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China, the long-term performance is positive

Dawid Krige, advisor of Banor Sicav Greater China Equity Fund, answers Fondi&Sicav's questions on Chinese stock market

"The outlook for Chinese domestic consumption is positive" comments Krige, Banor Capital

China equity has a P/e ratio of 12.85, sensibly lower than developed countries equity. Do you think this data shows a real discount of the Chinese stock market or it's something less relevant while considering this market?

While Chinese equity indices are currently on modest multiples, we don't think this is a particularly useful way to assess the investment opportunity set due to the prevalence of state-owned enterprises (SOEs), which in most instances deserve to trade at a discount. Instead, we find it instructive to consider the valuations and growth potential of high-quality Chinese companies in absolute terms and relative to their Western peers. On this basis, we view valuations to be highly attractive.

Take beverages for example: market-leading brands Kweichow Moutai, Wuliangye and Jiangsu Yanghe are centuries-old and enjoy household

familiarity. Yet they trade at a mere 7-12x this year's pre-tax earnings, compared to Diageo on 18x. Might lower profitability and/or growth potential explain the Chinese companies' valuation discounts? On the contrary: all three are highly profitable, and their earnings are forecasted to grow c. 20% p.a. over the next two years, i.e. three times that of Diageo's.
Similarly, ecommerce players Alibaba and JD.com are both growing faster than Amazon while trading at a fraction of the American company's price to gross merchandise value (the value of goods sold on an ecommerce platform). And in financial services, Noah, the Chinese wealth and asset manager, is expected to grow its earnings at more than 20% p.a. over the next two years, double that of the UK's Hargreaves Lansdown. Yet Noah is trading on 16x this year's earnings vs. Hargreaves on 33x. On a pre-tax earnings basis, its valuation discount is even more enticing.

Many people point at the private debt/GDP ratio (currently at 160%) as a time bomb for China financial market. What other factors could challenge the opportunities on the A-shares?

While issues such as debt, trade wars and slowing GDP do influence share prices in China periodically, they are unlikely to detract meaningfully from long term performance. Despite the naysaying about China in the popular global press, China was one of the fastest growing economies in the World last year with 6.4% growth.

Additionally, the Chinese government has said it is focused on domestic consumption as the key driver of economic growth. It has backed this up by putting money back into the pockets of consumers, with massive tax breaks for individuals and further planned tax breaks for corporations employing millions of consumers.

Further to this, the population is still urbanising, the middle class is still growing, the rich are getting richer. There are more dollar billionaires in China today than there are in the US.

The outlook for Chinese domestic consumption is positive and the companies which face these consumers should benefit.