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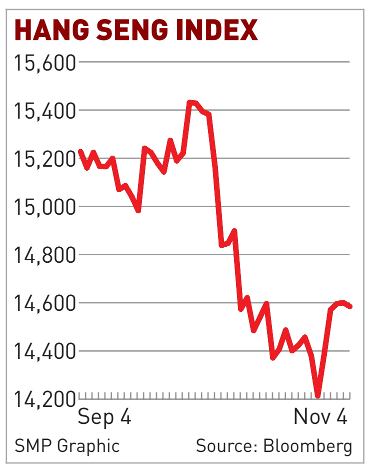
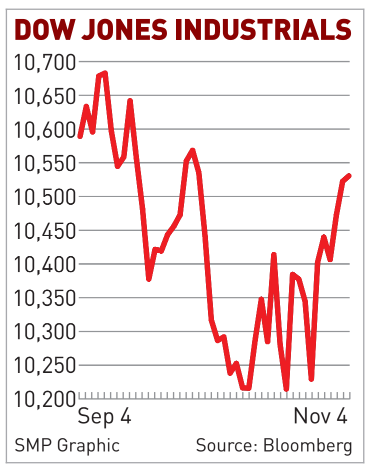


Hong Kong shares are likely to move in a narrow range this week as the threat of bird flu and persistent concerns over higher interest rates continue to cap gains, dealers say.

The banks' 50-basis-point increase, which was higher than the quarter of a percentage point rise in the US Federal Reserve's key rate, raises concerns about the outlook for the property market and the developers.

"There has been very little fund inflows. Investors are cautious and obviously bird flu is impacting the market," said Herbert Lau, chief investment officer of Cash Asset Management. "They are watching further development on the outbreaks."

The Hang Seng Index ended the week up 289.90 points or 2.0 per cent at 14,585.79. *AFP*



United States stocks could edge higher this week on hopes for strong holiday spending after retailers' October sales were healthier than expected.

However, crude oil prices at US$60 a barrel could spoil the mood on Wall Street. Some market strategists see stocks struggling for direction, with most earnings reports out of the way and little on the economic agenda.

"It's going to come down to how sales are pre-Christmas," said Marc Pado, a market strategist for Cantor Fitzgerald. "I would expect the week, while remaining positive, to have not as robust a move as we saw last week."

For the week, the Dow Jones Industrial Average ended up 1.2 per cent at 10,530.76, the S&P 500 gained 1.8 per cent to 1,220.14 and Nasdaq climbed 3.8 per cent to 2,169.43. *Reuters*

EXCHANGE RATES

HK$	Bid	Ask
£	13.5670	13.5670
SFr	5.9304	5.9304
*¥	6.5503	6.5529
S$	4.5545	4.5578
A$	5.6820	5.6856
C$	6.5494	6.5507
Baht	0.1888	0.1889
NZ$	5.2931	5.2979
*Won	0.7395	0.7395
M$	2.0564	2.0566
NT$	0.2304	0.2304
Euro	9.1583	9.1596
Peso	0.1407	0.1407
Yuan	0.9588	0.9589

Rates yesterday *per 100 units Source: Bloomberg

With rapid growth in electronic sales, China's richest man is poised to improve the position of the major player, says **Andy Mantel**

Gome plugged into market

Rapid economic development in China is drastically improving people's living standards.

Together with rising urbanisation and growing disposable income levels, a sizable retail market with high growth opportunities is emerging. According to the National Bureau of Statistics of China, annual retail sales of consumer goods on the mainland increased from 3.4 trillion yuan in 2000 to 5.4 trillion yuan in 2004.

Sales of household appliances and electronic products on the mainland are growing faster than the general retail market. Sales of these products increased from 296.9 billion yuan in 2000 to 518.4 billion yuan in 2004.

We find this sector very attractive and continuously monitor it for appropriate investment opportunities. Retail stocks command some of the highest valuations on the mainland – about 20 times current earnings.

Recently, we have taken a positive view on Gome Electric Appliances Holdings after its share price crashed because of market rumours. Based on turnover, Gome has been China's largest electrical and electronic products for the past four years. At the end of June the company operated 188 retail stores in 42 cities.

In late June, Gome's share price fell almost 40 per cent in less than two weeks because of persistent rumours that the chairman was setting up a new company in direct competition with the existing company to be run by a senior executive. Gome held a conference call to clarify to analysts that the new business line was a subsidiary that would concentrate on larger stores.

Gome chairman Wong Kwong-yu also bought 3.8 million shares worth approximately $16 million in the open market that same day, the first time he had bought back shares since the company successfully completed a backdoor listing in June 2004.

Falling prices in China's manufacturing industry is a well known problem, however Gome has tackled the problem with success. Its brand name has outpaced 32,000 electrical appliance retailers to become the largest player in China.

According to the Ministry of Commerce, the six biggest players generated sales of 67.7 billion yuan and controlled a combined market share of 18.7 per cent in the first half of this year. Among them, Gome has 5.4 per cent share, Sunning 4.9 per cent, and Yongle 2.6 per cent. With such a highly fragmented industry there is ample room for larger players with sufficient capital and management know-how to expand market share.

The 36-year-old Mr Wong, recently named China's richest person by *Forbes* magazine for a second year with a fortune of US$1.7 billion, has the track record and energy to successfully lead the company through the pending industry consolidation.

Gome has ample cash and the company has a return on equity of 39 per cent. The company has a 5 per cent operating margin, versus 3 per cent for its closest competitors. So far this year, half of Gome's 56 new shops have been set up in smaller, so-called tier two cities. Given the lower disposable income levels in these areas, however, Gome's sales per square metre for the group may decline in the short term. But with a lower cost base and the high probability that Gome can duplicate its success from larger cities, we believe the focus to expand in frontier cities is prudent and will contribute positively to the company's bottom line for years to come.

The average investment for a typical 3,500 sq m store is only 1.5 million yuan and suppliers take responsibility for investing in fixtures, equipment and decoration of their own retail spaces. This enables Gome to enlarge its operating scale under a low-capital expansion model and growing economies of scale benefits return on equity. Gome has achieved break-even at new stores within the first six to eight months of operation. Economies of scale can thus aid bulk purchase discounts and volume rebates from suppliers.

In the first half the company reported a turnover of $7.8 billion, up 32 per cent year on year. Excluding a $20 million non-recurring operating gain in the first half or last year, the recurring net profit rose 12.7 per cent to $224 million. Gome is trading at an estimated price/earnings multiple of 14 times this year's earnings.

We have decided to change two previous calls, namely the short recommendation in March for Nasdaq-listed online game operator The9Ltd and also the long recommendation in June for wireless equipment maker Comba Telecom.

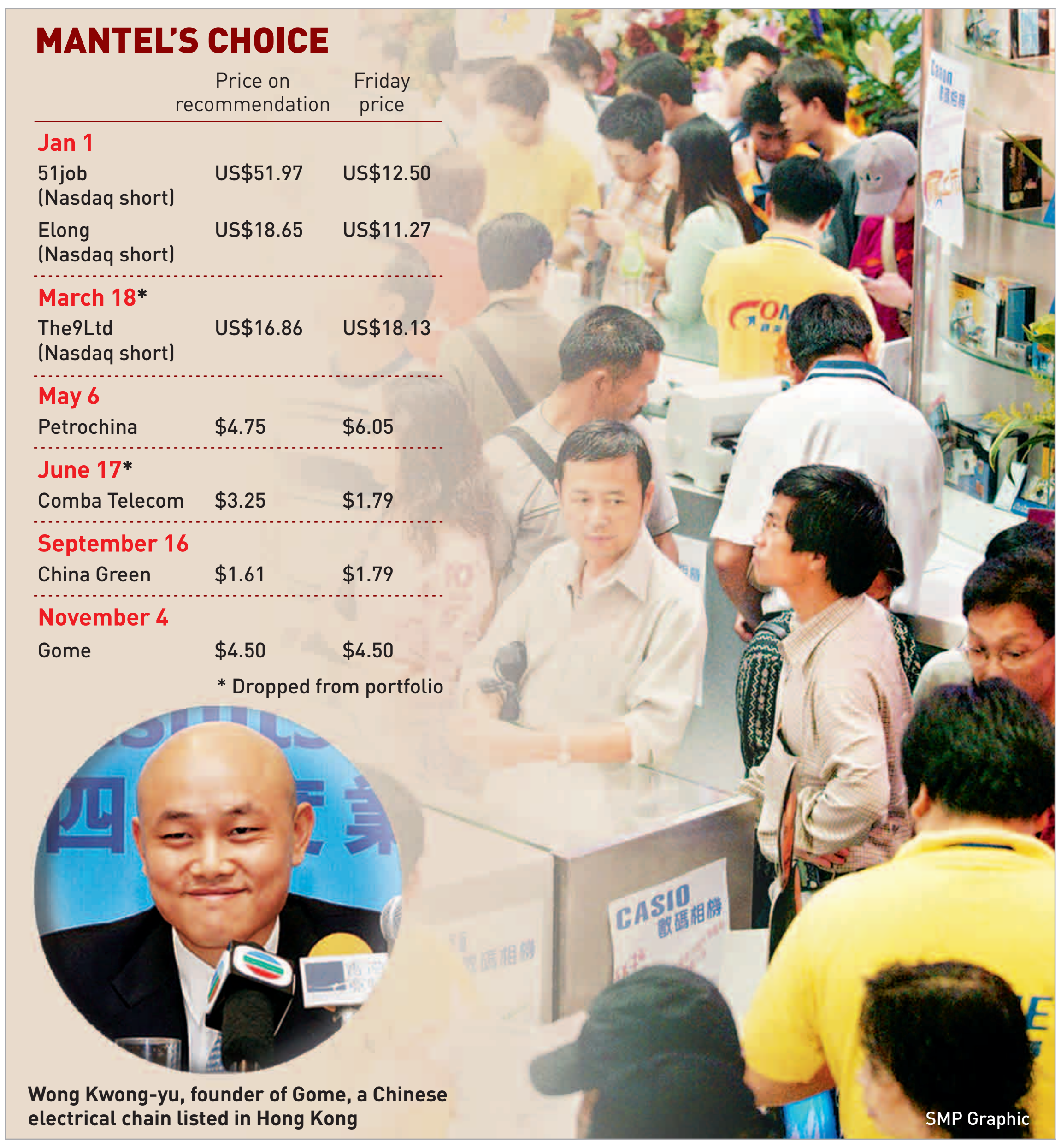
For the former, the durability of the online game model for the leading players has proven to be better than we expected and as a consequence we expect The9Ltd to post improved profitable quarterly earnings for the rest of the year after losing money in each of the first two quarters. Comba Telecom, on the other hand, has been hurt by falling orders due to China's delayed issuance of new 3G licences.

Andy Mantel is managing director of Pacific Sun Investment Management and manager of the China Mantou Fund. The fund is available to accredited professional investors only. www.pacificsun.com.hk

MANTEL'S CHOICE

	Price on recommendation	Friday price
Jan 1		
51job (Nasdaq short)	US$51.97	US$12.50
Elong (Nasdaq short)	US$18.65	US$11.27
March 18*		
The9Ltd (Nasdaq short)	US$16.86	US$18.13
May 6		
Petrochina	$4.75	$6.05
June 17*		
Comba Telecom	$3.25	$1.79
September 16		
China Green	$1.61	$1.79
November 4		
Gome	$4.50	$4.50

* Dropped from portfolio



Wong Kwong-yu, founder of Gome, a Chinese electrical chain listed in Hong Kong

SMP Graphic

Play a waiting game until fears recede

INVESTMENT TIPS
PAUL PONG

The China Construction Bank offering was over-subscribed more than 9 times for retail investors and my portfolio was allocated only 13,000 shares. I expect to hold it for the medium term for a 5 to 10 per cent gain.

Poor third-quarter results sent Sinopec's share price down despite a fall back in oil prices to around US$60 per barrel. Authorities have considered slowing down refining projects due to slower demand growth. Next year the company's capital expenditure will be cut by 4 billion yuan to 58 billion yuan.

This was the first time Sinopec's quarterly profits have dropped since listing. For the three-month period ending in September, profits declined to 8.6 billion yuan from 10.79 billion yuan a year earlier. Hong Kong Exchanges and Clearing has good prospects and will be maintained in the portfolio for the long term. Since inclusion, the share has risen 35 per cent. As the world's ninth-largest stock market and an important platform to Chinese enterprises raising funds, the Hong Kong stock exchange, operated by HKEx, should continue to provide steady returns.

Looked at from a different angle, HKEx can be viewed as a defensive hedge against rising oil prices or avian flu worries.

The market is consolidating at the moment and I will maintain the bolstered cash position until sentiment is clear.

I expect a weakening of the US dollar and an upward gold price to help boost the prices of precious metals. The FTSE Gold Mines Index and gold prices have advanced 4.9 per cent and 8.2 per cent respectively for the year. Amid fears of rising inflation the gold price reached a 17-year high in mid-October at US$483 an ounce.

Zijin Mining, the only gold mining stock listed in Hong Kong, is a possible selection for those who believe gold prices will continue on the upwards march.

I will take profits on Xinyu Hengdeli. The performance has been exceptional, rising more than 40 per cent since listing. The group is a mainland wholesaler and retailer of watches targeting affluent customers seeking international brands.

I question the upside potential of the two upcoming real estate investment trusts (reits). Property prices are capped by the rising prime rate, while rental yield is limited. Residential property prices have surged around 10 per cent compared to October last year.

Neither the Housing Authority's Link Reit nor Cheung Kong's Prosperity Reit appear attractive owing to the changing economic environment. According to investment bank UBS, the Link Reit will yield 5.1 per cent to 6 per cent, while Goldman Sachs says the range is 4.7 per cent to 6.1 per cent. The yield estimate on Cheung Kong's Prosperity Reit is between 5 and 5.3 per cent.

In my view, the danger of a flu pandemic is declining as the world is taking adequate precautions. The situation is different to the H5N1 outbreak in Hong Kong a few years ago. When fears subside, I believe the market will pick up in the weeks ahead. However, as there is some risk, I will be cautious now and defer any new investments.

Paul Pong is managing director of Pegasus Fund Managers. He is an SFC licence holder. Neither he nor his associates hold any stocks mentioned above.

PEGASUS' PORTFOLIO

Stock	No of shares	Average Entry price	Current price	Market value
Cheung Kong (Holdings)	1,000	$83.55	$80.35	$80,350
China Mobile (Hong Kong)	6,000	$35.00	$35.05	$210,300
Sinopec	28,000	$3.375	$3.40	$95,200
Hong Kong Exchanges and Clearing	10,000	$19.85	$26.80	$268,000
Li Ning	34,000	$3.275	$4.75	$161,500
Lianhua Supermarket	10,000	$8.20	$8.25	$82,500
PCCW	46,000	$4.475	$4.875	$224,250
Ping An Insurance	16,000	$13.25	$12.75	$204,000
Sino Land	22,000	$9.175	$8.45	$185,900
Xinyu Hengdeli	76,000	$1.32	$1.88	$142,880
China Construction Bank	13,000	$2.35	$2.35	$30,550

Starting capital: $2 million
Total portfolio value: $2,137,470
Portfolio gain: $137,470
Cash (excluding dividends and trading costs): $452,040

Hang Seng Index gain
(February 11 – November 4 2005): **5.35%**
Portfolio gain
(Feb 11 – Nov 4): **6.87%**
H-share index gain
(Feb 11 – Nov 4): **1.55%**

Indian rally looking stretched

Chris Davis

Fund managers are beginning to take a cool view on what may be an overheated market of speculative small-cap Indian stocks.

The spectacular rally that saw the broad market BSE 500 Index gain 266 per cent over the past 18 month is now looking stretched, with the average earnings of the index having risen to 17.9 from a post-Sars low of 8.34 in April 2003. The 30-stock BSE Sensex – the equivalent of the Hang Seng blue-chip index – has risen 222.6 per cent for the period to trade at an average price/earnings of 17, up from 15 at the start of the rally.

"The dedicated Indian managers we regularly speak to express concern about the small-cap area, arguing that many of the smaller companies now look frothy and susceptible to an earnings slowdown," said Jacqueline Aldhous, head of offshore equity analysis for London-based Forsyth Partners.

Hedge-fund managers are believed to have been especially active in India over the past year, but their long-term commitment to the market remains in question.

The current p/e of the BSE Small Cap Index of 31.2 appears fully valued compared with the broader indices. About US$6 billion of foreign funds have entered the market in the year to date.

Traditionally, the Indian market has been driven largely by domestic investors, especially the smaller cap stocks which are often viewed as too risky by the large foreign funds.

Krish Shanbhag a fund manager with HSBC Asset Management, said Indian small caps had risen sharply over the last six months and outperformed the large cap indexes but were currently going through a period of correction.

"Of the more than 3,000 small cap companies traded each day about 500 are risky penny stocks and this can mean uncertain territory for the unwary investor," Mr Shanbhag said.

In the last months, the small-cap index has declined almost 20 per cent, three times the fall for the Sensex, which dropped only 6.21 per cent for the period.

When sizing up individual stocks, Mr Shanbhag looks for companies that are growing rapidly but have yet to be recognised. "I look for growth companies trading at a discount," he explains. "I look for companies that have very low price/earnings to growth ratios, those that are trading at a discount to their growth rate," Mr Shanbhag said.

Analysts say the slip in the market has been caused by fears of inflation, owing to high crude oil prices and higher US interest rates.

Big funds have pulled about US$800 million out of the market since the peak in October.

Investors in line for Alberta gain

Chris Oliver

Alberta-based Redev Properties says those who bought into a Calgary shopping complex 2½ years ago stand to make a capital gain of 44 per cent if a recent offer for the site is accepted.

A vote will be put to stakeholders this week on a bid by a North American real estate investment trust for the 35,880 sq ft Northmount Village shopping mall in northwest Calgary. Investors stand to receive C$72,000 ($471,556) for each C$50,000 originally paid.

The project has yielded 7 per cent annually after deductions for mortgage payments and taxes, according to Brett Cameron, a sales director for Redev in Hong Kong. The project was marketed solely to Canadian investors, but similar projects have been sold in Hong Kong since Redev opened an office in January.

Interest in Alberta real estate, including its corporate headquarters Calgary and the provincial capital Edmonton, has soared on rising energy prices.

Redev is marketing the Whitemud Crossing & Shopping Plaza in Edmonton and the Castleridge Plaza Two in Calgary, both providing rental yield and possible capital gains in five to 10 years.

WHAT THE BROKER SAYS

Sharply rising grape costs in China this year and next are forecast to weigh on Dynasty Fine Wines Group, prompting Nomura to cut its rating on the stock from "buy" to "neutral".

Dynasty, in which Remy Cointreau and Tianjin Development have substantial stakes, made its debut on the Hong Kong exchange in January. The broker has cut its fair-value estimate from $3.22 to $2.73 a share, mainly because of the high costs. The counter closed on Friday at $2.775.

The grape yield per hectare in most vineyards in China has fallen at least 25 per cent this year because of adverse weather, though the effect has been partly offset by an increase in planted area.

Packaging costs have fallen on greater economies of scale and distribution margin should rise on stepped up marketing efforts in the second half. The broker expects growth in the sector to remain strong.

Nomura has built in a 12.5 per cent increase in grape costs for 2005 and 2006 to reflect the weather-affected supply. Its previous forecast of a 3 per cent cost year-on-year rise in costs was based on a global grape glut, though not in China. In its revised estimates for 2005, growth in earnings before interest and tax falls from 22 per cent to 9.5 per cent and net income growth falls from 27 per cent to 15 per cent.

WHAT THE BROKER SAID

About a year ago DBS Vickers Securities said sports goods manufacturer Li Ning was positioned to benefit from the success of China at the Athens Olympics and publicity leading up to the 2008 Beijing games. That, with increased leisure spending, bode well for the market in China.

The broker expected Li Ning's earnings to grow by 25 per cent a year from 2004 to 2006, driven by network expansion and margin improvement. It recommended Li Ning as a "buy" and set a one-year price target of $3.40.

The company was expected to make a net profit of 127 million yuan in 2004, 164 million yuan in 2005 and 198 million yuan in 2006. Strong distribution aside, Li Ning was distinguished from the other manufacturers in having an effective marketing strategy, the most recognised effort beings its sponsorship of Chinese Olympic athletes. That, coupled with its focus on product development, should strengthen the company's brand reputation. DBS Vickers believed momentum might enable the share to exceed its price target if earnings surprised to the upside.

The counter was trading around $3.03 about a year ago.

The company reported a profit of 133 million yuan for 2004. In August it said net profit in the first half of 2005 soared 42.6 per cent to 78.3 million yuan. The counter closed on Friday at $4.75.