

# China Equity Strategy

## Domestic funds will march to H-share market

### Equity Strategy

China

#### CSRC encourages local mutual fund to buy Hong Kong stocks

Last Friday, the China Securities Regulatory Commission (CSRC) released a set of guidelines for local mutual funds to participate in SH-HK Stock Connect<sup>1</sup>. Both existing and new funds are allowed to expand their investment scope into Hong Kong stocks, even without a QDII license. We do not expect the southbound Stock Connect trade to turn active immediately, as this is not an entirely new regulation. However, since the A-shares are now at a bubble stage (see our note ["How far away are A-shares from the peak, 27 Mar"](#)), we think the policy stance of CSRC will entice local investors to enter Hong Kong equity market.

#### Positive to H-share small-caps

A-share is now a bull-market without growth; H-share is a value market without liquidity. The daily turnover of HK market is now only 1/10 of A-shares. Additional liquidity from mainland investors could make a big difference to H-shares, in our view. We notice that the huge valuation gap between H- and A-share small caps (about 10x vs. 100x PER) has already caught attention of many local investors. Although HK small-caps are currently not eligible for the SH-HK Stock Connect, they are potential candidates in the upcoming Shenzhen-HK Stock Connect. Our channel check suggests some local funds are trying to get positioned ahead of this catalyst by accumulating quality and cheap H-share small-caps.

#### Moderately positive to H-share bank and real estate sectors

Local investors' interest on H-share blue chips is relatively low. The southbound Stock Connect trade is on average only US\$81mn per day, insufficient to move the needle for HK large-cap stocks. In our view, the Banks and Real Estate, as the two cheapest H-share sectors, will most likely attract some mainland investors due to supportive macro policies.

#### A stock screen of Hong Kong small-caps

We filter the Hong Kong small-cap universe based on the following criteria - 1) market cap between US\$0.3-2bn, 2) daily turnover up more than 50% in Mar 2015 than 6-month average, 3) fitting the hot themes in A-shares including "One Road, One Belt", "Internet+", "Made in China 2025", and SOE reform. The result is shown in Figure 2. Among them, UBS analysts have Buy rating on Cogobuy, West China Cement, CIMC Enric and China Foods.

**Figure 1: Potential Hong Kong small-cap beneficiaries with Buy rating**

Name	Ticker	Industry Group	UBS Rating	Target Price (HK\$)	Total mkt cap (US\$ mn)	ADT in Mar vs. 6 months	2015E PE	2014E EPS Gr	2015E EPS Gr	2015E PB	2015E ROE (%)
Cogobuy Group	0400.HK	Retailing	Buy	6.06	979	245%	16.5	158%	18%	3.2	21.1
West China Cement	2233.HK	Materials	Buy	1.00	647	232%	7.5	-8%	51%	0.7	9.5
Cimc Enric Hldg	3899.HK	Capital Goods	Buy	9.00	1,794	180%	11.3	0%	-2%	1.6	15.0
China Foods Ltd	0506.HK	Food&Beverage	Buy	3.10	1,158	170%	105.9	n.a.	n.a.	1.5	1.4

Source: Bloomberg, UBS estimates; Note: ADT – average daily turnover

<sup>1</sup> [http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201503/t20150327\\_274235.html](http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201503/t20150327_274235.html)  
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**Figure 2: Hong Kong small-cap stock screen results**

Name	Ticker	Industry Group	UBS Rating	Potentially eligible for SZ-HK stock	Total mkt cap (US\$ mn)	ADT in Mar 2015 vs. 6 months	2014E PE	2014E EPS Gr	2014E PB	2014E ROE (%)
Optics Valley Un	0798.HK	Real Estate	NR		346	448%	5.7	n.a.	n.a.	n.a.
Suncorp Tech Ltd	1063.HK	Technology Hardware	NR		927	430%	n.a.	n.a.	n.a.	n.a.
Changhong Jiahua	8016.HK	Technology Hardware	NR		347	375%	12.9	n.a.	n.a.	n.a.
Smi Holdings	0198.HK	Media	NR		420	359%	10.7	52%	n.a.	8.3
Technovator	1206.HK	Technology Hardware	NR		376	335%	10.2	19%	2.0	21.9
Igg	8002.HK	Software & Services	NR		744	306%	7.3	497%	2.6	41.2
New Focus Auto T	0360.HK	Automobiles & Compr	NR		359	295%	n.a.	n.a.	n.a.	n.a.
Kf Security	8315.HK	Commercial & Profess	NR		499	286%	n.a.	n.a.	n.a.	n.a.
Boyaa Interactiv	0434.HK	Software & Services	NR	Yes	596	273%	10.8	1%	2.3	20.8
Crmi	8158.HK	Pharmaceuticals, Biote	NR		657	272%	n.a.	n.a.	n.a.	n.a.
Sinosoft Technol	1297.HK	Software & Services	NR		558	265%	19.2	n.a.	n.a.	n.a.
Pacific Online	0543.HK	Software & Services	NR	Yes	498	245%	14.5	-7%	n.a.	n.a.
Tcl Multimedia T	1070.HK	Consumer Durables &	NR	Yes	930	245%	19.7	n.a.	1.0	5.3
Cogobuy Group	0400.HK	Retailing	Buy	Yes	979	245%	20.2	158%	2.9	27.9
Tom Group Ltd	2383.HK	Media	NR	Yes	1,100	241%	n.a.	n.a.	26.4	-31.3
Chinasoft Intl	0354.HK	Software & Services	NR		699	234%	21.9	26%	1.7	8.6
West China Cemen	2233.HK	Materials	Buy	Yes	647	232%	11.5	-8%	0.8	6.7
Hanhua Fin-H	3903.HK	Diversified Financials	NR		819	228%	7.4	n.a.	0.7	n.a.
Kingdee Intl Sft	0268.HK	Software & Services	NR	Yes	1,014	223%	24.0	52%	2.4	10.5
Hi Sun Technolog	0818.HK	Software & Services	NR	Yes	899	214%	13.7	735%	1.7	13.3
Viva China Holdi	8032.HK	Media	NR		910	213%	n.a.	n.a.	2.5	-18.6
Hc International	2280.HK	Software & Services	NR	Yes	716	212%	20.1	26%	3.7	22.0
Tongda Group Hld	0698.HK	Technology Hardware	NR	Yes	853	205%	9.7	25%	1.4	16.9
Capital Env	3989.HK	Commercial & Profess	NR		305	193%	n.a.	n.a.	n.a.	n.a.
The United Labor	3933.HK	Pharmaceuticals, Biote	NR	Yes	678	184%	8.0	n.a.	0.7	13.3
Aeon Credit Serv	0900.HK	Diversified Financials	NR		317	184%	n.a.	n.a.	n.a.	n.a.
Digital Domain	0547.HK	Capital Goods	NR		374	180%	37.2	n.a.	6.0	17.8
Cimc Enric Hldg	3899.HK	Capital Goods	Buy		1,794	180%	11.1	0%	1.8	17.7
Asia Satellite	1135.HK	Telecommunication Se	NR		1,456	178%	19.0	n.a.	n.a.	n.a.
China Foods Ltd	0506.HK	Food Beverage & Tob	Buy		1,158	170%	(35.8)	n.a.	1.4	-3.7
China Water Indu	1129.HK	Utilities	NR		318	169%	9.2	n.a.	n.a.	n.a.
Netdragon Webs	0777.HK	Software & Services	NR	Yes	959	168%	31.4	n.a.	n.a.	n.a.
Goldpac Group	3315.HK	Technology Hardware	NR	Yes	441	168%	16.7	-2%	2.2	14.2
Shanghai Fudan-H	1385.HK	Semiconductors & Ser	NR		470	167%	20.2	5%	n.a.	n.a.
Digital China	0861.HK	Technology Hardware	Neutral		1,114	167%	10.2	-36%	1.0	10.1
Tcl Comm Tech HI	2618.HK	Technology Hardware	NR	Yes	1,248	165%	7.9	233%	2.2	31.2
Baioo	2100.HK	Software & Services	NR		359	160%	n.a.	n.a.	n.a.	n.a.
China Suntien-H	0956.HK	Energy	NR		834	159%	14.2	-36%	0.7	5.0
Wumart-H	1025.HK	Food & Staples Retaili	NR	Yes	898	155%	17.1	-20%	1.8	10.5
Kingboard Chem	0148.HK	Technology Hardware	NR		1,595	153%	5.3	-9%	0.4	7.3
Concord Ne	0182.HK	Capital Goods	NR	Yes	554	153%	11.5	74%	0.7	6.0

Note: Potentially eligible stocks for SZ-HK stocks include Hang Seng Composite Small Cap index constituents and Shenzhen listed A/H stocks

Source: Bloomberg, UBS estimates

## Statement of Risk

Widely known risks facing China equities include: a hard landing in the property market, shadow banking defaults, currency depreciation against the US\$, and capital exodus. In our view, improper government policies to address these risks may shock the market. An overdose of liquidity, for example, may threaten to derail the transition from investment- to consumption-driven economy, and exacerbate credit default risk.

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12-Month Rating	Definition	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	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%
Sell	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 December 2014.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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<b>China Foods</b>	0506.HK	Buy	N/A	HK\$3.21	27 Mar 2015
<b>CIMC Enric Holdings</b>	3899.HK	Buy	N/A	HK\$7.20	27 Mar 2015
<b>Cogobuy Group</b> <sup>2, 4, 5</sup>	0400.HK	Buy	N/A	HK\$5.63	27 Mar 2015
<b>West China Cement</b>	2233.HK	Buy	N/A	HK\$1.11	27 Mar 2015

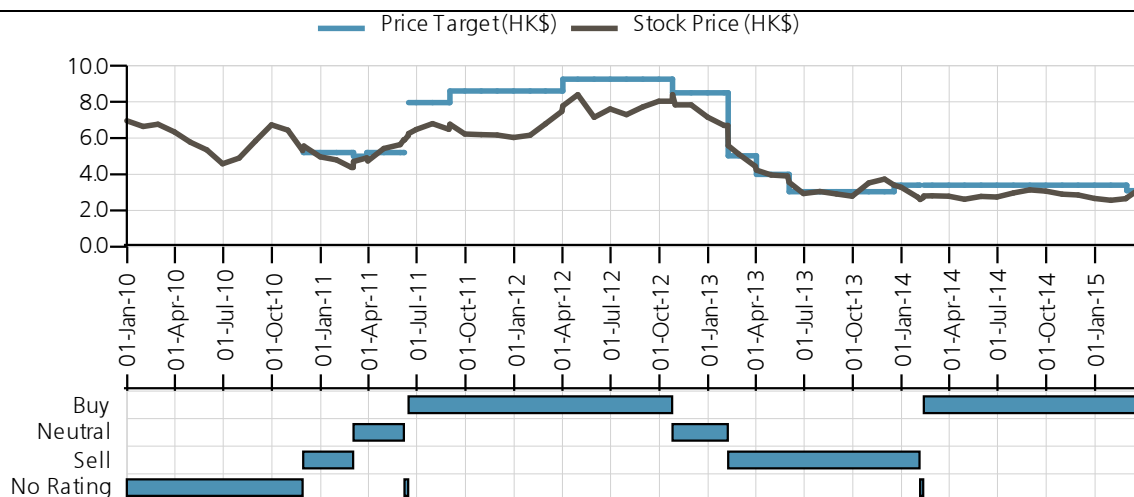
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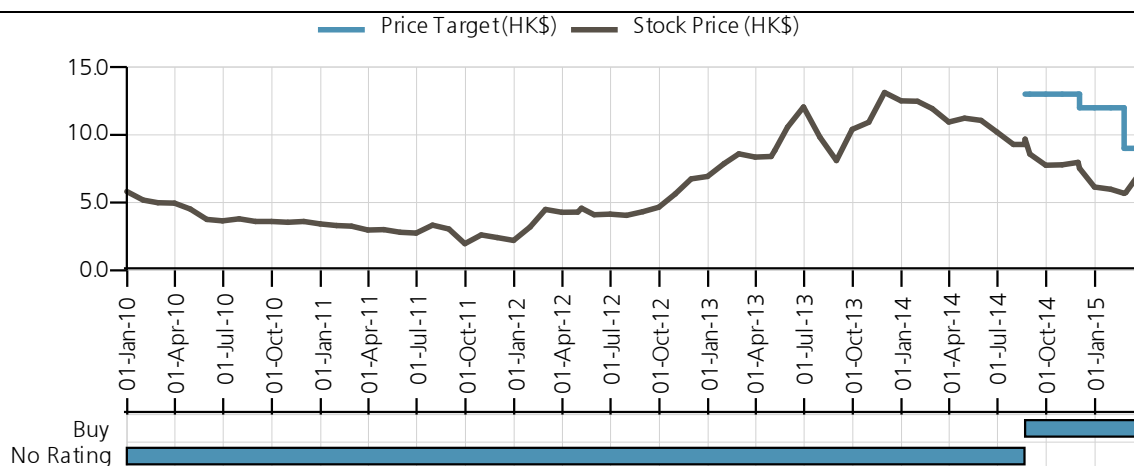
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### China Foods (HK\$)



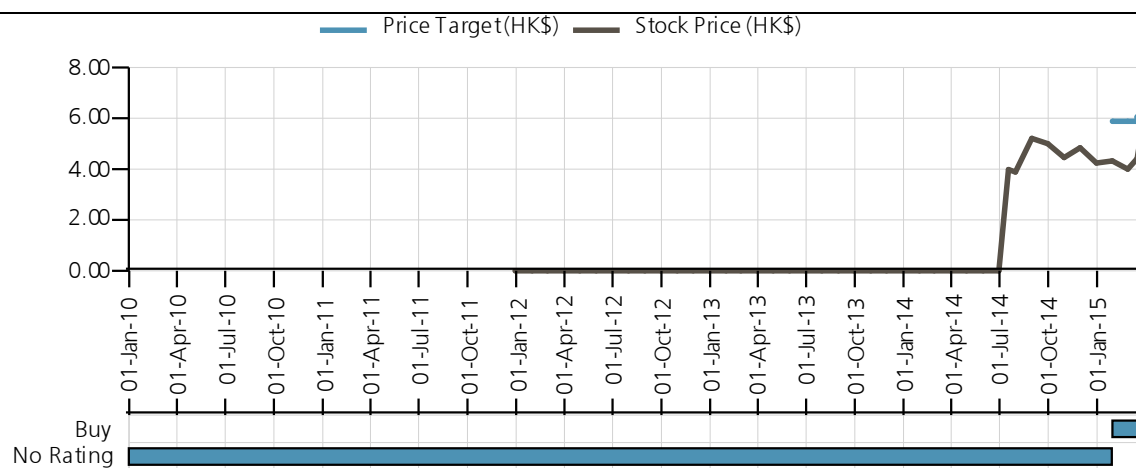
Source: UBS; as of 27 Mar 2015

### CIMC Enric Holdings (HK\$)



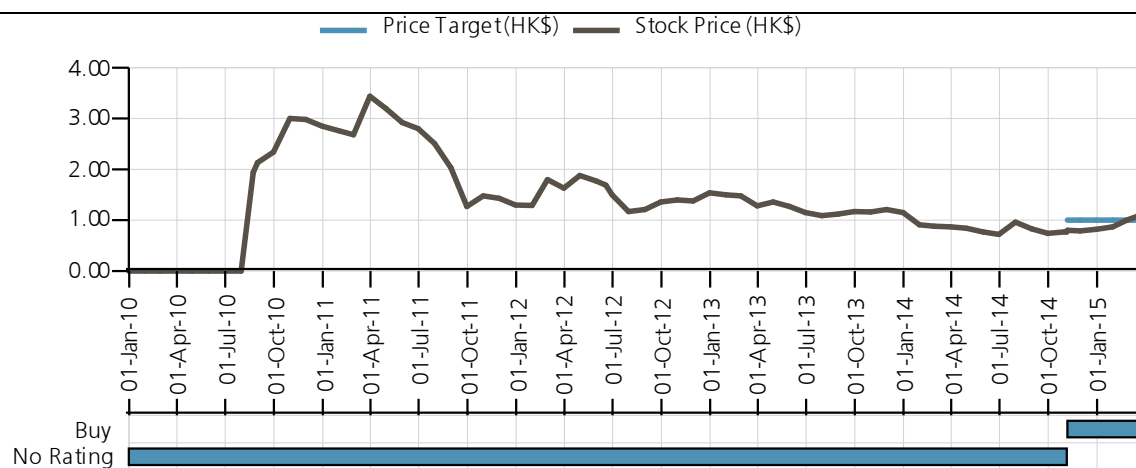
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## Cogobuy Group (HK\$)



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## West China Cement (HK\$)



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