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Strategy Update

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Delay in recovery and acceleration in reforms

While growth recovery is being somewhat delayed, we expect easier credit and more aggressive economic reforms to boost confidence from H2 this year.

Delay in growth recovery

We revise down our Q2 GDP forecast to 7.7% yoy from 7.9%, and largely as a result of this change and weaker-than-expected Q1, cut our 2013's full-year GDP growth forecast by 0.3ppts to 7.9%. We marginally lower our 2014 GDP growth forecast by 0.1ppt to 8.8%. Our forecast changes reflect a delay in growth recovery due to slower-than-expected transmission of total social financing (TSF) into real economic growth, the short-term impact of anti-corruption measures, and the inventory destocking from April.

However, we believe the broad trend of growth recovery in H2 this year and H1 next year will remain intact. The forthcoming recovery will be supported by the end of the on-going destocking, possible credit relaxation and slower RMB appreciation, a pick-up in real estate investment (with stabilization in real estate policy), a recovery in export demand, and improved confidence due to an announcement of major reforms in September/October.

Easier credit

Due to a few reasons, we believe that credit policy will likely be more relaxed than we previously thought. 1) Growth has been weaker than expected. 2) Inflation has been low in recent months, giving more room for monetary expansion. 3) 7m college students will graduate in June, but the % of them who have found jobs is substantially lower than that of same time last year. This puts pressure on the government to boost the pace of job creation. 4) Difficulties in getting additional fiscal expansion approved imply that credit easing is a more convenient option. 5) The recent acceleration in social financing has so far not translated into a visible impact on the economy, raising doubt on whether non-bank financing can truly substitute bank loans.

Reforms to be announced in autumn

We expect the government to announce a major economic reform package in September or October, involving a few dozen reforms in areas such as deregulation, fiscal, financial, resource pricing, capital account, rural land, and social security. Many reforms will help lift the quality and potential rate of long-term growth. We believe that deregulation and fiscal/resource pricing reforms will benefit railway/subway, gas, water and wind; social security reform will benefit insurance; capital account liberalization will benefit FX banks and brokers. On the other hand, coal will likely be hit by reforms.

Market outlook and a "reform" basket

In light of our new growth projection, we believe China's equity indices may remain range-bound in the near term, but an H2 rebound is likely as sequential growth recovery materializes and sentiment improves on expectations that reforms will lift growth quality and potential in the medium term. We present a basket of "reform beneficiaries", which includes BOC, Mengniu, Ping An, COLI, CITIC Securities, CRG, Beijing Enterprises, Longyuan, and BEWG.

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Table Of Contents

A delay in growth recovery 3
Easier credit...7
Reforms to be announced in autumn...9
Market outlook and a “reform” basket 13

A delay in growth recovery

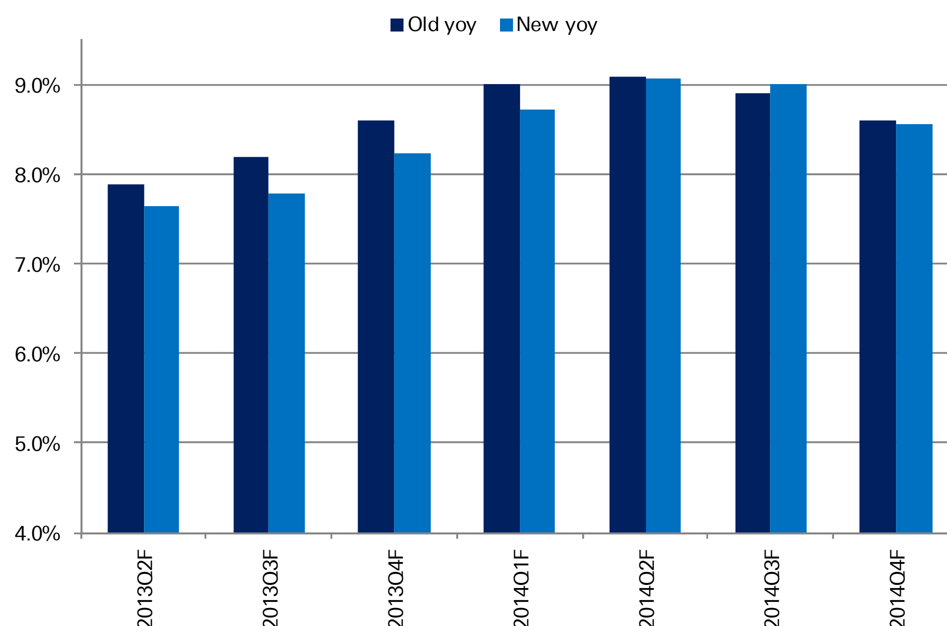
We revise down our Q2 GDP forecast to 7.7% yoy from 7.9%, and largely as a result of this change and weaker-than-expected Q1, cut our 2013's full-year GDP growth forecast by 0.3ppts to 7.9%. We marginally lower our 2014 GDP growth forecast by 0.1ppt to 8.8%. Our new forecasts, on both yoy and qoq basis, are presented in Figure 1 and are compared to our previous forecasts. The old and new forecasts for yoy growth are also shown in a bar chart (Figure 2).

Figure 1: Comparison between our old and new forecasts of GDP growth

	Old qoq	Old yoy	New qoq	New yoy
2013Q2F	2.0%	7.9%	1.8%	7.7%
2013Q3F	2.3%	8.2%	2.1%	7.8%
2013Q4F	2.3%	8.6%	2.3%	8.2%
2014Q1F	2.1%	9.0%	2.2%	8.7%
2014Q2F	2.1%	9.1%	2.1%	9.1%
2014Q3F	2.1%	8.9%	2.1%	9.0%
2014Q4F	2.0%	8.6%	1.9%	8.6%

Source: Deutsche Bank forecasts

Figure 2: Old and new yoy GDP growth forecasts



Source: Deutsche Bank forecasts

The direct causes of our Q2 downward revision are weaker-than-expected IP growth in April and weaker-than-expected HSBC flash PMI for May (it fell to 49.6 in May from 50.4 in April). As we pointed out before, the recent weakness is related to inventory destocking due to the energy and raw material price declines since April, as well as slow starts of new capex projects. We expect the inventory trend to remain depressive in June.

At a more fundamental level, our forecast changes reflect a slower-than-expected transmission of TSF into real economic growth. Historically, M2/credit leads GDP

growth by 2-3 quarters. If this relationship between "credit growth" and economic growth still holds, the acceleration in the growth of the stock for TSF (from 16% yoy mid-2012 to nearly 21% in recent months) should have delivered its positive impact on the real economy from Q2 this year. However, several reasons may have led to a slower and weaker transmission of real economy into TSF growth. First, the March announcement of real estate policy tightening has increased the perceived policy uncertainty facing developers, and therefore delayed project starts even if developers have sufficient sources for financing the launch of new projects. As a result, manufacturing companies in the material and equipment sectors also remain cautious if demand for construction is not expected to pick up quickly. Second, some provincial and city-level governments experienced reshuffling of senior officials after the NPC, leading to some disruption in the normal operations (e.g. pace of decision-making on infrastructure projects) at the local level for the past months. In other words, the "velocity" of TSF (i.e. pace at which money is spent) has declined due to these shocks to the confidence and the slow decision-making process. Given that this decline in velocity remains tentative in nature as it has to do with specific policy changes and one-off administrative reshuffling, we think the transmission of TSF recovery to GDP may now take 4-5 quarters, instead of the "normal time lag" of 2-3 quarters. [1]

In addition, anti-corruption measures, including the tightening of rules on official consumption in restaurants, also contributed to weaker retail sales growth and food and beverage production in the past few months of the year. In January-April, the revenue growth from the catering service fell to 8.3% yoy, down from 13.6% in 2012. This deceleration explained roughly half of the 2ppt slowdown in retail sales growth in the past months.

Looking forward, despite the delay in growth recovery, we believe the broad trend of growth recovery in H2 this year and H1 next year remains intact. The forthcoming recovery should be supported by the following factors:

1) The end of the on-going inventory destocking. According to our calculation, about 60% of the April mom PPI decline was driven by the decline in oil and petrochemical prices. This is mainly an external shock driven by global oil prices, partly on a more bullish outlook of US shale gas production. However, tentatively, it does generate an expectation of a fall in raw material prices and thus depressed demand for inventory. We are hopeful that this mini-inventory destocking cycle would end within 3-4 months. Therefore, some sequential recovery in demand for inventory could contribute positively to Q3 GDP growth.

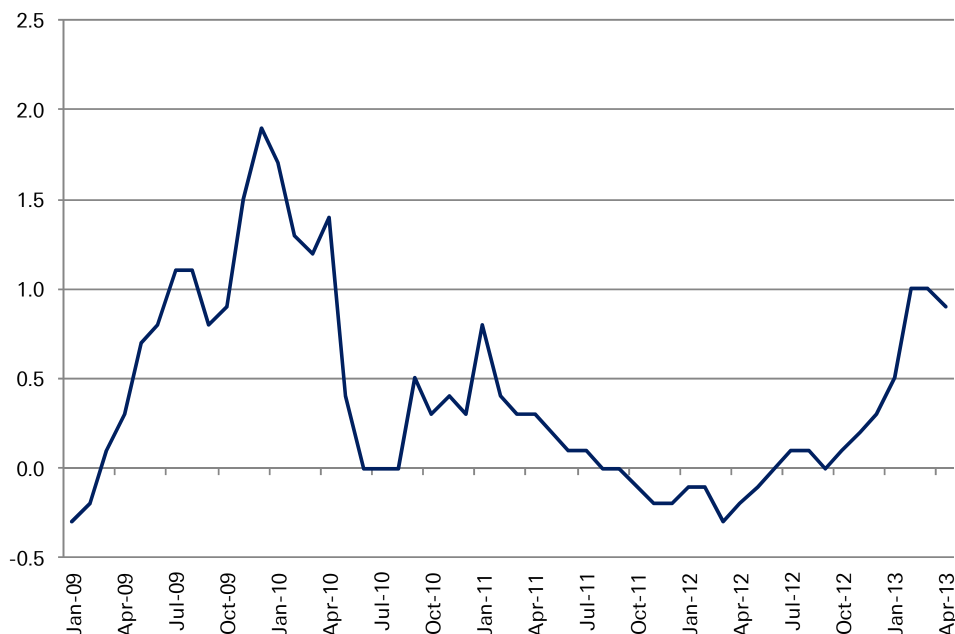
2) Possible credit relaxation and slower RMB appreciation in coming months. We will discuss this point in detail in the next section, but the thrust is that we believe monthly RMB new loans will likely be higher than expected in the coming months, as a low-profile policy response to weak Q2 economic performance and the recognition that non-bank financing has not delivered its expected boost to the real economy. In addition, given that the RMB has appreciated too fast (by 8% in REER terms in the past five months), and the Ministry of Commerce has publicly expressed concerns on its impact on export

[1] There are several other alternative explanations on why the acceleration in TSF has not or may not lead to a recovery in economic growth. First, TSF may increasingly involve double-counting as borrowers from banks re-lend in the form of trust or entrusted loans. Second, TSF may increasingly be used to refinance existing projects as some borrowers need to borrow more to cover the repayment of principals and interests of old loans. However, we have not found sufficient statistical evidence to support these "hypotheses".

competitiveness, we believe that RMB appreciation will slow in H2 this year. We will elaborate this point soon in a separate note.

3) The stabilization of real estate policy and resulting acceleration in real estate construction. Following the "policy scare" in March when the State Council announced its intention to "strictly enforce" the 20% capital gains tax on property transactions, all major cities announced their local implementation details in April without material changes in policy substance. On May 18, the National Bureau of Statistics concluded that "property price inflation has slowed". An NBS report showed that "the mom increase in property prices in most of the 70 key cities decelerated in April" (Figure 3).[2] This report will likely imply that real estate policy will stabilize in the coming months, and thus the reduction in policy uncertainty should allow developers to proceed with their planned construction. Note that land sales (measured in square meters sold) in the past four months has risen 16% yoy. Under a more normalized policy environment, it should translate into stronger real estate construction in H2 this year.

Figure 3: 70-city average residential property price inflation (primary market), % mom

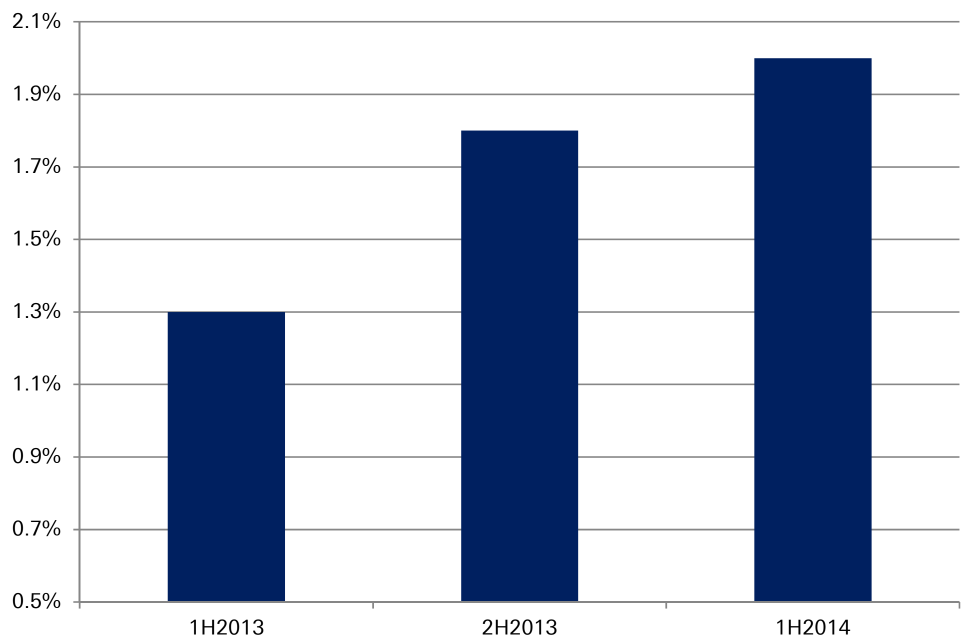


Source: Deutsche Bank, WIND, NBS

4) A recovery in export demand. According to DB's global economic forecasts, G3 GDP growth will likely recover from 1.3% yoy in H1 this year to 1.8% yoy in H2 this year and 2.0% in H1 next year (Figure 4). DB believes that this recovery will largely be led by a stronger US real estate market and capex outlook, and to a lesser extent benefiting from rising Japan consumption as well as well less fiscal contraction in Europe. Based on historical correlation and taking into account the recent changes in China's export/GDP ratio, we estimate that each 1ppt rise in G3 GDP growth should boost China's export growth by 7ppts and GDP growth by about 0.7ppts.

[2] http://www.stats.gov.cn/tjfx/grgd/t20130518_402897374.htm

Figure 4: G3 GDP growth forecast, yoy %



Source: Deutsche Bank, CEIC

5) The confidence impact of reforms to be announced in autumn. As will be discussed in detail in the last section of this report, we expect a major reform package to be announced in September or October this year. This package will likely include, among others, more specific steps towards deregulation (by permitting greater private sector investment in formerly restricted sectors), stronger incentives for services (via tax cuts), and legal reforms to allow greater transferability of agricultural land for non-agriculture usage. These steps should boost the growth potential and demand outlook for many sectors, and thus raise the confidence of entrepreneurs in starting new projects.

Easier credit

We believe that credit policy will likely be more relaxed than we previously thought. Specifically, we expect that annual RMB new loans will likely be in the range of RMB9-9.2tn compared with market expectations of RMB8.5-8.7tn, and interbank rates may drop somewhat from here on the PBOC's more accommodative open market operations. Due to the flexibility of commercial banks have in pricing their loans (30% below the benchmark rates), a slight drop in interbank rates can already permit a modest decline in actual lending rates. We do not expect an immediate cut in benchmark interest rates though.

The several reasons behind our expectation of a somewhat easier credit policy in the coming months are as follows:

First, PMI and IP growth have been weaker-than-expected in the past two months. This point is widely known already.

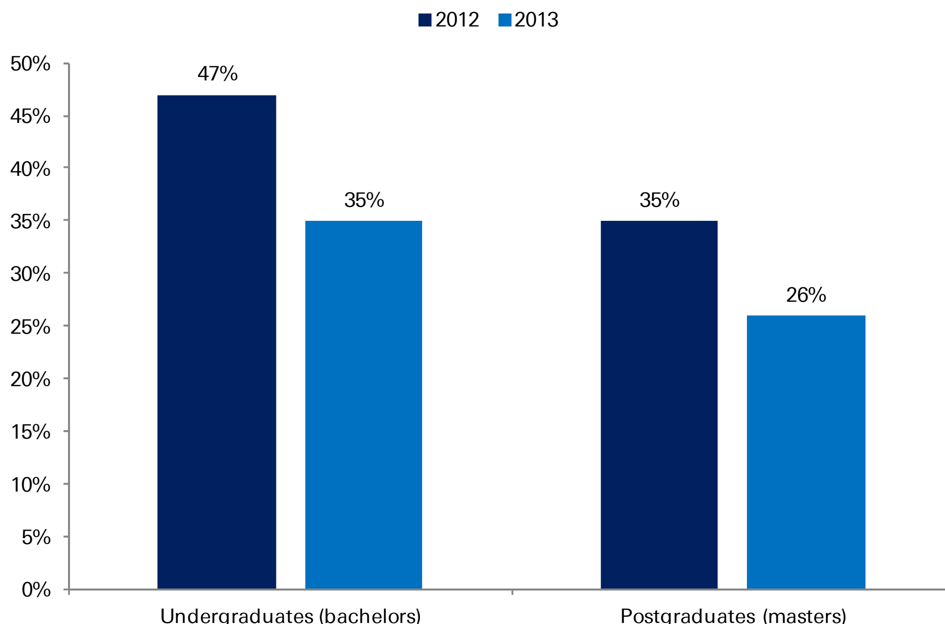
Second, inflation has been low in recent months, giving more room for monetary expansion. CPI inflation averaged 2.4% yoy in Jan-Apr, well below the government target of 3.5% for 2013 (Figure 5). PPI inflation also remained low at negative 2% yoy in Jan-Apr, suggesting limited cost-push pressure for CPI inflation later this year.

Figure 5: CPI inflation vs target

Source: Deutsche Bank, WIND, NBS

Third, only 30% of the 7m college graduates (to graduate in June) had found jobs by mid-April. This placement rate reported so far is about 10ppts lower than the ratio for at the same time last year (Figure 6). A survey conducted by the Ministry of Education (MoE) in February showed that among the 500 major employers (i.e. government agencies, foreign enterprises, SOEs and private corporates), their new hiring plans for 2013 are on average down 15% yoy in terms of number of openings. This puts significant social and political pressure on the government to boost the pace of job creation.

Figure 6: College graduates contract signing rate as of mid-April, 2013 vs. 2012



Source: MyCos Consulting, Tencent

Fourth, additional fiscal expansion is difficult given the complex NPC approval procedure, leaving credit policy as a more convenient option to support growth in the short term. Although many people argue that China still has room for fiscal expansion given its relatively low deficit/GDP ratio, in reality any revisions to the fiscal budget require parliamentary approval. This is the key reason why credit policy, which can be decided by the State Council itself, is a much more flexible (and low-profile) tool for influencing short-term growth outlook.

Fifth, the growing fear that non-bank financing may not have the same potency in boosting the real economy suggests that the government may permit faster bank loan growth. In the past three quarters, a major technical argument for the PBOC to keep a relatively low bank loan rate is that TSF has been accelerating, and faster non-bank financing growth suggests that bank loan growth should remain slow in order to avoid over-heating risks. So far, this concern has proved overdone as the impact of accelerating TSF has shown little effect on the real economy. Whether this is simply due to a longer time lag for transmission or due to a permanent reduction in the ability of TSF in driving economic activity remains a puzzle, but the PBOC will likely be under the pressure to de-emphasize the inflationary risk of non-bank financing and re-focus a bit on the role of bank credit in supporting growth.

Reforms to be announced in autumn

We expect the new leadership to announce a major economic reform package in September or October during the 3rd plenary session of the 18th Communist Party Congress. This package will likely involve a few dozen reforms in areas such as deregulation, fiscal, financial, resource pricing, capital account, rural land, social security, and SOEs. Many of these reforms will help lift long-term growth potential and/or quality of the economy. Specifically, we believe that deregulation and fiscal/resource pricing reforms will benefit railway/subway, gas, water and wind; social security reform will benefit insurance; capital account liberalization will benefit FX banks and brokers. On the other hand, coal and energy-intensive sectors are likely be hit by reforms.

The following figures present our expectation of five key reforms that may have a meaningful impact on the real economy and sectors that are of interest to investors. We also present the likely timetable for the implementation of these reforms, as well as sector beneficiaries.

Reform # 1: Deregulation. The government will likely abolish and decentralize many administrative approval rights and permit private sector investment in previously restricted sectors or sectors largely monopolized by state-owned enterprises. We expect more than 100 approval items to be abolished or decentralized in the near term and 300 approval items at the State Council level to be abolished or decentralized within the next few years. In the near term, the deregulation will likely focus on opening sectors such as railway, energy (wind, hydro, power grids, oil and gas pipelines, etc.) and telecom to private sector investment. In the medium term, we expect education, health, and financial sectors to become more open to private sector investments. The growth implication is that private sector investment will likely accelerate, and overall investment return in the economy should also improve given the higher efficiency of private sector investment. On sectors, we expect demand for power equipment, oil and gas drilling, and railway construction to grow faster as a result of the reforms (Figure 7).

Figure 7: Reform # 1 – Deregulation of investment approvals

Description	Possible timing	Direct impact	Overall impact
To remove/decentralize more than 100 approval items in the near term	Next few months	Increase private investments in wind, hydro, grids, oil & gas pipeline, railway, etc.	Boost overall investment return, demand for equipment and steel, higher usage of gas
To remove 300 central government approval items in the medium term	Next few years	Increased private investment in health, education, financial sectors	
Beneficiaries:	Power equipment, drilling, gas, railway construction		

Source: Deutsche Bank

Reform #2: Resource pricing reform. We expect the government to complete the resource pricing reforms in the coming two years. These reforms imply that gas prices will rise about 20% from now, water prices will rise 10-30% from now, and power sectors will enjoy a more stable margin going forward (Figure 8).

Figure 8: Reform # 2 – Resourcing pricing reform

Description	Possible timing	Impact
Introduce market pricing for gas in more provinces	Next 1-2 years	Higher margin for gas producers and better volume for distributors
Raise water tariffs	Next 1-2 years	Higher margins for water companies
Coal-power tariff pass-through	This year	Margin stability for IPPs
Beneficiaries:	Gas, water, IPPs	

Source: Deutsche Bank

Reform #3: VAT reform and reformation of central-local fiscal relations. The VAT reform will be extended to telco, railway and construction sectors and will cover the entire nation within the next 2-4 years. Once the reform is completed, annual tax savings could amount to RMB400bn per year for companies. We expect the railway sector to receive most visible tax cuts during this reform, as it "needs" most policy support to improve its financial position and for faster growth (Figure 9).

As a result of the VAT reform, which will effectively redistribute about RMB1tn in annual fiscal revenue away from the local governments to the central government, a major overhaul of the current central-local fiscal relationship will follow. As a result of this reform, we expect a number of expenditure responsibilities to be recentralized to the national government level (e.g. on items related to the cross-regional impact of food safety and environment regulations and enforcement), some new sources of revenues to be assigned to local governments (options include a new sales tax, consumption tax, and property tax), and more local governments to be allowed to issue municipal bonds to finance infrastructure projects. The implication of these reforms will be far-reaching – virtually all equity analysts will have to redo their financial projection spreadsheet as the tax system is redesigned. In particular, we believe that centralization of certain government functions will improve consumer confidence on locally produced food and beverages and more effectively curb pollution; the reduced reliance of local governments on land revenue will help mitigate the risk of property bubbles and policy uncertainty in the real estate sector; the development of the municipal bond market will help reduce LG reliance on bank lending for infrastructure and banks' NPL risks.

Figure 9: Reform # 3 – Reform of VAT and central-local fiscal relations

Description	Possible timing	Impact
Expanding VAT reform to telco, railway and construction sector	1-2 years	Tax reduction on railway, telco and construction
Expanding VAT reform to all service sectors	2-4 years	Tax reduction on other service sectors, including financials
Centralizing some expenditure responsibilities	1-3 years	Positive for food safety and environment
Decentralizing some fiscal revenues	1-3 years	Less reliance on land revenue and more stable real estate policy outlook
Permitting LGs to issue municipal bonds	Gradual	Reducing NPL risks for banks
Beneficiaries:	Railway, food, environment, and banks	

Source: Deutsche Bank

Reform # 4: Financial sector reforms. The key elements of financial reform will include further liberalization of interest rates and opening of the capital account. On interest rates, we expect the regulators to lift the deposit rate cap to 1.2x of the benchmark rate soon, and to allow banks to issue large-denomination CDs (certificates of deposits) that are free from interest rate caps. Although these liberalization measures may mean some further contraction on NIM in the banking system, we believe this trend is largely

priced in by the market. The positive aspect of issuing CDs is that it will help banks to reduce the risk of maturity mismatch.

On capital account liberalization, we think the government may soon announce a QDII2 system (e.g. give permission for wealthier individuals to invest overseas), further expand the QFII program, and allow qualified foreign institutions to issue RMB bonds (e.g. Panda bonds) in the on-shore market. This will allow greater fund flow from the mainland to Hong Kong and other overseas markets. We believe that banks specializing in the FX business, brokers, and the HK equity market will likely benefit from greater cross-border fund flows (Figure 10).

Figure 10: Reform # 4 – Financial sector reforms

Description	Possible timing	Impact
Raising deposit rate cap to 1.2x benchmark	H2 this year	Margin squeeze, higher demand for interest rate hedging
Introducing CDs	Within one year	Margin squeeze, higher demand for interest rate hedging
Lifting RMB trading band to 2%	H2 this year	Higher demand for FX hedging products
Introducing QDII2	H2 this year	Higher demand for cross-border financial services
Expanding QFII	Next 1-2 years	Higher demand for cross-border financial services
Opening capital account channels for RMB cross border flows	Next 1-2 years	Higher demand for cross-border financial services
Beneficiaries:	Brokers, insurance, FX banks, HK equity market	

Source: Deutsche Bank

Reform # 5: Environmental, social security, and rural land reforms. We group many other important reforms in this category. On environment, we expect the government to substantially raise the taxes (including resource tax consumption tax) on coal and other polluting sectors and environmental levies on pollutants (e.g. on SO2 and NOX). The fiscal revenue from these increases in taxes and levies on polluting sectors will likely be used to subsidize clean energies such as natural gas and wind.

On health insurance, policy makers now realize that the government-sponsored basic health insurance is unable to effectively cover critical illnesses (only 20% of medical bills for critical illnesses are reimbursed by the basic insurance), and thus commercially provided critical illness insurance will be a key solution. Part of the premium contribution to the basic health insurance scheme will likely be re-allocated to paying premiums for critical illness insurance. Tax incentives will also be provided to insurance companies that provide critical illness insurance policies. The implication is that insurance companies' premium growth will be enhanced due to faster development of critical illness insurance on government initiatives.

On pension reform, we expect the national government to centralize the PSGY pillar of the pension system and use tax incentives to encourage the development of a commercial pillar – annuities – as a key supplement to the PAGY system. This will imply faster growth of demand for pension products provided by insurance companies.

On rural land reform, we believe a key breakthrough will be the adoption of the Chengdu model to legalize farmers' land use rights in the form of land titles. This reform will significantly facilitate the leasing of agricultural land for large-scale farming, boost farmers' income growth, and allow greater mobility of farmers into non-agriculture sectors and urban areas. We expect this reform to be key in speeding up the pace of urbanization and enhancing the long-term growth potential of the country.

As for sectors, faster urbanization will drive demand for real estate and infrastructure construction, and the granting of land titles to farmers will allow banks to extend loans to farmers using land as collaterals (Figure 11).

Figure 11: Reform # 5 – Environmental, social security, and rural land reforms

Description	Possible timing	Impact
Higher resource taxes and pollution levies	Within one year	Negative for coal
Higher subsidies for clean energies	Next few years	Positive for gas, wind, solar
Higher spending on health care	Next few years	Positive for health care
Car license auctions	Next few years	Negative for auto
Higher subsidies for subway/railways	Next few years	Positive for subway/railway
Developing critical illness insurance	Next 1-3 years	Positive for insurance
Tax incentives for annuities	Next few years	Positive for insurance
Legalization of rural land titles	Next few years	Positive for construction, rural and agriculture banks
Beneficiaries:	Gas, wind, railway/subway, healthcare, insurance	

Source: Deutsche Bank

Market outlook and a “reform” basket

In light of our new growth projection of a sluggish June, we expect China’s equity indices may remain range-bound in the near term. However, we believe a rebound is likely in H2 as sequential growth recovery materializes and sentiment improves on expectations that major reforms will lift growth quality and potential in the medium term. **In particular, we believe that banks and real estate developers are likely to benefit from the cyclical recovery and the reduction in real estate policy uncertainties. Sectors that will benefit from reforms should include railway and drilling (on deregulation), gas and wind (on resourcing pricing, reform and environmental policy changes), insurance (on social security reform), brokers and FX banks (on capital account liberalization), and food (on food safety policy).**

The following figure shows the EPS growth and market valuations of the nine “reform beneficiaries” (Figure 12). Note that the earnings forecasts listed in this table are current expectations of our analysts and have not fully taken into account the potential benefits from reforms.

Figure 12: Valuations of “reform beneficiaries”

Company	Ticker	Sector	Rating	26-May Price local	26-May M. cap (US$m)	PE 2013	PE 2014	PB 2013	EPS CAGR 13-14	PEG (2013PE/ EPS CAGR 13-14)	PE Discount to 5Y AVG
Bank of China	3988.HK	Banks	Buy	3.66	132,679	6.0	5.9	0.9	2%	3.98	29%
China Mengniu Dairy	2319.HK	Food, Beverage & Tobacco	Hold	26.45	63,031	21.9	18.5	2.6	26%	0.84	12%
Ping An	2318.HK	Insurance	Buy	58.65	62,309	13.1	12.0	2.0	10%	1.37	80%
COLI	0688.HK	Real Estate	Buy	23.10	24,319	8.7	7.2	1.8	18%	0.48	37%
CITIC Securities	6030.HK	Diversified Financials	Hold	16.54	23,473	19.1	17.8	1.6	33%	0.57	12%
China Railway Group	0390.HK	Capital Goods	Buy	4.06	11,140	8.4	7.2	0.8	18%	0.48	71%
Beijing Enterprises	0392.HK	Capital Goods	Buy	60.55	8,982	18.4	14.5	1.6	27%	0.67	5%
Longyuan Power	0916.HK	Utilities	Buy	8.00	8,282	15.7	12.5	1.5	22%	0.70	44%
BEWG	0371.HK	Utilities	Buy	2.72	2,400	17.5	12.6	2.0	41%	0.43	25%
Average						14.3	12.0	1.6	22%	1.06	35%
MSCI China						9.3	8.5	1.4	7%	1.43	31%

Source: Deutsche Bank, Bloomberg Finance LP

Bank of China (3988.HK, Buy): BOC is known from its international businesses and we regard BOC as an inexpensive proxy for rising cross-border RMB business. Our sector analyst Tracy Yu believes that BOC is a key beneficiary of the internationalization of RMB and capital account liberalization, which will substantially boost FX-related transactions. In addition, the stock is least negatively affected by interest rate deregulation amongst the H-share listed banks and management is targeting for stable/higher NIM this year. We believe the BOC’s current valuation presents an attractive risk/reward profile. Tracy’s target price is equivalent to 1.10x 2013E P/B.

China Mengniu Dairy (2319.HK, Hold): China Mengniu Group (CMD) is one of the leading dairy product manufacturers in China, and a likely key beneficiary of improved

food safety standards and the resulting rise in consumer confidence in locally produced dairy products. Our sector analyst Winnie Mak agrees with the company's new strategic initiatives, to steer the company back to a high growth path even as near-term earnings could be volatile upon internal restructuring. If the new strategic initiatives are rolled out smoothly, we should see stronger growth in 2013.

Ping An (2318.HK, Buy): Our sector analyst Esther Chwei expects Ping An to deliver superior VNB growth in 2013, led by agency VNB recovery and helped by a relatively low base in 2012. In addition, Ping An has limited exposure to bancassurance (~3% of 2012 VNB) and should be resilient to further weakness in bancassurance sales resulting from regulatory changes. Furthermore, it should be the least affected by the potential lifting of the guarantee rate cap, as its exposure to traditional life policies is limited. Beyond that, its stronger exposure to China's coastal cities with more sophisticated customer base and agents should enhance its ability to sell more innovative products. Esther's estimates have so far not taken into account the potential positive impact from government policies supporting annuities and critical illness insurance policies.

COLI (0688.HK, Buy): In a market where most developers have less than five years' track record of consistent growth, COLI stands out with its continuous strong growth over the past decade. Given COLI's highly diversified portfolio, it will benefit from the acceleration in urbanization (partly driven by the rural land reform) in Tier 2 and 3 cities. Deutsche Bank property analyst Tony Tsang believes that COLI will continue to widen its lead over peers and trade at a premium valuation, given its well established systems, management's long-standing experience, careful planning, clear market positioning, timely acquisitions of new landbank and careful penetration into different provinces.

CITIC Securities (6030.HK, Hold): CITIC Securities is the largest China securities firm by operating revenue and capital base. During the past quarters, CITICS continued to gain market share in the margin financing business with a market share up from 8.8% in 3Q12 to 9.9% in 4Q12 (No.1 among Chinese brokers). Other business segments including the issuance of short-term financing bills (STFB) and brokerage income also delivered sound results. We believe the company will benefit from the upcoming intensive financial reforms, more active trading on the A share market, and capital account liberalization (e.g. QDII2).

China Railway Group (0390.HK, Buy): There are positive catalysts ahead for the overall sector, including: 1) stronger railway and subway investment, 2) potential VAT reform; and 3) stable or slight improved margin resulted from changes in the business mix. Our infrastructure analyst Phyllis Wang believes that railway and subway infrastructure capex will continue to grow 6% yoy and 25% yoy in 2013, respectively, above market expectations, to further support the sector's share price. She likes CRG in particular, due to the company's higher subway exposure. The stock is currently at a 2013E PE of 8.4x, attractive on the back of double-digit profit.

Beijing Enterprises (0392.HK, Buy): Beijing Enterprises is one of the most integrated gas utility companies in China, with c.75% of earnings coming from its core gas business. Our utilities analyst Eric Cheng expects its gas business to remain the key earnings growth driver and he believes earnings in the next two years will accelerate when the utilization of the midstream gas transmission pipelines and consumption by gas-fired power plants in Beijing start to ramp up. He also sees more room for higher return when: 1) the planned gas-fired cogeneration plants are fully operational; 2) the vehicle LNG refueling business ramps up; and 3) peak-trough gas demand during the year narrows.

Longyuan Power (0916.HK, Buy): China Longyuan Power is the listed wind power arm of China Guodian Group, one the largest power producers in China. The company is the largest wind farm operator in China and Asia. Our sector analyst Kai-Ting Wang sees Longyuan's valuation as attractive at the current depressed levels, given that industry fundamentals will likely improve on both near- and medium-term catalysts. For 2013, Kai-Ting expects the government to announce a list of supportive measures, including the implementation of the Renewable Portfolio Standard (RPS), acceleration of tariff premium payment and approvals for UHV transmission lines. Strong earnings growth from 2014 is also likely, given the visible capacity pipeline and turnaround in grid curtailment upon the commencement of pump storage facilities and UHV transmission lines.

Beijing Enterprises Water Group (0371.HK, Buy): Beijing Enterprises Water Group is a leading state-owned enterprise integrated water and sewage treatment provider in China, with its water plants located across 14 provinces and municipalities. Our sector analyst Kai-Ting Wong believes that BEWG will be the key beneficiary of the country's rapid growth in the environmental protection sector, with a strong EPS CAGR of 31% for 2013-2015E, given visible pipeline of projects (5m tons of water projects and HK$16bn of environmental renovation projects). This is supported by lower financing costs, given the recent bond issuance, and a more motivated management team, given the recent issuance of share options.

Appendix 1

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Additional information available upon request

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Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
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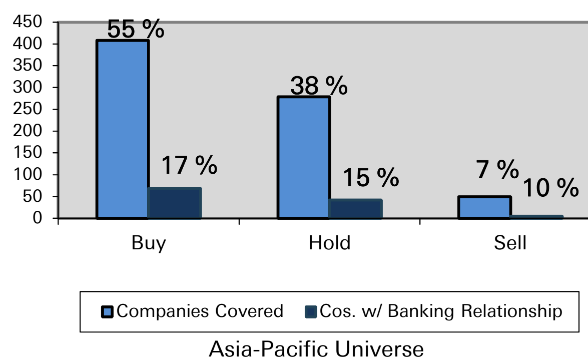

Asia-Pacific Universe

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