

## Q-Series®

# Corporate Governance in China

## Does corporate governance matter in China?

### Equity Strategy

China

### Corporate governance is reflected differently in the A- and H-share markets

Corporate governance is key to analysing downside risk, in our view. This is especially so in China with its relatively concentrated ownership structures, low level of board independence and prevalence of related-party transactions. Our research indicates that in the medium term, higher corporate governance ratings may at times correlate with positive financial performance and share price returns of H-share companies. However, there appears to be no obvious connection between corporate governance, financial performance and investment returns in the A-share market.

### Do privately-owned enterprises perform better than SOEs?

Our research is centred on companies listed in two governance databases. By comparing corporate governance and financial performance, we attempt to identify the key factors that may influence investment returns in different markets. Our research indicates that private enterprises in both the A- and H-share markets may be able to deliver better fundamental performances, possibly due to management incentives. Interestingly, despite scale advantages, central government SOEs perform worse in this respect than local SOEs.

### Corporate governance is relatively weak compared with other BRIC countries

The independence of boards of directors is relatively low in China compared to other BRIC countries. This may be because of SOE boards' political connections. However, political connections are sometimes value-enhancing for private companies. Interestingly, we note companies with conservative accounting policies produce a lower investment return in the long run than companies with neutral policies, while both perform better than companies with aggressive accounting policies.

### Most preferred companies

Geoff Dennis, UBS's emerging market strategist, recently recommended a number of SOEs in emerging markets due to strong ROE and undemanding valuations. UBS's China strategists, Li Chen and Wenjie Lu, also like China SOE investments based on ongoing SOE reform and inexpensive valuations. In this context, we list our preferred picks in the table below, and include both SOE and private companies.

### Valuation comparison of preferred picks in local currency & GMI rating terms

	Code	GMI ESG Rating	GMI AGR Rating	Rating	Share price (LC)	Price target	Market cap (HK\$ bn)	PE (x)		P/BV (x)		ROE (x)		Net dividend yield (%)	
								2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Industrial and Commercial Bank of China	1398.HK	C	—	Buy	4.79	5.60	1,564.3	5.2	5.1	1.0	0.9	21.9	19.5	6.8	4.9
Ping An Insurance (Grp) Co of China Ltd.	2318.HK	C	—	Buy	60.90	89.49	486.8	13.6	12.0	2.7	2.2	21.6	20.7	1.3	1.5
PICC Property & Casualty Co., Ltd.	2328.HK	C	Average	Neutral	10.46	12.50	145.0	10.3	11.6	2.0	1.8	20.5	16.4	3.0	2.6
China Construction Bank Corporation	0939.HK	C	—	Buy	5.41	6.40	1,373.1	5.1	5.0	1.0	0.9	21.4	19.4	6.9	5.0
Haitong Securities Co Ltd	6837.HK	B	—	Buy	11.46	13.90	118.6	22.0	17.7	1.4	1.4	6.7	8.0	1.3	1.6
Shandong Weigao Group Medical Polymer	8199.HK	C	—	Neutral	8.11	9.73	36.9	30.5	25.5	3.1	3.0	10.4	12.2	1.0	1.2
Dongfeng Motor Group Co. Ltd	0489.HK	C	Average	Buy	11.04	15.00	97.5	7.4	7.2	1.2	1.1	17.8	15.8	1.9	2.0
Guangzhou R&F Properties Co., Ltd.	2777.HK	D	Average	Buy	10.90	11.75	36.0	5.6	4.4	1.0	0.8	19.5	18.5	6.1	8.0
ZTE Corporation	0763.HK	C	—	Buy	16.22	20.00	58.4	29.5	15.1	1.9	1.8	6.8	12.3	0.8	1.7
China Communications Services Corp. Ltd.	0552.HK	D	Average	Buy	3.75	5.00	25.2	8.2	7.9	0.9	0.9	11.5	11.4	3.6	5.1

Note: Prices as of 15 April 2014. Source: GMI, Bloomberg, UBS estimates

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**Yankun Hou**

Analyst

S1460513020001

yankun.hou@ubssecurities.com

+86-213-866 8887

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# Investment Summary

Since the global financial crisis, corporate governance has been under the spotlight around the world. Various deficiencies in corporate governance systems that were exposed by the financial crisis have prompted a reassessment of how companies are managed.

At the most basic level, corporate governance is concerned with issues that result from the separation of ownership and control rights. It includes how to coordinate internal conflicts among different business interest groups as well as balance a company's short-term interests and long-term goals.

In order to be effectively and ethically governed, corporations not only need internal governance, but external governance as well. Therefore the presence of strong corporate governance standards indicates a sound institutional environment for corporations to operate in and where they can be held accountable for their actions.

Most studies of corporate governance are largely based on data from companies in developed countries with dispersed ownership structures. The results therefore may not be appropriate or relevant for an analysis of emerging markets, especially China, in our view. Despite rapid economic growth, China only began to adopt modern enterprise structures after the first Company Law was passed in 1993, which delineated the rights and responsibilities of corporations. Since then, the law has been revised four times in the context of the rapid economic growth of the country.

However, the regulatory system in China remains underdeveloped and the reliability of information from Chinese enterprises is relatively low. More importantly, managements of private enterprises and SOEs have different short-term and long-term incentives, which could lead to different operating risks and moral hazards.

Therefore we believe it is important to investigate the relationship between corporate governance and company performance in China. By doing so, investors can gain an understanding of current corporate governance practice in China, and understand why companies pursue different development strategies and the difference in share price performance among state-owned and private companies. Investors can then be prepared for the changes companies undergo during their development.

Our research is centred on companies listed in the following two databases. We also use the databases to study companies under UBS coverage.

- (1) The SSE Corporate Governance Index.
- (2) The GMI Governance Evaluation System.

**Corporate governance is concerned with issues that result from the separation of ownership and control rights**

**It is important to investigate the relationship between corporate governance and company performance in China**

Although China offers many attractive growth opportunities, we note there are multifaceted risks at both the country and company levels. We believe these risks require investors to have a solid understanding of company-level governance factors in the different markets, and our research focusses on A-share and H-share companies. By comparing corporate governance and financial performance, we attempt to identify the correlation between corporate governance and investment returns in each market. We examine the potential impact of corporate governance on the mid-to-long-term business performance and investment returns of companies regardless of the type of controlling shareholder

We believe we are the first to conduct such a detailed analysis of the correlation between corporate governance and financial performance and investment returns.

The results of our research indicate that in the H-share market, companies that score highly in the GMI ranking system demonstrated better financial performance and investment returns in the medium to long term. But there seems to be no obvious correlation between corporate governance and financial performance for A-share companies. We think there are four complex reasons for this:

- **Firstly, corporate governance is a complex topic which is difficult to quantify in a single rating.** We generally view governance ratings as a means to start asking questions rather than providing definitive answers.
- **Corporate governance data cannot predict a company's future development trajectory.** A company's strategy, business model and products have continually changed and evolved with the rapid growth of the Chinese economy. Therefore corporate governance data only reflects the history of the company instead of being predictive.
- **We believe that the phenomenon can be explained in part by investor 'style'.** Our analysis implies that corporate governance standards may not be high priority for many A-share investors. In addition, unlike mature markets, approximately 80% of the trading volume in the A-share market is retail. This type of investor tends to concentrate on short-term investment returns rather than long-term company development.
- **Another possibility is that some companies may disclose information in a less structured manner, which can affect share prices.** In contrast, the other group of companies may be more structured about disclosing information, which can result in less volatile share price performance.

Our research suggests that privately-owned enterprises have better financial performances than many SOEs in the long term. In addition, in both the A- and H-share markets, private enterprises have been able to generate better investment returns than many SOEs. One of the key factors for this is that many SOEs operate less efficiently than private enterprises due to different management incentives, in our view. In China, the independence of board of directors is relatively low compared to other BRIC countries, possibly because of SOE boards' political connections. However, political connections may sometimes be value-enhancing for private companies.

Last but not least, we note that companies with conservative accounting policies produce a lower investment return in the long run than companies with neutral accounting policies; while investment returns for companies with aggressive accounting policies are lower than those with conservative and neutral accounting policies.

**China: many attractive opportunities, but multifaceted risks at the country and company levels**

**Positive correlation between corporate governance and share prices in H-share market, but not in A-share market**

**Privately-owned enterprises have more impressive financial performances than many SOEs in the long term**

## Our preferred picks

According to Geoff Dennis, the UBS global emerging market strategist (please see, *The 'SOE' Sector in EM Equities*, 18 March 2014), the UBS constructed universe of SOEs in emerging markets (down 37% since April 2011) has significantly underperformed non-SOEs stocks, which have risen 9% over the same period. SOE stocks are generally big, unloved and inexpensive, and have been the major contributor to the poor performance by EM equities over the past three years. Our database of 210 SOEs across EM amounts to 26% of the total 822 stocks (and 29% of market cap) of MSCI GEMs, while the biggest SOE weight is in China (72% of the market).

According to the report, since the end of 2010, SOE and non-SOE valuations have diverged dramatically across emerging markets. Geoff estimates that SOEs are trading at just 6.9x forward earnings, below even their 2008 trough, and at a 48% discount to non-SOEs (13.2x), an all-time high. SOEs also trade close to book value (0.99x), compared to 1.87x for non-SOE stocks. Importantly, SOEs now trade at large discounts of 30-45% to their recent average valuations.

Geoff's research found that ROE appears little different for SOE versus non-SOE stocks in emerging markets. He argues that better ROE results for the SOEs may be due to favourable local market conditions for many of them. Therefore, investors appear skeptical about the real competitiveness of SOEs, and so the attractiveness of SOEs as an investment.

However, our research indicates that ROE for private enterprises in China is around 20% higher than SOEs (excluding banks) and ROA for private enterprises is at about a 30% premium to SOEs (excluding banks). Although some SOEs have dominant market positions, they can be distracted by political tasks in China and pursuit of profitability may not be a priority.

We believe that SOE stocks have been a major drag recently on valuations and performance in EM, especially in China, and investor sentiment on them remained poor until mid-March. Given our mildly positive view on EM equities for 2014, we believe investors should not entirely ignore some of the more attractive SOEs. In China, SOE reform is an important investment theme now and likely to be over the next couple of years. We believe there are at least four ways to improve SOE efficiency: 1) asset injections or a group listing; 2) industrial consolidation through M&A; 3) high dividend payouts to shareholders; and 4) share and option incentives.

We recommend the following stocks based on: 1) our analysts' recommendations and expectations of strong business performances in the next six to 12 months; and 2) companies who rank higher in the GMI rating system. Our preferred picks are Industrial and Commercial Bank of China (ICBC), Ping An Insurance, PICC Property & Casualty (PICC), China Construction Bank (CCB), Haitong Securities (Haitong), Shandong Weigao Medical Polymer (WG), Dongfeng Motor (Dongfeng), Guangzhou R&F Properties (Guangzhou R&F), ZTE Corporation (ZTE) and China Communications Services (CCS).

**Our most preferred companies are ICBC, Ping An Insurance, PICC P&C, CCB, Haitong, Shandong Weigao, Dongfeng, Guangzhou R&F, ZTE and CCS**

## **Industrial and Commercial Bank of China (1398.HK)**

ICBC remains our top pick in the banking sector due to its strong capital position, and good balance sheet liquidity and corporate governance. Established in 1984, ICBC is the largest domestic commercial bank. It had total assets of Rmb17.1trn, total loans of Rmb8.4trn and total deposits of Rmb13.2trn, representing market shares of 14.1% in loans and 14.9% in deposits, respectively, as at 30 June 2012. ICBC was ranked one of the top 25 companies in terms of its ESG (environmental, social and governance) score in the H-share market as rated by GMI. GMI issued ICBC with a "C" rating for its overall corporate governance.

Although there are major risks when investing in mainland China banks (eg, macro/asset quality risk, competitive risk and regulatory risk), we think ICBC will weather these risks better than peers based on a high percentage of lower-risk corporate loan customers (48% are SOEs), steadier loan growth in recent years and a reasonably strong IT system.

## **Ping An Insurance (2318.HK)**

Ping An Insurance was founded in 1988 and is headquartered in Shenzhen. It is an integrated financial services provider in China with three core businesses: insurance; banking; and investment. GMI rated Ping An "C" for corporate governance. According to GMI's historical ESG ratings, there has been a substantial improvement in Ping An's scores both domestically and globally.

We maintain our view that the life insurance sector will record strong growth in 2014 and that Ping An will be a leader. Ping An is focused on providing higher margin products, and the new guaranteed rate policy has changed some products in the life insurance industry. The new 4% rate *Ping An Fu* product has had some success. Ping An's strong distribution channel and agency force should ensure continued robust NBV growth. We think technological developments at Ping An will allow it to migrate non-traditional financial services customers to traditional financial services. We forecast NBV growth of 17%/12%/8% in 2014/2015/2016, based on the company's strong performance year to date.

## **PICC Property & Casualty (2328.HK)**

We view competition in the motor insurance segment in major cities as an on-going issue due to the potential for increased competition from foreign companies via internet sales. We believe PICC P&C has the discipline not to aggressively fight for market share and to continue to diversify into agricultural and liability insurance. The impact of a series of natural disasters in China since Q313 is manageable, in our view. We expect the increase in the combined ratio in the P&C sector to continue, and that PICC P&C's ratio will remain one of the best among large insurers. We forecast PICC P&C's combined ratio will be below 98% in 2013, 2014 and 2015.

The recent equity market rally should provide strong support for the company's NPAT. Rising distribution costs and claims inflation will likely be the main issues for the P&C sector. However, we believe that larger insurers such as PICC P&C will be able to control claims expenses through economies of scale and a more diversified business outside the major cities.

### **China Construction Bank (0939.HK)**

CCB is the No. 2 commercial bank in China in terms of total assets, and provides a comprehensive range of commercial banking products and services. GMI had given CCB a "C" rating for corporate governance in 2013. According to GMI's historical ESG ratings, there has been a substantial improvement in CCB's corporate governance.

We like CCB's strong capital position and funding franchise, as well as its prudent risk management track record. Management expects relatively tight liquidity in 2014 with a corresponding tight monetary policy. We think the sector's NPL is on a multi-year uptrend and expect banks to accelerate NPL disposals. CCB's Local Government Financing Vehicle loan balance was Rmb370bn (4% of total loans) as of Q313, 95% of which is covered by the projects' cash flows. CCB's wealth management product balance was Rmb1trn as of Q313, 50% of which is off-balance sheet non-principal guaranteed products. The bank has prudently provided an Rmb1.6bn (i.e. 16bp of total WMP) provision against off-B/S products, although no losses have occurred so far.

### **Haitong Securities (6837.HK)**

Haitong is a leading full-service investment bank in China and the country's second-largest securities firm by total assets. Haitong has also been one of the top-15 companies in terms of ESG score in the H-share market as rated by GMI.

In 2013, Haitong's equity and debt underwriting market shares expanded to 6.9% and 5.4%, ranking it No. 6 and No. 4 in the industry, respectively. Haitong recorded 34.4% YoY growth in investment banking fees mainly due from strong growth in consultancy and financial advisory fees. Haitong completed the acquisition of UT Capital Group in January 2014, with Haitong International holding 100% of the shares. We believe the acquisition will help improve Haitong's ROE (5.9% and 6.7% in 2012 and 2013) and bring synergy benefits to Haitong's comprehensive financial service offerings.

### **Shandong Weigao (1066.HK)**

Shandong Weigao Medical Polymer (WG) is a leading Chinese medical device manufacturer with a diversified portfolio of medical consumables. GMI had given CCB a "C" rating for corporate governance in 2013.

Weigao reported 2013 results with revenue growth of 25.1%, in line with our forecast, while normalised 2013 earnings of HK\$937m was 17.0% lower than our forecast, mainly due to much higher than expected SG&A expenses and FX losses in Q413. We lowered our 2014 normalised earnings forecast by 14.4%, assuming the company can deliver on its revenue growth guidance with stable margins.

### **Dongfeng Motor (0489.HK)**

Dongfeng is engaged in the manufacture and sale of commercial vehicles, passenger vehicles, engines and auto parts, and the production of vehicle manufacturing equipment. It has JVs with Honda, Nissan and Peugeot. GMI rated Dongfeng at an average "C" grade for corporate governance over the past five years, and it had the highest ESG rating among all automobile companies covered by GMI in the H-share market.

We view Dongfeng's investment in PSA Peugeot Citroën this year as an early milestone in the globalisation of the Chinese auto industry. We remain bullish on PSA's turnaround in 2014 based on improved EBIT and cash generation. Its net cash position of over €1bn (from net debt of €4bn) after the capital increase provides the means to finance R&D and industrial projects, in our view. Further advances in R&D should also help sales growth of Dongfeng PSA JV.

We expect Japanese branded autos to record 8-10% YoY market growth in the next three to five years, mainly driven by high growth in inland regions and replacement demand in coastal areas. We believe Dongfeng will maintain current utilisation of 85-90% and gross margin of around 20% in 2014. We estimate 2013/2014 EPS of Rmb1.21/Rmb1.26, 4.1%/0% higher than consensus.

### **Guangzhou R&F (2777.HK)**

Guangzhou R&F's contracted property sales were Rmb37.5bn as at end-November 2013, up 31% YoY and representing 89% of its full-year sales target of Rmb42bn. The company believes it is on track to achieve the target as new project launches should boost December sales. It targets sales of Rmb55bn for 2014, up 31% YoY from its 2013 target.

The company was one of the first city centre property developers in Guangzhou. Focusing on primary and leading second-tier cities, the company develops residential and commercial property for sale. It also has hotels, offices and retail malls as long-term investments. We believe Guangzhou R&F's higher margin than peers and 16% earnings CAGR in 2012-15E justify our target 6.2x 2014E PE.

### **China Communications Services (0552.HK)**

CCS is the largest telecom infrastructure and support service provider in China. Key services include telecom infrastructure construction, business process outsourcing, and application and content services. GMI rated CCS at an average "D" grade for corporate governance over the past five years. Although the overall rating was not high, the company was recognized for its impressive performances in the accounting and social impact categories with higher rates.

We expect total industry capex to rise 17% in 2014, after the rollover of China Mobile's 4G capex. We believe China Telecom's 4G network expansion will benefit CCS the most. We forecast 4G capex of Rmb49bn for China Telecom (expected to build 250,000 4G base stations in 2014). We believe the recent share price fall is overdone and valuation is attractive.

### **ZTE Corporation (0763.HK)**

ZTE reported 2013 revenue of Rmb75.23bn (down 10.6% YoY), gross profit of Rmb20.46bn (up 10.1% YoY) and net profit of Rmb1.36bn (Rmb2.84bn loss in 2012). Bottom line missed our expectation by 10% due to a weaker-than-expected top-line performance from: 1) the delay in China Mobile's 4G network rollout in 2013 with Rmb36bn of the 2013 4G capex budget carried over to 2014; and 2) losing ground in the fierce competition for the smartphone market.

Apart from China Mobile's aggressive 4G network rollout, we expect China Telecom to spend over 50% of capex on 4G in 2014 largely by reducing capex for the fixed-line business. The rapid development of mobile internet should push capex growth for 4G base stations and networks in the next three years. As one of China's top two networking hardware companies, we believe ZTE will be a key beneficiary of higher capex.



# Data sources and research methodology

Our data sources come from the following two databases:

- The SSE Corporate Governance Index.
- The GMI Governance Evaluation System.

## The SSE Corporate Governance Index

As a cooperative product of China Securities Index Co., Ltd and the Shanghai Securities Exchange, the SSE Corporate Governance Index refers to a group companies that have been re-organised into the SSE Corporate Governance Sector with the index ticker code of 000019.

In general, enterprises apply to be selected as sample stocks of the SSE Corporate Governance Index; 80% of the rating indicators in the application form are objective indicators. If listed companies meet the requirements, they are selected as candidates for the SSE Corporate Governance Sector.

The application starts with a questionnaire that assesses a company's corporate governance standards in six segments: the rights of the controlling shareholder, the degree of independence of the board of directors, the board of supervisors and management, information disclosure, and the interests of stakeholders. Next, self, public and expert evaluations (including fund management companies and insurance companies) take place and are combined to seek suggestions from the general public. The final results are produced after both rounds of evaluation are completed.

**Corporations need to apply to be selected as a sample stock of SSE Corporate Governance Index**

## GMI: ESG and AGR® Ratings

GMI provides ESG ratings for more than 6,200 companies worldwide incorporating 150 ESG KeyMetrics™ to help investors assess the sustainable investment value of corporations. The firm also provides Accounting and Governance Risk (AGR®) ratings and corresponding litigation probabilities for approximately 20,400 public companies worldwide. AGR metrics reflect the accuracy and reliability of a company's financial reporting. Clients of GMI Ratings include leading investment managers, asset owners, insurers, auditors, regulators and corporations seeking to incorporate accounting and ESG factors into risk assessment and decision-making.

**An independent provider of research and ratings on environmental, social, governance and accounting-related risks**

A signatory to the Principles for Responsible Investment (PRI), GMI Ratings was formed in 2010 through the merger of GovernanceMetrics International, The Corporate Library and Audit Integrity. In the 2013 Independent Research in Responsible Investment (IRRI) Survey conducted by Thomson Reuters Extel and SRI-CONNECT.com, GMI Ratings was named "The Best Independent Corporate Governance Research Provider", marking the second consecutive year GMI Ratings has received this honour. For more information please visit [www.gmiratings.com](http://www.gmiratings.com).

*UBS Americas, Inc., an affiliate of UBS Limited, owns a minority equity stake in GMI Ratings.*

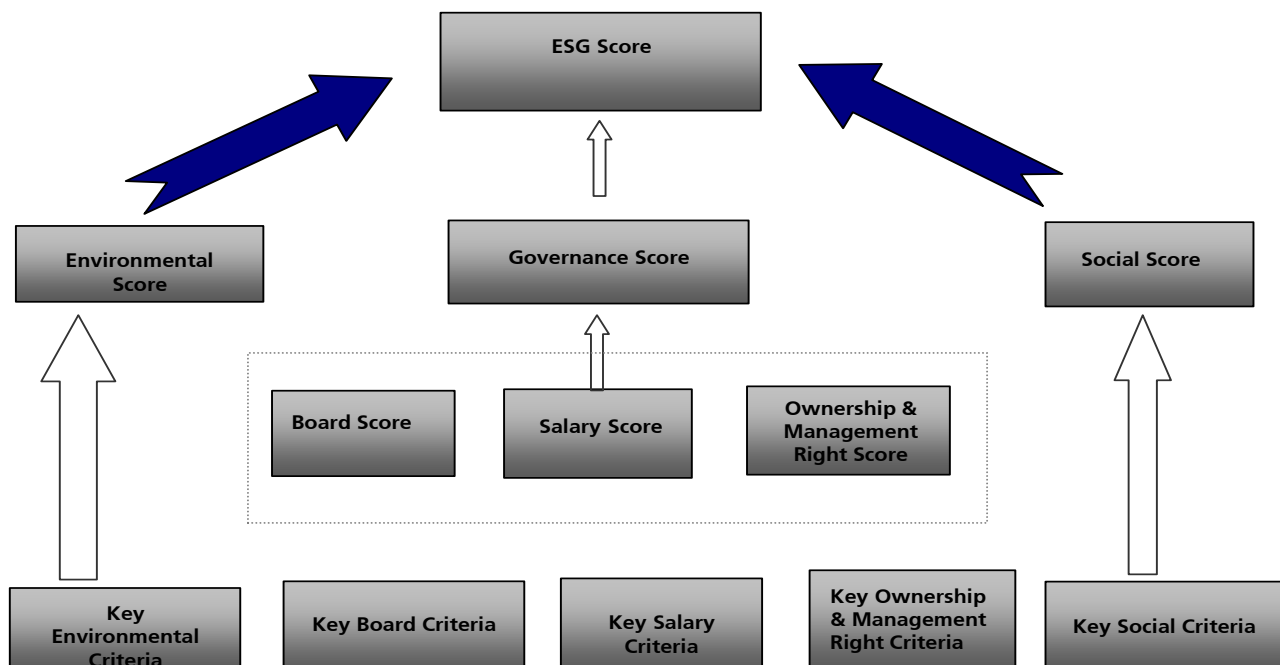
GMI ESG ratings consist of several categories, and include the following in its analysis:

- Board accountability
- Executive remuneration
- Ownership structure and shareholder's rights
- Accounting score
- Corporate behaviour: Environmental and Social score

GMI publishes two major types of ratings: ESG (Environmental, Social and Governance) ratings and AGR (Accounting and Governance Risk) ratings.

- The breakdown of ESG ratings is as follows:

**Figure 1: Breakdown of GMI 's ESG ratings**



Source: GMI

### AGR ratings

GMI's Accounting and Governance Risk (AGR®) ratings are based on an objective and quantitative approach to identify risks in the accounting practices and corporate governance of publicly held companies that could lead to adverse consequences. AGR ratings range from 1 (high risk) to 100 (low risk). Investors, insurance companies, auditors, regulators and other stakeholders use AGR as a risk management tool for quantitative disclosure of financial risks. AGR ratings are based on key corporate governance events and key financial ratios tied to:

- Revenue recognition
- Expense recognition
- Asset and liability valuation

## Methodology

To analyse the impact of corporate governance on a company's financial performance, we compared a selection A-share companies which are included in the SSE Corporate Governance Index with the same number of companies with similar market capitalisations and in the same sectors, but who are not included in the SSE Corporate Governance Index.

As companies need to apply and undergo several rounds of evaluation to be included in the SSE Corporate Governance Sector, we chose companies based on the assumption that stocks in the SSE Corporate Governance Index are different from companies that are not included in terms of corporate governance. We then conducted an analysis based on six financial indicators: three-year average ROE; three-year average ROA; gross margin; net margin; S&GA and five-year average revenue growth rate. In addition, we compared the stock price performance of companies that have been removed from the SSE Corporate Governance Index (possibly due to changes in corporate governance) and those that were added during the past three years.

For H-share companies, we divided listed companies into two groups based on GMI ESG ratings: companies with higher ESG ratings and those with lower ratings. We then conducted a similar analysis based on the above six indicators. We also made a comparison between the top 50% of 34 companies with higher ESG ratings and the bottom 34 companies in terms of stock price returns.

**For A-share companies, our research is based on data from SSE Corporate Governance Index and CCGINK**

**For H-share companies, we use data provided by GMI to further study the performance of Chinese companies listed on HSCEI**

# Corporate governance in China: relatively weak compared with other BRIC countries

In emerging markets in general and China in particular where share ownership tends to be more concentrated, the principal-agent framework often used to analyse governance in developed markets is not always relevant. In our view, the two most important considerations for EM investors are:

- The share ownership structure and whether the controlling/significant shareholders' interests are aligned with those of minority shareholders.
- High levels of disclosure and internal controls, and the quality of a company's disclosure and internal controls to reduce inherent information asymmetry.

**In EM, the alignment of interests with minority shareholders is more of a focus than potential principal-agent conflicts**

## Corporate boards—independence and political connections

In addition to relatively concentrated levels of ownership (including a high level of state ownership), board independence is relatively low in China, even compared to other BRIC countries (see Figure 3, over 90% of company boards have a majority of non-independent directors). From a corporate governance perspective, a lack of independence is generally considered an issue; therefore how do we assess boards of directors in China?

While there is no easy answer to this question, a 2011 paper in the *Journal of Corporate Finance* (Chen, Li, Sun, and Sun) explores the role of boards' political connections in China and raise several interesting points:

- According to the paper, political connections in SOEs are likely to be negative for value creation, as they tend to be imposed by governments.
- On the other hand, political connections at board level are likely to be value enhancing for private companies. A more recent Berkeley study from Haveman et al in 2013<sup>1</sup> shows that private enterprises with politically connected boards tend to outperform their non-connected peers. Since the government plays a very important role in the Chinese economy, having a minimal level of political connections can help private firms successfully navigate the system.

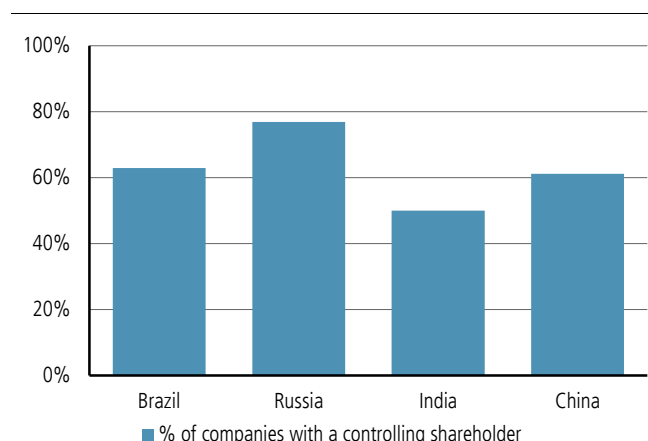
**For private enterprises, a politically connected board may not be a negative signal**

We view directors' independence as an important governance factor, especially when assessing audit committees. However, the above academic studies highlight the need to take local context into account, especially when considering the advisory role of the board (not just its monitoring role).

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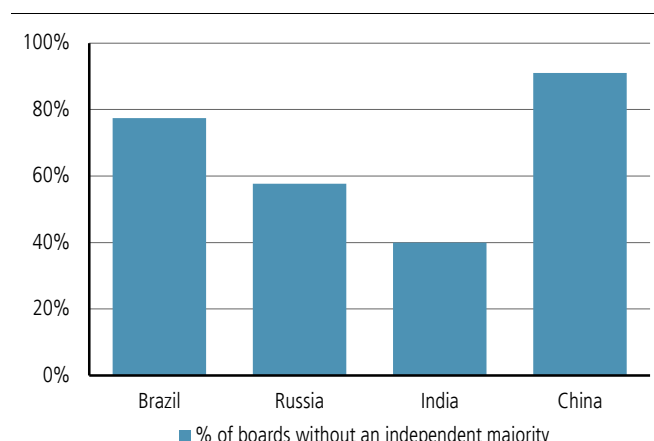
<sup>1</sup> *China's economic transition and the value of firms' political connections*, Haveman, Jia, Shi, Wang, 2013

**Figure 2: % of companies with a controlling shareholder**



Source: GMI Ratings

**Figure 3: % of companies with less than 50% independent directors**



Source: GMI Ratings

## Audit committees and related-party transactions

Beyond the ownership aspects discussed earlier, we believe financial disclosure and internal controls are other key areas to focus on in the context of tightly controlled companies. In fact, a recent investor survey identified related-party transactions and financial disclosure as the corporate governance areas that need most attention in China. Therefore we believe investors should pay particularly close attention to audit committee composition and related-party transactions.

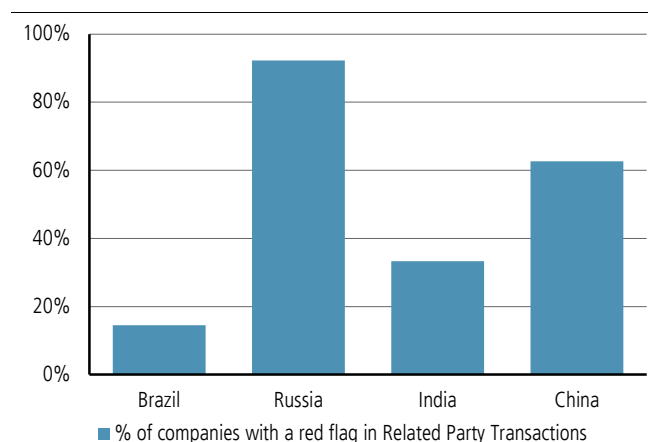
- We view audit committee composition as a good indicator when assessing the quality of a company's financial disclosure and internal controls. Despite low board independence in China, a sizeable minority of firms do have independent audit committees (see Figure 5). Issues surrounding audit committees including over-boarding, lack of industry expertise and independence seem to be important differentiators of corporate governance practice for H-share companies (see Figure 6).
- The prevalence of related-party transactions (RPT) is relatively high in China, although significantly lower than Russia. Most RPTs are part of the normal course of business, but by their nature they indicate the potential for a conflict of interest and deserve more scrutiny from investors. Several academic studies have linked RTPs to lower valuations, which may suggest that minority shareholders view it as a risk (eg, Kohlbeck, Mayhew, *Journal of Accounting and Public Policy*, 2010). We view the issue of RPT as potentially more risky when board independence is low, and in markets where auditing and reporting systems are relatively weak.

**In the context of low board independence, composition of the audit committee is a useful governance indicator**

**We view RPT as more risky when board independence is low and in markets where auditing and reporting systems are weak**

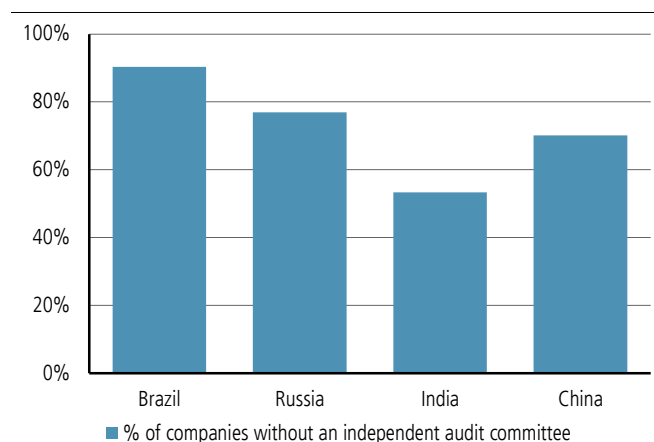
## RPTs and audit committee composition in China vs. other BRIC countries:

Figure 4: % of companies with RPTs in the past two years



Source: GMI Ratings

Figure 5: % of companies without a fully independent audit committee

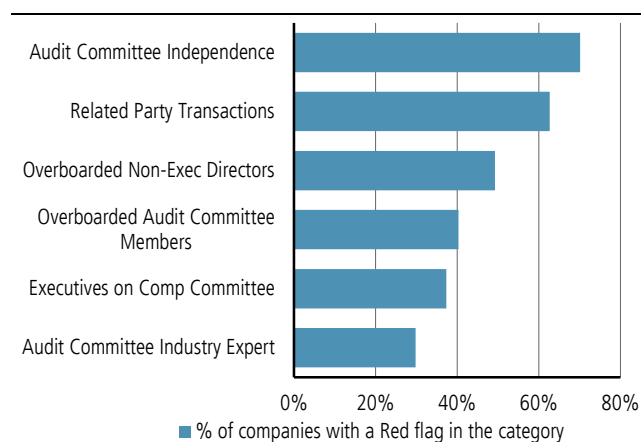


Source: GMI Ratings

## Practices differentiating companies within the H-share market

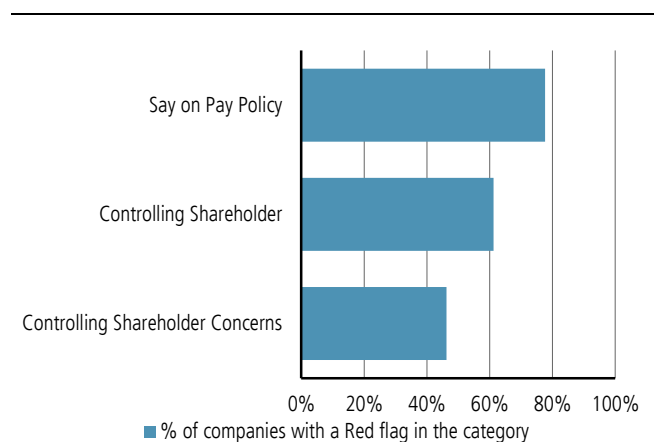
By using corporate governance data from GMI, we identify some key governance practices that drive differences in the H-share market. We define these as issues for which at least 20% of companies deviate from main market practice.

Figure 6: Key board issues



Source: Based on GMI Ratings data

Figure 7: Key ownership & control issues

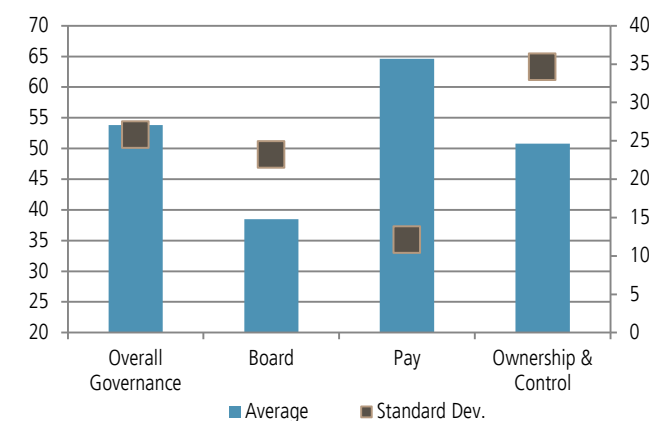


Source: Based on GMI Ratings data

Despite low levels of board independence and concentrated ownership, there are significant differences within the H-share market both in terms of ownership structure and board practices (see Figure 8). A look at standard deviation of GMI ratings shows higher variation for China corporate governance ratings (looking at GMI ratings for H shares) compared to other BRIC countries (see Figure 9). We believe this supports the case for picking companies with best-in-class corporate governance.

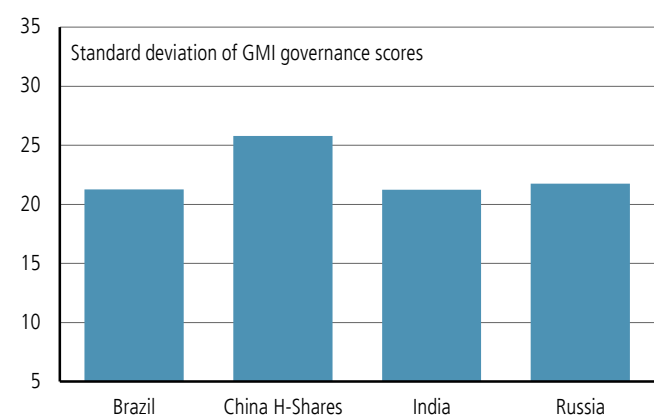
**There are significant differences within the H-share market both in terms of ownership structure and board practices**

**Figure 8: H shares: important differences in terms of ownership and board practices**



Source: GMI Ratings data, UBS-S

**Figure 9: Higher variance in corporate governance practices for H shares vs. other BRIC countries**



Source: GMI Ratings data, UBS-S

# A share vs. H share: corporate governance and investment returns

We have extensively reviewed academic reports on both the China market and developed markets during the preparation of this report. Although each research team may have different opinions and conclusions regarding the relationship between corporate governance and investment returns, we believe that companies with good corporate governance do not necessarily imply better investment returns for investors, at least not in the A-share market. However, we believe taking corporate governance into account can help avoid major investment mistakes, which is often more important for long-term investors.

Due to changes in policies and liquidity, there is no guarantee that companies with good financial results generate impressive investment returns. We therefore divide our research on corporate governance into two parts: firstly, the correlation between corporate governance and financial performance; and the correlation between corporate governance metrics and investment returns.

**No guarantee that companies with good financial results generate impressive investment returns**

## Corporate governance and financial performance

To analyse the impact of corporate governance on a company's operations and financial performance, we compared a list of A-share companies which are included in the SSE Corporate Governance Index with the same number of companies with similar market capitalisation and in the same industry, but that are not included in the SSE Corporate Governance Index. Figure 10 shows the correlation between corporate governance and company performance. We used the following indicators for our analysis:

- Four profitability indicators: three-year average ROE; three-year average ROA; gross margin; and net margin.
- Indicator measuring management expenses: S&GA.
- Long-term growth indicator: five-year average revenue growth rate.

We also chose two sample groups: constituent stocks of the SSE Corporate Governance Index during 2009-13, and non-constituent stocks of the SSE Corporate Governance Index during 2009-13 with similar market caps, as we believe there are differences between the two groups in terms of corporate governance. As shown in Figure 11, we did not find any major difference between the financial results of the two groups.

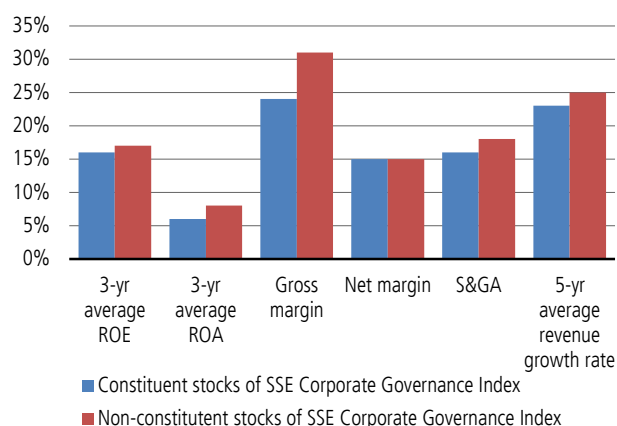
We analysed changes in constituent stocks included in the SSE Corporate Governance Index. The Shanghai Stock Exchange re-examines included stocks based on six aspects discussed before each year and adjusts the SSE Corporate Governance Index list accordingly to add and remove companies with changed corporate governance. We also selected the added and removed stocks of the SSE Corporate Governance Index during 2009-13 and divided them into two groups. One group is composed of stocks removed from the Index and the other group is composed of newly added stocks, as additions and removals from the SSE Corporate Governance Index are based on changes in corporate governance.

**For A shares, there was no visible difference in the financial performance of the removed companies and the added companies**

We then conducted an analysis based on the six financial indicators. To our surprise, we found that there was no visible difference in the financial performance of the removed companies and the added companies.

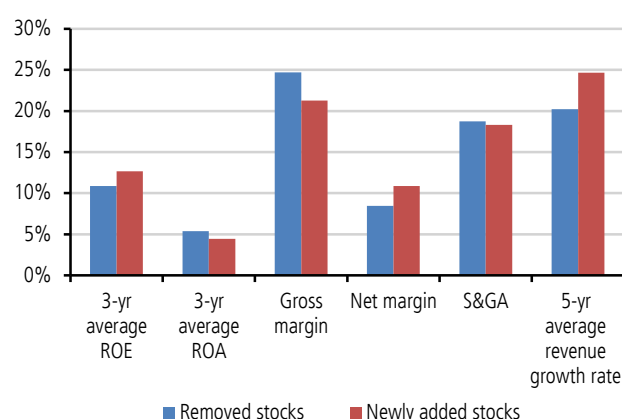


**Figure 10: Correlation between corporate governance and financial performance: SSE Corporate Governance Index constituent stocks vs. non-constituent stocks**



Source: Wind

**Figure 11: Financial performance comparison between added & removed SSE Corporate Governance Index stocks**



Source: Wind

We used GMI data for the Hong Kong market. We conducted a similar analysis on the correlation between corporate governance and H-share performance using the same indicators, namely three-year average ROE, three-year average ROA, gross margin, net margin, management expense ratio and five-year average revenue growth rate.

We divided 68 listed companies into two groups based on the GMI ESG ratings: one with higher ESG ratings and one with lower ratings. We found that the higher ESG rated companies outperformed the lower ESG rated companies in all financial indicators.

The result indicates that a higher GMI ranking may reflect the possibility of better profitability, growth potential and operating efficiency of a company. At the same time, we believe the GMI ranking system is sufficient as a corporate governance indicator, as the ratings are based on various key metrics that measure different mechanisms of corporate governance. Companies that score well are likely to have well-structured decision-making and evaluation systems in place. This in turn implies the potential for business performance to improve and an ability to attract investment.

## Corporate governance and stock price returns

We used ratings from GMI to compare the accumulated stock price return from 2008-2013 of top 50% of 34 companies with higher ESG ratings and the bottom 34 companies with lower ESG ratings on the H-share market. The result indicates that half of the companies with higher ESG ratings outperformed the other half (with lower ESG ratings) in terms of accumulated stock price returns from 2008-2012. After 2012, we found that companies with lower ESG ratings started to catch up and overtook companies with higher ESG ratings in terms of accumulated stock price returns. We also note that the stock price returns of top 50% of 34 companies with higher ESG ratings in the H-share market significantly outperformed the average stock price returns of companies covered by UBS-S under HSCEI index from 2008-2013.

What happened in 2012 that caused a big change in the stock price performance certainly needs further investigation. But given the data collected in the past 6 years overall, we cautiously conclude that good governance may at times correlate with positive share price returns. Meanwhile, we note that this says nothing about causality and may be a random result given the short period of time under review. Outcomes may also change if the base time is chosen differently.

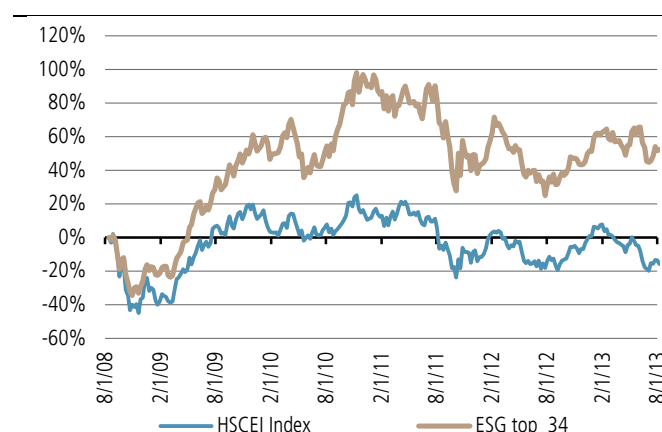
**In the H-share market, we cautiously note that investment returns for companies with good corporate governance may at times correlate with good GMI governance ratings**

**Figure 12: Accumulated stock price return comparison & GMI ratings: stocks with higher ESG ratings and those with lower ESG ratings (H share)**



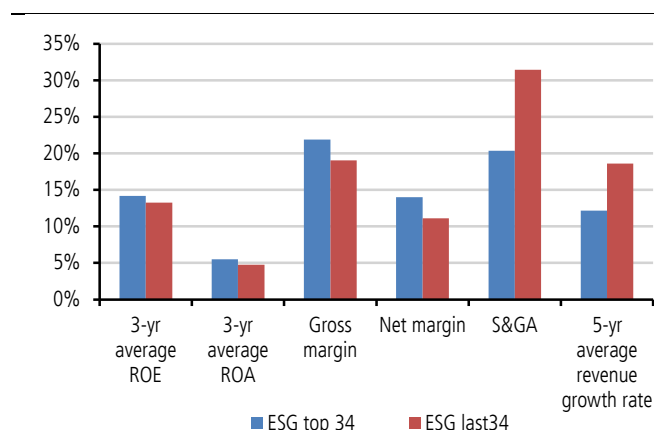
Source: GMI, Bloomberg, UBS-S

**Figure 13: Accumulated stock price return comparison: GMI ratings and UBS-S covered companies (H share)**



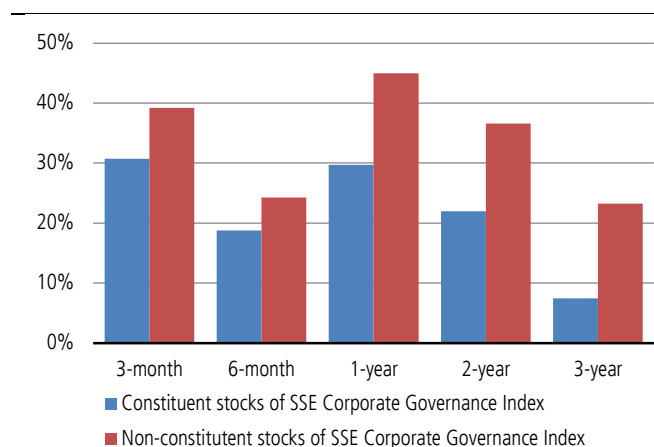
Source: Wind, UBS-S

**Figure 14: H-share companies with higher GMI rating have performed well financially**



Source: GMI, Bloomberg, UBS-S

**Figure 15: Stock price return comparison: constituent stocks vs. non-constituent stocks of the SSE Corporate Governance Index (A share)**

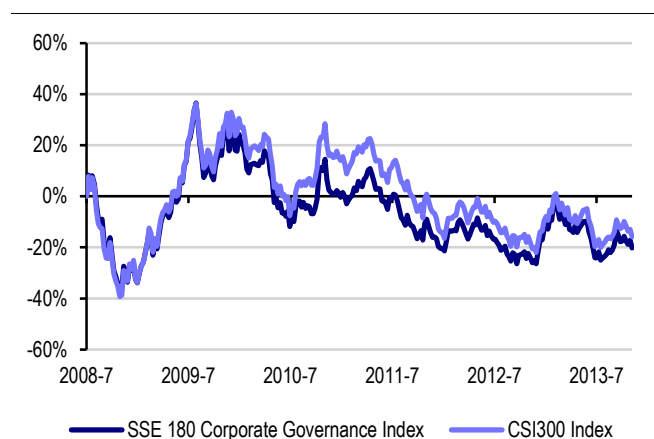


Source: Wind, UBS-S

However, this was not the case for the A-share market. As shown in Figure 13, non-constituent stocks of the SSE Corporate Governance Index significantly outperformed those which are included in the SSE Corporate Governance Index in almost all of the past three years in terms of stock price performance. Therefore we believe corporate governance is not a valid investment strategy for the A-share market, and at times an inverse relationship exists.

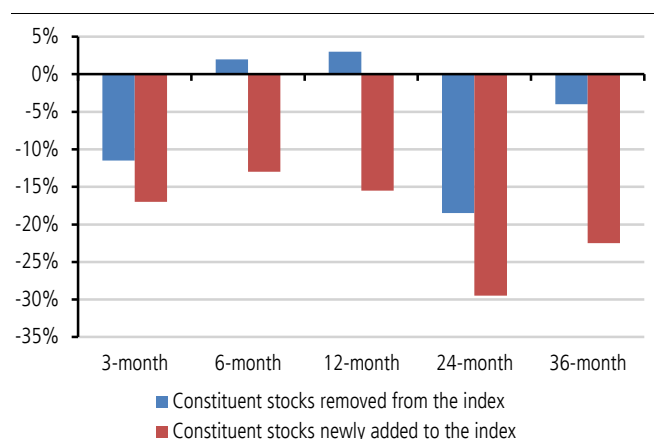
Again we conducted an analysis of changes of constituent stocks in the SSE Corporate Governance Index. We found that all companies that were removed from the index outperformed newly added companies in different periods during the past three years in terms of stock price performance. We understand that the addition and removal of companies from the SSE Corporate Governance Index is based on changes (improvement or deterioration) in corporate governance.

**Figure 16: SSE 180 Corporate Governance Index underperformed CSI300 Index over six years**



Source: GMI, Bloomberg, UBS-S

**Figure 17: Accumulated stock price return comparison: newly added constituent stocks vs. removed constituent stocks of the SSE Corporate Governance Index**



Source: GMI, Bloomberg, UBS-S

In short, it is the general view that H-share companies with good corporate governance are expected to at least record good fundamental performances in the main, if not necessarily good investment returns. Our research indicates that H-share companies with high GMI ratings tend to perform well in terms of

**It is the general view that H-share companies with good corporate governance should at least record good financial performance**

fundamentals. But we note that investment returns may differ based on the timing selection.

We note that A-share companies' financial performance shows no correlation with whether the companies are included in SSE Corporate Governance Index or not. In addition, investment returns for companies with different corporate governance do really not differ greatly.

We believe this can be explained as follows:

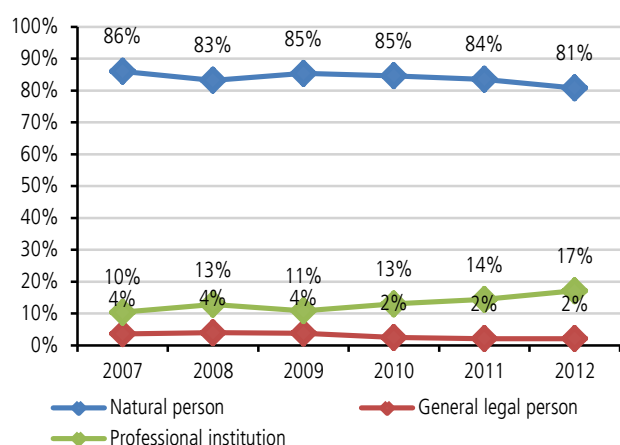
- There is a possibility that the data provided are not sufficient to reflect the true performance of companies' corporate governance. As China's capital market has only existed for a short period, it is possible that the data is less reliable than a more mature market and unable to give comprehensive feedback on the performance of corporate governance, especially in the A-share market.
- A company's strategy, business model and products are constantly changing and evolving along with the rapid growth of the Chinese economy. Corporate governance reflects the history of a company and is therefore not particularly predictive.
- We believe it can also be explained by investor style, as to some degree this reflects the lack of attention paid to corporate governance by A-share investors.
- Some companies may disclose information in a less structured manner, and their stock prices could be more volatile than companies that operate and disclose with greater discipline.

**Corporate governance data may not reflect the true performance of analysed companies' corporate governance**

- Last but not least, good corporate governance does not only include a variety of internal mechanisms, but also external mechanisms such as regulatory mechanisms and legal systems. The media in Hong Kong also plays an important role in supervising the activities of corporations, which increases the transparency of the market. On the other hand, the government intervenes in the mainland market and SOEs in particular are well-protected.

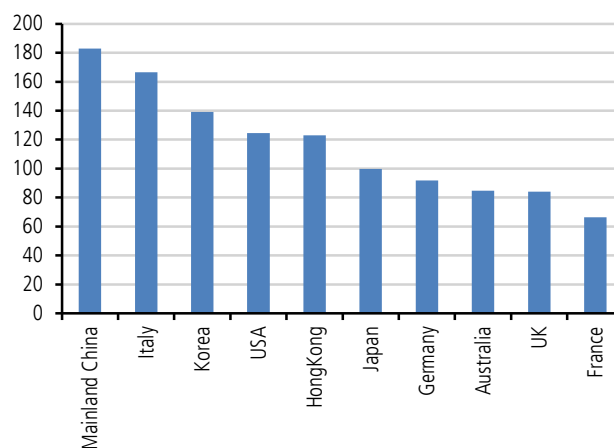
**External mechanisms such as regulatory mechanisms and legal systems are also important.**

**Figure 18: Share of retail investors in total commission pool**



Source: Wind

**Figure 19: Turnover ratio comparison: A-share market vs. overseas markets**



Source: Wind

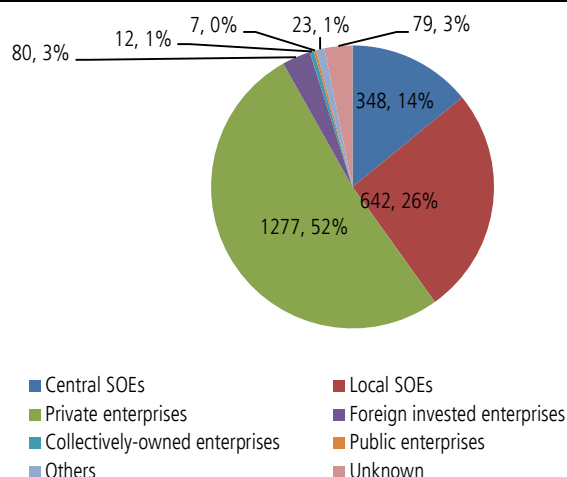
# SOEs vs. privately-owned companies: private enterprises deliver higher investment returns

## Corporate governance scores for private enterprises are higher than SOEs

As shown in the chart below, of the 2,468 mainland listed companies, 1,277 are private enterprises and account for 51.7% of the total, while 990 are local and central SOEs, accounting for 40.1%. Measured by market cap, however, SOEs account for 59.3% of the total market cap of the Shenzhen and Shanghai stock exchanges, with central and local SOEs accounting for 39% and 20.3%, respectively, while private enterprises only account for 26% of total market cap. This reflects the current status of China's economy: strong SOEs and weaker private enterprises.

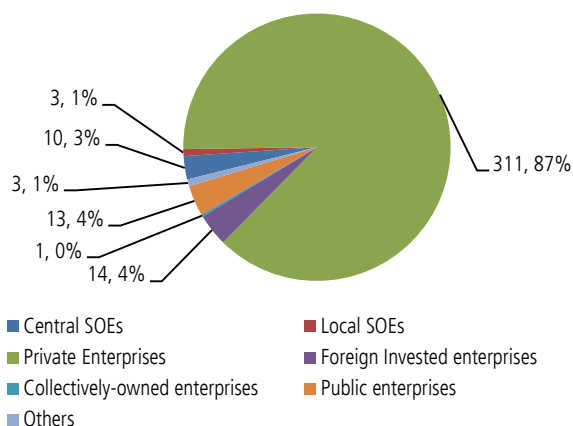
**The current status of China's economy: strong SOEs and weak private enterprises**

**Figure 20: Number of listed companies by type of controlling shareholder**



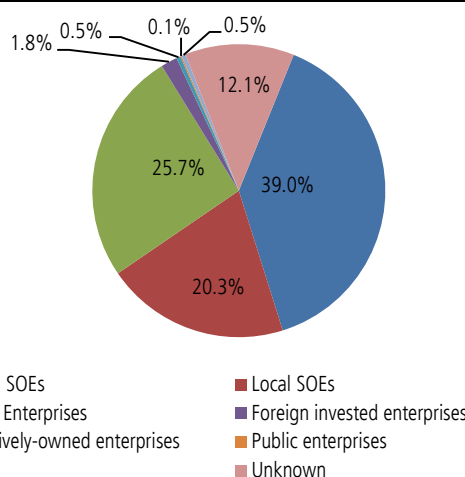
Source: Wind

**Figure 22: GEM board composition by type of controlling shareholder**



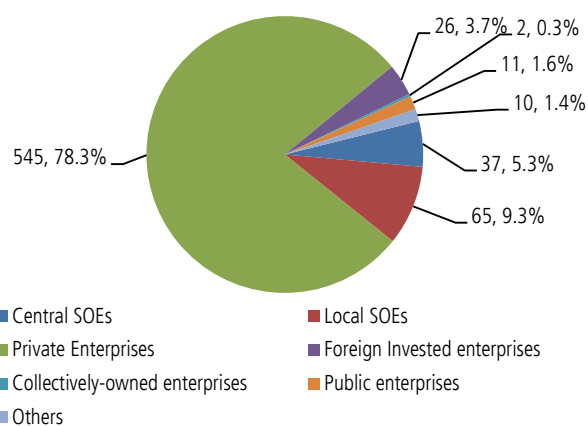
Source: Wind

**Figure 21: Listed company weighting to total market cap by type of controlling shareholder**



Source: Wind

**Figure 23: SME board composition by type of controlling shareholder**

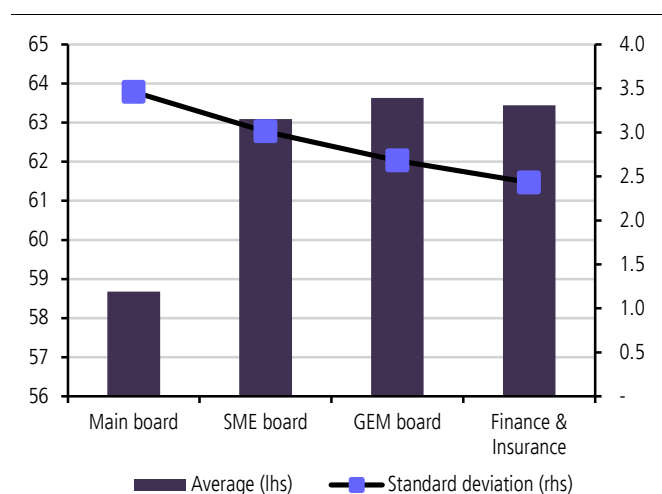


Source: Wind

According to a corporate governance report published by Nankai University which covered approximately 99.1% of listed companies, collectively-owned companies (owned by a large number of employees with diversified shareholders) have the highest corporate governance indicator (averaging 62.9). Scores for private enterprises and foreign invested enterprises were 61.0 and 60.8, respectively, and just 59.8 for SOEs.

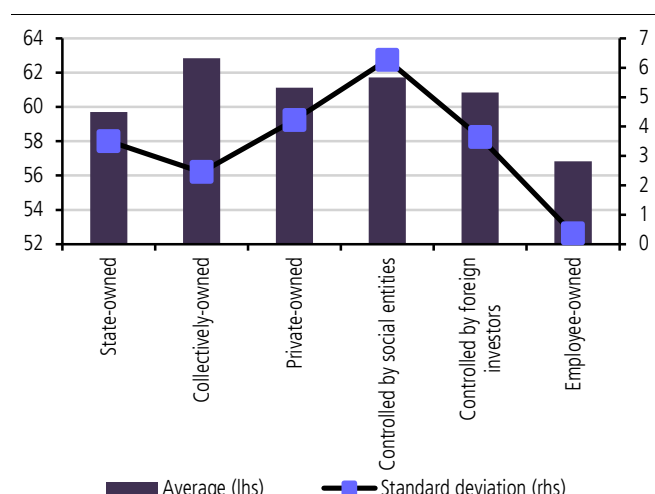
The GEM board in Shanghai scored 63.6 in 2012, according to the Chinese Corporate Governance Index, and the finance/insurance and SME sectors scored 63.3 and 63.1, respectively. The main board in Shanghai scored the lowest at 58.7. As SOEs account for 60% of total market cap of the main board while private enterprises account for 80% of GEM board market cap, it is not surprising that the corporate governance score of the main board is relatively low.

**Figure 24: Corporate governance scores of China's listed companies by sector/board (2012)**



Source: China Corporate Governance and Development 2012, UBS-S

**Figure 25: Average values and standard deviations of corporate governance scores of China's A-share companies by type of controlling shareholder (2012)**



Source: China Corporate Governance and Development 2012, UBS-S

In most cases, China's listed companies are characterised by a high shareholding concentration at both SOEs and private enterprises. This shareholding structure may lead to major differences in corporate behaviour by various stakeholders, reflected foremost in their attitudes towards corporate governance.

## SOEs

SOEs are enterprises invested, controlled or operated by the government. SOEs are for-profit as they need to retain and increase the value of state-owned assets. They are also public welfare entities, as they are usually established to realise stable economic growth targets and to assume the social responsibilities of facilitating employment and preventing inflation. SOEs are divided into central government owned and local government owned.

In the past two decades, rapid economic growth has boosted revenue growth and also possibly disguised many of the disadvantages of SOEs such as low operating efficiency and high costs. Slower economic growth has exposed the problem of severe overcapacity in particular and other problems including overstaffing and low efficiency. We believe these problems are the result of conflicting management incentive structures.

In addition, our research indicates that many local government SOEs are more efficient than central government SOEs. We believe this is because local SOEs rely on government support or monopoly conditions only in their local markets, and must compete in outside markets. Therefore local SOEs tend to operate more efficiently, in our view.

We believe the following characteristics of SOEs have resulted in low corporate governance:

- **Lack of market-driven competitive pressure.** Most SOEs have long been supported by the government, resulting in a top-down corporate culture which lacks competitive pressure and the incentive to innovate. Private enterprises do not have ultimate implicit guarantees from the government. In other words, if a private enterprise suffers losses, it may go bankrupt and exit the market. But SOEs will not suffer from the same consequence. This lack of sense of crisis is exactly the reason why many SOEs are gradually losing competitiveness and commitment for innovation, in our view.
- **Unclear allocation of responsibilities between the major shareholder and managers.** As the state owns an absolute majority of the shares in SOEs, there may sometimes be a less clear allocation of responsibilities between the chairman of the board and the general manager. The chairman often participates in daily operations and consequently strategic decisions and personnel appointments may be affected by government decisions. This could result in lower decision-making efficiency, in our view.
- **Unclear incentive schemes for management.** Most SOE executives are appointed by the government. The government evaluates the performance of managers by the SOE's contribution to GDP and how many jobs are created. As a result, simply growing the enterprise is the priority for many SOE managers. Furthermore, as the majority of profits are channelled to the government regardless of how much profit is created, managers have less incentive to increase net profit.

**An SOE has the characteristics of a for-profit company and a public welfare entity**

**Our research indicates that many local SOEs operate more efficiently than central SOEs**



- **Career goals may not be aligned with SOE profitability.** As mentioned earlier, many managers in SOEs are appointed by the government. Thus the career goal for many SOE managers may be to gain promotion in the civil service. To this end, some managers may be more interested in social responsibilities and helping smaller enterprises to grow, as these policies tend to impress the government the most. However, such activities to some extent may undermine minority shareholder interests.
- **Remuneration is relatively low for many SOE managers.** From a remuneration perspective, SOE executives are generally not highly paid (excluding implicit subsidies) compared to their peers in the private sector. Moreover, performance-based compensation only accounts for a very low share of total remuneration and there are minimal stock incentives. As a result, motivation for SOE executives is limited and they may be less willing to participate aggressively in market competition, in our view.
- **Control of operating costs is difficult.** This is especially so during the procurement process and corruption allegations have periodically surfaced at some SOEs. Oversight by the Commission for Discipline Inspection and Supervision could be compromised, as the Commission's evaluations are done via surveys of the workforce and it may be unwilling to expose possible operating cost loopholes and problems.

## Private enterprises

China's private enterprises mainly include: 1) family-owned companies that were developed by entrepreneurs or directly founded by family members; 2) partnerships jointly invested in and owned by friends or colleagues; and 3) acquired SOEs or collectively-owned enterprises.

We believe private enterprises operate more efficiently than SOEs mainly due to better incentive schemes, a more competitive attitude and higher management efficiency. As private enterprises are responsible for profit and loss, management remuneration is directly linked to profits. As a result, private enterprises are 'small but vigorous' and are more profit-oriented than revenue-oriented.

**Private enterprises are 'small but vigorous' and are more profit-oriented than revenue-oriented**

Most Chinese private enterprises are family run, and only a few have implemented modern management systems.

We believe that in the context of rapid growth of private enterprises, the following shortcomings in governance may begin to appear:

**With rapid development of private enterprises, many shortcomings may be exposed**

- **Single ownership.** Single ownership means one family holds a controlling stake in the company and there is a reluctance to delegate responsibility to outsiders who have bought a stake, resulting in highly concentrated ownership and management rights. Single ownership is relatively efficient at the initial growth stage of the company, as it saves administrative costs, reduces internal rivalries and accelerates capital accumulation. However, disadvantages may emerge when the company grows to a certain size.
- **Unclear ownership.** Private enterprises developed by entrepreneurs or founded by family members sometimes have difficulty delineating corporate property and personal property if an independent and comprehensive property rights system has not been established. Private enterprises that acquired bankrupt SOEs are also affected by this problem.

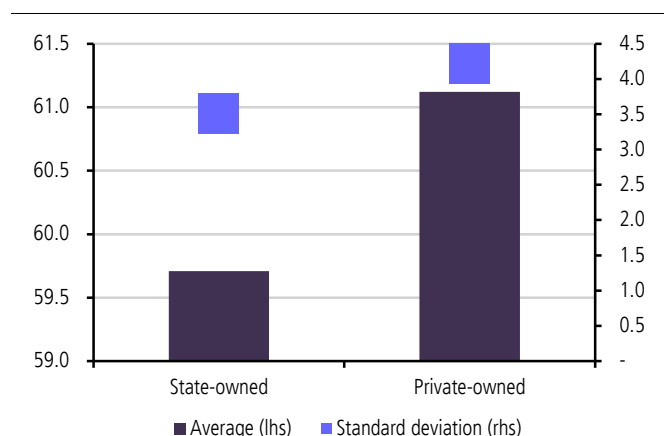
- **Inheritance issues.** The transition from the first generation (the founder) to the second generation (the children) can result in deterioration of management skills. Many Chinese family-run companies choose a paternalistic management model, and the main characteristics are family and blood ties coupled with centralised leadership and an autocratic decision-making process. When companies grow to a certain size, the limitations and arbitrary nature of this management model can negatively affect operational decisions.
- **Internal contradiction and conflicts between owners and managers of family-run companies.** Many family-run companies hire managers to improve competitiveness. However, conflicts can emerge when professional managers and the family disagree on strategy.
- **Asymmetrical information.** High shareholding concentration may lead to conflicts of interest between majority and minority shareholders, as controlling shareholders can exploit their information advantages and seek benefits for their own instead of benefits for all shareholders. Occasionally, some of the group's actions may not be wholly for the benefit of all shareholders, but based on the interests of the owning family, and lead to frequent related-party transactions.
- **Insufficient financial support.** One of the biggest disadvantages of single ownership is limited financing channels. Data indicate that self-raised equity funds account for up to 90.5% of Chinese family-owned companies' financing activities while bank loans account for 4%. Therefore many family-run companies use capital markets and raise funds in secondary markets, which can negatively affect minority shareholders.

## **Private enterprises perform better financially than most SOEs; central government SOEs lag local SOEs**

Our sample includes almost all A-share companies, constituent stocks of the SSE Corporate Governance Index (around 260 companies) and H-share companies in the GMI corporate governance database. We use the following six profitability indicators to evaluate long-term financial performance and investment returns: three-year average ROE; three-year average ROA; gross margin; net margin; management expense ratio; and five-year average operating revenue growth rate.

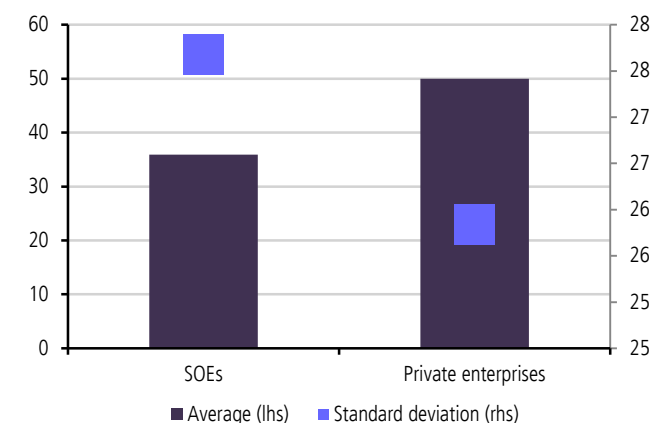
Our research indicates that in both the A- and H-share markets, the corporate governance index score for private enterprises is generally higher than for SOEs.

**Figure 26: Average values and standard deviations of SOEs and private enterprises in the A-share market (2012)**



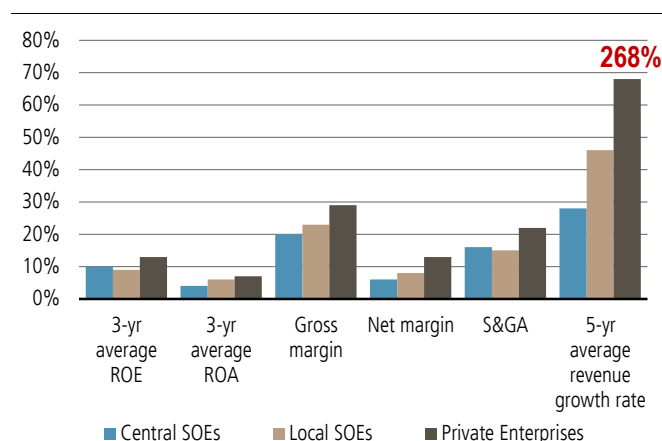
Source: GMI, UBS-S

**Figure 28: GMI's ESG score for selected H-share companies by controlling shareholder**



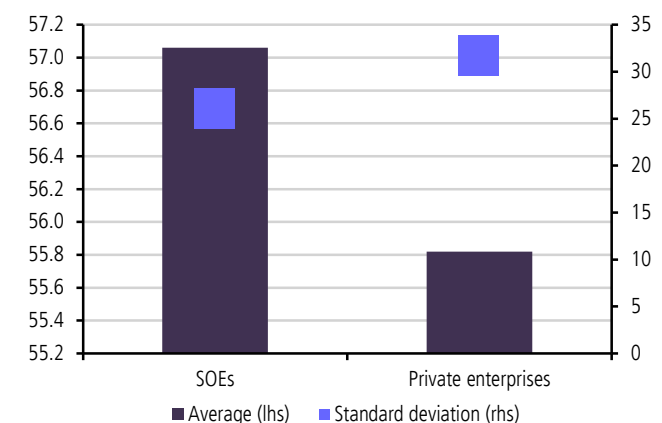
Source: GMI, UBS-S

**Figure 27: 3-yr average ROE, ROA, gross margin, net margin, S&GA and 5-yr average revenue growth of all A-share companies by controlling shareholder**



Source: Wind, Bloomberg, UBS-S

**Figure 29: GMI's AGR score for selected H-share companies by controlling shareholder**



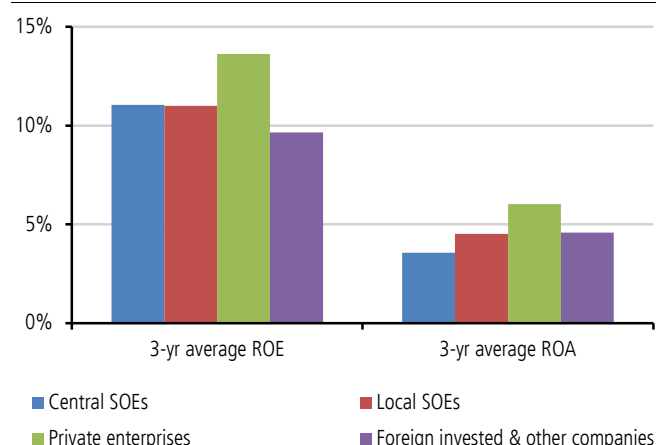
Source: GMI, UBS-S

Our research indicates that private enterprises also have better financial performances and substantially higher investment returns than SOEs in both the short and long term. Specifically, private enterprises perform better than central and local government SOEs in terms of three-year average ROE and three-year average ROA. Gross margins and net margins of central SOEs and local SOEs are also substantially lower than private enterprises. Furthermore, in terms of growth, private enterprises had the highest average annual revenue growth rates over five consecutive years while central SOEs had the lowest rates.

Private enterprises have the highest SG&A ratios, followed by central SOEs and local SOEs. It is generally believed that a high SG&A ratio indicates low operating efficiency. We agree. SOEs do not have a high SG&A ratio because of scale effects. The scale of many SOEs (in terms of market share, turnover, profit, or capital) is significantly larger than private enterprises and affects the scale of fixed cost allocation. As the charts below show, most indicators for local SOEs are significantly better than central SOEs. Moreover, for many companies listed on the SSE Corporate Governance Index, we note that private enterprises perform better financially than most SOEs, while central SOEs perform slightly worse than local SOEs.

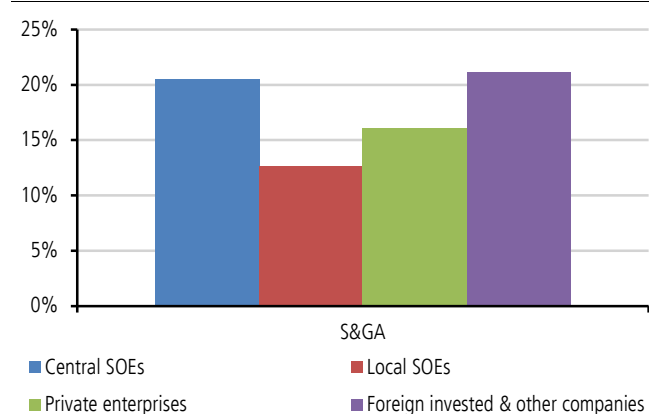
**Private enterprises have better financial performances and higher investment returns than SOEs in both the short and long terms**

**Figure 30: Three-year average ROA and ROE of sample companies listed on the SSE Corporate Governance Index by controlling shareholder**



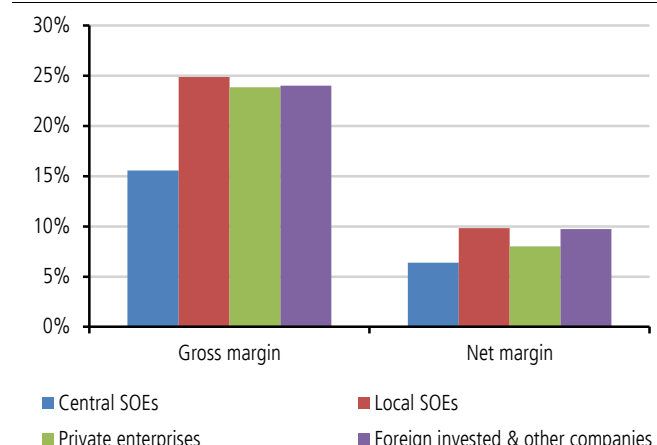
Source: Wind, Bloomberg, UBS-S

**Figure 32: S&GA of sample companies listed on the Shanghai Stock Exchange by controlling shareholder**



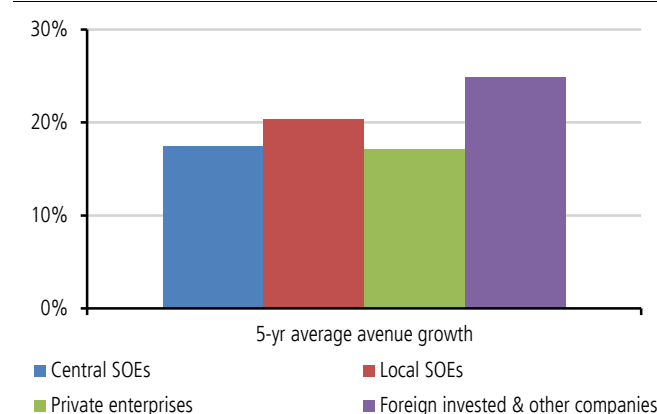
Source: Wind, Bloomberg, UBS-S

**Figure 31: Gross and net margins of sample companies listed on the SSE Corporate Governance Index by controlling shareholder**



Source: Wind, Bloomberg, UBS-S

**Figure 33: Growth of sample companies listed on the Shanghai Stock Exchange by controlling shareholder**



Source: Wind, Bloomberg, UBS-S

We believe the reasons for the above are as follows:

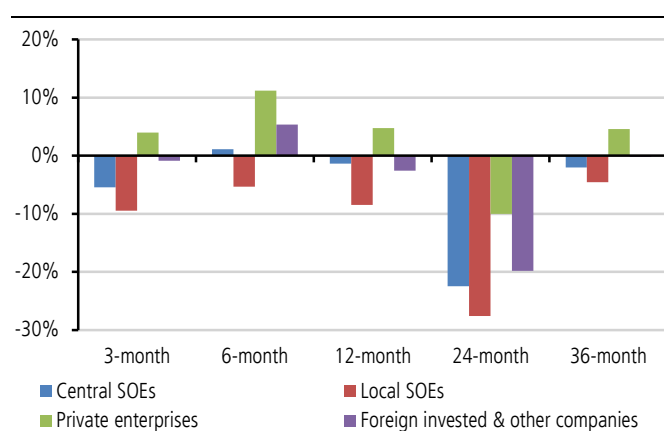
- While many central SOEs are monopolies, they also have social welfare responsibilities as a top priority instead of solely pursuing profits.
- Over the past decade, local SOEs may have been under increasing pressure from local governments to contribute to GDP growth, prompting an increase in growth scale (mainly in terms of turnover rate).
- Local SOEs tend to face local protectionism when they expand into other regions. Therefore their products and services need to be more attractive in order to win the competition against local enterprises. This can lead to a significant improvement in local SOEs' competitiveness.

## Private enterprises deliver higher investment returns than SOEs

Our sample includes all A-share companies, constituent stocks of the SSE Corporate Governance Index (around 260 companies) and H-share companies included in the GMI corporate governance database. In terms of return on investment of companies with different controlling shareholders, investment returns from private enterprises and foreign-invested enterprises in the A-share market are significantly higher than SOEs in both the short and long term. For companies in the H-share market on the other hand, investment returns from SOEs tend to be higher in the short term. But in the long term, private enterprises and foreign-invested enterprises generate better investment returns.

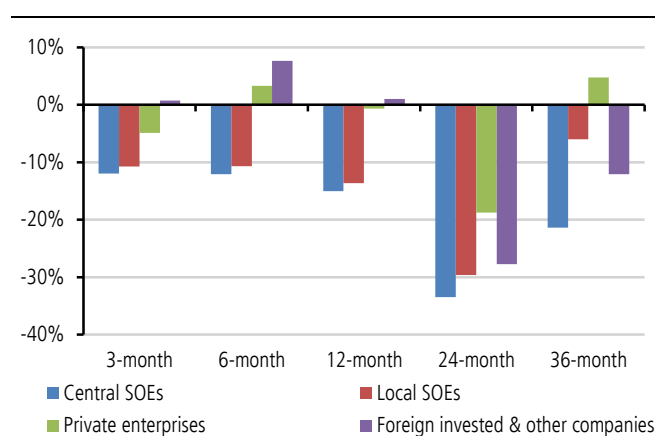
**Private enterprise and foreign invested enterprise returns are significantly higher than SOEs in both the short and long term**

**Figure 34: Accumulated returns of all A-share companies by controlling shareholder**



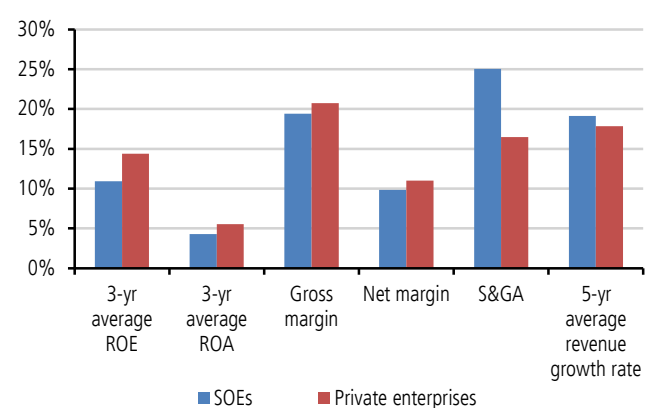
Source: Wind, Bloomberg, UBS-S

**Figure 35: Accumulated share price performance of sample companies listed on the SSE Corporate Governance Index by controlling shareholder**



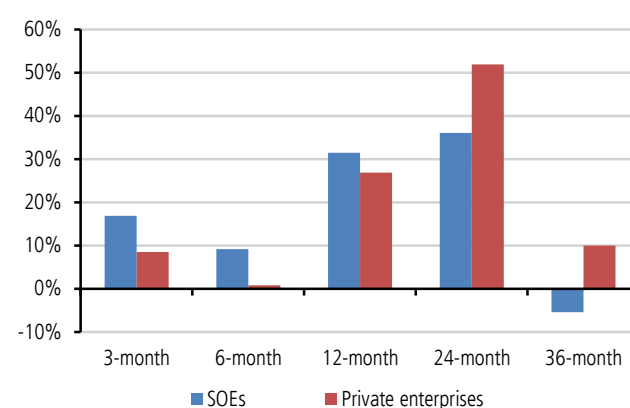
Source: Wind, Bloomberg, UBS-S

**Figure 36: Financial performance of H-share companies by controlling shareholder**



Source: GMI, Bloomberg, UBS-S

**Figure 37: Accumulated share price performance of H-share companies by controlling shareholder**



Source: GMI, Bloomberg, UBS-S

We believe the reasons for this are:

- The business goals of private enterprises are determined by their ownership structures and operating mechanisms. For many private enterprises, their only goal is to pursue profitability. Compared to SOEs, they must participate and deal with market competition. As a result, private enterprises are forced to improve competitiveness and profitability.
- Being small or medium sized is also an advantage. Compared to many large SOEs, the management style at private enterprises is relatively less bureaucratic, and entrepreneurs have a passion for innovation and the courage to take risks, in our view. Another benefit of being small is flexibility. Unlike many SOEs that are less flexible and less sensitive towards changes in the market and policy, the resilience of private enterprises is much higher and helps them to take advantage of market opportunities.
- Decision-making autonomy is the most important feature of private enterprises. They are able to make business decisions about which route and what method the enterprise should take to develop in the long term without being troubled by government intervention. Therefore we note the prevalence of strong managements and high operating efficiency in many private enterprises.

**Private enterprises are small/medium sized, have autonomous decision-making processes and are profit-driven**

**Decision-making autonomy is the most important feature of private enterprises**

# Conservative accounting does not lead to a high investment return

We divided the 67 listed companies covered by GMI and rated by AGR into three groups: the first group comprises 15 companies that use conservative/sound accounting recognition; the second group comprises 35 companies that use neutral accounting recognition; and the third group comprises 17 companies that use relative aggressive accounting recognition. AGR uses scores to show the reliability of a company's financial statements and corporate governance.

Here we adopt the International Accounting Standards Board's definition to define the soundness of accounting policies: "prudence means that under uncertain conditions, a degree of caution shall be exercised when making necessary estimates by the use of judgment. For example, assets or income shall not be overstated while liabilities or expenses shall not be understated".

In this process, management's subjective judgment, conservative or aggressive, would significantly affect the accounting results even if they are legally compliant or in line with the accounting standards. The continuity of accounting policies is also very important.

Our findings above show that the group using neutral accounting recognition has the highest long-term aggregate returns, followed by the group using conservative accounting recognition. The group using aggressive accounting recognition has the lowest long-term aggregate returns.

Why do companies using conservative accounting recognition have lower returns than those using normal/average accounting recognition? We attribute this to two reasons:

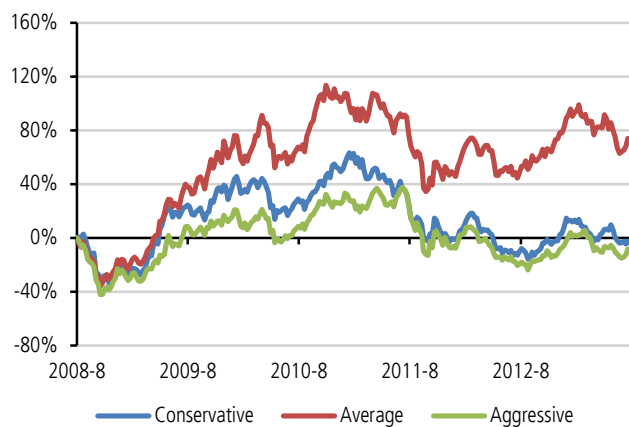
- These companies may use conservative accounting recognition for a number of reasons, including reducing their exposure to taxation, and may continue to do so. Investors cannot expect conservative accounting to normalise. Therefore the value of the companies may be understated due to their conservative accounting recognition.
- It takes professional investment knowledge to judge whether the accounting policy of a company is aggressive or conservative. Hence most investors may ignore the true value of a company. They may not fully understand the implications of a sound/conservative accounting policy for a company's earnings quality, but rather focus just on net profit.
- There are several definitions of conservative accounting – we are unable to test for how accurately the AGR reflects a company's accounting culture.
- The result may be random and specific to a given time period.

A company using aggressive accounting recognition may front-load its future earnings, which poses a risk: when the economy or an industry is weak, the company would be in no position to report its future earnings in advance, leading to a steeper-than-expected earnings downturn. Therefore the long-term aggregate return for the company's shares tends to be low.

**The group using neutral accounting has the highest long-term aggregate returns, followed by the group using conservative accounting recognition**

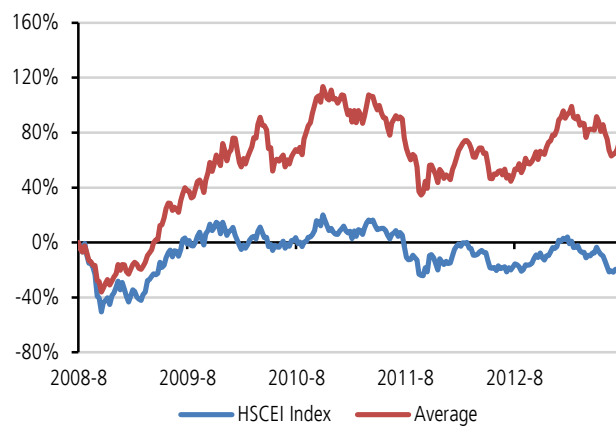
**Companies that use aggressive accounting recognition may overdraw future earnings, which poses a risk**

**Figure 38: Companies using neutral accounting recognition have the highest long-term returns**



Source: GMI, Bloomberg, UBS-S

**Figure 39: Companies using neutral accounting recognition have higher returns versus the HSCEI index**



Source: GMI, Bloomberg, UBS-S



**Figure 40: Valuation comparison in local currency & GMI ratings (H share)**

Company	Code	ESG Rating	AGR Rating	UBS Rating	Current Share Price	Target Price	Market Cap (billion)	PE		PB		ROE		Net Divident yield	
								2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
China Southern Airlines Co Ltd	HK1055	D	—	Buy	2.47	3.50	29.6	28.9	11.6	0.6	0.6	2.0	4.9	1.4	1.3
Huadian Power International Corp. Ltd.	HK1071	D	—	Buy	4.00	4.90	29.7	5.7	6.4	0.9	0.9	16.5	16.5	7.0	6.3
China Railway Construction Corp Limited	HK1186	D	—	Buy	6.93	10.50	88.3	6.7	6.1	0.9	0.8	13.7	13.4	2.4	2.7
Industrial and Commercial Bank of China	HK1398	C	—	Buy	4.79	5.60	1,564.3	5.2	5.1	1.0	0.9	21.9	19.5	6.8	4.9
China Datang Corp Renewable Power Co Ltd	HK1798	—	Very Aggressive	Buy	1.14	2.10	8.4	13.8	9.4	0.7	0.7	5.3	7.5	2.5	3.7
Zhaojin Mining Industry Company Limited	HK1818	C	Average	Buy	4.85	6.92	15.0	14.2	15.4	1.4	1.3	9.9	8.8	2.3	2.1
BBMG Corp	HK2009	D	Average	Buy	6.35	7.21	28.7	10.0	7.2	0.9	0.8	9.5	12.1	2.0	2.8
Ping An Insurance (Grp) Co of China Ltd.	HK2318	C	—	Buy	60.90	89.49	486.8	13.6	12.0	2.7	2.2	21.6	20.7	1.3	1.5
China Pacific Insurance (Group) Co., Ltd	HK2601	—	Conservative	Buy	25.50	32.21	233.3	21.7	19.0	2.0	1.8	9.5	9.5	1.8	1.8
Guangzhou R&F Properties Co., Ltd.	HK2777	D	Average	Buy	10.90	11.75	36.0	5.6	4.4	1.0	0.8	19.5	18.5	6.1	8.0
Dalian Port (PDA) Company Limited	HK2880	—	Conservative	Buy	1.86	2.60	12.4	9.2	8.2	0.5	0.5	5.6	6.1	4.3	4.9
China National Building Material Co. Ltd	HK3323	F	Aggressive	Buy	7.96	12.00	43.6	—	—	—	—	—	—	—	—
Zhuzhou CSR Times Electric Co., Ltd.	HK3898	D	—	Buy	24.35	30.10	30.7	14.3	15.3	2.5	2.4	19.6	16.7	1.8	2.0
China Molybdenum Co Ltd	HK3993	C	Aggressive	Buy	3.64	3.98	31.5	13.1	9.6	1.2	1.1	9.4	12.0	2.7	3.6
Zhejiang Expressway Co., Ltd.	HK0576	D	—	Buy	7.05	8.40	31.5	11.8	12.1	1.4	1.5	12.1	12.7	5.9	5.6
ZTE Corporation (H Shares)	HK0763	C	—	Buy	16.22	20.00	58.4	29.5	15.1	1.9	1.8	6.8	12.3	0.8	1.7
PetroChina Company Limited	HK0857	D	Conservative	Buy	8.68	10.00	1,739.1	10.4	10.6	1.1	1.1	11.3	10.5	4.3	4.3
China Construction Bank Corporation	HK0939	C	—	Buy	5.41	6.40	1,373.1	5.1	5.0	1.0	0.9	21.4	19.4	6.9	5.0
Datang International Power Generation Co	HK0991	D	—	Buy	3.11	4.00	57.5	7.7	6.2	0.8	0.7	10.8	11.7	4.5	5.2
New China Life Insurance Co Ltd	HK1336	—	Average	Buy	23.35	30.57	79.9	14.4	11.2	1.7	1.3	12.0	12.8	0.7	1.3
Guangzhou Automobile Group Co., Ltd.	HK2238	C	Very Aggressive	Buy	8.44	10.50	60.5	16.2	9.8	1.4	1.3	8.8	13.8	3.2	5.2
Haitong Securities Co Ltd	HK6837	B	—	Buy	11.46	13.90	118.6	22.0	17.7	1.4	1.4	6.7	8.0	1.3	1.6
Jiangsu Expressway Co Ltd	HK0177	D	—	Buy	8.79	10.60	39.6	13.0	12.1	1.7	1.8	13.9	14.9	5.6	5.9
China Railway Group Ltd	HK0390	D	—	Buy	3.72	4.90	82.4	7.2	6.3	0.7	0.7	11.1	11.5	2.2	2.4
China Communications Services Corp. Ltd.	HK0552	D	Average	Buy	3.75	5.00	25.2	8.2	7.9	0.9	0.9	11.5	11.4	3.6	5.1
Huaneng Power International Inc	HK0902	F	—	Buy	7.86	10.60	98.1	7.5	6.9	1.3	1.2	19.3	18.7	6.7	7.3
Anhui Conch Cement Co Ltd	HK0914	F	—	Buy	30.35	37.10	130.5	11.9	10.3	2.0	1.9	18.0	20.4	1.7	1.9
China Shenhua Energy Company Limited	HK1088	D	Conservative	Buy	21.95	27.40	381.5	9.1	8.8	1.4	1.1	16.8	13.6	4.4	4.0
China Coal Energy Company Limited	HK1898	F	Average	Buy	4.50	4.62	67.9	15.7	9.2	0.7	0.5	4.4	5.7	1.8	2.8
Dongfeng Motor Group Co. Ltd	HK0489	C	Average	Buy	11.04	15.00	97.5	7.4	7.2	1.2	1.1	17.8	15.8	1.9	2.0
CITIC Securities Co Ltd	HK6030	C	—	Neutral	17.24	19.60	169.4	28.6	21.7	1.7	1.6	6.0	7.7	1.1	1.5
PICC Property & Casualty Co., Ltd.	HK2328	C	Average	Neutral	10.46	12.50	145.0	10.3	11.6	2.0	1.8	20.5	16.4	3.0	2.6
China Shipping Development Co Ltd	HK1138	D	—	Neutral	4.54	4.97	17.3	-26.5	12.0	0.5	0.6	-1.9	4.8	0.0	3.1
China Shipping Container Lines Co Ltd	HK2866	C	—	Neutral	1.90	2.14	29.3	-15.5	13.7	0.7	0.7	-4.8	5.0	0.0	0.0
China Oilfield Services Limited	HK2883	F	—	Neutral	19.38	23.50	90.1	11.1	9.6	1.9	1.7	18.5	18.6	1.8	2.1
Bank of Communications Co., Ltd.	HK3328	C	—	Neutral	5.00	5.10	381.0	4.8	4.8	0.7	0.7	15.6	14.2	6.4	4.1
Bank of China	HK3988	C	—	Neutral	3.46	3.30	944.3	5.2	5.1	0.8	0.8	17.9	16.4	7.1	5.1
China Telecom Corporation Limited	HK0728	D	Average	Neutral	3.46	3.90	284.1	13.2	12.9	0.8	0.8	6.5	6.5	3.0	3.2
China CITIC Bank Corporation Limited	HK0998	D	—	Neutral	4.63	4.05	272.1	4.7	4.7	0.8	0.7	18.5	16.4	6.4	4.3
Air China Ltd.	HK0753	D	—	Neutral	4.58	5.20	59.0	26.1	12.3	1.3	0.8	4.9	7.7	1.0	2.0
Jiangxi Copper Co Ltd	HK0358	D	Aggressive	Neutral	13.52	14.55	53.3	12.3	9.9	1.0	0.8	8.1	8.3	4.0	1.0
Great Wall Motor Co Ltd	HK2333	C	—	Neutral	39.40	37.00	135.5	10.8	11.2	3.2	3.0	33.7	29.7	2.8	2.7
Shandong Weigao Group Medical Polymer Co	HK8199	C	—	Neutral	8.11	9.73	36.9	30.5	25.5	3.1	3.0	10.4	12.2	1.0	1.2
Agricultural Bank Of China Limited	HK1288	C	Conservative	Sell	3.30	3.10	1,009.1	5.7	5.1	1.1	0.9	20.9	19.0	6.1	4.9
Yanzhou Coal Mining Co Ltd	HK1171	D	—	Sell	6.28	4.73	37.3	43.3	11.4	0.8	0.6	1.8	5.2	0.3	2.5
BYD Company Limited	HK1211	C	Average	Sell	46.85	22.80	137.4	53.6	43.6	4.0	3.8	7.9	9.0	0.0	0.0
Tsingtao Brewery Co Ltd	HK0168	—	Average	Sell	57.80	57.70	77.2	31.2	27.9	3.8	3.5	12.9	13.0	1.0	1.1
Aluminum Corporation of China Limited	HK2600	C	—	Sell	2.99	2.26	52.6	-5.2	98.3	0.7	1.2	-13.8	0.9	0.0	0.0
Zijin Mining Group Co Ltd.	HK2899	C	Aggressive	Sell	1.87	1.45	56.9	17.2	16.3	1.3	1.1	7.6	7.0	4.7	2.1
Chongqing Rural Commercial Bank CO LTD	HK3618	C	Average	Sell	3.41	3.20	32.8	4.3	4.3	0.7	0.6	17.6	15.8	—	—
China BlueChemical Ltd.	HK3983	D	Conservative	Sell	4.14	3.60	19.1	7.7	8.6	1.0	—	13.7	—	4.8	—

Note: Prices of all tables as of 15 April 2014.

Source: GMI, UBS estimates

**Figure 41: Valuation comparison in Rmb & GMI ratings (H share, not covered by UBS)**

Company	Code	ESG Rating	AGR Rating	Market Cap (HKDbillion)	PE		PB		ROE		Net Divident yield	
					2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Tianjin Capital Environmental Prctn Grp	HK1065	A	—	12.6	18.51	16.80	1.36	1.29	6.60	7.30	1.38	1.75
Sichuan Expressway Company Limited	HK0107	C	Average	10.1	5.76	5.36	0.56	0.53	9.33	9.31	3.25	3.35
SINOPHARM HOLDING CO LTD	HK1099	D	Average	52.1	15.58	13.27	1.76	1.56	12.68	12.87	1.68	1.86
Qingling Motors Co. Ltd.	HK1122	—	Average	5.9	11.65	10.98	0.64	0.62	4.80	5.30	6.35	7.04
Guodian Technology&Environment Grp Corp	HK1296	—	Aggressive	12.4	11.25	10.60	1.01	0.94	5.93	8.00	0.31	1.05
Metallurgical Corporation of China Ltd.	HK1618	—	Average	39.7	6.71	6.37	0.70	0.65	6.80	7.65	1.22	1.63
China National Materials Company Limited	HK1893	C	Aggressive	5.5	7.17	6.23	0.38	0.36	4.26	5.45	1.88	2.86
Shanghai Jin Jiang Int Htl Grp Co., Ltd.	HK2006	—	Average	12.1	10.28	24.95	1.26	1.20	5.64	12.06	1.75	5.83
Xinjiang Goldwind Science & Tech Co Ltd	HK2208	B	Very Aggressive	30.4	25.93	18.65	1.35	1.28	3.27	5.14	0.68	1.06
Shanghai Electric Group Company Limited	HK2727	C	Average	57.8	12.19	11.47	0.98	0.92	8.39	7.87	2.64	2.68
BYD Electronic (International) Co Ltd	HK0285	—	Conservative	11.6	10.87	9.23	1.05	0.97	5.96	8.94	0.49	1.04
Beijing Capital Land Limited	HK2868	—	Conservative	6.0	2.65	2.44	0.56	0.42	13.67	17.70	9.41	11.24
Lingbao Gold Co Ltd	HK3330	—	Average	1.1	-	-	0.42	0.52	-19.20	0.30	0.00	0.09
First Tractor Co Ltd	HK0038	—	Average	8.0	11.14	8.46	0.85	0.77	6.52	7.57	1.94	1.92
Beijing Jingneng Clean Energy Co Ltd	HK0579	—	Average	24.4	11.62	8.78	1.72	1.50	13.06	14.30	1.54	2.09
Sinotrans Limited	HK0598	C	Conservative	17.1	13.07	10.42	1.21	1.13	6.45	7.66	1.14	1.52
Beijing Capital Internatnl Arprt Co Ltd	HK0694	C	Average	23.6	12.96	11.40	1.18	1.11	8.62	8.68	2.80	3.05
TravelSky Technology Limited	HK0696	B	Aggressive	18.8	10.81	9.78	1.63	1.49	14.35	14.40	2.95	3.24
Beijing Jingkelong Company Limited	HK0814	—	Aggressive	1.0	12.82	10.94	0.46	0.46	3.70	3.60	4.22	5.40
Guangzhou Pharmaceutical Company Limited	HK0874	C	—	40.0	20.92	16.93	3.83	3.22	17.14	17.37	0.60	0.99
Dongjiang Environmental Co Ltd	HK0895	—	Aggressive	9.4	19.47	13.65	2.45	2.18	9.64	11.06	0.75	0.83
China Suntien Green Energy Corp	HK0956	—	Conservative	10.1	12.55	10.39	1.15	1.04	9.31	9.49	1.13	1.55
Lianhua Supermarket Holdings Co Ltd	HK0980	B	Conservative	5.0	21.53	17.96	1.21	1.20	5.80	5.23	1.95	2.38
Wumart Stores Inc.	HK1025	C	—	10.6	15.22	13.65	2.20	2.14	16.52	14.44	3.17	3.25
Tong Ren Tang Technologies Co., Ltd.	HK1666	—	Average	15.3	24.30	19.58	3.35	3.03	15.28	14.09	1.62	1.76

Source: GMI, Bloomberg

**Figure 42: Valuation comparison of UBS covered companies in SSE Corporate Governance Index (A share)**

Company	Code	Rating	Current	Target	Controlling	Market	PE		PB		ROE		Net Dividend yield	
			Share Price (Rmb)	Price (Rmb)			2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Shanghai Pudong Development Bank	SS600000	Buy	9.85	11.40	Public	188.8	4.46	4.03	0.89	0.79	21.43	21.12	6.74	4.96
Shanghai International Airport	SS600009	Buy	13.07	15.00	Local state	25.6	14.10	12.23	1.46	1.28	10.69	10.97	2.70	0.82
Huaneng Power International - A	SS600011	Buy	5.35	7.50	Central state	78.7	7.21	5.92	1.30	1.05	19.28	18.66	6.94	8.44
Baosteel	SS600019	Buy	3.98	5.70	Central state	69.7	9.88	8.40	0.61	0.58	6.11	7.06	5.06	5.95
Huadian Power International - A	SS600027	Buy	3.22	3.80	Central state	23.8	7.63	6.50	1.18	0.96	16.54	16.55	5.24	6.16
China Petroleum and Chemical Corp - A	SS600028	Buy	5.29	6.36	Central state	642.1	9.03	8.03	1.15	1.06	12.85	13.12	3.80	4.28
SANY Heavy Industry	SS600031	Buy	5.71	8.90	Private	44.0	10.05	8.71	1.61	1.38	17.41	17.09	0.99	1.15
China Merchants Bank - A	SS600036	Buy	10.06	13.63	Central state	265.2	5.11	4.65	1.12	0.85	22.22	19.60	5.28	5.38
Poly Real Estate	SS600048	Buy	7.79	13.30	Central state	57.6	7.23	4.25	1.51	0.91	22.93	23.57	2.68	4.70
China United Network Communications - A	SS600050	Buy	3.10	3.90	Central state	66.6	22.92	16.37	0.67	0.61	2.94	3.76	4.97	7.26
Zhengzhou Yutong Bus	SS600066	Buy	16.89	20.50	Private	21.4	11.84	10.19	2.46	2.10	22.69	22.26	2.95	3.43
Wuhan Humanwell Healthcare	SS600079	Buy	27.49	36.00	Private	13.5	33.86	22.99	3.99	3.44	12.42	16.10	0.30	0.44
Guangzhou Development Industry	SS600098	Buy	5.12	6.86	Local state	14.1	10.67	9.78	1.03	0.97	10.00	10.26	4.37	4.77
SAIC Motor	SS600104	Buy	14.32	18.90	Local state	164.3	6.57	5.97	1.18	1.08	19.07	19.00	8.12	8.94
Shanxi Lanhua Sci-Tech Venture	SS600123	Buy	8.20	24.75	Local state	9.6	5.70	4.55	0.93	0.81	16.95	18.97	5.27	6.59
China Railway Tielong Container Logistic	SS600125	Buy	5.38	7.64	Central state	7.1	13.29	10.10	1.60	1.45	12.57	15.05	2.52	3.17
China CYTS Tours Holding	SS600138	Buy	20.54	22.60	Central state	8.5	25.31	22.55	3.10	2.61	13.27	12.57	0.67	0.71
Beiqi Foton Motor	SS600166	Buy	5.47	7.30	Local state	15.7	32.46	25.83	1.03	0.97	3.22	3.87	1.84	2.07
Shandong Nanshan Aluminium	SS600219	Buy	5.03	5.84	Others	9.9	14.00	12.90	0.64	0.55	4.66	4.36	2.09	1.40
Jiangsu Hengrui Medicine	SS600276	Buy	34.83	45.00	Private	47.2	34.70	31.67	6.65	6.11	21.07	21.15	0.30	0.31
Inner Mongolia Eerduosi Cashmere Product	SS600295	Buy	8.15	9.70	Private	8.5	10.71	14.02	1.19	1.23	11.66	8.93	-	2.14
Yantai Wanhua Polyurethanes	SS600309	Buy	17.23	20.96	Local state	37.2	12.04	11.06	3.30	2.48	31.56	25.57	5.33	6.46
Shanghai Jahwa United	SS600315	Buy	36.49	53.00	Central state	25.1	37.66	26.01	9.06	6.47	26.52	26.79	1.14	1.65
Beijing Capital Development	SS600376	Buy	4.92	6.51	Local state	11.5	10.56	5.52	0.99	0.73	9.64	14.03	2.93	3.62
Jiangsu Expressway - A	SS600377	Buy	6.08	9.07	Local state	31.8	10.64	10.42	1.43	1.53	13.74	14.88	6.87	6.81
Gemdale	SS600383	Buy	7.26	8.24	Public	32.6	9.13	7.07	1.07	0.94	13.21	14.16	1.47	1.41
NARI Technology Development	SS600406	Buy	14.91	18.10	Central state	33.8	24.47	20.24	6.85	5.23	31.35	29.31	0.00	0.00
Jianghuai Automobile	SS600418	Buy	10.42	11.00	Local state	13.4	11.43	11.14	1.54	1.73	14.30	16.47	2.70	2.78
Henan Rebecca Hair Products	SS600439	Buy	4.38	5.54	Private	4.1	22.52	18.45	1.73	1.67	7.80	9.46	-	-
Zhuzhou Times New Material Technology	SS600458	Buy	9.22	12.80	Central state	6.3	33.97	23.48	2.37	2.04	8.77	8.70	0.88	1.28
Tianjin Tianyao Pharmaceutical	SS600488	Buy	4.23	5.20	Local state	4.1	113.40	39.70	1.89	1.70	1.84	4.37	0.41	0.42
Zhongjin Gold	SS600489	Buy	8.12	12.04	Central state	24.3	18.85	16.82	2.14	1.95	12.04	12.13	1.33	1.78
Keda Industrial	SS600499	Buy	20.38	28.00	Private	13.7	26.93	24.10	3.49	4.08	13.96	18.10	0.86	0.96
Kweichow Moutai	SS600519	Buy	174.49	206.00	Local state	181.0	11.60	10.80	3.97	3.49	38.72	34.93	4.21	4.00
Zhejiang Huahai Pharmaceutical	SS600521	Buy	11.80	17.00	Private	8.5	24.78	20.66	2.89	2.85	14.07	14.55	1.11	1.47
Shandong Gold Mining	SS600547	Buy	16.87	28.38	Local state	24.8	15.85	16.39	2.77	2.42	18.92	15.76	0.76	0.73
Jiangsu Kanion Pharmaceutical	SS600557	Buy	29.84	42.80	Private	12.6	44.20	33.24	6.19	5.70	15.06	18.54	0.30	0.36
Hundsun Electronics Co Ltd	SS600570	Buy	28.54	24.00	Private	17.5	29.46	40.28	7.49	10.49	28.37	29.27	0.68	0.50
Xinjiang Ba Yi Iron & Steel	SS600581	Buy	3.84	5.80	Local state	3.1	18.00	12.16	0.96	0.76	5.43	6.44	1.93	2.86
Offshore Oil Engineering	SS600583	Buy	7.85	10.50	Central state	30.9	11.65	10.60	1.94	1.85	20.58	18.65	1.38	-
Anhui Conch Cement - A	SS600585	Buy	17.84	24.70	Local state	104.7	9.45	7.79	1.96	1.74	22.30	24.62	2.09	2.57
Yonyou Software	SS600588	Buy	17.36	25.20	Private	16.7	20.23	25.06	3.46	4.77	17.67	20.11	2.63	1.94
Guizhou Yibai Pharmaceutical	SS600594	Buy	40.19	49.00	Private	14.8	23.91	25.39	5.44	5.96	25.43	26.29	0.71	0.67
Shanghai Yuyuan Tourist Mart	SS600655	Buy	7.61	10.00	Private	11.1	10.74	10.11	1.69	1.51	16.63	15.73	2.79	2.97
Fuyao Glass	SS600660	Buy	8.43	12.00	Foreign	17.3	8.52	8.25	2.08	1.94	25.89	25.05	6.13	6.06
Qingdao Haier Co.	SS600690	Buy	16.78	24.00	Collective	46.7	11.37	9.55	3.28	2.61	32.39	30.46	2.64	3.14
Anhui Heli	SS600761	Buy	13.06	14.15	Local state	6.7	10.60	12.95	1.40	1.75	14.03	14.31	3.22	2.54
Topchoice Medical Investment	SS600763	Buy	42.00	55.00	Private	6.7	47.73	55.76	8.62	10.65	19.86	21.12	-	-
GD Power Development	SS600795	Buy	2.37	2.90	Central state	41.5	7.03	6.07	1.15	0.96	17.21	16.76	5.07	6.52
Huaxin Cement - A	SS600801	Buy	12.09	14.30	Foreign	11.7	10.51	9.36	1.42	1.19	14.33	13.45	1.51	1.69
Beijing Wangfujing	SS600859	Buy	17.70	32.50	Central state	8.4	9.25	8.30	1.22	1.06	14.15	13.70	-	-
Inner Mongolia Yili Industrial	SS600887	Buy	38.45	50.00	Central state	81.2	31.94	23.01	5.24	4.45	22.27	20.90	0.64	0.96
Xiamen International Airport	SS600897	Buy	15.15	16.70	Central state	4.6	10.33	9.11	1.80	1.56	18.54	18.32	2.78	2.51
China Yangtze Power	SS600900	Buy	5.96	10.12	Central state	99.2	10.83	10.37	1.26	1.19	11.93	11.82	4.88	5.10
Daqing Railway	SS601006	Buy	6.94	11.10	Central state	105.0	8.03	7.72	1.30	1.20	17.29	16.16	6.23	6.74
China Shenhua Energy - A	SS601088	Buy	14.51	21.00	Central state	306.0	8.29	7.36	1.39	0.95	17.17	13.77	4.78	4.76
Jiangsu Hengli Highpressure Oil Cylinder	SS601100	Buy	10.02	15.00	Central state	6.5	23.91	20.10	1.87	1.72	8.00	8.90	1.48	0.42
China National Chemical Engineering	SS601117	Buy	6.39	10.90	Central state	31.2	9.17	7.52	1.48	1.26	17.40	18.08	1.03	1.64
Beijing Sifang Automation	SS601126	Buy	17.37	23.50	Central state	7.2	18.24	14.65	2.26	2.03	12.96	14.59	1.88	2.34

Source: GMI, UBS-S estimates

**Figure 43: Valuation comparison of UBS covered companies in SSE Corporate Governance Index (A share)**

Company	Code	Rating	Current	Target	Controlling	Market	PE		PB		ROE		Net Dividend yield	
			Share Price (Rmb)	Price (Rmb)			2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Shenzhen Gas	SS601139	Buy	7.27	8.80	Central state	14.7	24.99	21.03	3.55	2.72	15.41	13.47	1.60	1.89
Bank of Beijing	SS601169	Buy	7.66	9.90	Central state	69.2	5.03	4.31	0.85	0.73	17.93	18.13	3.98	4.64
Pang Da Automobile Trade	SS601258	Buy	5.13	6.80	Central state	13.7	18.63	10.35	1.43	1.26	7.99	12.93	-	-
Ping An Insurance (Group) - A	SS601318	Buy	40.07	62.01	Central state	323.1	11.12	9.96	2.26	1.86	21.58	20.75	1.64	1.81
Guangshen Railway - A	SS601333	Buy	2.74	4.05	Central state	19.4	13.29	8.24	0.73	0.70	5.56	8.64	2.94	4.97
Industrial & Commercial Bank of China A	SS601398	Buy	3.46	4.62	Central state	1,254.7	5.40	4.65	1.09	0.83	21.90	19.52	6.59	5.46
China Pacific Insurance - A	SS601601	Buy	16.58	22.57	Central state	154.6	18.10	15.75	1.73	1.49	9.54	9.49	2.16	2.22
Shanghai Pharmaceuticals - A	SS601607	Buy	13.26	18.00	Central state	35.8	16.00	14.66	1.38	1.28	8.92	9.08	1.30	1.41
China Life Insurance - A	SS601628	Buy	14.24	19.71	Central state	411.5	18.16	12.06	2.04	1.67	11.22	14.63	1.89	2.86
Shanxi LuAn Environmental Energy	SS601699	Buy	8.04	16.00	Central state	19.1	12.54	11.39	1.14	1.05	9.28	9.60	1.60	1.76
Zhengzhou Coal Mining Machinery - A	SS601717	Buy	5.67	7.50	Central state	8.9	14.73	11.66	1.36	0.93	9.28	8.17	2.09	2.86
CSR Corp - A	SS601766	Buy	4.53	5.40	Central state	65.4	14.75	12.26	1.67	1.60	11.95	13.64	2.03	2.45
China Oilfield Services - A	SS601808	Buy	18.27	25.70	Central state	83.2	12.92	11.07	2.23	1.91	18.55	18.62	1.55	1.81
China International Travel Service	SS601888	Buy	35.19	43.30	Central state	35.1	25.50	21.58	3.81	3.52	18.58	16.95	0.59	0.69
Yonghui Superstores	SS601933	Buy	6.27	8.75	Central state	21.2	24.80	19.28	4.12	3.69	17.41	20.18	1.81	2.33
China Construction Bank - A	SS601939	Buy	4.00	5.33	Central state	1,101.4	5.24	4.59	1.05	0.84	21.38	19.38	6.67	5.45
China Auto Research Institute	SS601965	Buy	15.60	18.60	Central state	10.0	15.26	21.58	1.99	2.74	13.77	13.45	0.99	0.70
Datang International Power - A	SS601991	Buy	3.75	4.70	Central state	46.1	13.20	9.33	1.39	1.05	10.81	11.71	2.61	3.43
Ping An Bank	SZ000001	Buy	10.97	12.68	Public	107.4	6.54	5.93	1.03	0.83	15.47	15.05	1.53	3.37
China Vanke	SZ000002	Buy	7.76	13.60	Public	90.3	7.39	4.66	1.46	0.96	21.57	22.32	4.03	6.44
CSG Holding	SZ000012	Buy	7.90	12.60	Public	16.8	15.08	11.60	2.20	1.97	15.39	17.92	3.32	4.31
China Merchants Property	SZ000024	Buy	18.13	33.30	Central state	30.9	10.54	6.00	1.66	1.03	16.77	18.46	1.86	3.33
FIYTA Holdings	SZ000026	Buy	7.12	8.60	Central state	2.8	22.40	15.56	1.90	1.69	8.72	11.32	-	1.39
Shenzhen Zhongjin Lingnan Nonfemet	SZ000060	Buy	5.70	9.89	Local state	11.9	40.18	23.41	2.75	1.91	7.04	8.35	-	1.71
ZTE Corporation - A	SZ000063	Buy	13.68	21.00	Public	46.8	34.39	15.23	2.07	3.09	6.17	16.38	0.22	1.58
Shenzhen Airport	SZ000089	Buy	3.83	4.50	Local state	6.6	13.52	19.73	0.88	0.80	6.68	4.18	0.74	0.51
TCL Corporation	SZ000100	Buy	2.60	3.60	Public	22.1	9.66	8.68	1.46	1.14	16.55	15.19	2.46	1.72
Zoomlion Heavy Industry Science & Tech A	SZ000157	Buy	4.93	7.70	Local state	38.3	8.15	7.19	0.88	0.80	11.19	11.64	2.45	2.78
Weichai Power - A	SZ000338	Buy	18.15	24.80	Local state	39.4	12.56	8.11	1.51	1.17	12.70	15.41	0.71	1.03
Tangshan Jidong Cement	SZ000401	Buy	9.49	10.30	Local state	13.5	35.57	20.15	1.14	1.08	3.23	5.49	0.42	0.74
Shandong Dong-E E-Jiao	SZ000423	Buy	35.42	55.00	Central state	23.5	22.03	14.65	5.60	3.76	27.71	28.34	1.51	2.27
XCMG Construction Machinery	SZ000425	Buy	6.86	9.60	Local state	14.4	9.92	8.33	0.77	0.71	8.05	8.90	1.01	1.20
Midea Group	SZ000527	Buy	45.90	58.00	Private	81.1	5.07	9.20	1.90	3.06	43.38	37.93	5.91	3.26
Guangxi Liugong Machinery	SZ000528	Buy	6.00	8.80	Local state	6.8	13.03	10.50	0.70	0.66	5.50	6.44	0.77	0.95
Guangdong Electric Power Development	SZ000539	Buy	4.92	5.87	Local state	20.9	7.29	7.27	1.15	1.01	16.92	14.79	2.23	2.24
Weifu High-Technology	SZ000581	Buy	24.30	36.50	Local state	23.9	22.01	15.95	2.43	2.30	11.68	14.81	1.53	2.11
Jiaozuo Wanfang Aluminum	SZ000612	Buy	6.08	7.20	Central state	7.1	24.64	26.36	1.50	1.56	7.76	6.07	4.55	-
Chongqing Changan Automobile	SZ000625	Buy	11.99	19.50	Central state	66.3	15.91	8.28	2.96	2.23	20.38	30.71	1.01	1.95
Gree Electrical Appliance	SZ000651	Buy	30.12	39.00	Local state	93.5	8.64	7.13	2.82	2.28	36.10	35.29	4.63	5.61
Jinke Property	SZ000656	Buy	8.51	12.60	Private	10.1	6.15	4.85	1.19	0.97	21.32	22.09	1.46	1.86
Daye Special Steel	SZ000708	Buy	5.86	8.50	Central state	2.7	14.15	9.39	0.91	0.77	6.64	8.58	3.15	-
Jiangxi Wannianqing Cement	SZ000789	Buy	10.02	16.00	Local state	4.2	9.69	7.33	2.02	1.65	23.05	24.67	2.89	4.10
FAW Car Company	SZ000800	Buy	10.45	17.50	Central state	17.5	15.60	10.44	2.00	1.68	13.73	17.52	-	-
He Bei Cheng De Lolo	SZ000848	Buy	23.30	31.50	Private	9.5	27.09	22.49	8.95	7.40	36.94	36.77	1.33	1.60
Guangdong Highsun	SZ000861	Buy	9.93	15.00	Private	4.9	10.18	8.72	2.45	2.05	26.25	25.57	1.10	3.44
Emei Shan Tourism	SZ000888	Buy	17.70	22.00	Local state	4.7	38.87	21.49	3.10	2.61	8.56	12.88	0.43	1.40
Angang Steel - A	SZ000898	Buy	3.16	3.80	Local state	24.2	30.36	17.30	0.49	0.48	1.64	2.81	-	2.89
Jinling Pharmaceutical	SZ000919	Buy	13.79	18.50	Local state	7.0	25.65	37.58	1.85	3.04	7.34	8.27	1.98	-
Jizhong Energy Resources	SZ000937	Buy	6.37	11.30	Local state	15.3	11.82	11.44	0.94	0.89	8.94	7.99	1.69	1.75
Beijing Zhong Ke San Huan High-Tech	SZ000970	Buy	13.37	15.40	Central state	14.5	45.65	29.29	4.42	3.61	10.01	13.12	-	-
Shanxi Kishan Coal & Electricity Power	SZ000983	Buy	5.32	10.80	Local state	17.2	11.27	10.71	1.05	0.96	9.70	9.34	0.56	0.58
Yuan Longping High Tech Agriculture	SZ000998	Buy	24.71	28.60	Private	10.4	50.07	34.83	5.90	6.63	13.30	20.63	0.22	0.20
Zhejiang NHU	SZ002001	Buy	21.69	28.00	Central state	16.2	15.22	11.87	2.04	2.14	13.96	19.29	2.71	2.18
Huangshan Novel	SZ002014	Buy	8.08	11.40	Central state	2.7	16.90	11.11	2.01	1.55	12.27	14.97	-	-
Shanghai Kehua Bio-engineering	SZ002022	Buy	23.60	32.00	Central state	11.6	28.16	34.07	6.62	9.35	24.74	28.72	3.09	2.26
Suning Commerce Group	SZ002024	Buy	7.39	15.00	Central state	56.0	83.69	34.04	1.94	1.84	2.34	5.56	0.06	0.29
YGSOFT Inc	SZ002063	Buy	21.30	28.50	Central state	9.8	25.38	18.80	5.60	4.47	25.41	26.46	0.83	1.12
Shandong Sun Paper Industry	SZ002078	Buy	6.92	8.15	Central state	8.2	19.89	17.23	1.16	1.47	6.30	8.88	-	-

Source: GMI, UBS-S estimates

**Figure 44: Valuation comparison of UBS covered companies in SSE Corporate Governance Index (A share)**

Company	Code	Rating	Current	Target	Controlling	Market	PE		PB		ROE		Net Divident yield	
			Share Price (Rmb)	Price (Rmb)			2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Gold Mantis Construction Decoration	SZ002081	Buy	18.70	33.50	Central state	22.0	13.99	10.48	3.95	2.96	32.35	32.31	0.76	1.07
Xinjiang Tecon Animal Husbandry Bio Tech	SZ002100	Buy	10.36	14.50	Central state	4.1	25.47	20.55	2.73	2.43	11.65	12.50	-	-
Bank of Ningbo	SZ002142	Buy	8.94	10.94	Central state	26.2	5.45	4.74	1.00	0.85	19.88	19.40	3.67	4.22
RiseSun Real Estate Development	SZ002146	Buy	11.70	15.76	Central state	23.3	8.59	6.14	2.32	1.61	30.91	29.82	1.12	2.12
GRG Banking Equipment	SZ002152	Buy	18.69	29.00	Central state	14.3	15.46	16.30	2.91	3.31	20.59	22.23	1.29	1.23
Hangzhou Binjiang Real Estate	SZ002244	Buy	6.80	8.40	Central state	9.4	8.14	4.97	1.60	1.04	21.58	23.19	1.27	2.01
Better Life Commercial Chain Share	SZ002251	Buy	13.07	17.50	Central state	7.8	17.26	14.09	3.58	3.16	21.38	23.85	3.40	4.26
Yantai Tayho Advanced Materials	SZ002254	Buy	8.66	11.39	Central state	4.6	25.22	22.57	2.59	2.43	10.81	11.11	2.58	2.88
Beijing Oriental Yuhong Waterproof	SZ002271	Buy	24.45	33.00	Central state	8.8	20.21	17.57	4.55	4.20	24.98	26.66	0.98	1.71
Shenzhen Salubris Pharmaceuticals	SZ002294	Buy	30.20	52.00	Central state	19.6	26.37	17.47	6.30	4.34	26.60	28.10	0.56	0.41
Beijing Orient Landscape	SZ002310	Buy	24.81	43.20	Central state	14.9	16.64	12.32	4.27	3.23	29.12	29.88	0.47	0.60
Guangdong Zhongsheng Pharmaceutical Co	SZ002317	Buy	19.45	30.00	Central state	6.9	38.36	23.59	4.32	3.68	11.60	16.47	1.29	2.10
Shenzhen Hongtao Decoration	SZ002325	Buy	9.65	11.61	Central state	6.8	23.26	16.65	3.81	3.18	18.07	20.84	0.59	0.86
Haining China Leather Market	SZ002344	Buy	14.23	25.00	Central state	15.9	7.73	6.38	2.13	1.68	30.99	29.45	2.59	3.13
Yantai Jereh Oilfield Services	SZ002353	Buy	60.20	90.00	Central state	38.6	42.51	24.60	10.14	4.68	26.21	25.98	0.33	0.64
Zhejiang Yasha Decoration	SZ002375	Buy	26.09	32.43	Central state	16.8	18.84	13.77	3.90	3.09	22.89	25.02	0.39	0.53
Shandong New Beiyang Information Tech	SZ002376	Buy	10.78	16.20	Central state	6.5	26.84	20.09	3.46	3.06	14.81	16.18	1.19	1.56
Rainbow Department Store	SZ002419	Buy	11.12	15.00	Central state	8.8	12.33	10.10	1.77	1.51	15.95	16.14	-	-
Cachet Pharmaceutical Co.	SZ002462	Buy	18.93	23.00	Central state	4.5	33.46	37.01	2.37	3.47	7.41	9.74	0.92	0.54
Shenzhen Grandland Decoration	SZ002482	Buy	14.94	26.00	Central state	7.9	14.74	10.78	2.22	1.89	16.10	18.92	0.96	1.36
Zhejiang Beimgate Scientific Industrial	SZ002570	Buy	27.80	36.00	Central state	18.0	25.86	22.90	4.84	3.97	19.94	18.75	1.33	1.20
Suofeiya Home Collection	SZ002572	Buy	17.99	24.00	Central state	7.9	29.43	24.86	4.17	4.05	15.20	17.22	1.53	1.80
Shangdong Realcan Pharmaceutical	SZ002589	Buy	46.82	58.00	Central state	4.5	31.03	23.33	4.28	3.66	14.73	16.90	0.33	0.44
Shangdong Himile Mechanical Science&Tech	SZ002595	Buy	41.01	50.00	Central state	8.2	18.87	18.28	2.64	3.28	14.57	19.02	2.04	2.32
Pubang Landscape Architecture	SZ002663	Buy	13.15	19.70	Central state	7.4	28.38	18.15	3.94	2.98	14.80	17.53	0.72	1.23
Chengdu Hongqi Chain	SZ002697	Buy	10.70	13.60	Central state	4.3	23.09	17.85	2.33	2.11	10.51	12.41	1.08	1.40
Xinghui Auto Model	SZ300043	Buy	35.50	46.70	Central state	8.3	24.07	33.54	3.14	6.33	14.16	22.51	0.75	0.53
Beijing Originwater Technology	SZ300070	Buy	33.40	47.60	Central state	30.2	39.60	24.38	6.83	5.00	19.26	22.83	-	-
Hangzhou Songcheng Tourism Development	SZ300144	Buy	24.10	26.50	Central state	13.4	28.91	33.54	2.86	3.80	10.27	11.98	0.62	0.89
Hand Enterprise Solutions	SZ300170	Buy	20.66	24.60	Central state	5.5	34.59	26.61	3.75	3.41	11.93	13.41	0.79	1.03
Shanghai Tofflon Science and Technology	SZ300171	Buy	32.69	48.00	Central state	6.9	25.71	20.30	2.91	2.66	11.73	13.71	1.73	2.20
Shenzhen Techand Ecology & Environment	SZ300197	Buy	20.81	31.40	Central state	6.6	26.03	18.32	3.72	3.13	15.25	18.56	0.47	0.38
Hunan ER-KANG Pharmaceutical	SZ300267	Buy	28.35	36.50	Central state	12.9	26.57	53.74	3.85	8.35	15.46	16.70	0.47	0.23
Zhuhai Hokai Medical Instruments	SZ300273	Buy	33.85	39.00	Central state	14.9	87.40	48.97	14.19	11.64	17.30	26.11	0.62	1.05
Tianjin MOTIMO Membrane Technology	SZ300334	Buy	33.20	41.00	Central state	5.8	66.47	39.13	7.34	6.25	11.60	17.25	0.26	0.44
Guangzhou Devotion Thermal Technology	SZ300335	Buy	14.64	17.10	Central state	3.0	44.00	29.11	3.86	3.54	9.00	12.68	1.04	1.56
China Coal Energy - A	SS601898	Buy	4.23	5.50	Central state	54.4	22.57	10.84	0.92	0.58	4.12	5.67	1.33	2.40
Jiangling Motors - A	SZ000550	Buy	25.50	30.00	Local state	22.0	9.05	10.79	1.37	2.02	17.61	18.47	4.44	3.72
Jiangsu Yanghe Brewery Joint Stock	SZ002304	Buy	52.41	69.40	Central state	57.1	11.39	12.06	3.24	2.76	31.02	24.69	3.62	2.90
Beijing Toredad Outdoor Products	SZ300005	Buy	19.96	23.00	Central state	8.8	34.88	27.35	8.81	7.01	27.89	28.54	0.73	0.85
Canny Elevator	SZ002367	Neutral	7.17	17.50	Central state	2.7	16.59	8.23	2.67	1.31	16.21	17.23	2.46	5.08
Guangzhou Baiyun International Airport	SS600004	Neutral	7.00	6.95	Local state	8.1	8.84	8.31	1.02	0.98	11.97	12.19	5.09	5.95
Hua Xia Bank	SS600015	Neutral	8.51	7.96	Public	77.9	5.30	4.66	0.93	0.80	18.51	18.36	3.77	4.29
China Shipping Development - A	SS600026	Neutral	4.19	4.67	Central state	13.9	(35.08)	13.61	0.61	0.58	(1.73)	4.35	-	2.63
China Southern Airlines - A	SS600029	Neutral	2.55	2.83	Central state	23.7	37.47	14.95	0.74	0.71	2.05	4.86	1.37	1.28
Huangshan Tourism Development - A	SS600054	Neutral	12.36	11.00	Local state	6.0	37.98	28.29	2.99	3.06	7.71	11.11	0.34	0.57
Hisense Electric	SS600060	Neutral	11.72	12.40	Local state	15.7	8.74	8.04	1.55	1.36	18.97	18.04	3.43	3.73
Inner Mongolia Baotou Steel Rare Earth	SS600111	Neutral	21.01	22.90	Local state	51.1	43.13	28.95	8.68	5.72	21.65	21.08	0.90	1.38
Xinhu Zhongbao	SS600208	Neutral	2.99	3.46	Private	18.8	7.66	5.96	1.29	1.06	18.06	19.48	-	-
Sinotrans Air Transportation Development	SS600270	Neutral	13.51	11.50	Central state	12.7	11.20	16.48	1.27	2.06	12.15	12.68	3.55	2.43
Shandong Huatai Paper	SS600308	Neutral	2.74	3.10	Private	3.2	29.28	16.43	0.48	0.47	1.64	2.87	1.31	2.34
Fujian Longking	SS600388	Neutral	28.98	30.00	Private	12.6	36.01	24.59	4.32	3.82	12.80	16.49	1.06	1.20
COSCO Shipping	SS600428	Neutral	3.19	3.87	Central state	5.4	358.54	42.39	0.82	0.81	0.23	1.93	0.08	0.71
Baoji Titanium Industry	SS600456	Neutral	12.24	13.40	Local state	5.3	536.16	117.02	1.73	1.48	0.32	1.26	-	3.14
Tsingtao Brewery - A	SS600600	Neutral	40.51	45.00	Local state	54.7	27.96	24.91	3.41	3.06	12.82	12.93	1.10	1.24
Jiangzhong Pharmaceutical	SS600750	Neutral	16.70	19.00	Local state	5.3	26.10	20.70	2.50	2.31	9.82	11.60	1.59	2.00
Shanghai Jinjiang Int Hotels Development	SS600754	Neutral	14.92	15.50	Local state	9.1	22.26	19.31	2.82	1.96	12.66	12.34	-	2.69
Jiangsu Yueda Investment	SS600805	Neutral	10.12	11.00	Local state	8.9	6.84	6.57	1.70	1.38	28.06	23.16	1.40	1.46
Maanshan Iron & Steel - A	SS600808	Neutral	1.66	1.70	Local state	12.6	86.24	22.98	0.56	0.54	0.65	2.39	-	-
Shanxi Xinghuacun Fen Wine Factory	SS600809	Neutral	15.64	17.00	Local state	13.9	10.89	11.68	3.37	2.79	33.31	26.13	4.79	2.06

Source: GMI, UBS-S estimates



**Figure 45: Valuation comparison of UBS covered companies in SSE Corporate Governance Index (A share)**

Company	Code	Rating	Current Share Price (Rmb)	Target Price (Rmb)	Controlling Shareholder	Market Cap (billion)	PE		PB		ROE		Net Dividend yield	
							2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Bank of Nanjing	SS601009	Neutral	7.82	8.30	Central state	23.8	5.23	4.62	0.85	0.74	17.27	17.18	4.78	5.42
Air China - A	SS601111	Neutral	3.52	4.30	Central state	47.3	25.15	11.52	1.15	1.10	4.47	7.93	1.02	2.09
Industrial Bank	SS601166	Neutral	9.98	9.45	Central state	196.0	5.23	4.05	1.08	0.82	22.32	22.02	4.06	4.93
Guangzhou Automobile - A	SS601238	Neutral	7.65	7.80	Central state	48.5	19.92	13.78	1.52	1.40	7.85	10.56	1.51	2.18
Agricultural Bank of China - A	SS601288	Neutral	2.43	2.57	Central state	809.4	5.18	4.72	1.02	0.85	20.88	18.98	6.67	5.30
Bank of Communications - A	SS601328	Neutral	3.79	4.11	Central state	287.4	5.27	4.58	0.78	0.62	15.58	14.22	5.88	4.36
Xi An Shaangu Power	SS601369	Neutral	6.99	7.35	Central state	11.6	13.82	10.09	2.08	1.61	15.59	17.32	-	-
Joeone	SS601566	Neutral	12.34	14.00	Central state	7.1	13.01	12.14	1.58	1.41	12.34	12.28	0.77	0.82
Aluminum Corporation of China - A	SS601600	Neutral	3.35	3.84	Central state	42.2	57.41	136.05	1.23	1.70	2.15	0.94	-	-
Great Wall Motor - A	SS601633	Neutral	36.38	42.00	Central state	108.7	13.58	10.99	4.02	3.18	33.45	32.34	2.58	3.19
PetroChina - A	SS601857	Neutral	7.63	8.41	Central state	1,395.0	11.71	11.66	1.34	1.17	11.80	10.35	3.84	3.86
Zijin Mining Group - A	SS601899	Neutral	2.27	2.60	Central state	45.6	29.96	24.50	2.31	1.62	7.62	7.00	3.43	1.43
Bank of China (Group) - A	SS601988	Neutral	2.62	2.75	Central state	757.5	5.28	4.83	0.85	0.72	17.94	16.44	6.93	5.39
China CITIC Bank - A	SS601998	Neutral	4.85	4.71	Central state	218.3	4.92	5.88	0.85	0.90	18.48	16.42	6.12	3.40
People.cn	SS603000	Neutral	75.91	73.10	Central state	20.3	68.64	47.41	8.75	7.47	13.25	16.99	0.10	0.15
Shenzhen Chiwan Wharf Holdings - A	SZ000022	Neutral	14.29	16.50	Central state	9.2	18.06	15.90	2.33	2.17	13.35	14.16	2.77	3.15
Shenzhen Energy	SZ000027	Neutral	5.62	6.02	Local state	15.1	10.40	11.21	0.93	0.88	9.23	8.03	4.37	2.41
COFCO Property	SZ000031	Neutral	3.44	3.68	Central state	6.3	11.57	10.01	1.20	1.09	10.92	11.42	1.11	1.29
Financial Street	SZ000402	Neutral	5.20	5.28	Local state	16.1	7.02	5.54	0.77	0.66	11.63	12.46	4.41	4.51
Shandong Chenming Paper	SZ000488	Neutral	4.47	4.80	Local state	9.0	11.96	12.73	0.55	0.59	4.71	4.61	7.10	6.74
Luzhou Laojiao	SZ000568	Neutral	17.65	17.50	Local state	25.3	10.11	8.44	3.29	2.25	33.92	27.49	7.58	8.95
Anhui Gujing Distillery - A	SZ000596	Neutral	19.50	20.60	Local state	9.0	13.80	11.99	2.54	2.21	19.55	19.71	1.88	1.95
Beijing Yanjing Brewery	SZ000729	Neutral	6.86	8.00	Local state	19.6	26.04	21.54	1.50	1.57	6.32	7.49	1.57	1.39
Sound Environmental Resources	SZ000826	Neutral	29.48	34.90	Private	19.0	36.14	27.52	4.80	3.71	14.24	14.54	0.31	0.50
Wuliangye Yibin	SZ000858	Neutral	17.60	14.90	Local state	68.2	8.56	9.19	1.89	1.66	23.71	19.23	3.62	2.26
Yunnan Tin	SZ000960	Neutral	11.78	11.50	Local state	10.9	(10.27)	107.52	1.95	1.65	(22.01)	1.67	-	-
Lijiang YuLong Tourism	SZ002033	Neutral	12.80	14.50	Central state	2.8	18.73	15.06	2.92	2.70	16.16	18.59	1.22	1.20
Rongxin Power Electric	SZ002123	Neutral	7.90	8.55	Central state	4.0	27.45	24.69	1.76	1.66	6.62	6.92	-	0.55
Dalian Tianbao Green Foods	SZ002220	Neutral	6.88	7.20	Central state	3.2	25.42	17.08	2.08	1.76	8.50	10.90	-	-
Jiangsu Yuyue Medical Equipment & Supply	SZ002223	Neutral	30.65	30.50	Central state	16.3	54.52	43.16	10.53	8.76	20.98	22.16	0.40	0.42
Shen Zhen Beauty Star	SZ002243	Neutral	7.37	8.25	Central state	2.6	41.95	27.65	1.67	1.72	5.49	6.41	0.43	0.59
Jiangsu Nhwa Pharmaceutical	SZ002262	Neutral	24.87	31.00	Central state	8.3	43.12	29.30	9.70	7.44	25.02	28.73	0.28	0.43
Shanghai Metersbonwe	SZ002269	Neutral	10.01	11.20	Central state	10.2	23.47	13.79	2.66	2.30	10.89	17.89	1.28	1.81
Luolai Home Textile	SZ002293	Neutral	21.49	23.05	Central state	6.2	15.59	12.50	2.83	2.42	19.50	20.90	1.58	2.06
ShenZhen Fuanna Bedding and Furnishing	SZ002327	Neutral	14.82	16.00	Central state	4.8	16.89	13.91	2.94	2.31	19.01	17.83	1.10	1.33
Shenzhen GEM High-Tech	SZ002340	Neutral	10.93	11.90	Central state	8.4	50.54	38.40	3.32	3.09	7.00	8.33	0.30	0.39
Hunan Mendale Hometextile	SZ002397	Neutral	14.83	16.50	Central state	2.3	23.31	19.53	1.93	1.79	8.48	9.50	0.86	1.02
Shenzhen MTC Co Ltd	SZ002429	Neutral	12.10	16.00	Central state	13.4	22.82	16.23	3.55	3.03	16.54	20.15	1.31	1.85
Hangzhou Hangyang	SZ002430	Neutral	7.42	8.00	Central state	6.0	20.77	17.41	1.78	1.63	8.87	9.76	0.80	0.48
Hunan Kaimeite Gases	SZ002549	Neutral	20.85	16.40	Central state	5.7	97.54	53.81	7.16	6.45	7.52	12.61	0.31	0.56
China Oil HBP Science & Technology	SZ002554	Neutral	11.56	13.50	Central state	5.3	35.10	28.16	3.85	3.43	11.55	12.86	0.27	0.44
Qiaqia Food	SZ002557	Neutral	19.46	23.20	Central state	6.6	26.02	21.22	2.64	2.59	10.52	12.34	3.21	3.94
BYD - A	SZ002594	Neutral	48.57	39.20	Central state	110.2	66.23	50.96	5.13	4.66	8.06	9.58	-	-
Shijiazhuang Yiling Pharmaceutical	SZ002603	Neutral	37.32	40.00	Central state	19.7	70.02	47.69	3.77	4.41	5.72	9.64	0.30	0.41
Wuhu Token Science	SZ300088	Neutral	19.59	24.50	Central state	9.6	32.98	21.48	5.65	4.53	18.49	23.43	0.51	0.30
Zhangjiagang Furui Special Equipment	SZ300228	Neutral	61.29	80.00	Central state	8.2	40.43	25.12	8.62	6.27	25.09	28.05	0.23	0.45
Yangzijiang Shipbuilding (Holdings) Ltd.	YAZG.SI	Neutral	1.09	1.21	Private	4.2	6.08	8.58	1.01	1.06	19.69	12.73	5.01	3.14
Shanghai International Port (Group)	SS600018	Neutral	4.72	4.33	Local state	107.4	20.01	17.87	2.17	2.08	11.05	11.89	3.06	3.43
Dalian Zhangzidao Fishery	SZ002069	Neutral	12.80	13.30	Central state	9.2	85.41	64.45	3.48	3.30	4.16	5.25	-	-
China Eastern Airlines - A	SS600115	Sell	2.49	2.43	Central state	30.1	67.23	11.24	1.53	1.09	2.08	10.58	-	-
Yanzhou Coal Mining - A	SS600188	Sell	6.50	6.40	Local state	29.9	50.29	14.58	1.64	0.72	3.10	5.32	0.15	1.95
Shandong Horney Aquatic Development	SS600467	Sell	5.34	3.95	Private	4.0	38.99	44.57	1.37	1.33	3.54	3.03	1.65	-
Sichuan Tuopai Shede Wine	SS600702	Sell	11.64	8.90	Local state	4.0	530.07	83.32	2.79	1.74	0.51	2.11	2.18	0.66
China Shipping Container Lines - A	SS601866	Sell	2.19	2.06	Central state	23.5	(20.73)	19.53	1.00	0.95	(4.76)	4.98	-	-
China COSCO Holdings - A	SS601919	Sell	3.36	3.20	Central state	32.9	(12.05)	12.36	1.47	1.31	(11.78)	11.23	-	-
Jiugui Liquor	SZ000799	Sell	11.95	8.70	Foreign	4.0	(49.89)	241.39	2.22	2.20	(4.35)	0.91	-	-
Fujian SeptWolves Industry	SZ002029	Sell	8.14	7.00	Central state	6.3	12.46	12.46	1.32	1.20	11.10	10.08	0.70	0.77
Haoxiangni Jujube	SZ002582	Sell	19.12	19.50	Central state	2.9	38.80	34.74	2.14	2.04	5.45	6.02	0.52	0.58
Shinva Medical Instrument	SS600587	Suspended	93.19		Local state	18,524	36.62	49.76	5.50	9.11	14.61	19.98	0.37	0.24

Source: GMI, UBS-S estimates



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<b>Neutral</b>	FSR is between -6% and 6% of the MRA.	42%	34%
<b>Sell</b>	FSR is > 6% below the MRA.	11%	23%
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<b>Buy</b>	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
<b>Sell</b>	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 March 2014.

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## Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>China Communications Services</b>	0552.HK	Buy	N/A	HK\$3.64	14 Apr 2014
<b>China Construction Bank</b> <sup>2, 4, 5, 16a, 22</sup>	0939.HK	Buy	N/A	HK\$5.51	14 Apr 2014
<b>Dongfeng Motor</b> <sup>5, 16b</sup>	0489.HK	Buy	N/A	HK\$11.32	14 Apr 2014
<b>Guangzhou R&amp;F Properties</b> <sup>2, 4, 5, 18</sup>	2777.HK	Buy	N/A	HK\$11.16	14 Apr 2014
<b>Haitong Securities - H</b> <sup>2, 4, 5, 16a</sup>	6837.HK	Buy	N/A	HK\$11.76	14 Apr 2014
<b>Industrial &amp; Commercial Bank of China</b> <sup>2, 4, 5, 16a, 22</sup>	1398.HK	Buy	N/A	HK\$4.84	14 Apr 2014
<b>PICC Property and Casualty</b> <sup>16a</sup>	2328.HK	Neutral	N/A	HK\$10.66	14 Apr 2014
<b>Ping An Insurance (Group)</b> <sup>13, 16a, 22</sup>	2318.HK	Buy	N/A	HK\$61.50	14 Apr 2014
<b>Shandong Weigao Medical Polymer</b>	1066.HK	Neutral	N/A	HK\$8.24	14 Apr 2014
<b>ZTE Corporation</b> <sup>16a</sup>	0763.HK	Buy	N/A	HK\$16.40	14 Apr 2014

Source: UBS. All prices as of local market close.

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