China: Where Are Pockets Of Value Rising From The Dust?

This article was written by Jaco Visser and originally published on Citywire South Africa. The article can be found on their website here.

The Chinese stock market has been a big detractor of emerging market returns over the past three years, as investors got spooked by the implosion of the country's property sector and geopolitical tension with the US and Taiwan. However, some areas of value have risen from the dust.

'There are pockets of interesting companies,' said Rob Brewis, portfolio manager at Aubrey Capital Management. 'They're few and far between, and you need to be selective.'

Philipp Wörz, Citywire + rated fund manager at PSG Asset Management, recently visited China. In conversations with local property industry experts, it was estimated that filling the excess residential property inventory would take another three years.

Property is an important part of [China's GDP]; it's about a quarter of the country's GDP,' Wörz told Citywire South Africa. 'The old [economic] model was driven by property, but that ship has sailed. The government is reorienting the [economic] focus.'

He described the slump in construction activity in China in recent years as 'the source of a lot of pain in the country'. That is evident in the performance of the Chinese equity market.

The MSCI China index, which tracks 657 stocks or about 80% of the value of the country's listed equities, has had a tough period recently. According to MSCI data, over the last three years, the gauge shrunk 17.5% annually in dollar terms through the end of June and 4.1% annually over the past five years.

The MSCI China index is part of the key MSCI Emerging Markets index, which acts as a benchmark for many funds focusing on this asset class.

In valuation terms, the index traded on a forward P/E of 9.4 and a dividend yield of 2.7% at the end of June.

In comparison, the MSCI Emerging Markets ex-China index, which tracks 673 companies in developing markets outside of China, traded on a forward P/E of 13.6 and a dividend yield of 2.6% on 28 June. The ex-China gauge gained an annualised 1.35% over the three years through the end of June and 6.66% annually over five years, both in dollar terms.

Value remains

Despite the Chinese market's underperformance compared with other emerging peers, stocks still offer value.

'I think there is value to be had in a lot of places as the market looks quite cheap,' said Brewis (pictured below). 'The question is some [stocks] can stay cheap for a long time, and that's the challenge.'

For instance, Brewis, who helps manage emerging market strategies not for sale in South Africa, saw value in China's beleaguered e-commerce space.

'The e-commerce sector looks incredibly cheap these days,' he said. 'Tencent… is probably one of the better big companies because it's a business you can't do without.'

Ecommerce stocks

Tencent Holdings, listed in Hong Kong, has gained 15.9% over the past year and trades at a P/E of 26 and dividend yield of 0.9%. Over the past six months, the stock has gained 34%. One reason for Tencent's sharp rerating is the release of the mobile phone game Dungeon & Fighter, which was keenly anticipated. Also, in May, the company reported a 62% jump in net income for the first three months of the year, compared with the same period a year earlier, according to company financial statements.

Another tech stock that has outperformed the Chinese market is Tencent Music Entertainment Group, listed on the New York Stock Exchange. The share has almost doubled over the past 12 months and trades at a P/E of 32 and dividend yield of 0.9%.

'[It's] the Spotify of China,' Brewis said. 'It's a slightly different model than Spotify, but basically the same path, which is persuading more and more people to pay for your product. Over the last few years, they've taken that paying ratio from about 10% to 20%, [whereas] Spotify is 40%. There is still some room to go.'

A so-called recovery play for Brewis is the online travel company Trip.com Group.

The company, listed in Hong Kong, gained 48% over the past 12 months and traded at a P/E of 22.4. During the first three months of the year, Trip.com saw total revenue jump around 80% as domestic hotel and air ticket bookings increased by more than 20% each and outbound hotel and air ticket bookings more than doubled each compared to the same period a year earlier, according to an earnings release.

'It has still more to go,' Brewis said. 'It's a bit of a recovery play as China opens up, and people start to travel.'

Online travel

Despite Chinese consumers under pressure from the fallout of the country's property bubble cutting back on discretionary spending, Brewis saw a generational effect at play.

'Travel is one of the things that the Chinese, particularly the younger generation, want to keep doing,' he said. 'Trip.com is well placed to take advantage of that.'

For Wörz (pictured below), ANTA Sports Products, listed in Hong Kong, presents value as structural and societal changes take hold in China. The Chinese government cracked down hard on online gaming in recent years, prompting the country's people to be more active.

'It's a sportswear company that benefits from structural growth drivers of sports in China,' Wörz said, 'which, ironically, is also aligned to the goals of the government. The market is underappreciating that growth potential in China and the potential to expand internationally.'

ANTA's share price declined almost 11% over the past 12 months and is trading at a P/E of 18 and dividend yield of 2.8%. However, according to Wörz's estimate, the stock trades at a forward P/E of 13, leaving an upside of 28%.

‘It’s [trading at] a big discount with high growth potential,’ he said.

Beer and ports

Sticking to undervalued stocks, Wörz is also optimistic about Budweiser Brewing Company APAC, which is listed in Hong Kong. The stock lost almost half its value over the past 12 months and trades at a P/E of 19 and dividend yield of 4.3%. The company is a subsidiary of Anheuser-Busch InBev.

‘It benefits from strong premiumisation of beer consumption in China and long-term growth in India,’ Wörz said. ‘We’re buying what we think is a long-term compounder at a low valuation of low-teens [forward] P/E, [and] a lot of net cash on the balance sheet.’

PSG has also invested in CK Hutchison Holdings, a Hong Kong-based conglomerate that includes port operations in around 25 countries, telecommunication businesses in Europe, and a health and beauty retail unit.

The stock has lost 19% over the past 12 months to trade on a P/E of 6 and dividend yield of 6.8%.

‘It’s one of Hong Kong’s oldest companies,’ Wörz said. ‘It’s got some reasonably quality businesses, but it’s trading at a 70% discount to NAV. Ultimately, we think we’re getting paid to wait for some value unlock in the years to come through a dividend yield of almost 7%.’