	1.5336	35.69	3.527	9,020	49.13	7.805	44.23	0.7882	119.02
2007	1Q	33.09	943	7.814	1.5172	32.64	3.456	9,118	48.26	7.729	43.59	0.8079	117.56
	2Q	32.74	928	7.818	1.5326	32.32	3.450	9,054	46.33	7.614	40.75	0.8484	123.39
	3Q	32.58	932	7.769	1.4909	32.06	3.405	9,137	45.06	7.508	39.74	0.8850	114.97
	4Q	32.44	930	7.798	1.4412	30.16	3.306	9,419	41.40	7.304	39.41	0.8780	111.71
2008	1Q	30.41	980	7.782	1.3799	31.40	3.192	9,217	41.87	7.012	39.97	0.9128	99.85
	2Q	30.35	1,029	7.797	1.3616	33.18	3.267	9,225	44.76	6.856	42.95	0.9597	106.17
	3Q	32.13	1,130	7.766	1.4314	34.24	3.439	9,378	46.92	6.846	46.94	0.7888	105.94
	4Q												

Source: CEIC, Datastream (WMR), Daiwa
[#] US$ per AU$
Note: All exchange rates are end-of-period values

Foreign reserves (US$m)

		Taiwan	Korea	Hong Kong	Singapore	Thailand	Malaysia	Indonesia	Philippines	China	India	Australia
	1998	90,341	52,041	89,625	75,021	29,536	26,196	-	10,781	144,960	30,056	16,126
	1999	106,200	74,055	96,256	77,048	34,781	30,859	24,352	15,012	154,675	34,935	21,952
	2000	106,742	96,198	107,545	80,170	32,661	29,886	29,394	15,024	165,574	40,077	18,815
	2001	122,211	102,821	111,174	75,677	32,993	30,848	28,016	15,645	212,165	48,112	18,662
	2002	161,656	121,413	111,921	82,219	38,924	34,602	32,037	16,171	286,407	71,110	21,560
	2003	206,632	155,352	118,387	96,244	42,148	44,902	36,296	16,866	403,251	103,151	33,250
	2004	241,738	199,066	123,569	112,575	49,832	66,713	36,320	16,029	609,932	131,178	37,152
	2005	253,290	210,391	124,280	116,173	52,066	70,497	34,724	18,495	818,872	137,206	43,248
	2006	266,148	238,956	133,210	136,261	66,985	83,167	42,586	22,967	1,066,344	177,251	54,863
	2007	270,311	262,224	152,702	162,957	87,455	119,483	56,920	33,754	1,528,249	275,316	26,799
2004	1Q	226,523	163,557	123,752	102,559	43,036	51,347	37,419	16,336	439,822	112,959	36,636
	2Q	230,092	167,030	120,770	101,386	43,306	53,890	34,851	16,179	470,639	119,511	35,069
	3Q	233,006	174,448	118,398	102,535	44,768	56,872	34,802	15,941	514,538	119,579	30,338
	4Q	241,738	199,066	123,569	112,575	49,832	66,713	36,320	16,029	609,932	131,178	37,152
2005	1Q	251,135	205,447	122,407	112,752	48,681	72,415	36,030	16,526	659,144	141,514	36,447
	2Q	253,615	204,986	121,997	114,898	48,357	75,200	33,865	17,723	710,973	138,370	42,817
	3Q	253,746	206,731	122,747	115,250	49,795	80,334	30,318	18,542	769,004	143,059	36,009
	4Q	253,290	210,391	124,280	116,173	52,066	70,497	34,724	18,495	818,872	137,206	43,248
2006	1Q	257,051	217,344	125,848	121,766	55,266	73,702	40,082	20,844	875,070	151,622	44,151
	2Q	260,351	224,357	126,631	128,316	58,057	79,035	40,107	21,124	941,000	162,912	47,411
	3Q	261,551	228,224	130,300	128,945	61,593	79,817	42,353	21,593	988,000	165,305	46,083
	4Q	266,148	238,956	133,210	136,261	66,985	83,167	42,586	22,967	1,066,344	177,251	54,863
2007	1Q	267,485	243,915	135,370	137,736	70,863	98,768	47,221	24,684	1,202,031	199,179	57,565
	2Q	266,052	250,702	136,310	144,056	73,000	118,911	50,924	26,383	1,332,625	213,362	67,602
	3Q	262,938	257,294	140,850	152,450	80,687	112,965	52,875	30,902	1,433,611	247,762	46,608
	4Q	270,311	262,224	152,702	162,957	87,455	119,483	56,920	33,751	1,528,249	275,316	26,799
2008	1Q	286,860	264,246	160,775	177,462	109,970	144,915	58,987	36,624	1,682,177	311,885	33,175
	2Q	291,405	258,098	157,609	176,650	105,676	145,053	59,453	36,712	1,808,828	312,087	34,410
	3Q	281,130	239,672	160,600	168,802	102,422	113,890	57,108	35,782	1,905,585	283,941	28,426
	4Q											

Source: CEIC, Datastream, Daiwa

Money supply (% YoY)

		Taiwan (M2)	Korea (M2)	Hong Kong (M2)	Singapore (M2)	Thailand (M2)	Malaysia (M2)	Indonesia (M2)	Philippines (M2)	China (M2)	India (M3)	Australia (M3)
	1998	8.6	22.6	11.6	30.2	9.4	1.5	62.3	8.0	14.8	20.2	7.7
	1999	8.3	5.3	8.8	8.5	1.8	13.7	11.9	19.3	14.7	18.2	10.2
	2000	6.5	3.8	7.8	(2.0)	4.0	5.2	15.6	4.8	12.3	16.5	4.5
	2001	4.4	8.3	(2.7)	5.9	5.8	2.2	13.0	6.9	17.6	14.1	14.5
	2002	2.6	14.1	(0.9)	(0.3)	1.3	5.8	4.7	9.5	16.9	15.9	7.2
	2003	5.8	3.0	8.4	8.1	6.3	11.1	8.1	3.3	19.6	13.0	11.7
	2004	7.4	5.9	9.3	6.2	5.8	25.4	8.1	9.4	14.9	12.8	9.1
	2005	6.5	7.0	5.1	6.2	6.1	15.4	16.4	9.0	17.6	17.8	8.2
	2006	5.3	11.4	15.6	19.4	8.2	16.6	14.9	21.9	16.9	19.3	13.0
	2007	0.9	11.5	20.8	13.4	6.3	9.5	18.9	9.4	16.7	22.6	22.4
2004	1Q	8.4	2.7	8.7	9.9	6.7	12.5	6.5	4.8	19.1	16.8	10.9
	2Q	8.0	4.5	6.8	10.7	6.6	11.4	9.1	5.6	16.4	14.9	9.7
	3Q	7.0	6.2	6.5	8.4	7.4	17.9	8.3	5.5	14.1	13.9	8.9
	4Q	7.4	5.9	9.3	6.2	5.8	25.4	8.1	9.4	14.9	12.8	9.1
2005	1Q	5.6	6.6	9.2	4.3	4.8	25.7	9.1	12.2	14.2	12.3	7.7
	2Q	6.7	7.4	8.9	4.6	4.2	32.2	10.1	13.4	15.7	13.7	8.9
	3Q	6.4	6.5	8.6	8.3	4.9	24.2	16.6	14.3	17.9	18.6	9.3
	4Q	6.5	7.0	5.1	6.2	6.1	15.4	16.4	9.0	17.6	17.8	8.2
2006	1Q	6.1	6.6	8.6	8.1	8.6	15.2	17.1	7.2	18.8	21.2	9.6
	2Q	5.7	7.7	13.2	11.1	9.3	11.2	16.8	12.3	18.4	18.0	10.1
	3Q	5.9	8.9	14.4	12.8	8.6	12.2	12.3	14.1	16.8	19.0	11.3
	4Q	5.3	11.4	15.6	19.4	8.2	16.6	14.9	21.9	16.9	19.3	13.0
2007	1Q	5.8	11.5	16.6	23.0	8.3	17.3	15.1	17.9	17.3	21.5	14.4
	2Q	4.6	10.9	20.8	23.6	8.1	13.0	15.8	19.4	17.1	21.7	16.1
	3Q	3.3	11.0	22.4	20.0	6.9	12.2	17.1	11.4	18.5	21.3	18.8
	4Q	0.9	11.5	20.8	13.4	6.3	9.5	18.9	9.4	16.7	22.6	22.5
2008	1Q	2.2	13.9	13.5	11.9	5.7	11.8	15.3	9.6	16.2	20.8	21.1
	2Q	1.5	15.1	5.6	7.5	4.4	15.7	17.0	4.6	17.3	20.7	19.2
	3Q	3.4	14.5	1.8	10.5	4.8	15.6	16.9	13.4	15.2	19.2	19.5
	4Q											

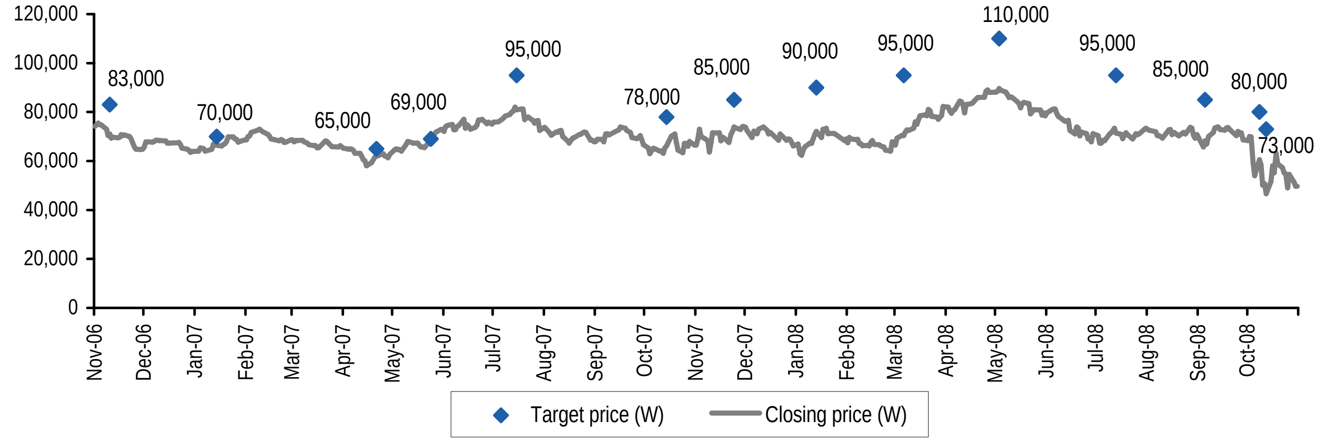
Source: CEIC, Datastream, Daiwa

Appendix II

Korea: share prices and Daiwa recommendation trends

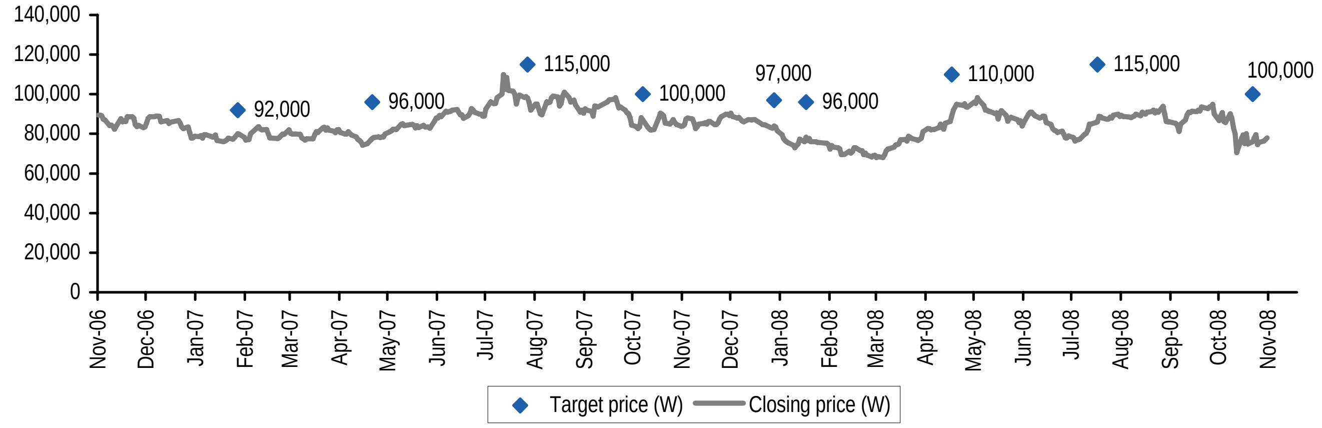
Automobiles and components: Hyundai Motor

Date	2008-10-24	2008-10-20	2008-09-17	2008-07-25	2008-05-15	2008-03-18	2008-01-25	2007-12-06
Target price (W)	73,000	80,000	85,000	95,000	110,000	95,000	90,000	85,000
Rating	2	2	2	2	2	2	2	2



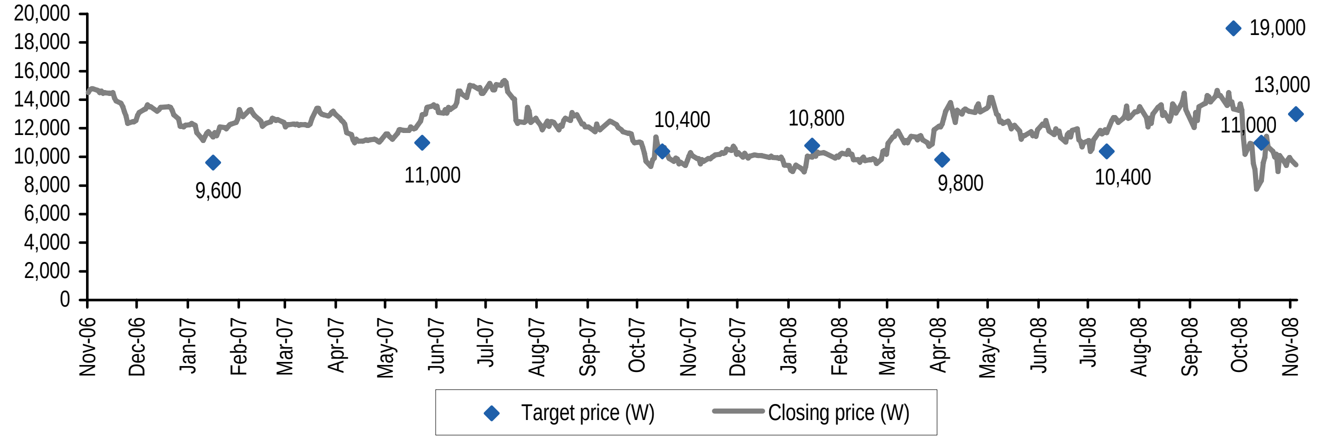
Automobiles and components: Hyundai Mobis

Date	2008-11-3	2008-7-30	2008-4-30	2008-1-30	2008-1-10	2007-10-22	2007-8-9	2007-5-4
Target price (W)	100,000	115,000	110,000	96,000	97,000	100,000	115,000	96,000
Rating	2	2	2	2	2	2	2	2



Automobiles and components: Kia Motors

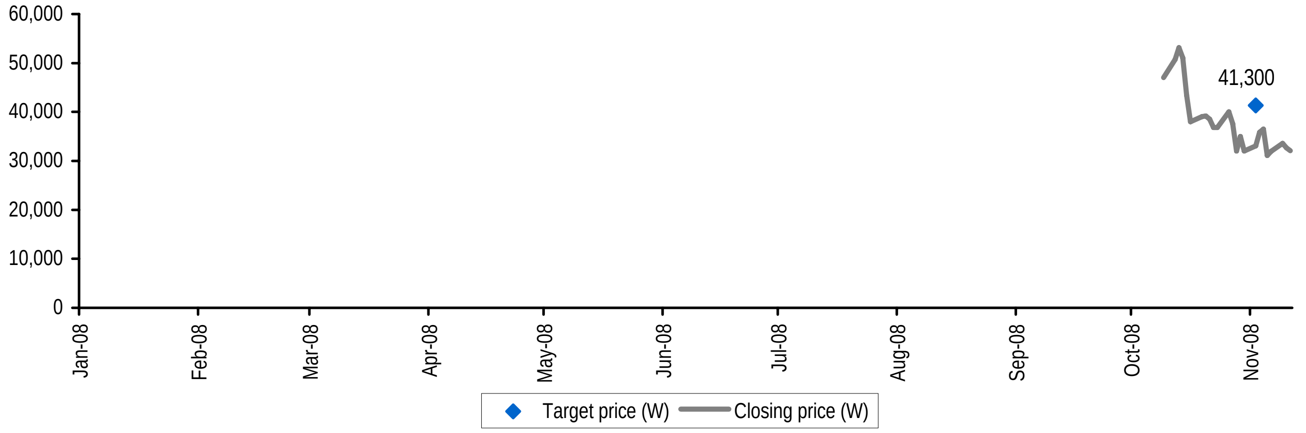
Date	2008-11-17	2008-10-27	2008-10-10	2008-07-25	2008-04-16	2008-01-28	2007-10-29	2007-06-05
Target price (W)	13,000	11,000	19,000	10,400	9,800	10,800	10,400	11,000
Rating	2	2	2	4	4	3	3	4



Source: Daiwa

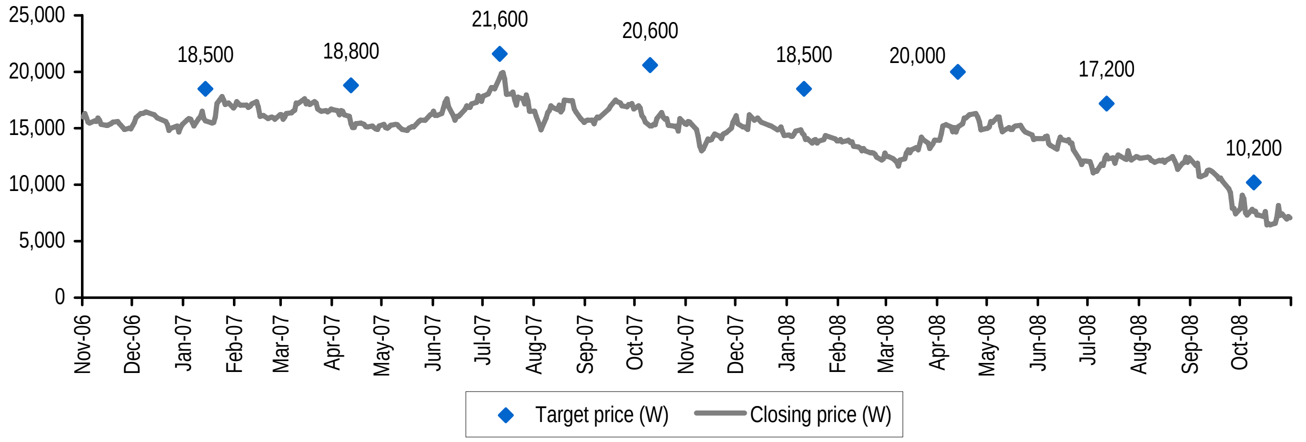
Banks: KB Financial Group

Date	2008-11-04
Target price (W)	41,300
Rating	2



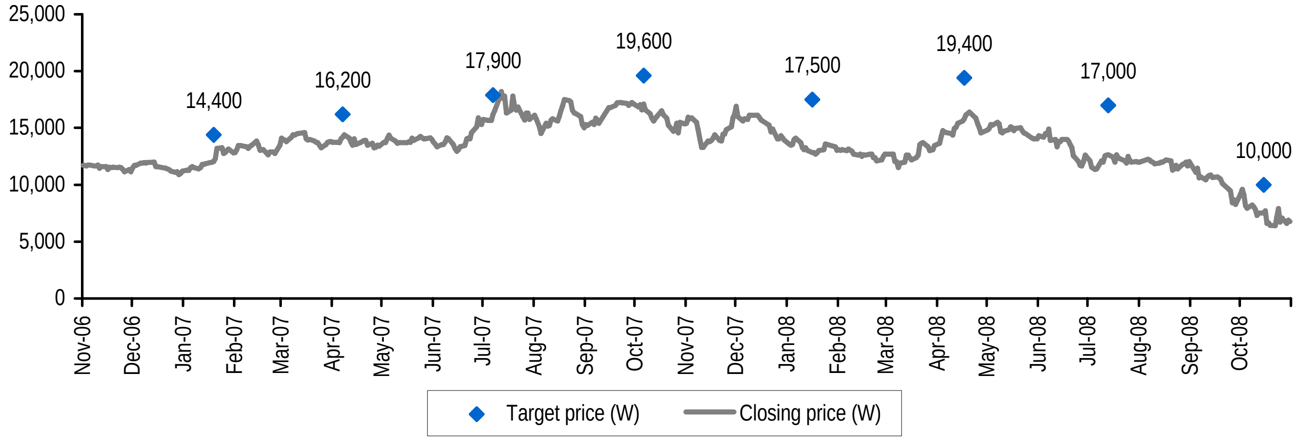
Banks: Daegu Bank

Date	2008-10-22	2008-07-24	2008-04-28	2008-01-23	2007-10-22	2007-07-23	2007-04-24	2007-01-26
Target price (W)	10,200	17,200	20,000	18,500	20,600	21,600	18,800	18,500
Rating	2	2	2	2	2	2	2	2



Banks: Pusan Bank

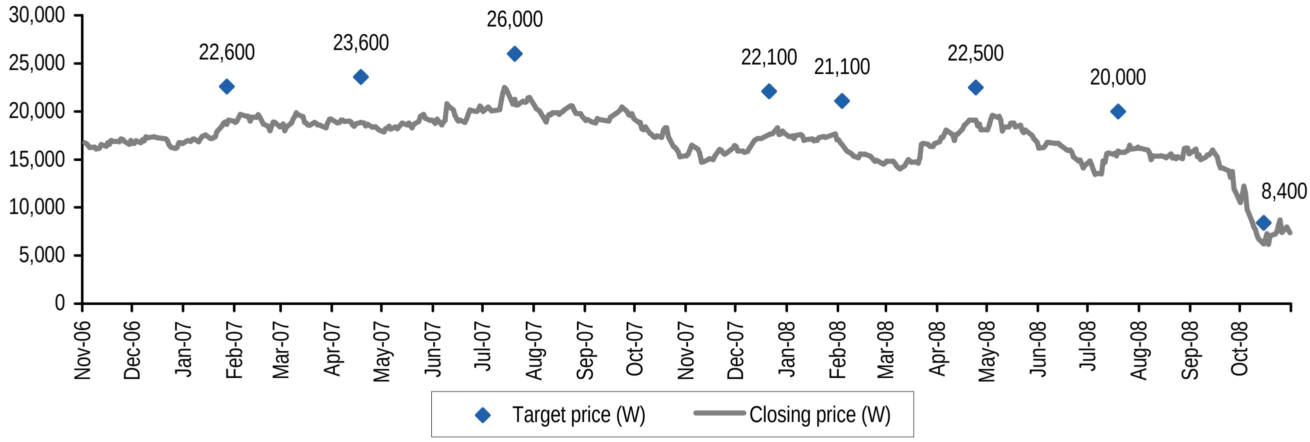
Date	2008-10-28	2008-07-28	2008-04-29	2008-01-28	2007-10-18	2007-07-19	2007-04-19	2007-01-31
Target price (W)	10,000	17,000	19,400	17,500	19,600	17,900	16,200	14,400
Rating	2	2	2	2	2	2	2	2



Source: Daiwa

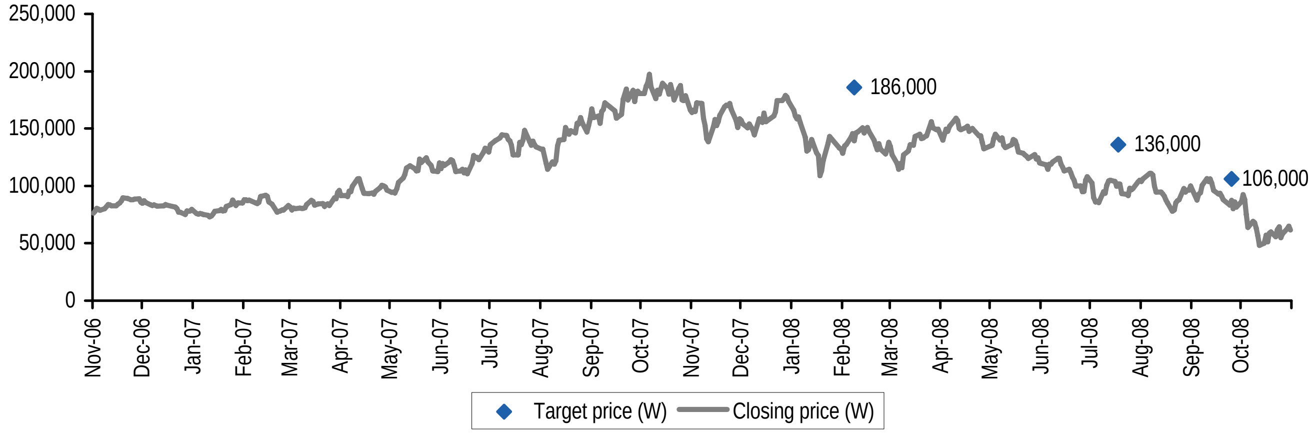
Banks: Industrial Bank of Korea

Date	2008-10-27	2008-07-31	2008-05-06	2008-02-15	2008-01-02	2007-08-01	2007-04-30	2007-02-08
Target price (W)	8,400	20,000	22,500	21,100	22,100	26,000	23,600	22,600
Rating	2	2	2	2	2	2	2	2



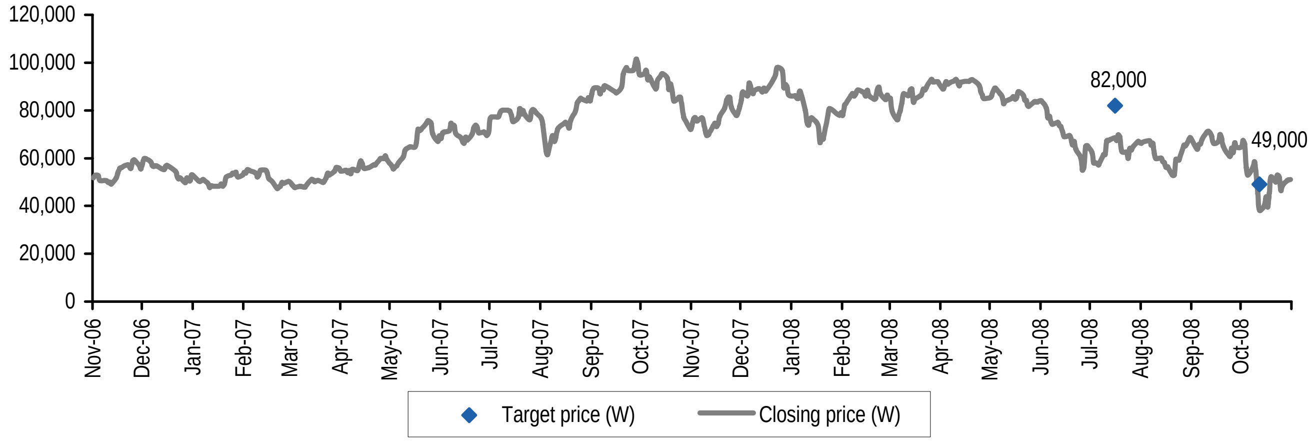
Construction: GS Engineering & Construction

Date	2008-10-08	2008-07-30	2008-02-20
Target price (W)	106,000	136,000	186,000
Rating	2	2	2



Construction: Hyundai Engineering & Construction

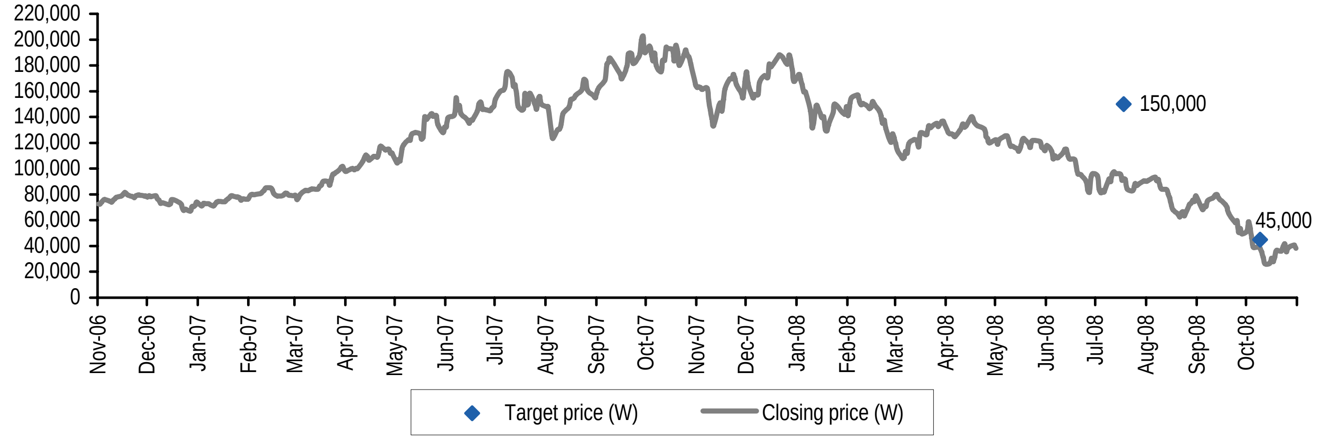
Date	2008-10-27	2008-07-30
Target price (W)	49,000	82,000
Rating	2	2



Source: Daiwa

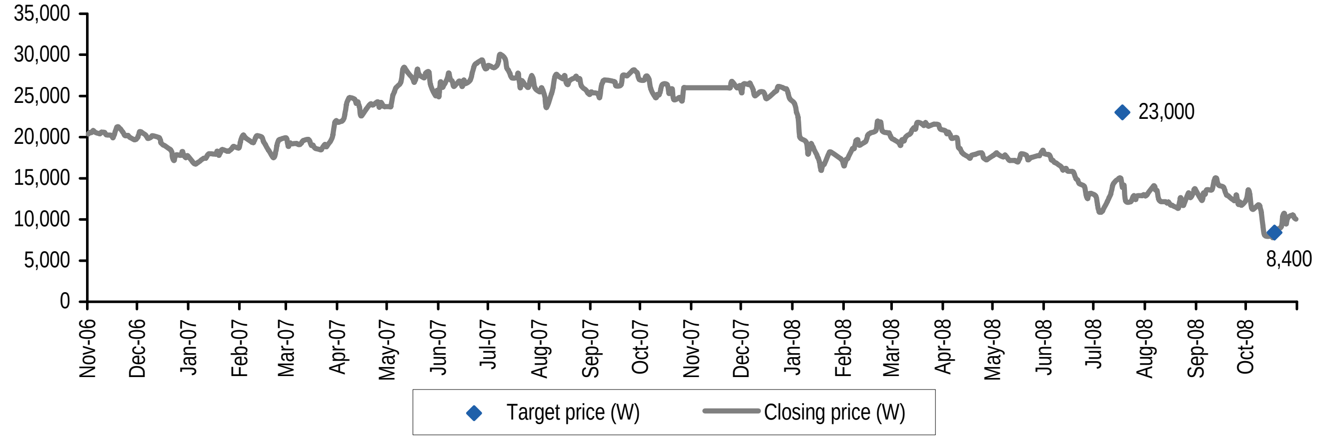
Construction: Daelim Industrial

Date	2008-10-22	2008-07-30
Target price (W)	45,000	150,000
Rating	3	1



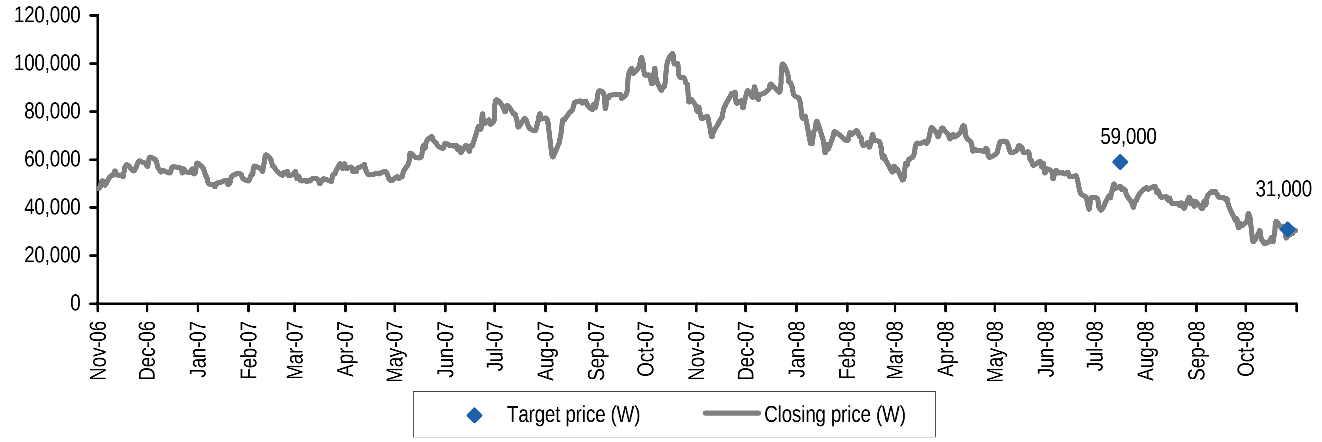
Construction: Daewoo Engineering & Construction

Date	2008-10-31	2008-07-30
Target price (W)	8,400	23,000
Rating	3	1



Construction: Hyundai Development

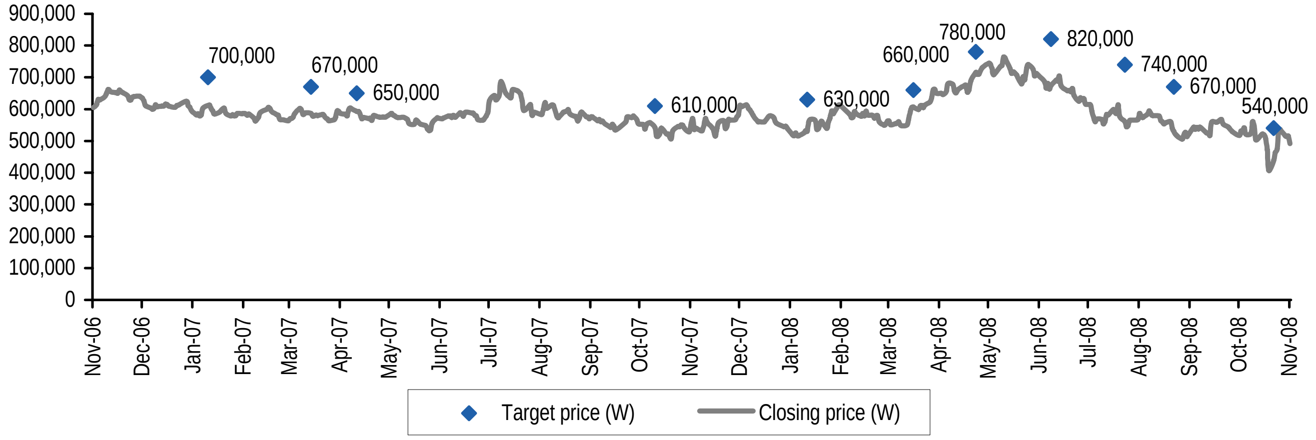
Date	2008-11-10	2008-07-30
Target price (W)	31,000	59,000
Rating	3	2



Source: Daiwa

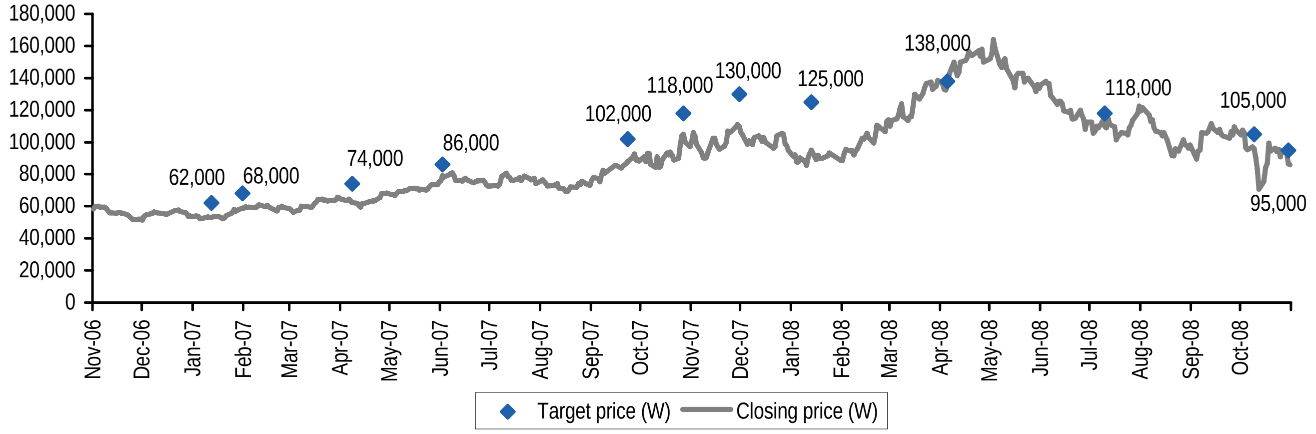
Electronics: Samsung Electronics

Date	2008-10-27	2008-08-27	2008-07-28	2008-06-13	2008-04-28	2008-03-21	2008-01-16	2007-10-15
Target price (W)	540,000	670,000	740,000	820,000	780,000	660,000	630,000	610,000
Rating	2	2	2	2	2	2	2	3



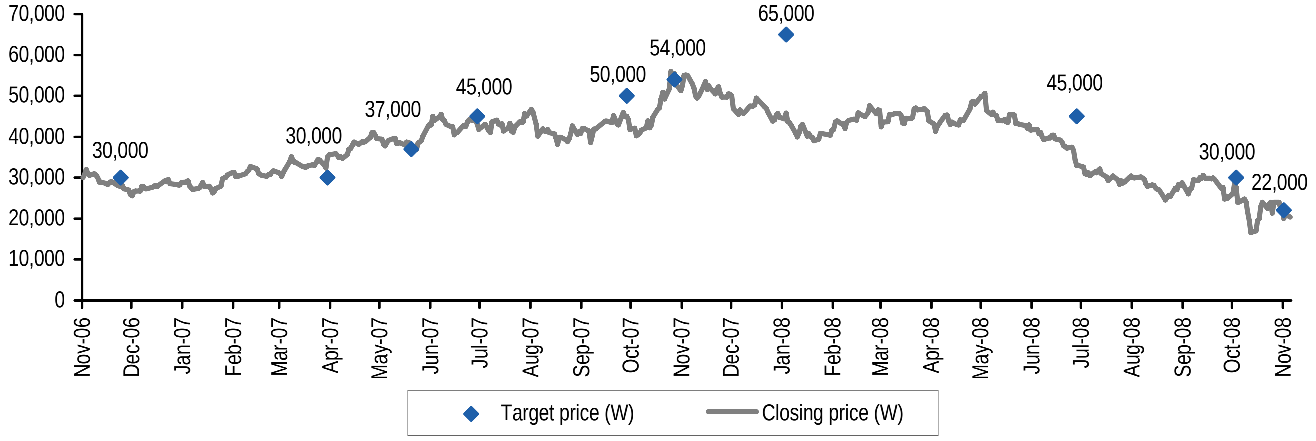
Electronics: LG Electronics

Date	2008-11-12	2008-10-21	2008-07-22	2008-04-17	2008-01-25	2007-12-12	2007-11-08	2007-10-05
Target price (W)	95,000	105,000	118,000	138,000	125,000	130,000	118,000	102,000
Rating	3	3	3	3	2	2	2	2



Electronics: LG Display

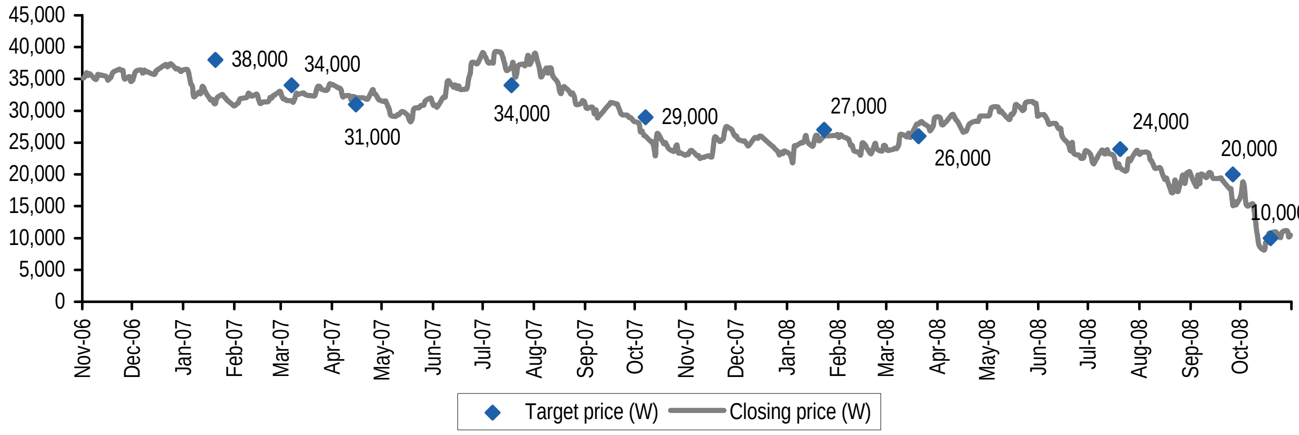
Date	2008-11-14	2008-10-15	2008-07-10	2008-01-15	2007-11-08	2007-10-10	2007-07-11	2007-06-01
Target price (W)	22,000	30,000	45,000	65,000	65,000	54,000	50,000	45,000
Rating	3	3	2	1	2	2	2	2



Source: Daiwa

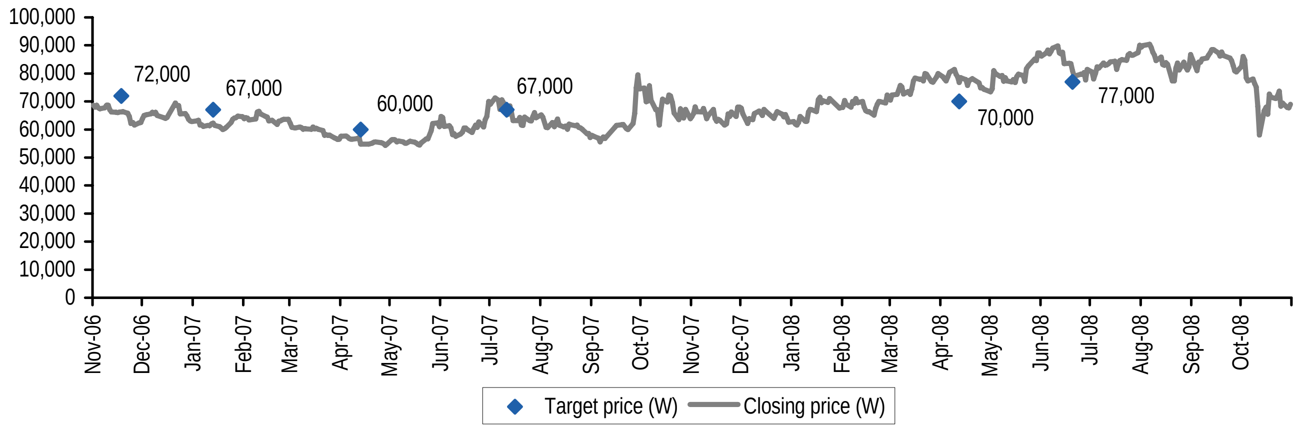
Electronics: Hynix Semiconductor

Date	2008-10-31	2008-10-08	2008-08-01	2008-04-01	2008-02-04	2007-10-19	2007-07-30	2007-04-27
Target price (W)	10,000	20,000	24,000	26,000	27,000	29,000	34,000	31,000
Rating	4	3	3	3	3	3	3	3



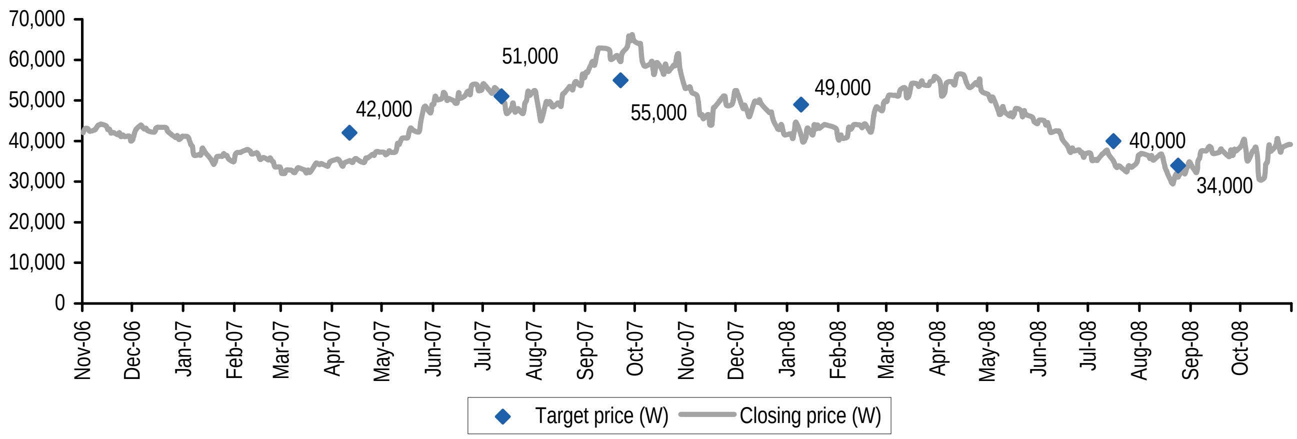
Electronics: Samsung SDI

Date	2008-07-02	2008-04-24	2007-07-23	2007-04-25	2007-01-25	2006-11-30	2006-10-26	2006-07-26
Target price (W)	77,000	70,000	67,000	60,000	67,000	72,000	75,000	77,000
Rating	3	3	3	3	3	3	3	2



Electronics: Samsung Electro-Mechanics

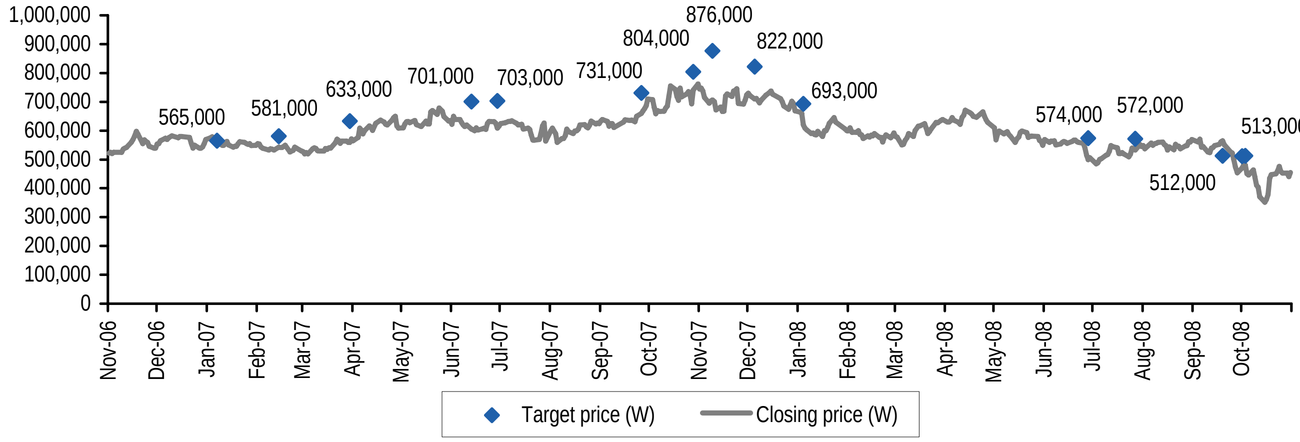
Date	2008-09-05	2008-07-28	2008-01-21	2007-10-04	2007-07-24	2007-04-23	2006-10-23	2006-07-24
Target price (W)	34,000	40,000	49,000	55,000	51,000	42,000	45,000	40,000
Rating	3	3	3	3	3	2	2	2



Source: Daiwa

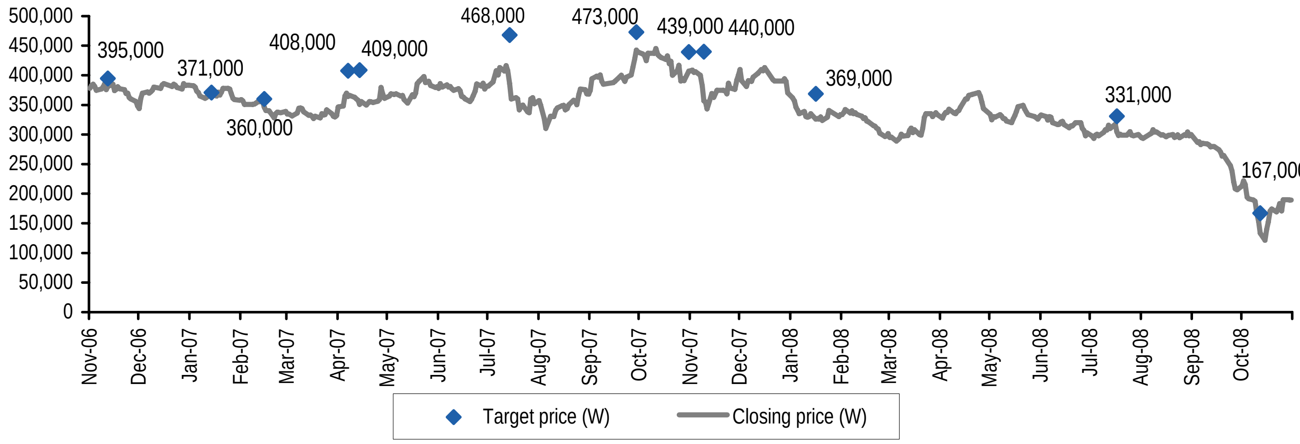
Retail: Shinsegae

Date	2008-10-15	2008-10-13	2008-10-01	2008-08-08	2008-07-10	2008-01-16	2007-12-17	2007-11-21
Target price (W)	513,000	512,000	513,000	572,000	574,000	693,000	822,000	876,000
Rating	4	4	4	3	3	3	2	2



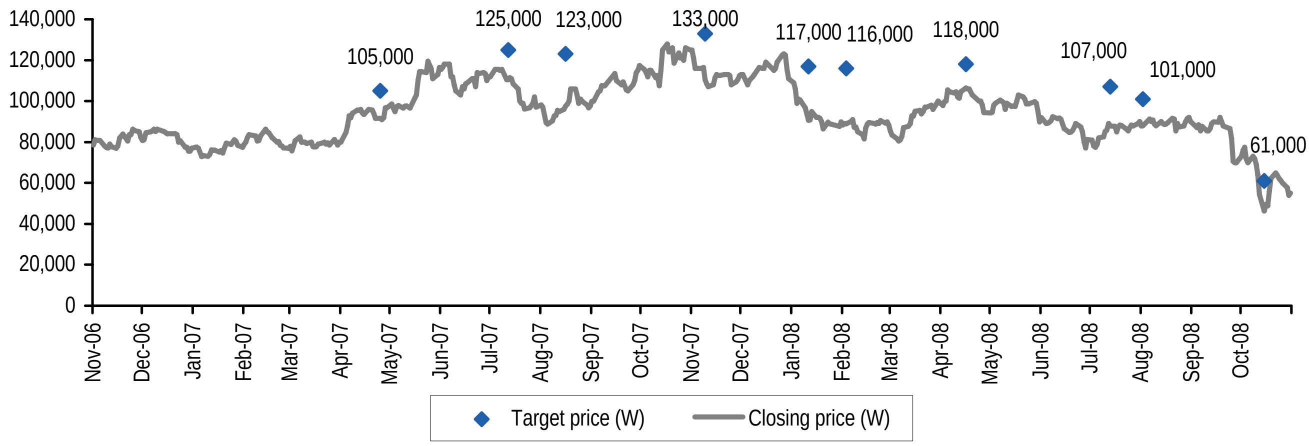
Retail: Lotte Shopping

Date	2008-10-24	2008-07-29	2008-01-28	2007-11-21	2007-11-12	2007-10-11	2007-07-26	2007-04-26
Target price (W)	167,000	331,000	369,000	440,000	439,000	473,000	468,000	409,000
Rating	3	3	3	2	2	2	2	2



Retail: Hyundai Department Store

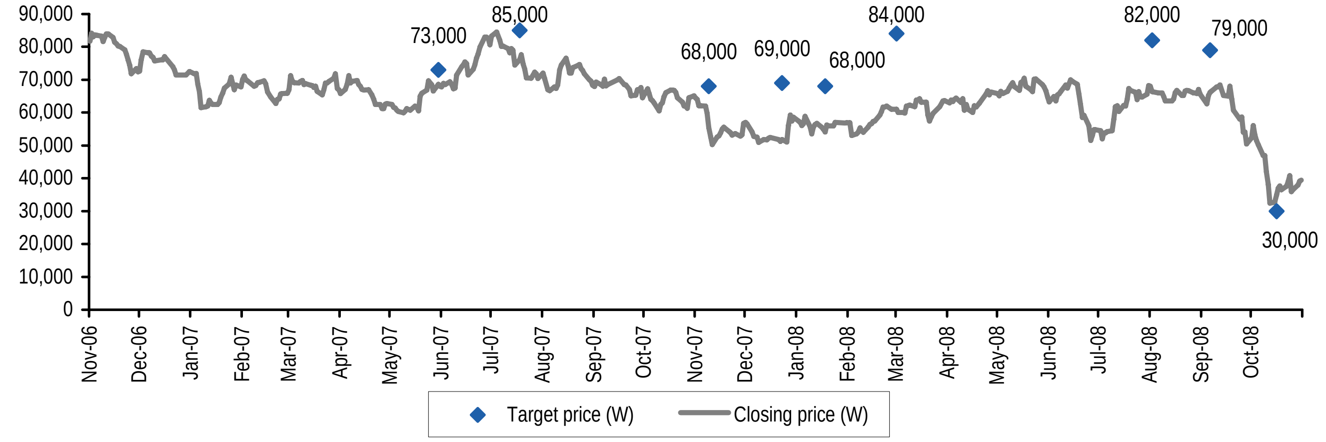
Date	2008-10-27	2008-08-14	2008-07-25	2008-04-28	2008-02-15	2008-01-23	2007-11-21	2007-08-28
Target price (W)	61,000	101,000	107,000	118,000	116,000	117,000	133,000	123,000
Rating	3	2	2	2	2	2	2	2



Source: Daiwa

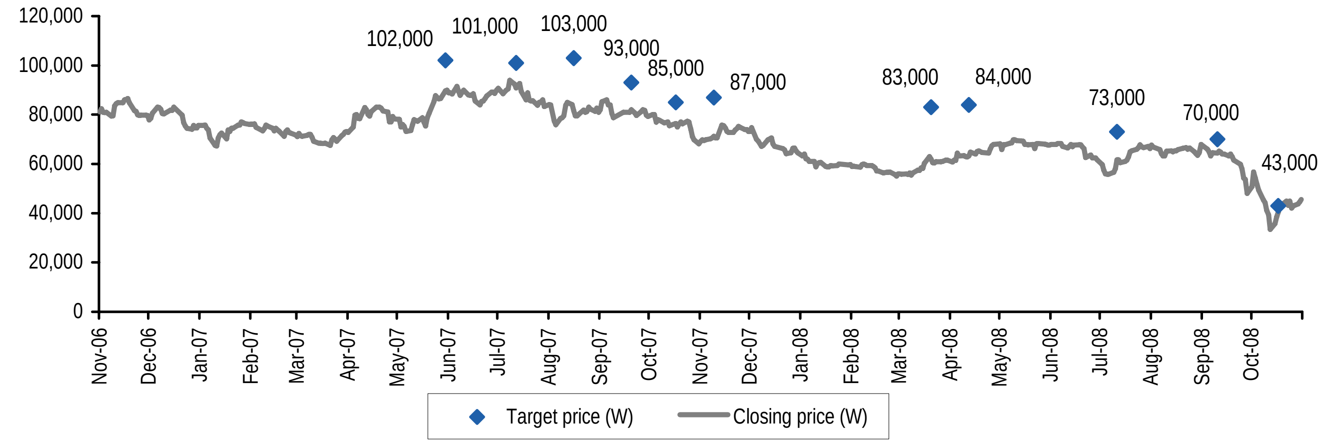
Retail: CJ Home Shopping

Date	2008-10-28	2008-09-18	2008-08-14	2008-07-23	2008-03-13	2008-01-30	2008-01-04	2007-11-21
Target price (W)	30,000	79,000	82,000	82,000	84,000	68,000	69,000	68,000
Rating	4	2	2	1	1	2	2	2



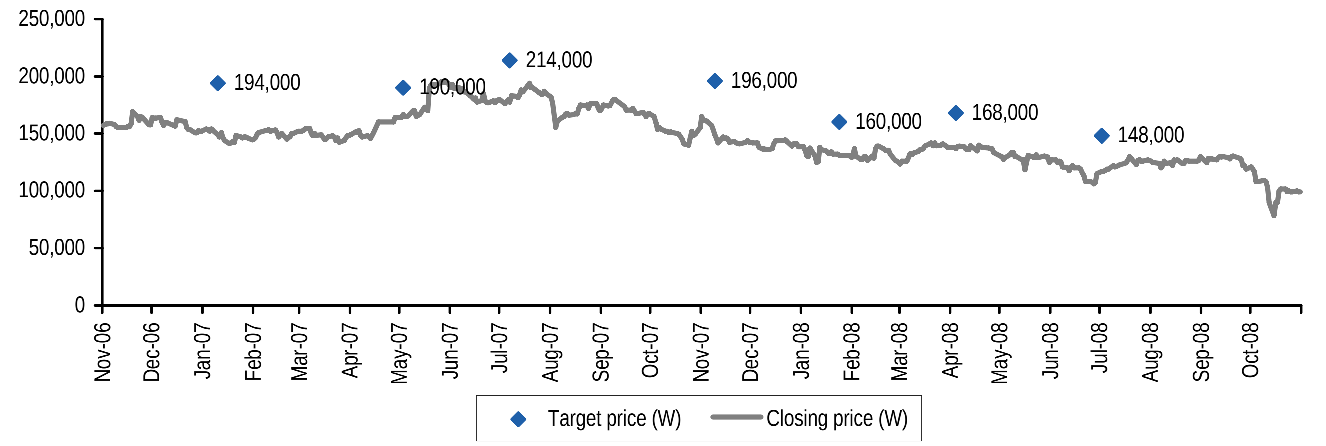
Retail: GS Home Shopping

Date	2008-10-29	2008-09-22	2008-08-14	2008-07-23	2008-04-24	2008-04-01	2007-11-21	2007-10-29
Target price (W)	43,000	70,000	73,000	73,000	84,000	83,000	87,000	85,000
Rating	3	3	3	2	2	2	2	2



Retail: Gwangju Shinsegae

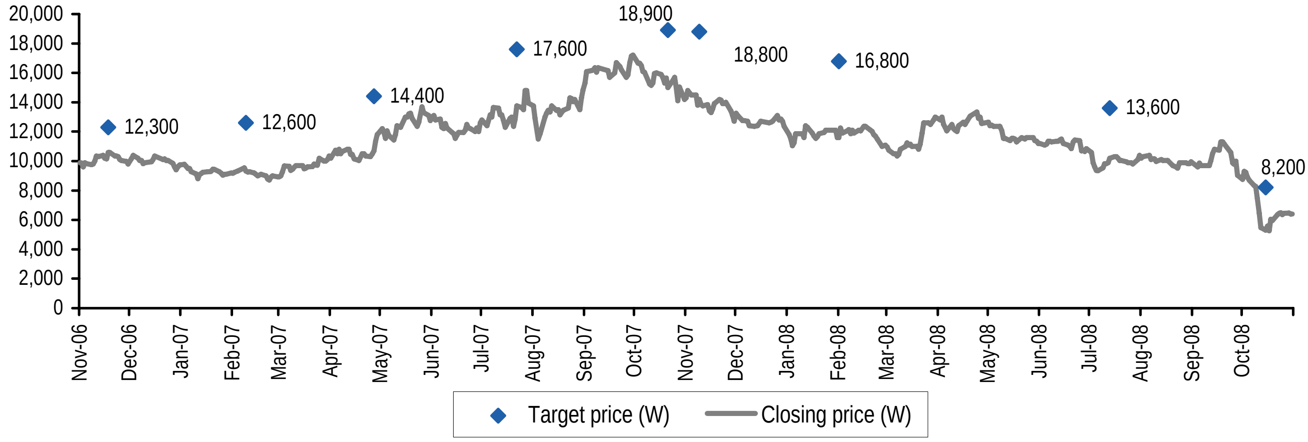
Date	2008-07-14	2008-04-16	2008-02-05	2007-11-21	2007-07-19	2007-05-15	2007-01-22	2006-10-19
Target price (W)	148,000	168,000	160,000	196,000	214,000	190,000	194,000	196,000
Rating	2	2	2	2	2	2	2	2



Source: Daiwa

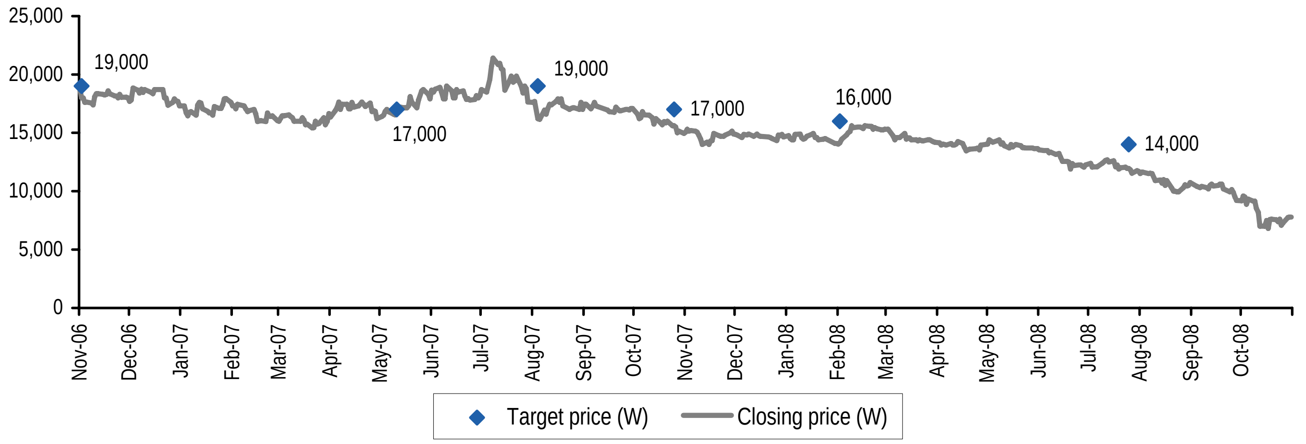
Retail: Hyundai DSF

Date	2008-10-27	2008-07-25	2008-05-07	2008-02-13	2007-11-21	2007-11-02	2007-08-03	2007-05-09
Target price (W)	8,200	13,600	16,800	16,800	18,800	18,900	17,600	14,400
Rating	2	2	2	1	1	1	1	1



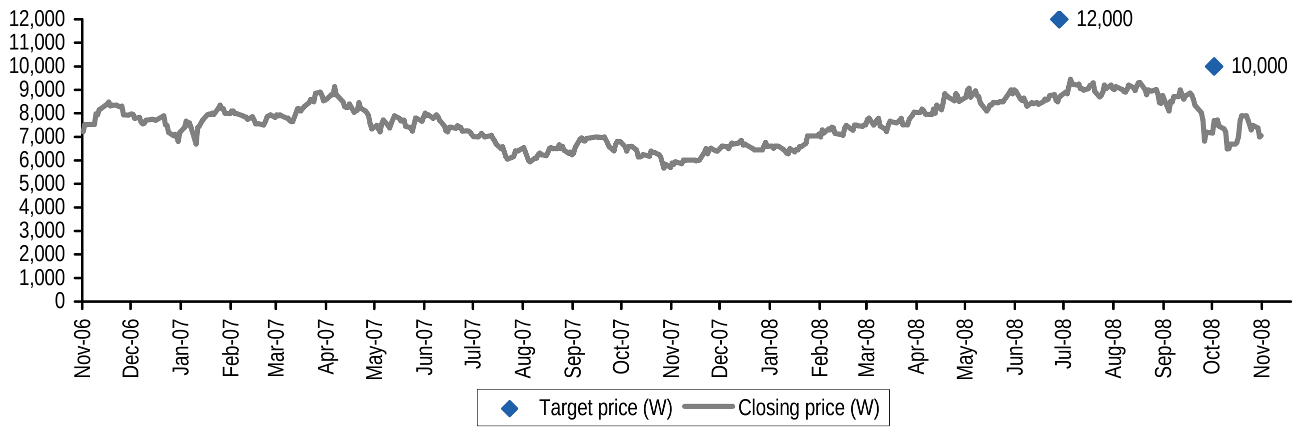
Retail: Daegu Department Store

Date	2008-08-06	2008-02-14	2007-11-06	2007-08-16	2007-05-23	2006-11-14	2006-10-25	2006-03-14
Target price (W)	14,000	16,000	17,000	19,000	17,000	19,000	16,000	20,000
Rating	3	3	3	3	3	3	3	3



Retail: Hanssem

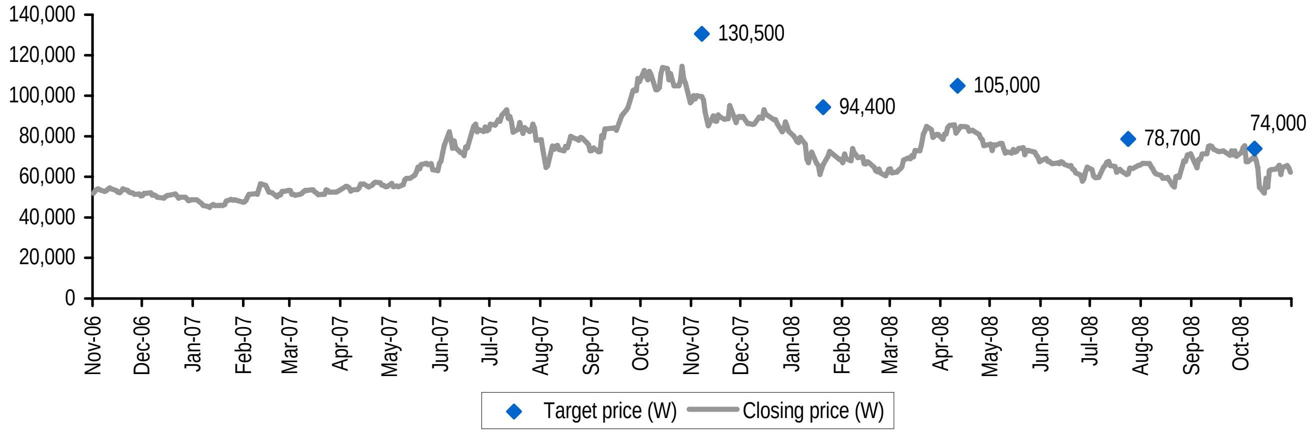
Date	2008-10-14	2008-7-10
Target price (W)	10,000	12,000
Rating	2	2



Source: Daiwa

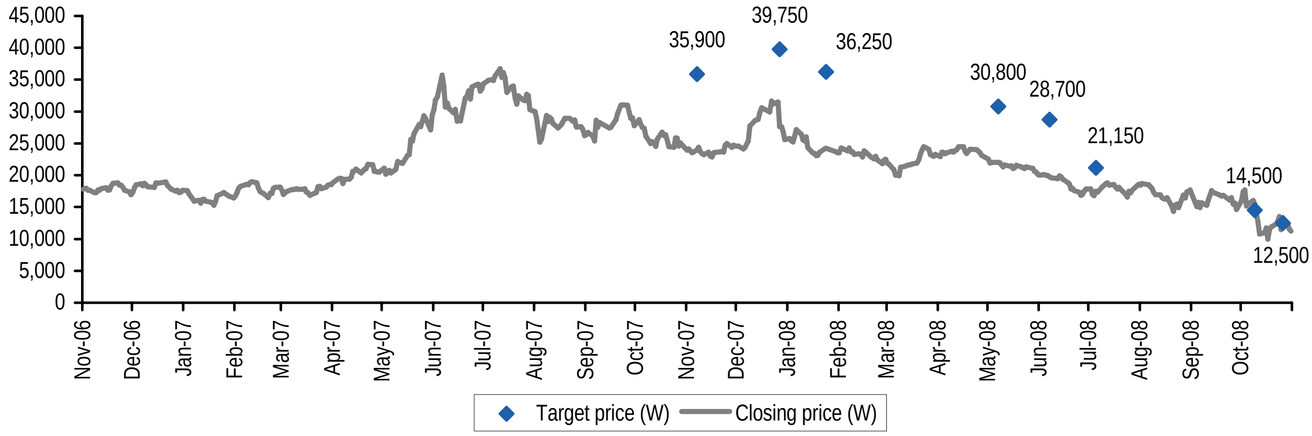
Securities: Samsung Securities

Date	2008-10-22	2008-08-06	2008-04-23	2008-02-01	2007-11-19
Target price (W)	74,000	78,700	105,000	94,400	130,500
Rating	3	2	1	1	1



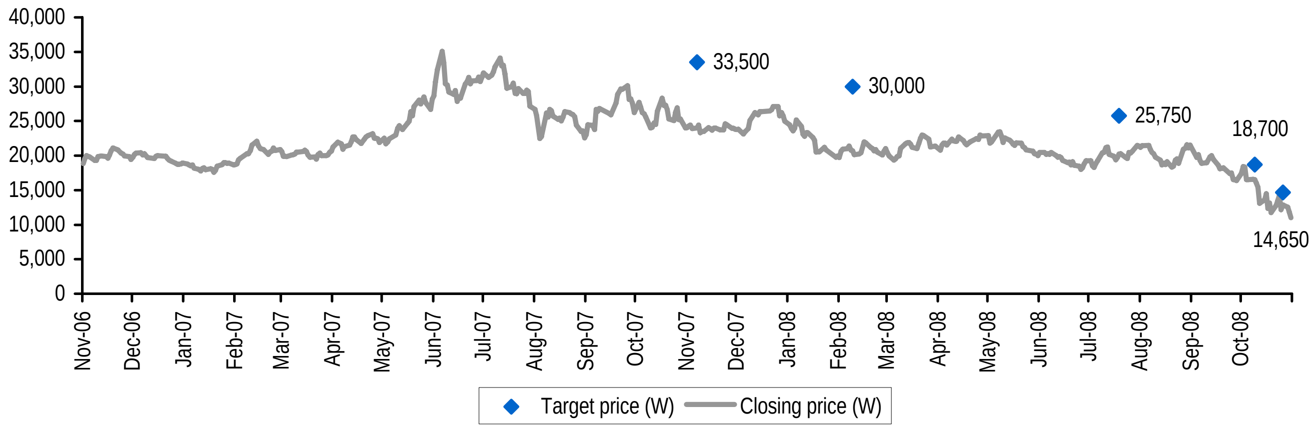
Securities: Daewoo Securities

Date	2008-11-10	2008-10-22	2008-07-17	2008-06-19	2008-05-19	2008-02-05	2008-01-08	2007-11-19
Target price (W)	12,500	14,500	21,150	28,700	30,800	36,250	39,750	35,900
Rating	4	4	2	1	1	1	1	1



Securities: Woori Investment & Securities

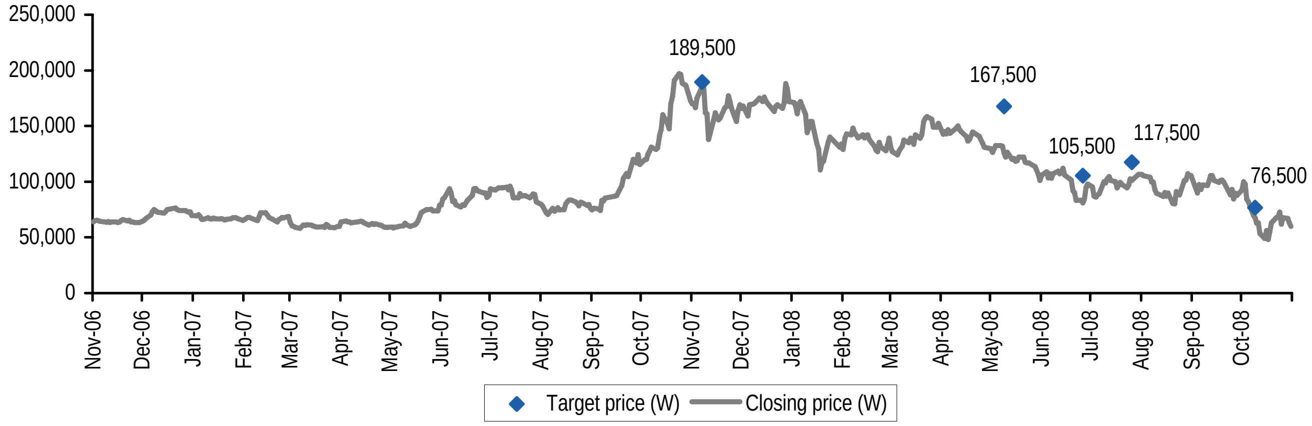
Date	2008-11-10	2008-10-22	2008-08-01	2008-02-21	2007-11-19
Target price (W)	14,650	18,700	25,750	30,000	33,500
Rating	3	3	2	1	1



Source: Daiwa

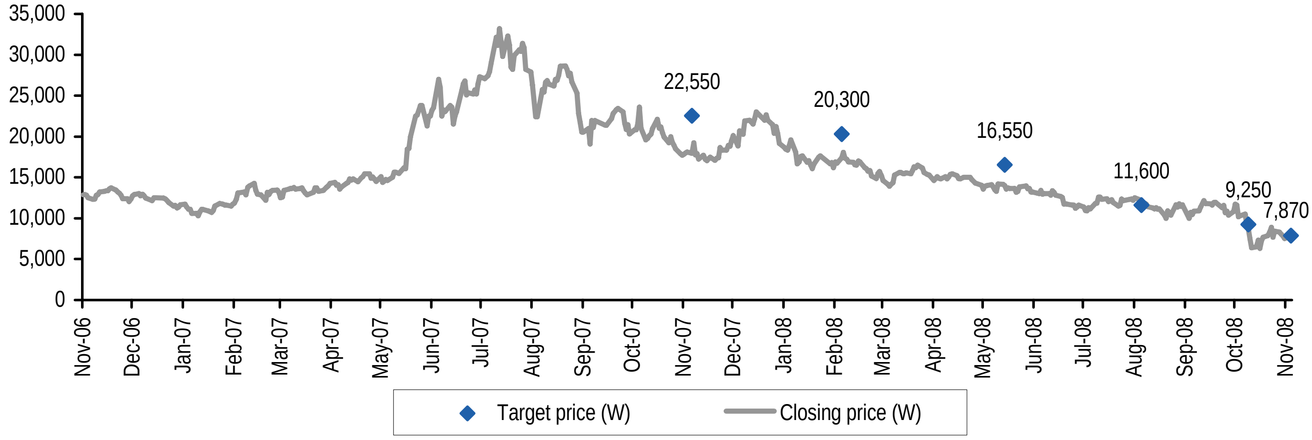
Securities: Mirae Asset Securities

Date	2008-10-22	2008-08-08	2008-07-08	2008-05-21	2008-01-28	2007-11-19
Target price (W)	76,500	117,500	105,500	167,500	189,500	189,500
Rating	3	2	2	2	2	3



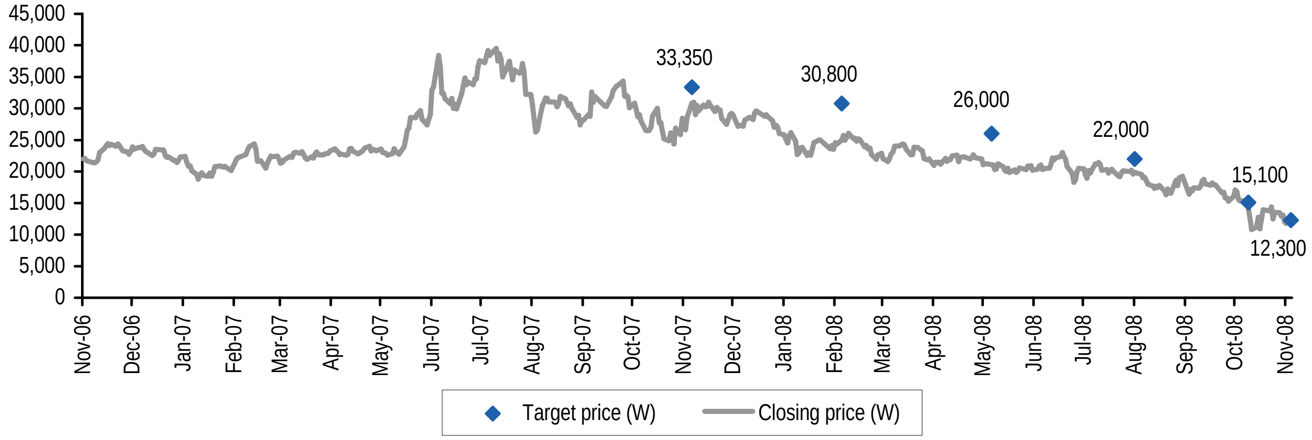
Securities: Hyundai Securities

Date	2008-11-18	2008-10-22	2008-08-18	2008-05-27	2008-02-18	2007-11-19
Target price (W)	7,870	9,250	11,600	16,550	20,300	22,550
Rating	4	4	3	2	2	2



Securities: Daishin Securities

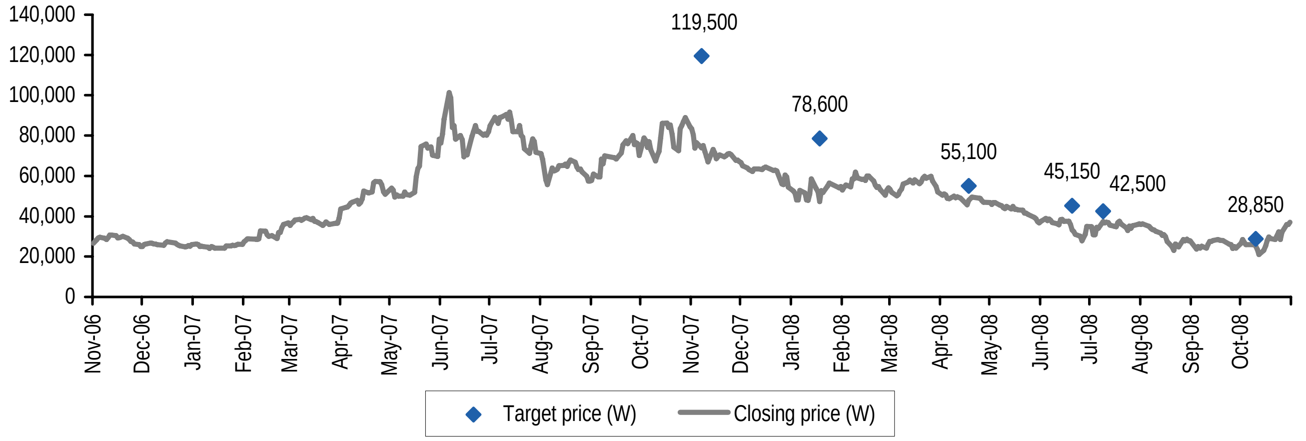
Date	2008-11-17	2008-10-22	2008-08-18	2008-05-19	2008-02-18	2007-11-19
Target price (W)	12,300	15,100	22,000	26,000	30,800	33,350
Rating	4	4	3	2	2	2



Source: Daiwa

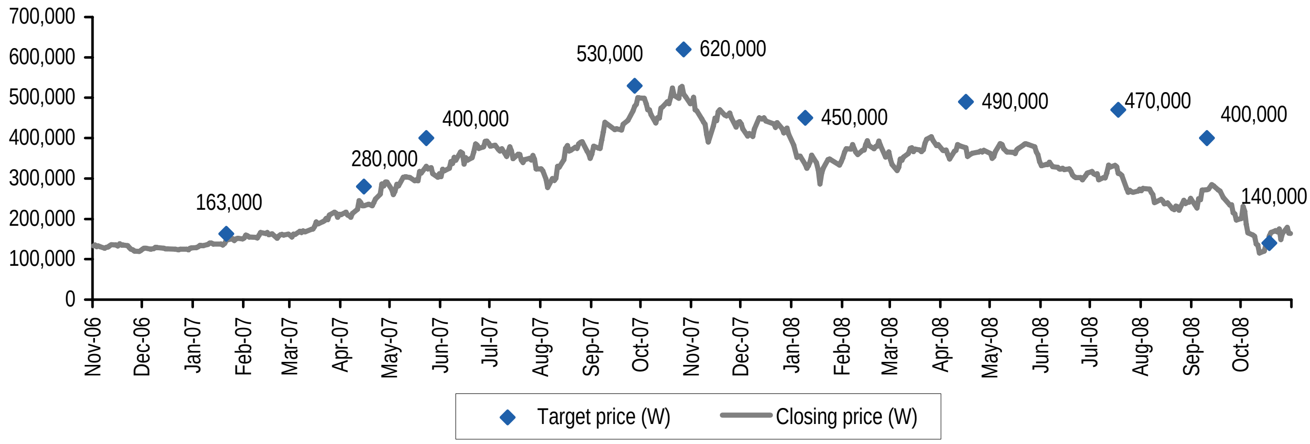
Securities: KIWOOM Securities

Date	2008-10-22	2008-07-21	2008-07-02	2008-04-30	2008-01-30	2007-11-19
Target price (W)	28,850	42,500	45,150	55,100	78,600	119,500
Rating	3	2	2	2	1	1



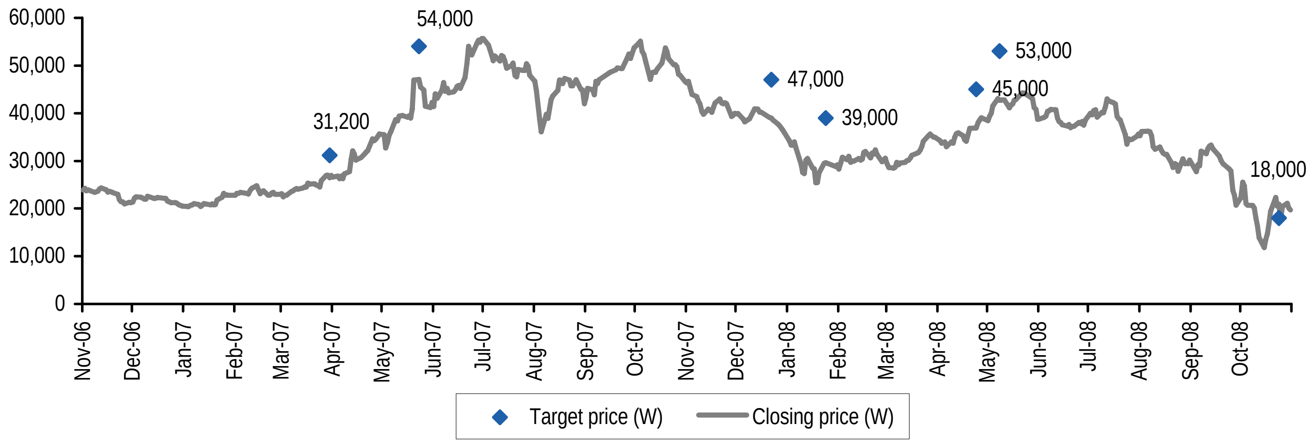
Shipbuilding: Hyundai Heavy Industries

Date	2008-10-31	2008-09-22	2008-07-30	2008-06-20	2008-04-28	2008-01-21	2007-11-08	2007-10-09
Target price (W)	140,000	400,000	470,000	490,000	490,000	450,000	620,000	530,000
Rating	4	1	1	1	2	2	2	2



Shipbuilding: Samsung Heavy Industries

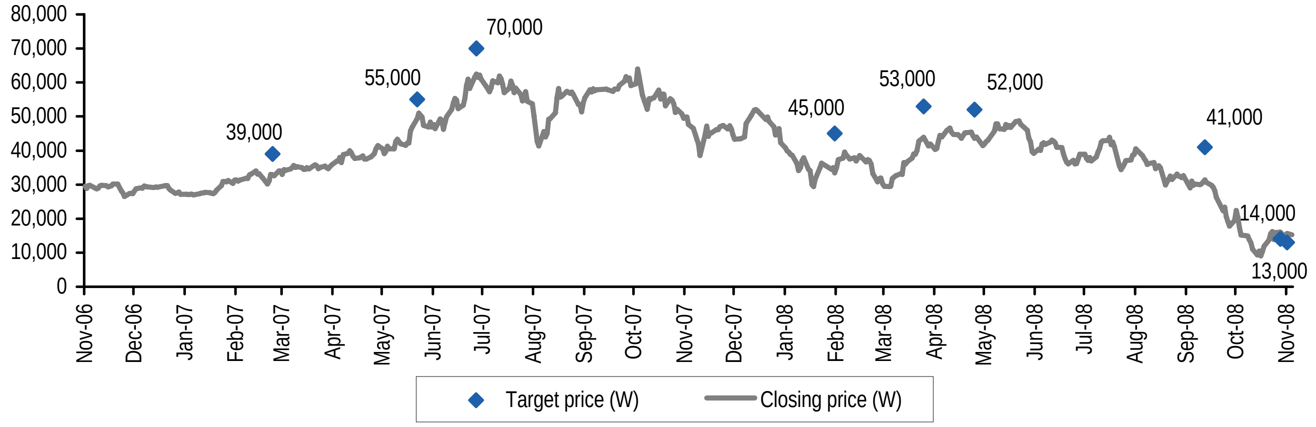
Date	2008-11-06	2008-05-20	2008-05-06	2008-02-05	2008-01-03	2007-06-04	2007-04-11	2006-09-08
Target price (W)	18,000	53,000	45,000	39,000	47,000	54,000	31,200	26,500
Rating	4	2	2	2	2	2	2	2



Source: Daiwa

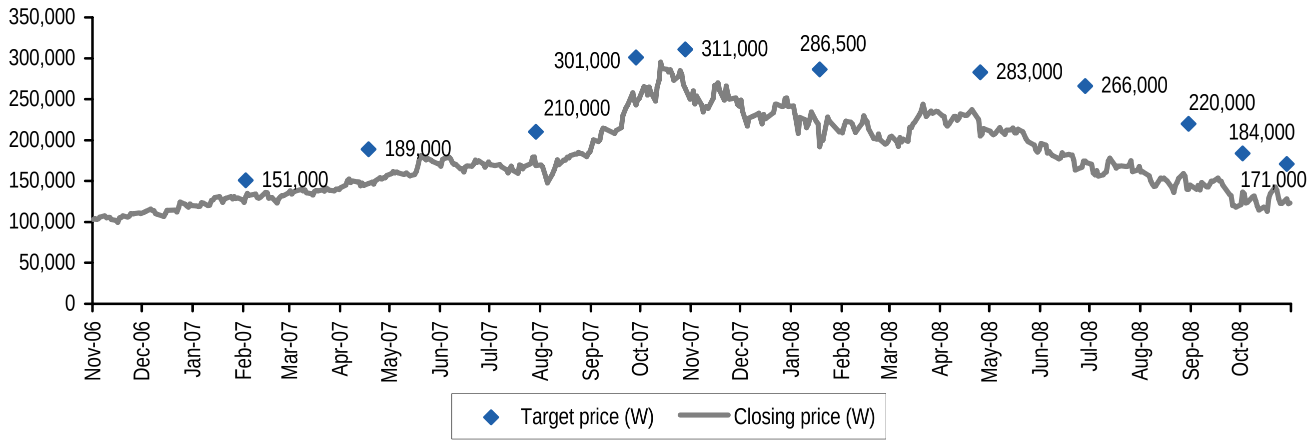
Shipbuilding: Daewoo Shipbuilding & Marine Engineering

Date	2008-11-17	2008-11-10	2008-09-25	2008-05-08	2008-04-07	2008-02-13	2007-07-10	2007-06-04
Target price (W)	13,000	14,000	41,000	52,000	53,000	45,000	70,000	55,000
Rating	4	4	2	2	2	2	2	2



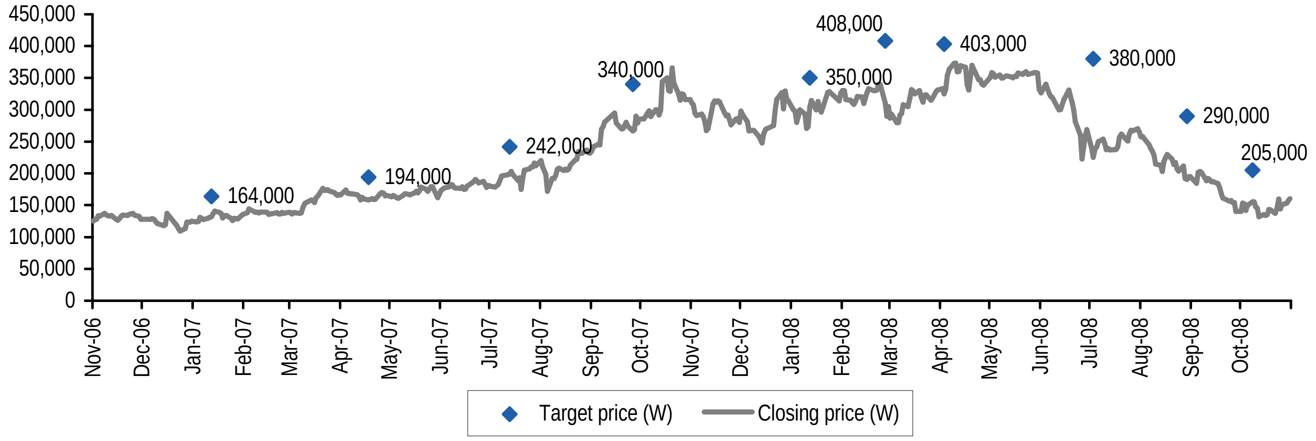
Software: NHN

Date	2008-11-10	2008-10-14	2008-09-11	2008-07-10	2008-05-07	2008-01-30	2007-11-09	2007-10-10
Target price (W)	171,000	184,000	220,000	266,000	283,000	286,500	311,000	301,000
Rating	2	1	1	1	2	2	2	2



Software: Megastudy

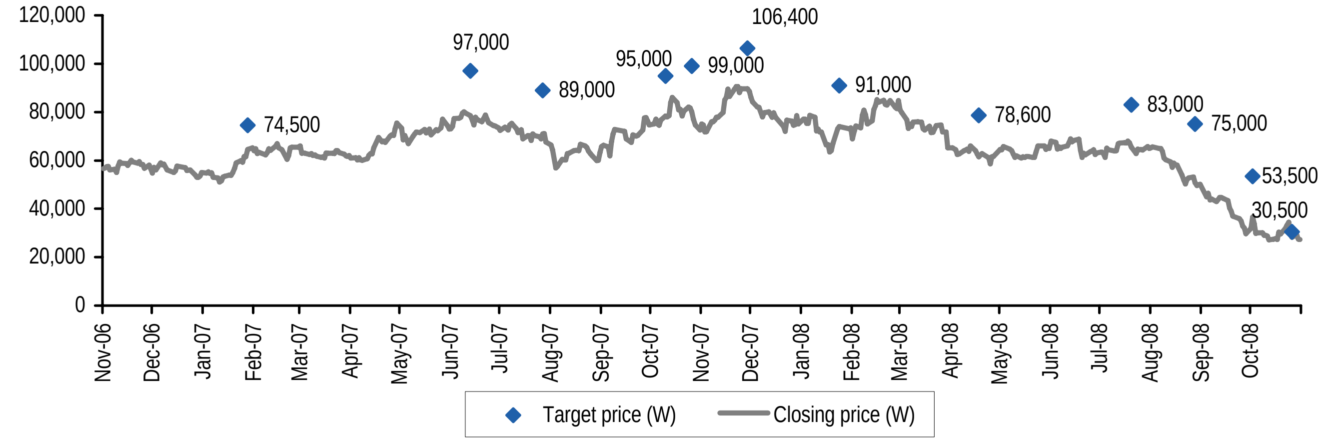
Date	2008-10-20	2008-09-10	2008-07-15	2008-04-15	2008-03-10	2008-01-24	2007-10-08	2007-07-25
Target price (W)	205,000	290,000	380,000	403,000	408,000	350,000	340,000	242,000
Rating	2	1	1	2	2	2	2	2



Source: Daiwa

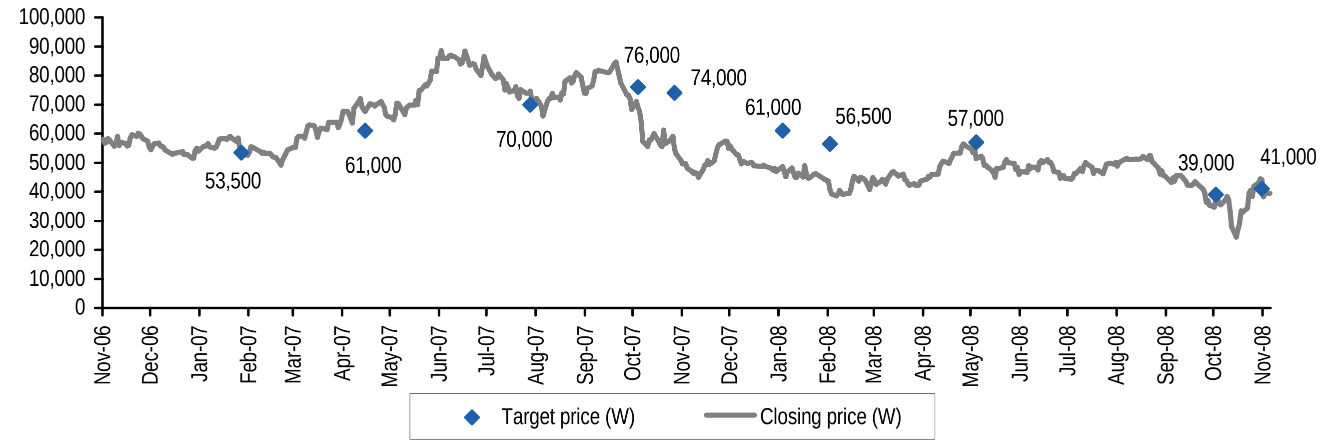
Software: Daum Communications

Date	2008-11-07	2008-10-14	2008-09-09	2008-08-01	2008-04-30	2008-02-05	2007-12-11	2007-11-07
Target price (W)	30,500	53,500	75,000	83,000	78,600	91,000	106,400	99,000
Rating	3	2	2	2	2	2	2	2



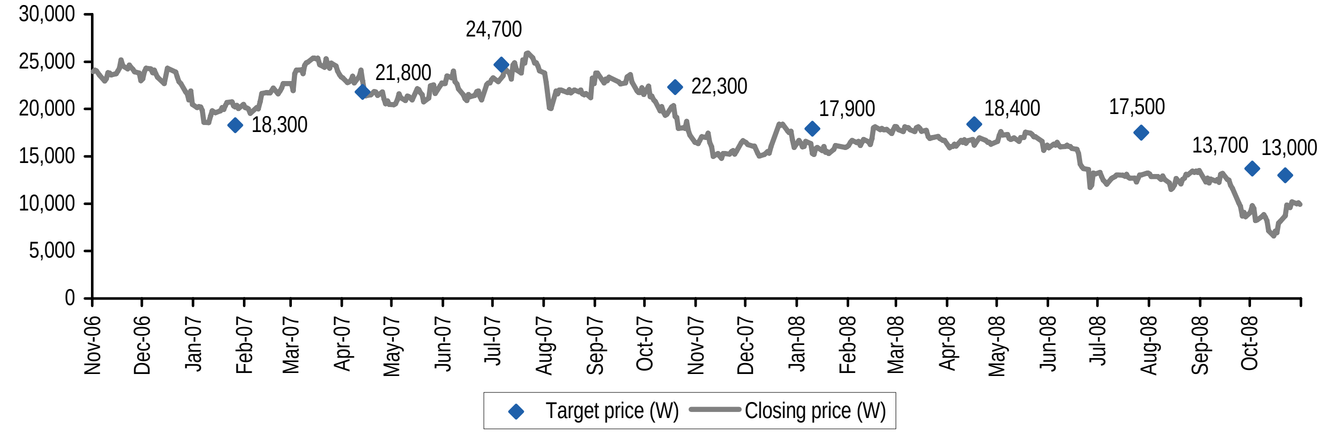
Software: NCsoft

Date	2008-11-13	2008-10-14	2008-05-16	2008-02-14	2008-01-15	2007-11-08	2007-10-23	2007-10-16
Target price (W)	41,000	39,000	57,000	56,500	61,000	74,000	76,000	76,000
Rating	3	3	3	2	2	2	2	3



Software: CJ Internet

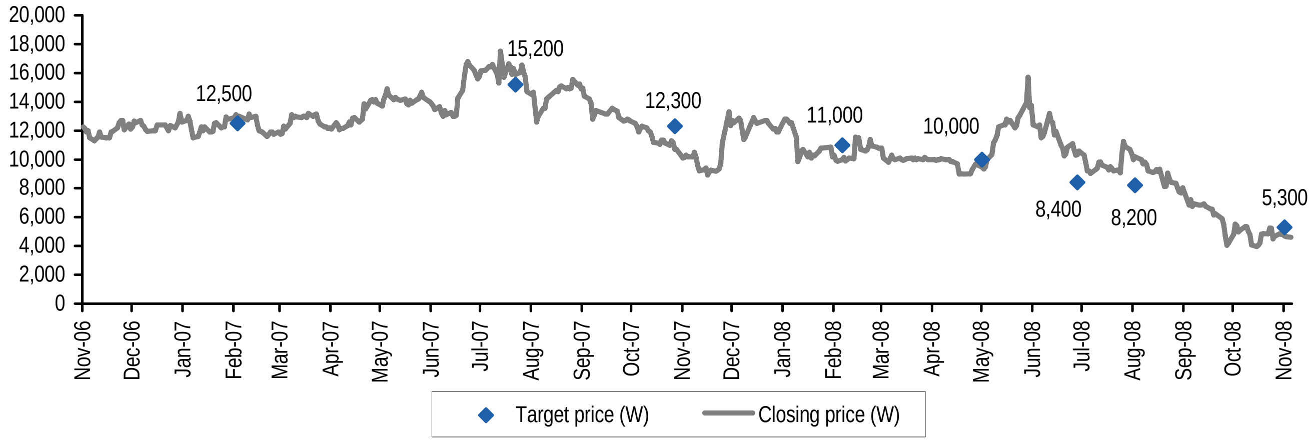
Date	2008-11-03	2008-10-14	2008-08-08	2008-04-29	2008-01-22	2007-10-31	2007-07-18	2007-04-25
Target price (W)	13,000	13,700	17,500	18,400	17,900	22,300	24,700	21,800
Rating	2	2	2	3	3	3	3	3



Source: Daiwa

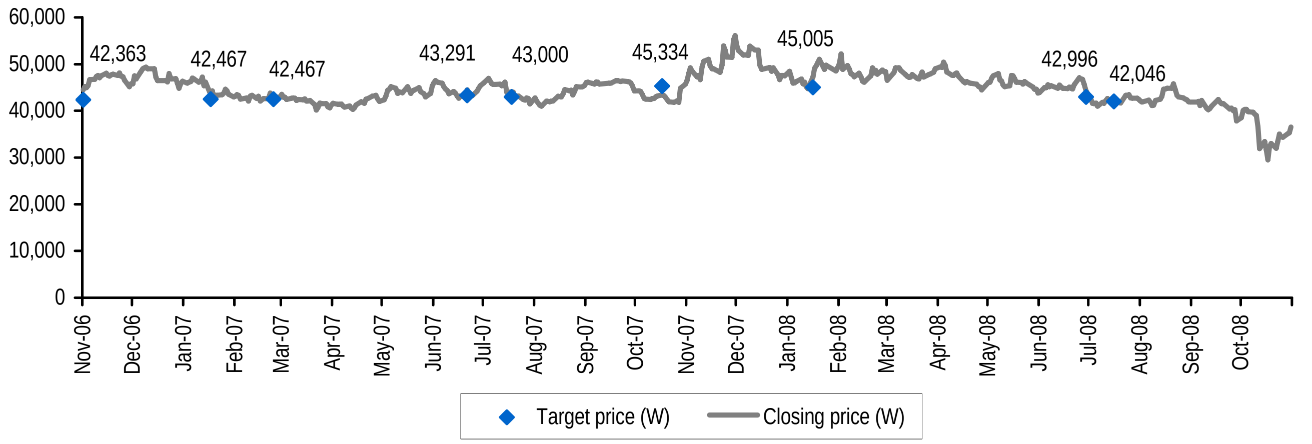
Software: Webzen

Date	2008-11-14	2008-08-14	2008-07-10	2008-05-13	2008-02-18	2007-11-08	2007-08-03	2007-02-15
Target price (W)	5,300	8,200	8,400	10,000	11,000	12,300	15,200	12,500
Rating	3	4	4	3	3	3	3	3



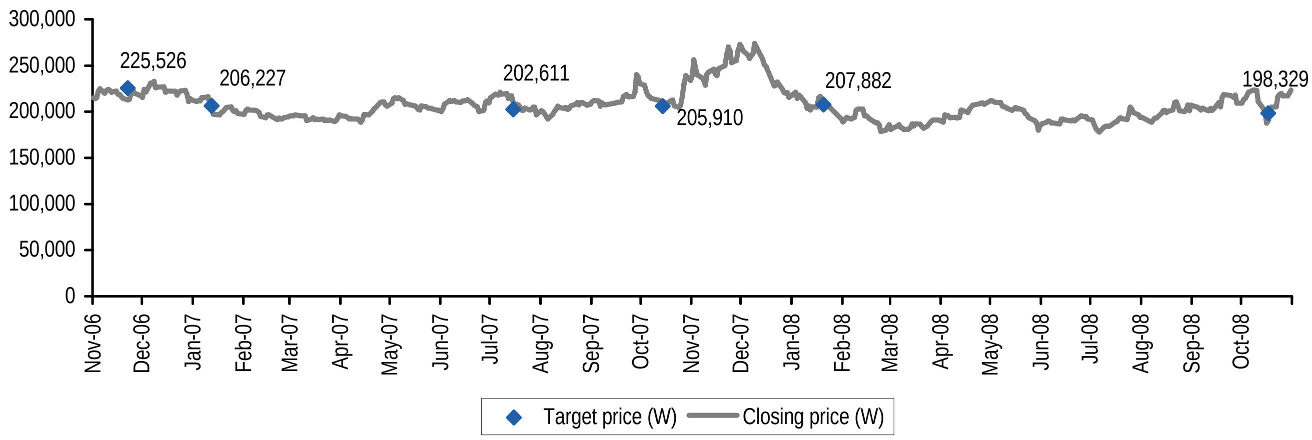
Telecommunications: KT Corporation

Date	2008-07-28	2008-07-11	2008-01-28	2007-10-29	2007-07-30	2007-07-03	2007-03-08	2007-01-29
Target price (W)	42,046	42,996	45,005	45,334	43,000	43,291	42,467	42,467
Rating	3	3	3	3	3	3	3	4



Telecommunications: SK Telecom

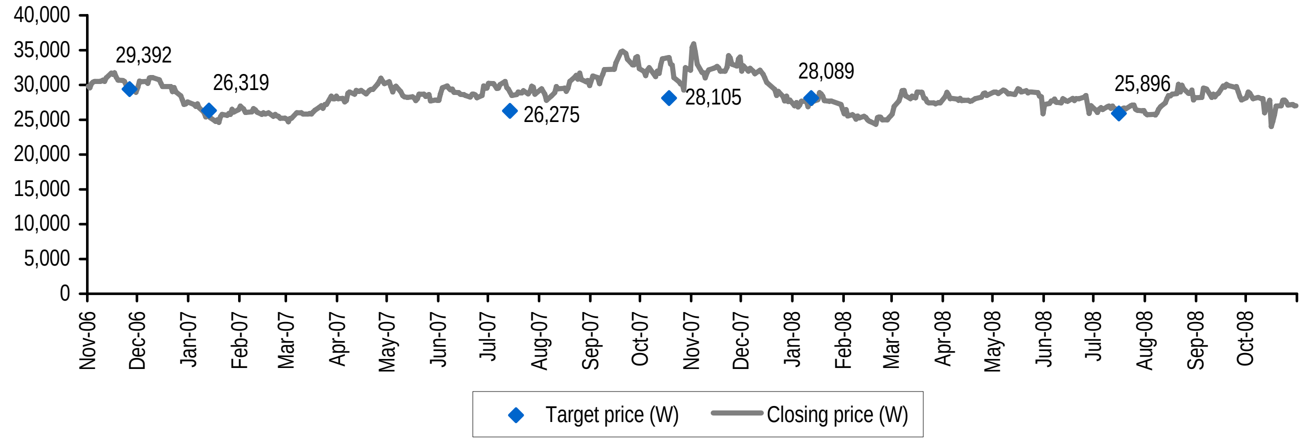
Date	2008-10-29	2008-02-01	2007-10-26	2007-07-27	2007-01-24	2006-12-04	2006-10-27	2006-08-02
Target price (W)	198,329	207,882	205,910	202,611	206,227	225,526	203,597	194,267
Rating	3	3	4	3	3	3	3	3



Source: Daiwa

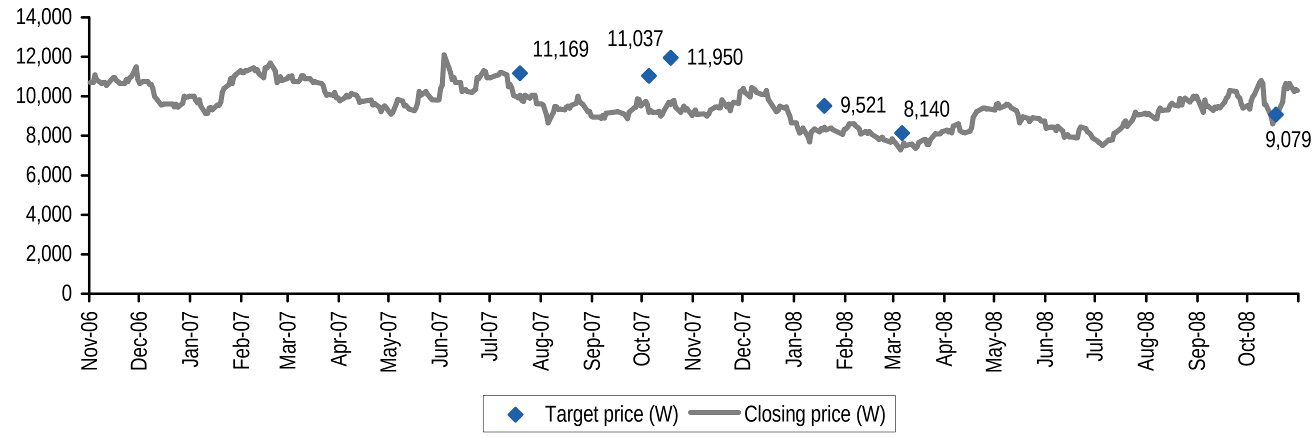
Telecommunications: KT Freetel

Date	2008-07-28	2008-01-24	2007-10-30	2007-07-26	2007-01-25	2006-12-08	2006-09-29	2006-08-01
Target price (W)	25,896	28,089	28,105	26,275	26,319	29,392	27,451	27,900
Rating	3	3	4	3	3	3	3	3



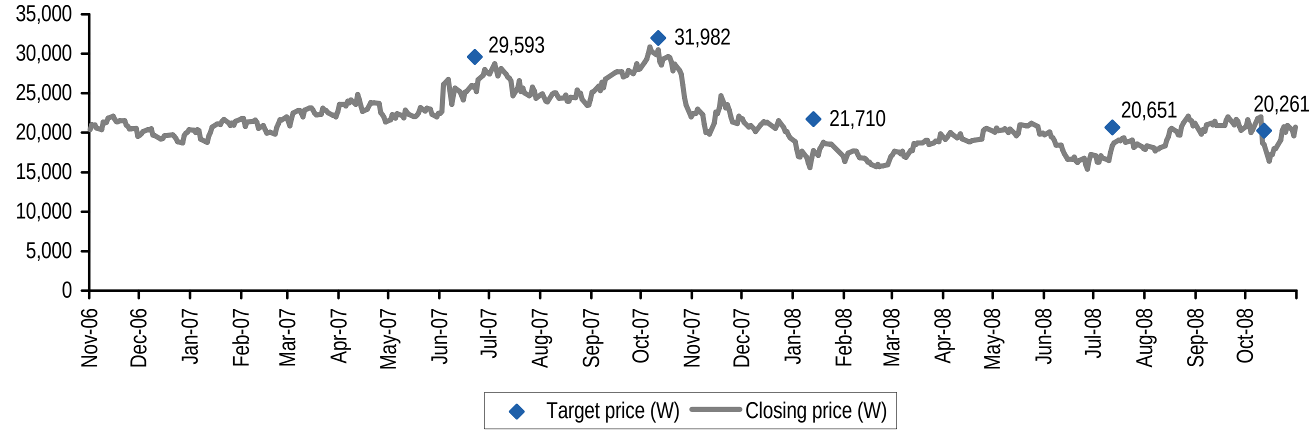
Telecommunications: LG Telecom

Date	2008-10-30	2008-03-18	2008-01-31	2007-10-30	2007-10-17	2007-07-31	2007-07-03
Target price (W)	9,079	8,140	9,521	11,950	11,037	11,037	11,169
Rating	3	3	2	2	2	3	3



Telecommunications: LG Dacom

Date	2008-10-24	2008-07-24	2008-01-25	2007-10-23	2007-07-04
Target price (W)	20,261	20,651	21,710	31,982	29,593
Rating	2	2	2	2	2



Source: Daiwa

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