

China A Shares – Get Connected

MMA: bridging the A/H gap

Equity Strategy

Asia Pacific

MMA to drive A/H compression

Chinese A and H shares often trade at very different prices (+/- 30% is not uncommon), and in aggregate dual-listed A shares currently trade at a 10% discount. Much can be explained by China's relatively closed capital account and large differences in the investor base. As such, we believe that this gap should start to narrow with the introduction of Shanghai-Hong Kong Mutual Market Access (MMA).

Bridging the gap

We believe a number of reasons can explain the gap: (1) Liquidity premium – individuals and small institutions in the A-share market favour small caps vs. institutions paying a premium for H share large caps (Figures 1 & 2). (2) Asymmetry of information and styles – mainland investors are more news-flow driven, trade more frequently and prefer growth to value. (3) H-share investors are more sensitive to macro data. (4) Cost of capital differences (LIBOR vs. SHIBOR) means dividend yields appear more attractive to H-share investors. (5) Stock specific factors driven by company/shareholder actions in either share class.

A shares at a discount or with scarcity value should benefit

We believe that MMA will be a positive catalyst for A shares and neutral/slightly negative for H shares. International investors may prefer inexpensive A shares in the large-cap financials and materials sectors. Consumer and health care may benefit from scarcity value given greater opportunities to play the "new economy" theme in the A-share market. Overseas value-oriented investors could also exploit asymmetry in investment styles to buy stable blue-chips at a discount.

Eight A share stock ideas

With the help of our analysts we have identified eight A shares that are trading at a discount to their H shares and may benefit from the introduction of MMA. These are Anhui Conch Cement, China Merchants Bank, Citic Securities, Haitong Securities, Huaneng Power, Jiangsu Expressway, Ping An and Tsingtao Brewery.

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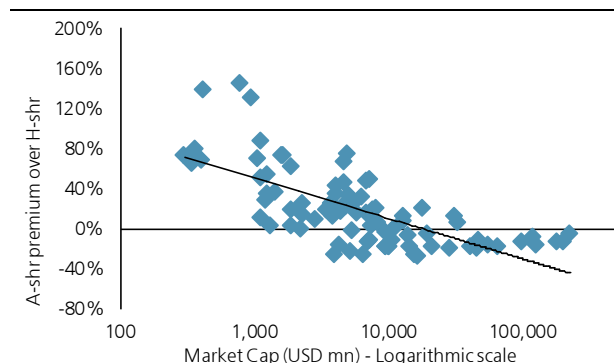
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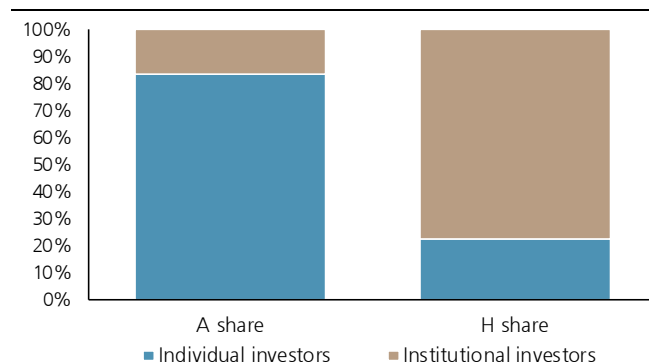
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Figure 1: A-share premium over H share of dual-listed companies vs. market cap



Source: Bloomberg, UBS

Figure 2: Transaction structures of A- and H-share markets (investor structure)



Source: CEIC Note: A-share market is as of 2011.

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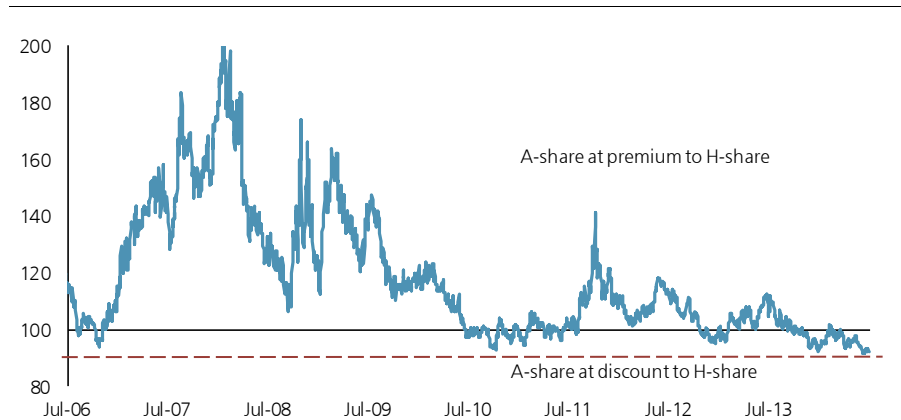
Understanding the A/H gap

The Shanghai-Hong Kong Mutual Market Access (MMA) is likely to be a major topic in the coming months. Last week we launched our [MMA Primer](#), highlighting the key attributes of the scheme but also looking at the potential implications for the A-share market, including the prospects for the narrowing of the A/H share trading range over time. In this publication we explore the A/H gap in more depth, looking at the potential drivers, how this may evolve over time and highlight eight most preferred A-shares (see pages 11-13) that may benefit. These comprise: Anhui Conch Cement, China Merchants Bank, Citic Securities, Haitong Securities, Huaneng Power, Jiangsu Expressway, Ping An and Tsingtao Brewery.

MMA could see the A/H gap narrow. We explore why the gap exists and outline eight A-shares that may benefit

Around 86 companies are dual-listed in A- and H-share markets, but only those listed in Shanghai will be eligible in the initial stage of MMA. In theory two lines of stock for the same asset with similar shareholder rights, should be expected to trade at similar prices. However the China A and H-shares often trade at very different prices. Historically, the A-to-H-share price gap was as high as 200% (A-shares trading at double the value of H-shares) as we saw in January 2008. After the global financial crisis however, A-share retail investors' enthusiasm began to wane. Since 2010, the price gap has been largely range-bound between 90%-120% - see Figure 3.

Figure 3: A-to-H share price discount of dual listed stocks near an all-time high



Source: Bloomberg, UBS Securities

For individual stocks, the A-to-H share price gap can be persistently large. For instance, Anhui Conch, the largest listed cement company in China, usually trades at more than 20% A-to-H discount. And Chalco, a leading aluminum smelter, often trades at a 40% A-to-H premium.

The capital flow restriction imposed by Chinese regulators between A-share and H-share markets cannot fully explain the persistent A/H price gap. Billions of US dollars of "hot money" travel between Hong Kong and China mainland every month, via informal channels such as falsified cross-border trades and underground banking¹. So why does this so-called "hot money" not exploit the potential arbitrage opportunities? We believe there are a number of factors which may explain why this gap exists. These are largely related to the existence of two

¹ According to the People's Bank of China (PBoC), the size of hot money is in a range of +/- US\$80bn in normal years, with the exception of US\$292bn in outflows in 2012

quite distinct investor bases which can drive differences in liquidity premium, information, investment styles and cost of capital. But also stock specific factors can also play a part as we outline below.

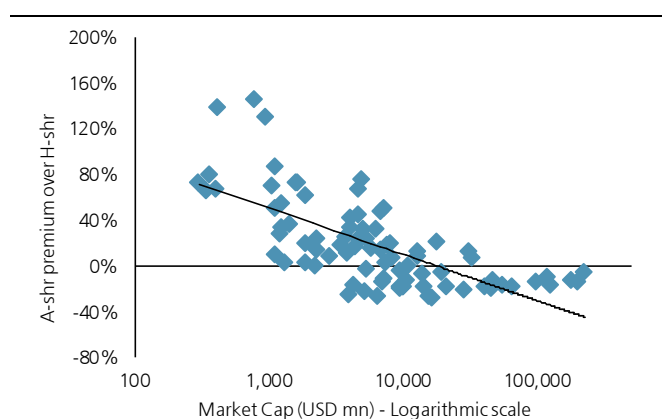
1. Liquidity premium

The A-share market is crowded with individual investors and small institutions in contrast to the H-share market which is dominated by relatively large institutional investors (see Figure 5). Naturally, the H-share market penalizes small-cap stocks with a liquidity discount (see Figure 4). On average, small-cap H-share stocks with less than US\$1bn market cap have over 50% price discount to their A-shares. In contrast, all ten large-cap H-share stocks with more than US\$45bn market cap trade at price premium to their A-shares.

It's common that many A-share small cap companies are more actively traded than large-cap stocks. For instance, the ChiNext Board comprises 380-odd stocks with average market cap of US\$750mn. It accounts for only 5% of the total free float market cap of A-shares but generates 15% of total trading turnover. This phenomenon does not exist in the H-share market - the GEM (Growth Enterprise Market) board of HKEx represents 0.7-0.8% of both total market cap and trading turnover.

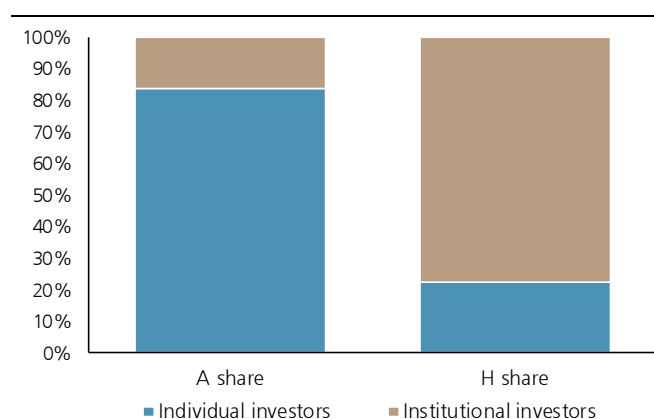
Small-cap H-shares trade at >50% discount to their A-shares

Figure 4: A-share premium over H-share of dual-listed companies vs. market cap



Source: Bloomberg, UBS Securities

Figure 5: Transaction structures of A/H-share markets (investor structure)



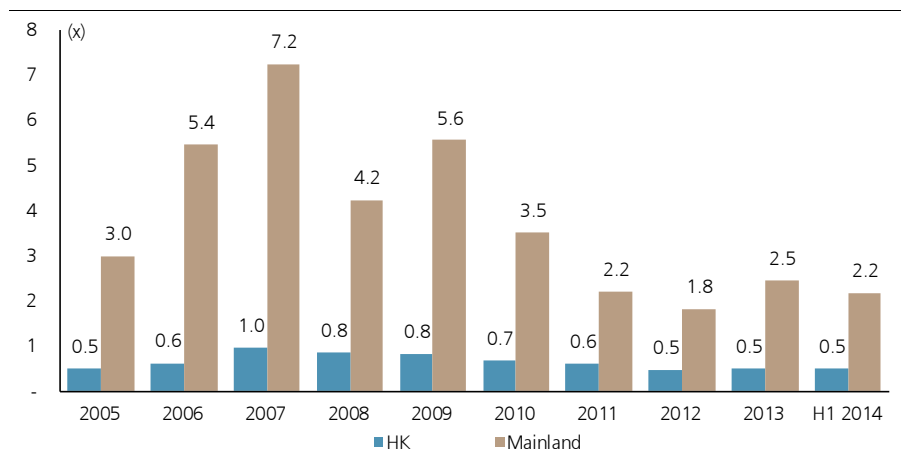
Source: CEIC Note: A-share market is as of 2011.

2. Asymmetry of information and investment style

In general, A-share investors have more "on-the-ground" information from companies and local media. As such they are typically more news-flow driven and this drives a greater willingness to re-shuffle their portfolios more frequently to capture short-term volatility in data and news-flow. Whereas in the H-share market, there are a plethora of investment styles, and we believe many institutional investors in comparison rely more on top-down analysis and more "value" driven styles than the domestic A-share investors. On average, the trading turnover is 2.5x the A-share free float market cap compared to just 0.5x on the Hong Kong market (see Figure 6). Additionally, domestic institutions often have a flexible investment mandate. Even long-only investors can hold more than 30% cash position and significantly deviate from benchmark sector weighting, allowing them to move stock positions more aggressively than overseas investors.

A-share investors are typically more news-flow driven and stock turnover is more than 4x higher

Figure 6: Annualized turnover / free float market cap

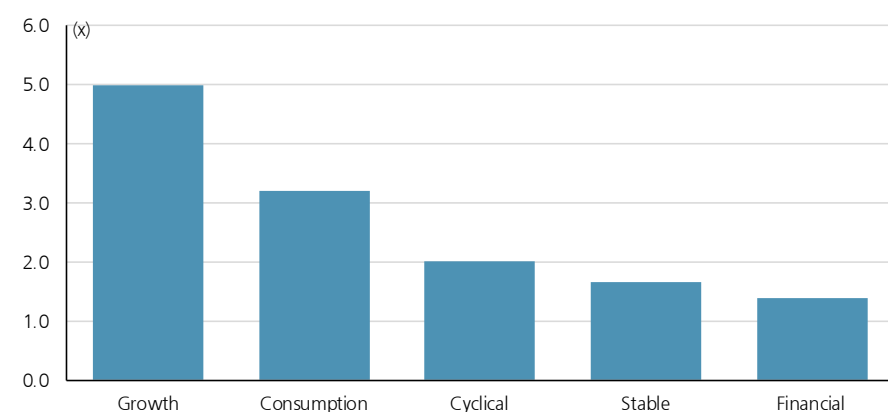


Source: CEIC

The "growth" stocks are by far the most actively traded ones in A-share market (see Figure 7). Stocks with exciting growth themes, such as cyber security, 3D printing and smart wearable devices, often trade at 6-8x turnover/market cap ratio. That means every 1.5 months; investors buy or sell all of their positions related to certain themes. Clearly this behaviour deviates significantly from the typical investment behaviour of overseas institutions.

A-share investors focus more on "growth" stocks, but H-share put more emphasis on "value"

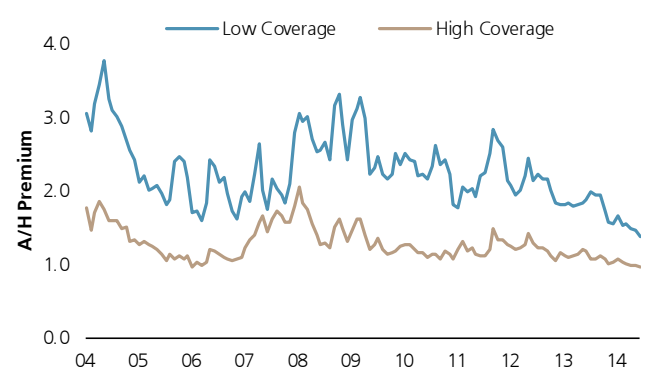
Figure 7: Trading turnover / free float market cap by investment style (2013)



Source: Wind, Citic Securities Investment Style index

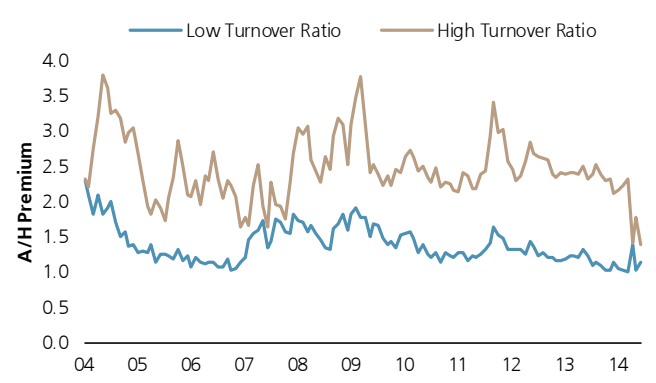
Using analysis from our Quant team, they assessed the relevance of various factors as driving the AH price gap, and identified information held and the level of speculative trading as statistically significant factors. Our quant team looked at variations in the AH gap using market cap and analyst coverage (Figure 8) as a proxy for information asymmetry, and price volatility and turnover ratios (Figure 9) to gauge speculative trading.

Figure 8: Information asymmetry: A/H premium by analyst coverage



Source: UBS Quantitative Research

Figure 9: Speculative trading: A/H premium by turnover ratio



Source: UBS Quantitative Research

So we believe that asymmetry of information and investment styles can help explain the price premium in the A-share market for growth stocks. For instance, Great Wall Motor, a leading Sports Utility Vehicle (SUV) manufacturer, traded at a c.40% A/H premium in 2013 when the SUV sales grew more than 45% YoY and caught a lot of market attention. But this premium narrowed to around 20% in H1 2014 when the SUV theme and attention faded. Similarly, the A-share market became excited by the environment protection theme much earlier than the H-share market. Tianjin Cap Environment, a large water treatment player, had over a 200% A/H price premium during 2009-2012. The H-share market started to pay attention to this theme in mid-2013 and since then the premium has narrowed, and currently stands at around 70%.

3. Sensitivity to macroeconomic data

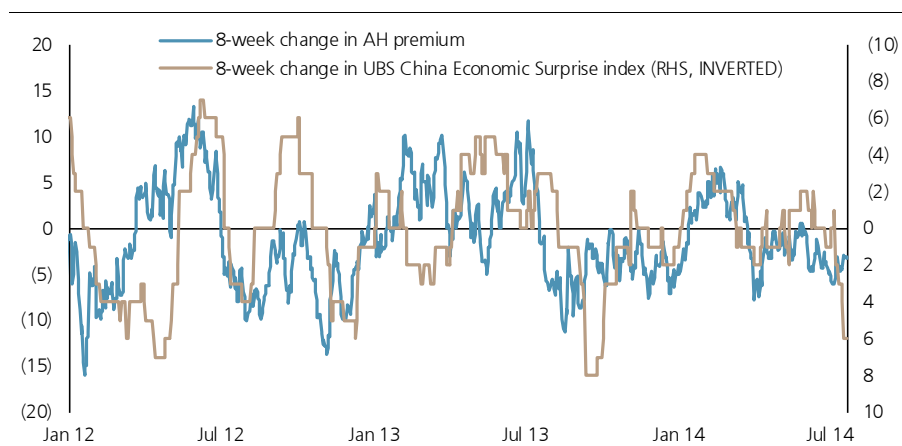
We find that the A-share market is less sensitive to macroeconomic surprises. H-shares tend to outperform (underperform) A-shares when the macro data are better (worse) than consensus expectation according to the UBS China Economic Growth Surprise index (see Figure 10).

H-shares are more sensitive to macro-economic data

We believe this relationship could be explained in four ways. Firstly, as we mentioned, international investors tend to focus more on top-down approaches than the typical A-share investor who would be more sensitive to industry/company specific news but indifferent to small changes in the macro backdrop. Secondly, international investors have alternative investment options. In a weak China macro environment they may prefer to buy alternative stocks in other countries/regions, increasing the sensitivity of the H-share market to China macro data, whereas A-share investors have limited non-China alternatives. Thirdly, many A-share retail investors tend not to focus too much on data. Investment stories are easier to catch their attention. And finally, it is possible that A-share investors have more high-frequency or "on the ground" data points to adjust their expectation ahead of the announcement of macro indicators.

In recent months, we've observed a split of perceptions on the macro economy by domestic and overseas investors. The capital flow of the H-share market turned positive from May 2014, as some macro indicators, including PMI, new starts of fixed asset investment projects, and power output, marginally improved in May and June. A-share investors seem more alert to the anecdotal evidence of further deterioration in the shadow banking system and real estate market. Correspondingly, the A vs. H price discount has widened by about 5% since May.

Figure 10: Change in AH premium and economic surprises (inverted)



Source: Bloomberg, UBS Global Economics

4. Cost of capital

Due to China's closed capital account, the cost of capital for onshore and offshore investors varies significantly. The cost of capital in the A-share market is primarily driven by domestic money market liquidity, which uses SHIBOR as a proxy. Conversely the H-share market is closely linked to LIBOR, i.e. the international money market rates. Since early 2009 1-month LIBOR has remained below 0.4% given ultra-low base rates and several rounds of quantitative easing in major economies. Meanwhile, China's liquidity environment has been very volatile, with 1-month SHIBOR fluctuating in a wide range of 1%-10%.

Under the current market environment, the cost of capital is at least 200bps higher in A-shares relative to H-shares. This helps explain why stocks with high dividend yields, such as banks and Independent Power Producers (IPPs) often trade at a discount in the A-share market. For instance, a 4.5% dividend yield may look attractive to an overseas investor in a world of low rates. But it is currently similar to the risk-free bond yield in the domestic market.

The higher volatility of onshore cost of capital has another layer of implication for the AH price gap. The annualized volatility of 7-day Libor is around 20%, but it's over 200% for 7-day SHIBOR. The sentiment of domestic investors is thus more prone to swings in sentiment in companies with high financial gearing. This may also explain why most of the A-shares of material, construction and utilities companies trade at price discount to their H-shares.

Cost of capital higher to A-share investors and therefore dividend yields appear less attractive

5. Company/shareholder actions

In some cases, the AH price gap can be a result of company or shareholder specific factors. For example the following corporate events would have an unequal impact on the two share classes:

- A company issues a convertible bond attached to the A share stock price;
- A company uses outstanding A-shares for M&A;
- A company makes secondary offering in A-share market;
- The lock-up period for A-share major shareholders expires;
- Major shareholder transaction (large buy or sell order) in A-shares ;

Differences can be explained by stock specific factors

- The government gives administrative orders to domestic institutions, such as the National Security Funds and large insurance companies, to stabilize the A-share market;
- Credit events, such as defaults, happen to an A-share major shareholder.

MMA to drive a compression of the A/H trading range

In our view, MMA is major step in changing the relationship between the A and H share markets. We would expect it to affect the first four of the five aforementioned drivers and thus help compress the typical trading range that A and H shares have historically traded in. Although clearly there is still scope for material differences in share prices as a result of stock specific factors or ongoing differences in tax rates for example too.

We would expect that with the launch of MMA, the research, information and existing understanding of each market will begin to mutually penetrate into the opposite investors' community. Overseas investors may instil some global macro understanding into the A-share market and similarly a greater focus on valuations, especially in a backdrop of slowing China growth. Mainland investors may mirror some growth themes and high-frequency industry data onto the H-share market, and foreign investors may need to develop a stronger understanding of "on the ground" data and domestic news-flow.

Mainland retail investors may also find the liquidity discount of H-share small-caps unfairly high; and overseas institutional investors may prefer large cap A-shares with high dividend yields. Therefore, differences in the liquidity premium, sensitivity to macroeconomic data, and asymmetry of information and investment style may play a diminishing role in driving the A/H share gap going forward. Additionally MMA requires overseas participants to exchange foreign currencies to Chinese Yuan in order to invest in A-shares (and vice-versa for the southbound trade), and thus differences in cost of capital may begin to narrow between the mainland and Hong Kong.

Evolution of A/H share gap

MMA is likely to drive a compression in the A/H trading range, but until full liberalisation of the China securities market, this gap is unlikely to fully close. In our view, the A/H share gap will experience three stages, each allowing different market opportunities.

Stage I: Small amount of capital enters A-share market

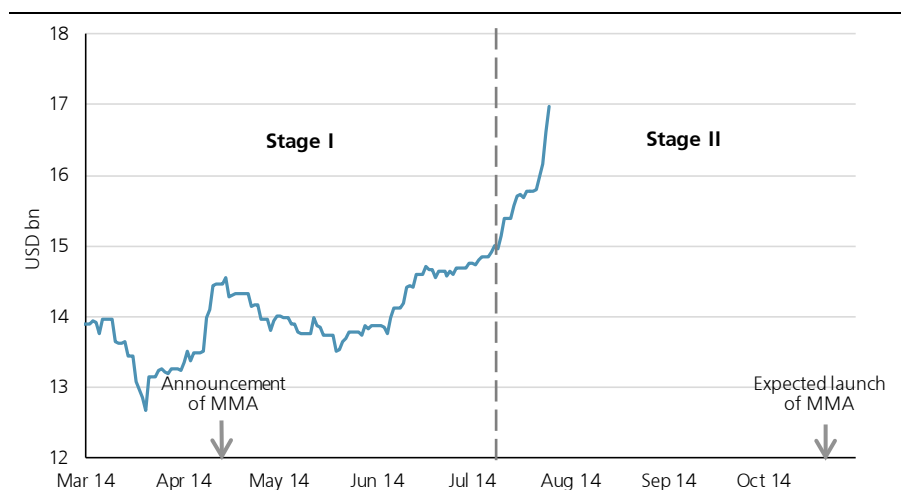
→ Minimal impact on A/H share gap

In this initial stage, investors do not fully commit to the potential impact of MMA. Only a fraction of early investors add to A-share positions ahead of MMA launch through existing channels (QFII and RQFII). The size of capital involved in this stage is small and cannot move the stock prices of large cap A-shares. Therefore we see minimal impact on the A/H price gap. At this stage, the investment opportunities are focussed on A-shares with deep price or valuation discount to H-share peers.

We believe this stage has now passed with July marking a turning point. ETF volumes of China A-shares have begun to pick-up in recent weeks (and also relative to H-share ETFs) as HK and international investors have begun to actively prepare and position themselves for MMA launch (see Figure 11).

MMA should drive a compression of the A/H gap as investor bases merge and cost of capital differences narrow

Figure 11: HK-listed A-share ETFs started to gain traction in early-July



Source: Bloomberg. Note: AuM of HKD and CNH share classes of the 10 largest HK listed A-share ETFs

Stage II: Large overseas institutions actively trade A-share market → A/H share trading range starts to compress

At this stage, overseas institutions actively seek investment opportunities in the A-share market. They also launch A-share linked products to their clients and accumulate A-share stock positions. Such behaviours will lead to material changes over time of the aforementioned drivers of the A/H price gap, such as liquidity premium and investment style. Assuming MMA quota and eligible securities restrictions are eased over time foreign investors could become a significant proportion of the investor base and trading activity, particularly with the inclusion of A-shares in MSCI benchmarks. At this stage, stocks that are more appealing to international investors are likely to perform, for example A-shares with deep valuation discounts, high dividend yields and scarcity value.

As international investors enter the market, stocks at a discount, with attractive dividend yield and scarcity value are likely to benefit

Stage III: Long-term scenario → Narrow A/H trading range

In the near-term we do not see A/H shares fully converging. Longer term though, we believe the A/H trading range could become quite narrow, but we may need to be at (or close to) a stage where quota restrictions are no longer in place and the China securities market is close to full liberalisation. At this stage, China A-shares would likely be fully included in MSCI benchmarks and foreign investors would be a large enough proportion of trading volumes for differences in investment styles to be minimal. Investors would have a good understanding of the A-share market and therefore stock picking global leaders in the right industries is likely to be in favour.

Sector Implications

We summarize the possible impact on A/H shares and key rationales in the table below (see Figure 12). In general, we believe that the launch of MMA is likely to be a positive catalyst for the A-share market and neutral/slightly negative for H-shares.

We believe that the materials and financial sectors may see active trading shortly after the launch of MMA. Many large-cap A-share names in these sectors are trading at 15% or higher discount to their H-shares and international clients may look to switch into the A-share counterparts, particularly if they regard the policy environment to be pro-growth.

In our view, the consumer and healthcare sectors provide a lot of re-rating opportunities in the mid to long-term. There are many A-share companies with scarcity value providing exposure to "new economy" segments, such as tourism, traditional Chinese medicine, smart home appliances and media.

Many A-share blue-chips, especially in the autos and food & beverage sector, trade at a valuation discount to their H-share peers mainly due to the "growth" focused investment style of domestic investors. Many of them prefer to capture the high-growth stage of companies and lack the patience to wait for established market leaders to compound their profits. Overseas "value" oriented investors could exploit such an asymmetry of investment style to buy quality companies at a discount under the MMA scheme.

Investors may switch into A-share counterparts at large discounts, e.g. materials and financials

Consumer and health care could benefit as more opportunities in the A-share market to play "new economy" themes

Attractively valued blue-chips may appeal to international investors

Figure 12: Estimated market impact within 6 months after the launch of MMA

Sector	% of index		Est. impact of MMA		Rationale
	SH A-shr	HK H-shr	A-shr	H-shr	
Energy	16.5%	11.0%	Neutral	Neutral	A/H gap is due largely to company specific reasons
Materials	8.4%	2.4%	Positive	Negative	A/H gap driven by liquidity premium; A-shr large-caps cement and steel and to benefit
Industrials					
- Capital Goods	11.5%	3.5%	Neutral	Neutral	A-shr large-cap construction to benefit but small-cap machinery likely to pay
- Commercial Services	0.2%	0.4%	Neutral	Neutral	Most A-shr leading players are not eligible for MMA at this stage
- Transportation	4.7%	1.4%	Positive	Neutral	A-shr high-div-yield stocks are attractive to overseas value investors
Consumer Discretionary					
- Automobiles & Comp	2.5%	2.0%	Positive	Neutral	A-shr provides better exposure to mass-mkt automakers and auto parts
- Consumer Durables & App	1.6%	1.0%	Positive	Positive	A-shr home appliance makers are attractive to overseas investors; H-shrs even cheaper
- Consumer Services	0.7%	0.0%	Positive	n.a	A-shr provides unique exposure to tourism segment
- Media	1.1%	0.0%	Neutral	n.a	A-shr provides exposure to movie/culture/education segments but most are small caps
- Retailing	1.5%	1.3%	Neutral	Neutral	A-shr more expensive due to small caps, which attract few overseas investors
Consumer Staples	4.3%	6.5%	Positive	Neutral	A-shr stock universe is larger and has many quality segment leaders
Health Care	4.0%	1.6%	Positive	Neutral	A-shr stock universe is larger and has many quality segment leaders
Financials					
- Banks	24.3%	23.6%	Positive	Negative	MMA helps align perception on macro and cost of capital, and thus narrow the gap
- Diversified Financials	3.2%	1.0%	Positive	Neutral	MMA boosts brokers' business. A-shr small-caps very expensive but large-caps cheap
- Insurance	4.5%	5.0%	Positive	Neutral	Mixed impact as A/H gap mainly driven by investors' different perception and focus
- Real Estate	3.6%	6.4%	Neutral	Neutral	A-shr more expensive among caps; MMA will help large caps catch up
Information Technology					
- Software & Services	1.1%	9.4%	Neutral	Neutral	Most leading players are listed overseas
- Technology H/ware & Eq	1.4%	1.6%	Neutral	Neutral	A-shr is expensive and Taiwan provides higher quality players
Telecom	0.7%	17.4%	Neutral	Neutral	Leading players are listed in HK; small weight in Shanghai index
Utilities	3.6%	3.9%	Positive	Neutral	A-shr high-div-yield stocks are attractive to overseas value investors
Overall	100%	100%	Positive	Slightly negative	

Source: UBS estimates

Top A-share stock ideas

Based on aforementioned key drivers for AH gap and discussions with our analysts, we believe the below A-share stocks (Figure 13) are likely to benefit from a narrowing of the AH gap in the near-term.

Eight stocks that may benefit

As mentioned above we see some interesting opportunities in the financial and material sectors given the large discounts. In the financial sector we favour Ping An Insurance, Haitong Securities, CITIC Securities and China Merchant Bank, and in the Materials sector we believe Anhui Conch Cement A-shares could benefit.

We also think the A-shares at a discount with high dividend yields may also benefit given their attractions to foreign investors. These candidates include Jiangsu Expressway and Huaneng Power International. We also like Tsingtao Brewery in the Food & Beverage sector and the company is a global leader in its area.

Figure 13: A-share beneficiaries

Code	Company	GICS Sector	A-share mkt cap (US\$ m)	Avg. daily turnover (US\$ m)	A-H discount (%)	Dividend yield	14E PE (x)	EPS (Rmb)			ROE (%)
								2013	2014E	2015E	
600585	Anhui Conch Cement	Raw materials	11,812	60	23.1	1.9%	7.3	1.8	2.5	2.7	26.1
600377	Jiangsu Expressway	Industrial	3,890	6	17.2	6.0%	11.4	0.5	0.6	0.6	14.2
600600	Tsingtao Brewery	Consumer Stpls	4,704	18	15.5	1.1%	26.3	1.4	1.6	1.7	12.2
600030	CITIC Securities	Finance	20,978	159	15.4	1.1%	20.8	0.5	0.6	0.7	7.7
600011	Huaneng Power Int'l	Utilities	10,602	15	15.3	6.1%	6.9	0.9	0.9	0.7	19.3
601318	Ping An Insurance	Finance	33,837	180	15.4	1.5%	10.7	3.6	4.1	4.6	20.7
600036	China Merchants Bank	Finance	36,500	85	12.3	5.7%	4.9	0.4	0.5	0.6	8.0
600837	Haitong Securities	Finance	13,143	97	7.6	1.2%	19.0	2.3	2.2	2.3	19.8

Source: UBS estimates. Note: Price data as of 28 Jul 2014

Ping An: We think the Ping An A-share stock price is undervalued for several reasons. These mainly include: 1) sell-off by large shareholders, especially in 2012-2013; 2) its issuance of convertible bonds and its further financing in 2013; 3) different financial factors and investor structures. The A-share market is a closed market, while the H-share market is an open one. For Ping An, once its P/EV in the H-share market falls below 1x, there will be buy-in from overseas long-term funds, but in the A-share market, because of the lack of long-term funds, its valuation can often remain below 1x P/EV; and 4) From the asset allocation perspective, as insurance stocks have a higher weighting in Hong Kong and H-share investors often find it difficult to deviate from the benchmark, while A-share investors may deviate significantly from the index, so their positions in insurance stocks have always been substantially lower than the weighting of insurance stocks in the A-share market. We think that some of these factors should begin to fade in the coming months and the introduction of MMA may be a catalyst for a re-rating.

CITIC Securities: H-share investors pay more attention to the company's long-term outlook and value its fundamentals such as overall strength, business development, and talent pool, while A-share investors pay more attention to factors such as short-term fluctuations in earnings. Overseas investors will favour CITIC Securities as it is the largest securities firm in China, it has the strongest overall strength and best long-term outlook. Moreover, the A-share market is relatively closed and influenced by factors such as tight liquidity. Typically the larger the broker the greater the A-share valuation discount will be, but we believe this will likely change with the introduction of MMA.

Haitong Securities: Since listing on the H-share market Haitong's A-shares typically traded at a premium. But this premium has continued to shrink and in June 2014 A-shares started trading at a discount. We attribute this change mainly to A-share investors paying more attention to short-term fluctuations in earnings. For instance, valuation of Haitong in the A-share market increased significantly when its earnings performance was relatively outstanding in H113, while its share price in the A-share market began to weaken in June 2013 as its earnings continuously declined in H213 due to bond investment. Looking into 2014, Haitong has enjoyed a solid earnings growth in H1, and should post a faster earnings growth in H2 due to the low base last year. We believe the A/H-share discount on Haitong's shares could narrow after the official launch of the MMA.

China Merchants Bank: China Merchants Bank's A/H discount has widened since June 2013 and it is currently at a 17% discount – the highest among all dual listed banks. We believe this is mainly due to: 1) the progress of shares allotment was slower than market expectation, which also had a negative impact on its capital position. 2) The progress of its "second strategic business transformation" was below the investors' expectation - while the H-share market weighs more on the retail strength of CMB, A-share market investors care more about its "second strategic business transformation" which means higher instant earnings growth driven by improving asset pricing. We saw that the shares allotment was completed at the end of 2013, and we expect its emerging effect of the improved business transition and the arrival of MMA to drive its A/H share price discount to narrow.

Anhui Conch Cement: In the Materials sector, we like Anhui Conch Cement. Anhui Conch Cement's A/H discount has been widening over the past five years, continuously rising from the initial spread of c10% to its highest level of 60%. It is currently at c35%. We think several reasons attribute to this: 1) Market structure: among H-share listed cement companies, Conch Cement's profitability, cash flow, and balance sheet are far better than its competitors, and high-quality cement stocks are relatively scarce as investment targets; 2) Valuation system: Overseas investors not only conduct valuation based on EPS, but also pay attention to free cash flow, and Conch Cement's free cash flow is better than its peers due to its excellent level of management; 3) Investment horizon: In the medium to long term, Conch Cement's competitiveness is likely to help continuously improve its market share and profitability. We think these reasons likely to fade with initiation of MMA program, because overseas investors pay more attention to medium to long-term value, while domestic investors are more focused on short-term returns and reluctant to assign high valuations.

Huaneng Power International: Huaneng's H-share premium started to appear in 2013 on the back of significantly improved profitability due to coal price declines; dividend yield was as high as 7.6% at the time when its share price was at the lowest level. This is more attractive to international investors with A-share investors typically favouring growth rather than dividend yields, and forward looking A-share investors also had more concerns about tariff reduction. We think the MMA program will attract new funds to the A-shares at a c.20% discount, but around October when there will be a reduction in tariffs, H-share listed power companies could see corrections.

Jiangsu Expressway: We believe that differing investor appetites are the primary reason for the significant A-share discount. A-share investors generally dislike value stocks with a stable business model but only small growth potential, but this is

more favourable to an H-share investor that we believe is attracted to Jiangsu Expressway's strong cash flow generating ability and a consistent high dividend pay-out ratio. Therefore with the launch of MMA we would expect the gap to narrow as value-driven HK institutional investors will be attracted to A-share dividend yield.

Tsingtao Brewery: Tsingtao Brewery's A/H discount has been widening over the past three years, and it is currently at c15%. We attribute this to: 1) since there are many A-share Food & Beverage sub-sectors, investors are not paying much attention to the beer sector as its sales growth and profitability are relatively poor compared to the Chinese liquor sector in 2010-12 and the dairy sector in 2013; 2) Tsingtao Brewery is preferred by overseas investors as the company's cash flow, balance sheet, and dividend ratio are at better levels among the H-share listed Food & Beverage companies, and a long-term consolidation trend is visible in the sector. We think A/H spread is likely to narrow with the arrival of MMA and stronger SOE reform expectations.

Appendix

A/H share price premium/discount of dual listed companies

Figure 14: A/H share price premium/discount of dual listed companies

Name	Sector	A-shr ticker	H-shr ticker	A-shr Premium to H-shr	1Y Avg Premium	5Y Avg Premium	A-shr mkt cap (USD bn)	H-shr mkt cap (USD bn)
China Vanke Co-H	Real Estate	000002.SZ	2202.HK	-27%	n.a.	n.a.	15.4	2.9
Weichai Power-H	Capital Goods	000338.SZ	2202.HK	-25%	-22%	8%	5.1	2.2
Anhui Conch-H	Materials	600585.SH	0914.HK	-23%	-27%	-15%	11.8	5.0
Angang Steel-H	Materials	000898.SZ	0347.HK	-22%	-23%	-7%	3.3	0.8
China Pacific-H	Insurance	601601.SH	2601.HK	-19%	-21%	-11%	20.3	11.0
Jiangsu Expres-H	Transportation	600377.SH	0177.HK	-17%	-23%	-6%	3.9	1.5
China Life Ins-H	Insurance	601628.SH	2628.HK	-17%	-16%	-8%	49.9	21.4
Agricultural-H	Banks	601288.SH	1288.HK	-16%	-11%	-10%	120.2	15.0
China Rail Cn-H	Capital Goods	601186.SH	1186.HK	-16%	-20%	-7%	8.4	2.0
China Shenhua-H	Energy	601088.SH	1088.HK	-16%	-16%	-6%	40.8	10.0
Huaneng Power-H	Utilities	600011.SH	0902.HK	-16%	-12%	36%	10.6	4.3
Citic Securit-H	Diversified Financials	600030.SH	6030.HK	-16%	-13%	-8%	21.0	3.0
Tsingtao Brew-H	Food Beverage	600600.SH	0168.HK	-16%	-11%	-3%	4.7	5.3
Ping An Insura-H	Insurance	601318.SH	2318.HK	-16%	-21%	-18%	33.9	26.3
China Com Cons-H	Capital Goods	601800.SH	1800.HK	-15%	-14%	-14%	7.5	3.4
China Rail Gr-H	Capital Goods	601390.SH	0390.HK	-15%	-15%	5%	8.0	2.3
Icbc-H	Banks	601398.SH	1398.HK	-15%	-9%	-5%	153.9	59.1
Sinopec Corp-H	Energy	600028.SH	0386.HK	-13%	-7%	27%	76.8	24.8
China Merch Bk-H	Banks	600036.SH	3968.HK	-13%	-9%	-9%	36.6	9.3
Fosun Pharma-H	Pharmaceuticals	600196.SH	2196.HK	-12%	4%	6%	5.8	1.4
China Const Ba-H	Banks	601939.SH	0939.HK	-12%	-8%	-6%	6.4	183.6
Ceb Bank-H	Banks	601818.SH	6818.HK	-10%	-4%	-4%	16.7	3.2
Bank Of Commun-H	Banks	601328.SH	3328.HK	-9%	-6%	-3%	26.8	26.2
Bank Of China-H	Banks	601988.SH	3988.HK	-9%	-3%	7%	85.4	40.0
Huadian Power-H	Utilities	600027.SH	1071.HK	-8%	11%	109%	4.3	0.9
Haitong Securi-H	Diversified Financials	600837.SH	6837.HK	-8%	14%	15%	13.2	2.6
Petrochina Co-H	Energy	601857.SH	0857.HK	-8%	12%	25%	205.4	29.0
Air China Ltd-H	Transportation	601111.SH	0753.HK	-6%	-7%	39%	4.9	2.8
Csr Corp Ltd-H	Capital Goods	601766.SH	1766.HK	-5%	-7%	4%	10.0	1.8
China Cnr Corp-H	Capital Goods	601299.SH	6199.HK	-5%	n.a.	n.a.	8.3	1.8
Zte Corp-H	Tech Hardware	000063.SZ	0763.HK	5%	15%	7%	6.2	1.3
China Minsheng-H	Banks	600016.SH	1988.HK	6%	23%	9%	29.0	7.0
Guangshen Rail-H	Transportation	601333.SH	0525.HK	7%	-1%	33%	2.4	0.6
Shanghai Pharm-H	Health Care Equipment	601607.SH	2607.HK	8%	2%	5%	4.0	1.5
China Citic Bk-H	Banks	601998.SH	0998.HK	9%	23%	23%	23.4	10.0
New China Life-H	Insurance	601336.SH	1336.HK	10%	17%	20%	8.4	3.8
Guangzhou Auto-H	Automobiles	601238.SH	2238.HK	13%	20%	25%	5.5	2.5
Shenzhen Expre-H	Transportation	600548.SH	0548.HK	13%	27%	44%	1.0	0.4
China Oilfield-H	Energy	601808.SH	2883.HK	14%	18%	54%	8.6	4.6
Maanshan Iron-H	Materials	600808.SH	0323.HK	14%	12%	17%	1.6	0.4
China Shipping-H	Transportation	600026.SH	6199.HK	15%	17%	33%	1.6	0.8
China Intl Mar-H	Capital Goods	000039.SZ	2039.HK	15%	12%	13%	3.0	3.0
China Coal Ene-H	Energy	601898.SH	1898.HK	16%	33%	24%	6.5	2.5
Jiangxi Copper-H	Materials	600362.SH	0358.HK	16%	28%	76%	4.7	2.7
Anhui Express-H	Transportation	600012.SH	0995.HK	16%	21%	25%	0.8	0.3
Dongfang Elect-H	Capital Goods	600875.SH	1072.HK	17%	22%	23%	3.4	0.6

Name	Sector	A-shr ticker	H-shr ticker	A-shr Premium to H-shr	1Y Avg Premium	5Y Avg Premium	A-shr mkt cap (USD bn)	H-shr mkt cap (USD bn)
Hisense Kelon -H	Consumer Durables & App	000921.SZ	0921.HK	18%	40%	147%	1.3	0.6
Xinjiang Gold-H	Capital Goods	002202.SZ	2208.HK	18%	42%	95%	3.2	0.6
Zoomlion Heavy-H	Capital Goods	000157.SH	1157.HK	18%	7%	9%	4.8	0.9
Great Wall Mot-H	Automobiles	601633.SH	2333.HK	20%	24%	23%	10.0	4.3
China Southern-H	Transportation	600029.SH	1055.HK	20%	22%	79%	2.8	0.9
Byd Co Ltd-H	Automobiles	002594.SZ	1211.HK	24%	33%	39%	12.4	5.9
China Cosco Ho-H	Transportation	601919.SH	1919.HK	24%	18%	44%	4.1	1.1
Datang Intl Po-H	Utilities	601991.SH	0991.HK	25%	58%	124%	6.3	1.7
China East Air-H	Transportation	600115.SH	0670.HK	26%	26%	84%	3.4	1.4
Livzon Pharm-H	Pharmaceuticals	000513.SZ	1513.HK	26%	n.a.	n.a.	1.4	0.7
Baiyunshan Ph-H	Pharmaceuticals	600332.SH	0874.HK	29%	34%	97%	4.3	0.7
Aluminum Corp-H	Materials	601600.SH	2600.HK	31%	56%	88%	5.8	1.8
Bbmj Corp-H	Materials	601992.SH	2009.HK	33%	31%	48%	3.8	0.9
Metallurgical-H	Capital Goods	601618.SH	1618.HK	35%	50%	57%	4.8	0.6
Sichuan Exp-H	Transportation	601107.SH	0107.HK	36%	59%	75%	1.0	0.3
Dongjiang Envi-H	Commercial Serv	002672.SZ	0895.HK	36%	75%	92%	1.2	0.3
Zhengzhou Coal-H	Capital Goods	601717.SH	0564.HK	38%	60%	53%	1.2	0.2
Zijin Mining-H	Materials	601899.SH	2899.HK	43%	68%	60%	5.8	1.5
Yanzhou Coal-H	Energy	600188.SH	1171.HK	44%	59%	64%	3.6	1.6
China Shipping-H	Transportation	601866.SH	1513.HK	44%	51%	63%	3.3	1.1
Shandong Chen-H	Materials	000488.SZ	1812.HK	48%	74%	66%	0.8	0.2
Shanghai Elect-H	Capital Goods	601727.SH	2727.HK	49%	67%	106%	6.4	1.3
Dalian Port Pd-H	Transportation	601880.SH	2880.HK	54%	79%	84%	1.6	0.3
Beijing North-H	Real Estate	601588.SH	0588.HK	56%	94%	125%	1.1	0.2
Sinopec Shang-H	Materials	600688.SH	0338.HK	66%	102%	185%	3.9	1.1
Shandong Xinhui-H	Pharmaceuticals	000756.SZ	0719.HK	68%	160%	201%	0.3	0.1
First Tractor-H	Capital Goods	601038.SH	0038.HK	69%	104%	87%	0.8	0.3
Shenji Group-H	Capital Goods	600806.SH	0300.HK	71%	175%	196%	0.3	0.1
Tianjin Cap-H	Commercial Serv	600874.SH	1065.HK	74%	184%	218%	1.4	0.3
Chongqing Iron-H	Materials	601005.SH	1053.HK	74%	170%	173%	1.5	0.1
Jingcheng Mac	Capital Goods	600860.SH	0187.HK	76%	213%	231%	0.3	0.1
Nanjing Panda-H	Tech Hardware	600775.SH	0553.HK	77%	178%	302%	0.8	0.2
Cmcc-H	Materials	603993.SH	3993.HK	79%	147%	179%	4.6	0.9
Jingwei Textil-H	Capital Goods	000666.SZ	0350.HK	85%	99%	188%	0.9	0.2
Northeast Elec-H	Capital Goods	000585.SZ	0042.HK	103%	218%	248%	0.3	0.1
Shandong Molon-H	Energy	002490.SZ	0568.HK	120%	332%	280%	0.8	0.2
Luoyang Glass-H	Capital Goods	600876.SH	1108.HK	139%	311%	344%	0.3	0.1
Zhejiang Shiba-H	Automobiles	002703.SZ	1057.HK	149%	n.a.	n.a.	0.6	0.1
Sinopec Yizhen-H	Materials	600871.SH	1033.HK	n.a.	n.a.	n.a.	n.a.	0.5
Guangzhou Ship-H	Capital Goods	600685.SH	0317.HK	n.a.	n.a.	n.a.	n.a.	1.0

Source: Bloomberg, UBS Quantitative Research
Note: Price data as of 28 Jul 2014

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China Merchants Bank - A ^{2, 4, 16a}	600036.SS	Buy	N/A	Rmb10.97	28 Jul 2014
CITIC Securities - A ^{16a}	600030.SS	Buy	N/A	Rmb13.22	28 Jul 2014
Haitong Securities - A ^{2, 4, 5, 16a}	600837.SS	Buy	N/A	Rmb10.07	28 Jul 2014
Huaneng Power International - A ^{16b}	600011.SS	Buy	N/A	Rmb6.26	28 Jul 2014
Jiangsu Expressway - A	600377.SS	Buy	N/A	Rmb6.32	28 Jul 2014
Ping An Insurance (Group) - A ^{13, 16a, 22}	601318.SS	Buy	N/A	Rmb43.83	28 Jul 2014
Tsingtao Brewery - A	600600.SS	Neutral	N/A	Rmb41.91	28 Jul 2014

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