

China's A-share market: V-shaped trajectory ahead

Expect 20-30% correction in 1Q-2Q07 on possible 4Q06 earnings disappointment or government intervention

Consensus estimates at 12%QoQ or 619%YoY for 4Q06 earnings seem overly optimistic. Besides, if A-share market doesn't correct during results season and continue to rally strongly, it would be vulnerable to stronger government intervention, in our view.

Buy on weakness though as 1-year outlook still positive

- 1- Consensus earnings forecasts for 2007-08 seem reasonable;
- 2- Release of non-tradable will not become significant until 2009 and we can take profit in 1H08;
- 3- Valuation currently at high level of the reasonable range (Chart 13, p7); and
- 4- A-share market rally so far is rather insignificant, compared to what witnessed in Korea or Taiwan in late 1980s.

A and H-share performance not as correlated as thought

A- and H-share index or MSCI China is not as highly correlated as thought, either based on index or weekly performance (Table 2 & 3, p.9). Of course, Hong Kong-listed insurance companies and A-share track fund correlate closely with A-share performance. Investors can either sell now and buy back on weakness, or hold through the coming volatility.

Four investment themes

- 1- Asset injection & group listing, e.g. Changli & Foton Motor
- 2- Management incentives, e.g. Chunlan, Shengyi and Conba.
- 3- Mid-cap rising industry stars and niche players, e.g. Rebecca & Qinghai Potash
- 4- Upward earnings revisions, e.g. Valin Tube & Shandong Haihua

Please refer to Table 5 on page 11 for the stocks to focus under our 4 investment themes.

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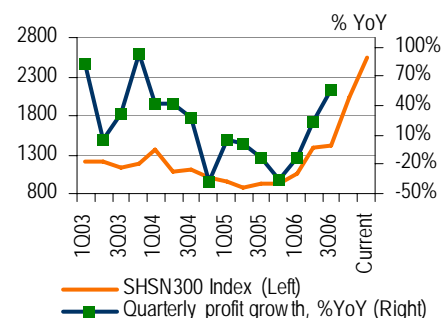
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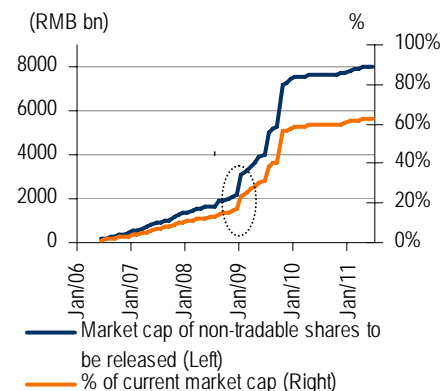
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Chart 1: A-share market: earnings growth & price performance



Source: Wind, Bloomberg, Merrill Lynch Research

Chart 2: Non-tradable share release schedule



Source: Wind, Merrill Lynch Research

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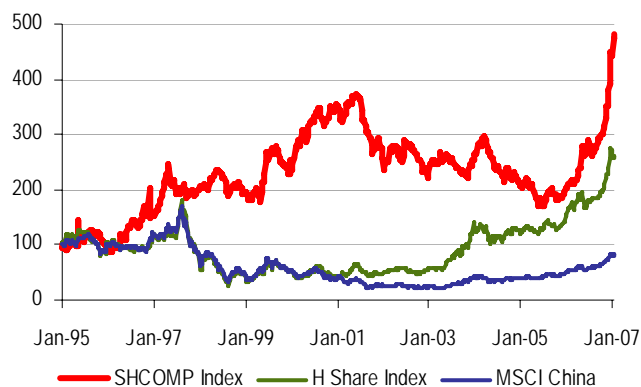
A-share market to be V-shaped A-share rally driven by earnings rebound

A share market rose by 130% during 2006 and by 140% since the beginning of 2006 - the strongest rally ever since the A-shares were introduced in the early 1990s, and much stronger than H-shares or MSCI China (Chart 3).

In our view, the rally has been driven by earnings improvement.

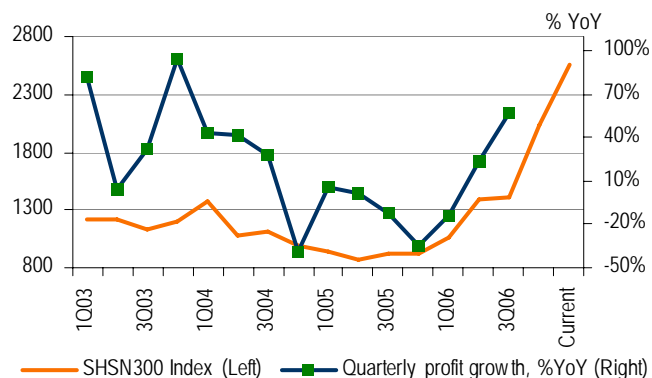
- Earnings averaged for all A-share companies bottomed out in 4Q05, and staged a remarkable rebound in the following quarters through 3Q06 (Chart 4);
- True, earnings were strong even in 2003-2004, and A-share market rally back then was short-lived. This however can be explained by the following two factors:
 - Earnings growth started to trend downwards in 4Q03 after a brief acceleration, which is of course negative for the A-share market;
 - A-share market sentiment was hurt by the overhang of non-tradable share issue and financial difficulties of securities companies back then, both of which have now been resolved.
- Earnings rebound since 2006 is largely driven by the improvement of business environment reflected in the upward trend in industrial profit as shown in Chart 5, p.3.

Chart 3: A-share outperforms H or MSCI China Index



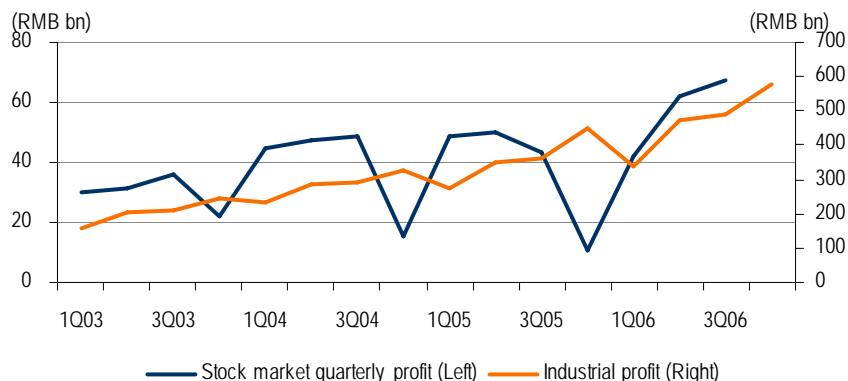
Source: Bloomberg, Merrill Lynch Research

Chart 4: A-share market: earnings growth & price performance



Source: Wind, Bloomberg, Merrill Lynch Research

Chart 5: A-share market earnings & industrial profit



Source: CEIC, Bloomberg, Merrill Lynch Research

But 20-30% correction expected in 1Q-2Q07

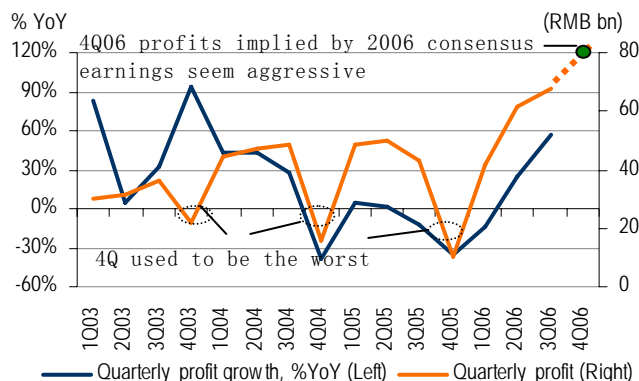
We expect A-share market to correct by 20-30% some time in 1Q-2Q07, because 4Q06 earnings may fall short of the elevated expectations; or the government may increase its intervention to cool down market activities.

Consensus estimation for 4Q06 seems overly optimistic

4Q06 reporting season will start soon with most companies reporting 2006 results in March – Apr and may disappoint.

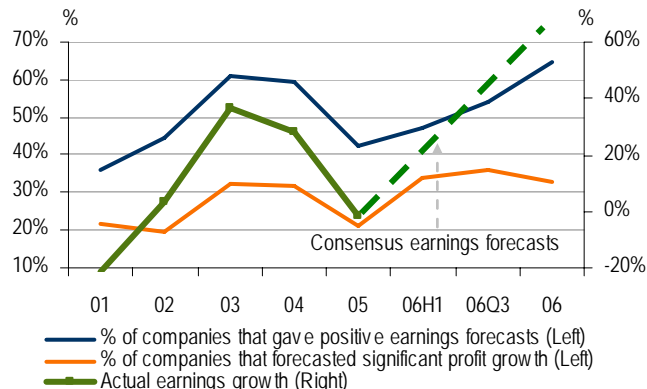
- For the entire 2006, consensus forecasts are looking for 54%YoY earnings growth, or 62% if companies IPOed in 2006 are excluded, up from a drop of 2%YoY in 2005 (See Chart 8).
- This indicates consensus forecasts are also looking for a 12% QoQ or 619% YoY gain in 4Q06 earnings. But for most A-share companies, earnings tend to drop significantly QoQ in 4Q, as more costs are usually allotted to the final quarter of the year (Chart 6);
- True, in 4Q06, earnings should have been boosted by sizable asset injection which didn't happen in the previous years. But this may not be enough to push up earnings as significantly as what's in consensus earnings forecasts.
- Also, historically, actual earnings growth tends to under-perform number of companies which provide positive earnings guidance by a visible margin. But now consensus forecasts are now looking for earnings growth to exceed in 4Q06 (Chart 7).

Chart 6: A-share market earnings: level & growth (YoY)



Source: Wind, Bloomberg, Merrill Lynch Research

Chart 7: Earnings guidance, A-share market earnings & consensus earnings forecasts



Source: Wind, Merrill Lynch Research

Government needs to increase its market intervention

If 4Q06 earnings don't disappoint and the A-share market continues to rally strongly, then the government will have to increase its intervention to cool down A-share fever.

- For the current Chinese leaders, 'social harmony' is their top priority, which includes wealth equality and housing security. Naturally, they are glad that ordinary individuals can now make money from the stock market, while they have been denied from the property market.
- However, they are also very well aware of the fact that if the stock market continues to rise very rapidly, it usually will be followed by sharp correction. By then, many individual investors will be very unhappy and may protest in the street. This is considered unacceptable in the run up to the 17th Party Congress which is to be held in October or November this year and Olympics in mid 2008.
- Already, it is making gentle effort to limit stock market rally:
 - China Securities Regulatory Commission (CSRC) has quietly suspended the approval of mutual funds for stock investment;
 - It has also speeded up the approval of IPOs;
 - SASAC (State-owned Assets Supervision and Administration Commission) has also tightened scrutiny over SOEs' stock trading.
 - Most recently, retail investors are required to leave their photos with their brokers when they open up accounts.
- But these measures are too gentle to cool down the market. Consequently and subsequently, the government may consider hiking deposit rates and stamp duties which will fail too. What will indeed hurt market sentiment is capital gain tax.

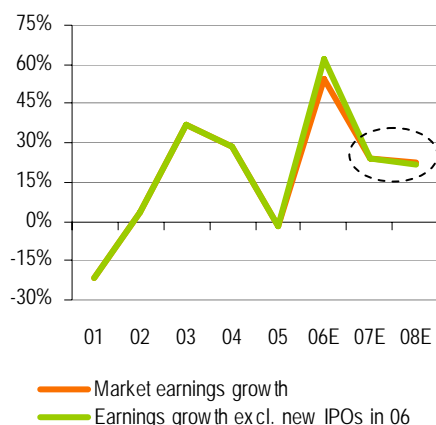
1-year outlook still positive

We however recommend investors to buy on weakness, because we remain positive towards the A-share for the coming year, for the following four reasons: 1) consensus earnings forecasts for 2007-08 seem reasonable; 2) release of non-tradable will not become significant until 2009 (we could take profit in 1H08); 3) liquidity is rarely a problem for China's stock market; 3) valuation can be easily stretched; and 4) stock market rally during the hey days of Korea and Taiwan was much stronger than the A-share market gain so far.

1. Earnings forecasts for 2007 and 08 seem reasonable

For 2007 and 2008, consensus forecasts are looking for 24%YoY and 22%YoY earnings growth (chart 8), respectively, which are much higher than the 7%YoY averaged for 2000-2005, but still seem reasonable, for the following reasons.

Chart 8: A-share market earnings & actual consensus forecasts



Source: Wind, Merrill Lynch Research

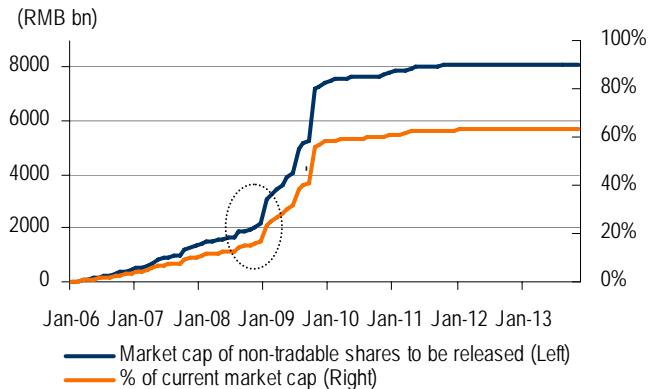
- Newly listed companies have much better earnings quality, thanks to the improvement of IPO quality, including A-share listing of H-shares;
- Income tax unification, to be passed in the coming National People's Congress which is scheduled for early March, is estimated to boost 2008 earnings growth by 8% points; Further down the road, VAT will be shifted from production- to consumption-based, which will allow companies to deduct equipment depreciation from VAT bills and hence boost earnings for capital-intensive companies;
- Earnings growth should be further enhanced by 'group listing' or quality asset injection by parent companies, which can now sell shares, and hence benefit from the share price performance of their listed companies. Prior to the free float reforms, parent companies were not allowed to sell non-tradable shares and didn't have any incentives to boost share prices of listed companies;
- Incentives structure is being put in place to enhance management passion and quality;
- Most importantly, overall economic outlook remains positive for the stock market, barring any hard landing in the US.
 - We once worried about the potential over-capacity in various sectors but we also knew that without any shock in demand, earnings growth won't collapse for the entire economy or market, though it will happen for some specific sectors, eg, in alumina, and steel. We were worried about the risk of hard landing in the US, but were convinced in late 2006 that soft landing is a more likely scenario.

For China's A-share market, assuming earnings growth to be averaged at 20%YoY in 2007 and 2008, we believe A-share price index could go up by 20% without pushing up valuation.

2. Release of non-trade shares not significant until 2009

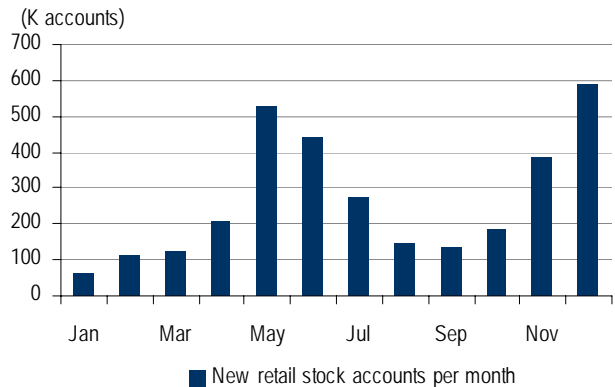
Based on the release schedule for non-tradable shares, amount of shares to be released will not become significant until 2009 and we could take profit in 1H08 (Chart 9).

Chart 9: Non-tradable share release schedule



Source: Wind, Merrill Lynch Research

Chart 10: Monthly opening of new retail accounts for stock investment



Source: Anbound, Merrill Lynch Research

3. Liquidity is rarely a problem for A-share market

Liquidity itself never acts as catalyst for any of the markets in any of the countries in the world, rather it exacerbates market volatility and China is not an exception.

Easy money made in the stock market is drawing investment interest across the country.

By now, retail stock accounts have already exceeded 80mn.

- About 3.2mn new accounts were opened in 2006 (Chart 10);
- In 2006 alone, a total of RMB346bn, 3.5% of A-share market cap, were raised by mutual funds for stock investment, up 395%YoY, 46% of the total funds raised by investment funds in history.
- Some individuals are starting to mortgage their housing for stock investment.

Liquidity supply is rarely a problem in China. Opportunity cost for stock investment is very low with only 2.52% pa for one-year deposits and total deposits held by households in the banking sector currently at RMB15 trillion, or 150% of total A-share market capitalization.

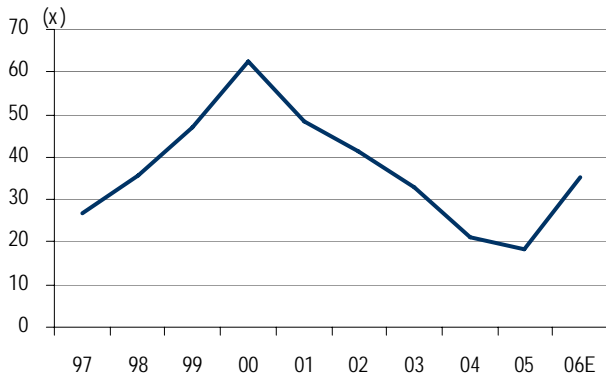
4. Valuation currently at high end of a reasonable range

At the moment, Shanghai & Shenzhen 300 Index (SHSN300) is trading at 31X 06PE and 25X 07PE; and Shanghai Composite Index (SHCOMP) at 35.2X 06PE and 28.4X 07PE.

In terms of 2006PE, Shanghai & Shenzhen 300 Index (SHSN300) and Shanghai Composite Index (SHCOMP) are trading at 74% and 98% premium to MSCI China and 77% and 101% to H-share Index. But A-share PE was as high as 62 in Dec 2000 (Chart 11)

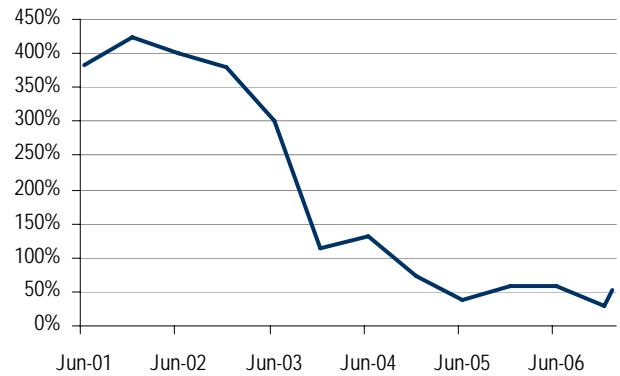
For dual listed shares, A-shares are enjoying 46% price premium over H (median premium), up from about 30% at the end of 2006. But it was more than 400% in 2001, just before the A-share market started its 4-year correction (chart 12).

Chart 11: Historical PE ratio for Shanghai A shares



Source: Bloomberg, Merrill Lynch Research

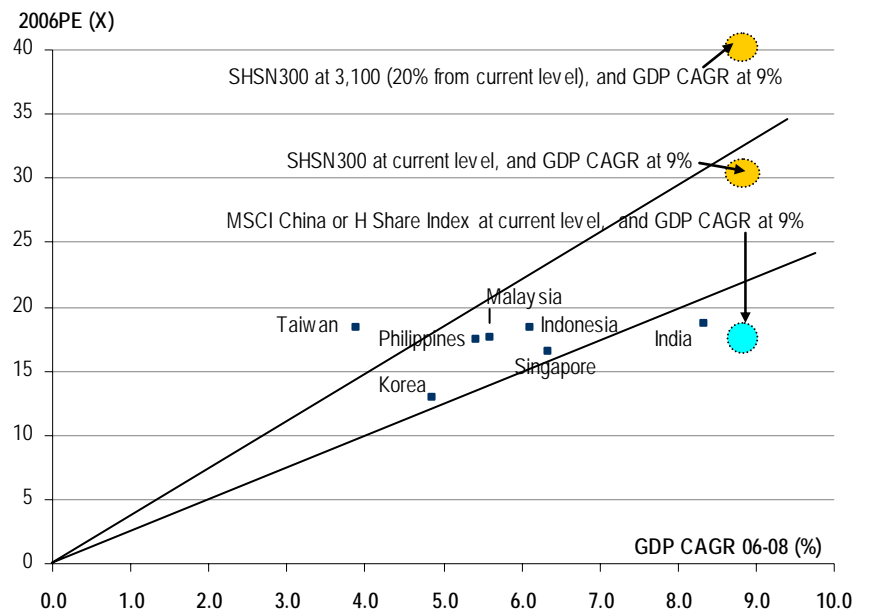
Chart 12: Historical A-H premium for dual listed companies (Median)



Source: Bloomberg, Merrill Lynch Research

Also, if we use 9%YoY GDP CAGR for 2007-2008, the current valuation for A-share market is at the high end of a reasonable range (Chart 13).

Chart 13: Asia markets: 06PE & GDP CAGR 06-08



Source: Merrill Lynch Research

4. A-share market rally so far insignificant compared to what seen in late 1980s in Korea or Taiwan

The rally in late 1980s of Korea and Taiwan was much stronger than the A-share market run-up so far.

- Stock market gained by almost 650% during mid-1985 - Mar 1989 in Korea and 1800% in Taiwan during Jul 1985 – Jan 1990.
- It was the bubble bursting in Japan in 1989/90 that brought an abrupt ending to the stock market rally in both Korea and Taiwan.
- But even after all the correction, stock indices today are still 245% higher than the level seen in 1987, which was already over 100% higher than the lows seen in 1985 (Table 1).
- If investors entered the market at the peak in 1989-90, and have held on to today, they would have made 35% loss in Taiwan, but 43% gain in Korea.

Table 1: Similar market rallies in Asia

Taiwan' 1985-1990 rally								Peak	Adjustment period	
	Jul 1985	Jul 85-Jan 86	Jan 86-Jan 87	Jan 87-Jan 88	Jan 88-Jan 89	Jan 89-Jan 90	Jan 89-Jan 90	Total	Jan 90-Sep 90	
TWSE Index (period end)	637	883	1,150	2,844	6,157	12,054	12,054		2,705	
Performance		39%	30%	147%	117%	90%	90%	1792%	-78%	
Market earnings growth				29.4%	81.8%	-10.5%	-10.5%		-15.4%	
Deposit rates (domestic banks, weighted average, %p.a.)	6.5	6.5 - 6.2	5.7 - 4.3	4.2 - 3.8	3.8	4 - 6.7	4 - 6.7		7 - 7.2	
Real GDP growth, %YoY	5.0	5.0	11.6	12.7	7.8	8.2	8.2		5.4	
Korea' 1985-1989 rally								Peak	Adjustment period	
	May 1985	May 85-Mar 86	Mar 86-Mar 87	Mar 87-Mar 88	Mar 88-Mar 89	Mar 88-Mar 89	Mar 88-Mar 89	Total	Mar 89-Jul 92	
KOSPI Index (period end)	134	200	405	656	1,003	1,003	1,003		510	
Performance		49%	103%	62%	53%	53%	53%	648%	-49%	
1-year deposit rates, %p.a.	10	10	10	10	10	10	10		10	
Real GDP growth, %YoY	6.9	6.9-10.1	10.1	8.7	10.1	10.1	10.1		6.6, 3.7	
Japan' 1970-1973 rally								Peak	Adjustment period	
	Dec 1970	Dec 70-Jan 72	Jan 72-Jan 73	Jan 72-Jan 73	Jan 72-Jan 73	Jan 72-Jan 73	Jan 72-Jan 73	Total	Jan 73-Oct 74	
TPX Index (period end)	148	199	404	404	404	404	404		262	
Performance		34%	92%	92%	92%	92%	92%	173%	-35%	
Prime Lending Rate (Long-term, %p.a.)	8.5	8.5 - 8.2	8.2 - 7.7	8.2 - 7.7	8.2 - 7.7	8.2 - 7.7	8.2 - 7.7		7.7 - 9.9	
Nominal GDP growth, %YoY		4.4	8.4	8.4	8.4	8.4	8.4		8, -1.2	
China's present rally since late 2005								Peak	Adjustment period	
	Nov 2005	Nov 05-Present	Nov 05-Present	Nov 05-Present	Nov 05-Present	Nov 05-Present	Nov 05-Present	Total	Nov 05-Present	
SHCOMP Index (period end)	1090	2882	2882	2882	2882	2882	2882		?	
SHCOMP Performance, %		164%	164%	164%	164%	164%	164%	164%	?	
1-year deposit rates, %p.a.	2.52	2.52	2.52	2.52	2.52	2.52	2.52		?	
Real GDP growth, %YoY		10.4-10.7	10.4-10.7	10.4-10.7	10.4-10.7	10.4-10.7	10.4-10.7		?	

Source: Merrill Lynch Research, Bloomberg, CEIC

A- and H-share correlation not as high as though

In general, A- and H-share index or MSCI China is not as highly correlated as thought, either based on index or weekly performance (Table 2 & 3).

Interestingly however, A-share index is getting increasingly correlated to MSCI China, based on weekly performance (Table 3).

Of course, Hong Kong-listed insurance companies and the A-share track fund correlate closely to A-share performance. Investors can either sell now and buy back on weakness, or hold through the volatility.

Table 2: Correlation between SHCOMP & HSCEI

	Index itself	Daily Performance	Weekly Performance
1H04	63.4%	18.5%	17.9%
2H04	-23.2%	32.8%	44.5%
1H05	55.2%	26.4%	60.8%
2H05	49.7%	26.9%	53.0%
1H06	45.3%	21.6%	55.5%
2H06	97.5%	23.5%	68.2%
YTD 2007	-44.3%	18.9%	58.2%
2004-2007	74.5%	22.3%	41.7%

Source: Bloomberg and Merrill Lynch Research

Table 3: Correlation between SHCOMP & MSCI China

	Index itself	Daily Performance	Weekly Performance
1H04	68.4%	21.6%	21.0%
2H04	-57.3%	-1.7%	39.7%
1H05	-29.0%	-5.7%	46.4%
2H05	41.3%	15.6%	48.9%
1H06	84.6%	-7.6%	48.7%
2H06	62.4%	7.7%	63.8%
YTD 2007	57.6%	4.3%	84.8%
2004-2007	65.2%	6.3%	39.1%

Source: Bloomberg and Merrill Lynch Research

Four investment themes

We have highlighted the following four investment themes: 1) asset injection & group listing; 2) management incentives; 3) mid-cap rising industry stars and niche players; and 4) upward earnings revisions

1. Asset injection & group listing

Asset injection has become a major force behind earnings growth in 2007. Investors should focus on those stocks that have significant potential of asset injections, but avoid the expensive ones.

Please refer to Table 5 on page 11 for companies to focus under this theme.

2. Management incentives plans

Those A-shares companies which have already introduced management options have significantly outperformed the market. Incentives make the management more willing to perform, and to show their performance. Investors should pay attention to those companies that has plan to introduce share options.

In some cases, management may purposely squeeze profits or disclose bad news before the introduction of stock options, and do the contrary afterwards. But, this is a case-by-case risk; it does not change our bullish view on those companies that has plan to introduce stock options.

Please refer to Table 5 on page 11 for companies to focus under this theme.

Table 4: Small & mid-cap stocks outperforming large cap ones

Market cap US\$	YTD Performance , 2007 (%)
>100bn	-1.3
10-100bn	29.8
1-10bn	43.6
0.5-1bn	35.6
<0.5bn	31.4

Source: Wind, Merrill Lynch Research

3. Mid-cap rising industry stars and/or niche players

We had a “Switch from large caps to Mid-caps call” at the beginning of the year. Mid-small caps had significantly outperformed the large caps (Table 4). We believe this call is still valid. This is because large cap stocks has rallied strongly prior to 2007 and thus offer little value.

Please refer to Table 5 on page 11 for companies to focus under this theme.

4, upward earnings revisions

In China, experience shows that those sectors and stocks which have earnings upgraded (downgraded) in the run-up to results season are quite likely to deliver upside (downside) surprises.

- The following sectors and stocks have recently had earnings forecasts upgraded by analysts: iron & steel (e.g. BaoSteel, Angang, Laiwu Steel, Jinan Steel, Taigang, Valin Tube, Jinan Iron, Midea Electric , Handan Steel, Tangshan Steel), commercial banks (e.g. China Merchants, Pudong Development Bank, Shenzhen Development Bank), securities houses (e.g. CITIC Securities), autos (e.g. FAW Xiali, Dongfeng Moto, and Shanghai Auto), properties (e.g. Vanke), refineries (e.g. Sinopec) and some other sectors (e.g. Yangtze Power, Qinghai Potash, Shandong Haihua, Chiwan Wharf, Changyu, Suning, Air China, Qingdao Haier) (Table 6).
- The following sectors and stocks have recently had earnings forecasts downgraded by analysts: telecom equipment (e.g. ZTE), pharmaceutical (e.g. Tong Ren Tang), non-ferrous (e.g. Shandong Aluminum), some consumer names for which, earnings expectations are rather high (e.g. Luzhou Lao Jiao, Pudong Jinqiao, Jianghuai Auto, Homey Aquatic, Wangfujing, Zhangzidao Fish, China Youth Travel Services, Guangsheng Railways, and some other sectors (e.g. Shanghai Pechem, Pinggao Elec, Liuzhou Chem, Zhenhua Port, Chenming Paper, Datong Coal, Baotou Steel, Shenyang Mach, and New Hope) (Table 6).

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Table 5: Stock to focus under the 4 investment themes

Ticker	Name	Name	Status	Cap US\$ bn	Performance			PE			Note
					1M	3M	1Y	06E	07E	08E	
<u>Asset injections</u>											
600507	Changli	长力股份	Announced	0.3	36.3	40.2	52.1	12.8	13.8	NM	Parentco, Nanchang Steel, may go for group listing.
000768	Xian Aircraft	西飞国际	Potential	1.3	43.6	54.6	88.8	130.8	42.2	26.0	Potential asset injection. Beneficiary of China's defense spending. Stock options to be introduced.
600879	Launch Vehicle	火箭股份	Potential	1.2	30.5	45.6	63.8	47.1	33.3	26.0	Potential asset injection. Beneficiary of China's defense spending.
000800	Faw Car	一汽轿车	Potential	1.2	48.9	89.9	83.5	24.1	21.5	17.0	Parentco still has a lot of unlisted assets. Asset injection possible.
600166	Foton Motor	福田汽车	Potential	0.5	43.0	64.0	88.5	73.7	34.1	21.9	DaimlerChrysler became the NO. 2 shareholder. Parentco still has substantial unlisted assets. Beijing Hyundai potential acquisition target.
000895	Shuanghui Dev	S 双汇	Potential	2.0	-	-	-	35.5	29.4	24.1	Parentco, in which Goldman Sachs acquired stake, has plans to go for group listing, either via separate listing or asset injection into Shuanghui.
600717	Tianjin Port	天津港	Potential	2.1	33.0	44.7	49.8	33.0	29.7	26.3	Internal competitors held by parentco to be injected.
000022	Chiwan Wharf	深赤湾 A	Potential	1.6	7.3	43.3	47.6	19.2	17.5	16.7	To benefit from China Merchants (parentco) restructuring
000878	Yunnan Copper	云南铜业	Potential	1.4	37.0	46.2	31.3	12.1	8.2	6.9	Parentco to inject all copper mining assets into listco in next 2 years to achieve group listing
600010	Baotou Steel	包钢股份	Potential	1.7	31.7	77.9	79.5	18.4	12.9	10.6	To issue 3bn new shares (approx RMB7bn) to parentco to acquire remaining assets.
600497	Yunnan Chihong	驰宏锌锗	Announced	1.9	48.1	147.0	136.5	20.1	16.2	18.3	To issue 35mn new shares to acquire the assets of the parentco. 100% of Zhaotong Lead & Zinc targeted.
600219	Nanshan Indust	南山铝业	Potential	0.8	15.9	50.6	92.6	39.6	10.5	7.5	To issue shares to the parentco to acquire alumina assets.
600308	Huatai	华泰股份	Announced	0.8	2.0	84.6	82.4	16.3	13.1	11.4	To acquire chemicals assets of the parent co
600886	Huajing	国投电力	Potential	1.1	45.8	87.8	92.3	22.2	16.1	15.1	Already acquired some assets from parentco, but more to be required. Dachao Shan Hydro Power next target.
600642	Shenergy	申能股份	Completed	3.2	26.5	62.9	63.1	16.1	16.6	14.7	Parentco may go for group listing
<u>Stock options (announced and potential)</u>											
600854	Js Chunlan	春兰股份	Potential	0.3	16.7	25.3	14.2	55.3	NM	NM	Famous air conditioner brand. Share price depressed by loss warnings. The company may introduce stock options.
000488	Chenming Paper	晨鸣纸业	Announced	1.3	52.3	84.3	68.7	17.2	13.9	11.8	Stock options introduced
600019	Baoshan Steel	宝钢股份	Announced	21.5	19.5	129.5	151.8	15.9	14.3	12.0	Stock options introduced. To inject Pugang Luojing Project with the following products: Medium plate, capacity 3mn tons/year (compared to 22mn-ton current capacity). Project to be completed in 2008.
600572	Conba	康恩贝	Announced	0.2	28.1	33.0	24.9	26.3	17.8	15.7	Stock options introduced. Asset injection potential.
600183	Shengyi Tech	生益科技	Announced	1.3	34.3	53.5	46.4	22.1	19.5	16.6	
000651	Gree Electric	格力电器	Announced	1.8	51.3	117.7	108.8	24.9	21.3	17.7	Famous air-conditioner brand.
000527	Midea Electric	美的电器	Announced	1.5	64.1	107.4	108.2	26.5	22.8	19.7	Famous air-conditioner brand.
<u>Mid-cap rising industry stars and/or niche players</u>											
600583	Offshore Oil	海油工程		4.0	15.3	66.1	80.4	45.6	37.4	29.9	
600439	Rebecca	瑞贝卡		0.5	48.3	74.9	99.3	44.3	35.0	26.7	
600415	Commo City	小商品城		1.3	6.1	33.8	42.8	36.4	31.3	24.5	
600820	Sh Tunnel Eng	隧道股份		0.6	63.7	91.3	91.8	37.1	27.2	21.4	
000792	Qinghai Potash	盐湖钾肥		2.9	29.0	52.3	61.1	31.7	25.6	20.7	
<u>Upward earnings revisions</u>											
000932	Valin Tube	华菱管线		1.4	28.4	47.6	49.2	15.6	12.8	10.6	
600028	Sinopec Corp	中国石化		108.0	8.4	61.6	116.9	17.5	14.6	12.2	
000822	Sd Haihua	山东海化		0.5	28.7	47.6	40.3	13.6	11.0	9.5	

Source: Wind, Consensus estimates, Company data

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Table 6: Consensus earnings revisions in January 2007

Ticker	Name	Name In Chinese	EPS revision		Ticker	Name	Name In Chinese	EPS revision	
			1 month	4 months				1 month	4 months
600059	Guyuelongshan	古越龙山	12.0%	-5.8%	601699	Lu'an	潞安环能	-0.5%	7.2%
600570	Handsome	恒生电子	11.4%	63.1%	000726	Luthai Textile	鲁泰 A	-0.5%	-0.9%
000932	Valin Tube	华菱管线	9.1%	20.0%	600825	Sh Xinhua Media	新华传媒	-0.5%	-41.0%
600022	Jinan Iron	济南钢铁	8.3%	54.7%	600362	Jiangxi Copper	江西铜业	-0.6%	25.7%
000527	Midea Electric	美的电器	5.6%	9.7%	600323	Nanhai Develop	南海发展	-0.6%	-3.0%
600420	Modern Pharm	现代制药	4.5%	-17.9%	600196	Fosun Pharm	复星医药	-0.6%	2.0%
600036	Merchants Bank	招商银行	3.9%	-7.0%	000541	Foshan Light	佛山照明	-0.8%	-5.9%
600522	Zhongtian Tech	中天科技	3.5%	24.9%	000039	Intl Container	中集集团	-0.8%	-3.5%
600391	Chengfa Tech	成发科技	3.2%	3.8%	600795	Gd Power	国电电力	-0.8%	-1.6%
600690	Qingdao Haier	青岛海尔	3.2%	14.0%	600686	King Long Moto	金龙汽车	-0.8%	-2.4%
600001	Handan Steel	邯郸钢铁	3.1%	26.9%	600467	Homey Aquatic	好当家	-0.9%	-45.5%
600188	Yanzhou Coal	兖州煤业	2.9%	-6.9%	600236	Guiguan Elec	桂冠电力	-1.1%	-3.1%
000919	Jinling Pharm	金陵药业	2.9%	2.9%	000550	Jiangling Moto	江铃汽车	-1.1%	3.2%
600801	Huaxin	华新水泥	2.5%	8.3%	600312	Pinggao Elec	平高电气	-1.1%	0.0%
000709	Tangshan Steel	唐钢股份	2.5%	21.2%	002004	Huapont Pharm	华邦制药	-1.2%	-8.2%
000792	Qinghai Potash	盐湖钾肥	2.4%	4.3%	000969	Advanced	安泰科技	-1.3%	-33.4%
002028	Siyuan Electric	思源电气	2.3%	1.4%	600015	Hua Xia Bank	华夏银行	-1.3%	-2.6%
600006	Dongfeng Auto	东风汽车	2.3%	-2.2%	000731	Sc Meifeng	S 川美丰	-1.4%	4.8%
600636	Shanghai 3F	三爱富	2.3%	-0.2%	600761	Heli	安徽合力	-1.5%	8.1%
600000	Pudong Dev	浦发银行	2.2%	-6.3%	600436	Pientzehuang	片仔癀	-1.5%	-3.0%
600005	Wuhan Steel	武钢股份	2.1%	15.0%	600423	Liuzhou Chem	柳化股份	-1.5%	-7.1%
000001	Sz Dev Ban	S 深发展 A	2.1%	93.4%	002010	Zj Transfar	传化股份	-1.6%	0.5%
600718	Sy Neusoft	东软股份	2.1%	5.6%	600806	Jiaoda Hi-Tech	S 交科技	-1.6%	-1.6%
002097	Sunward Intelligent Machinery	山河智能	2.1%	600087	Water Transpor	南京水运	-1.7%	-1.3%	
600007	Cn World Trad	中国国贸	2.0%	-19.5%	600479	Qianjin	千金药业	-1.8%	-1.8%
000002	Vanke	万科 A	2.0%	-3.4%	600550	Tianwei	天威保变	-1.8%	1.7%
600104	Shanghai Auto	上海汽车	1.9%	-47.4%	600232	Golden Eagle	金鹰股份	-1.9%	-11.6%
600797	Insigma	浙大网新	1.8%	2.6%	000911	Nanning Sugar	南宁糖业	-2.1%	-0.9%
600219	Nanshan Indust	南山铝业	1.8%	7.3%	000930	Bbca	丰原生化	-2.2%	-12.2%
600030	Citic	中信证券	1.7%	18.1%	000021	Shenzhen Kaifa	长城开发	-2.2%	-8.7%
600685	Guangzhou Ship	广船国际	1.7%	46.3%	600485	Zhongchuang	中创信测	-2.4%	-28.4%
000549	Torch Automobile	S 湘火炬	1.5%	-1.5%	600536	China Software	中国软件	-2.5%	-4.9%
000612	Wanfang Alum	焦作万方	1.5%	3.3%	000778	Ductile Pipes	新兴铸管	-2.5%	-34.3%
600508	Sh Energy	上海能源	1.5%	1.5%	600078	Chengxing Chem	澄星股份	-2.6%	-8.5%
002056	Dmegc Magnetics	横店东磁	1.5%	5.0%	000876	New Hope Agri	新希望	-2.8%	2.5%
600269	Ganyue Express	赣粤高速	1.4%	-22.3%	002008	Han'S Laser Tech	大族激光	-2.9%	-1.8%
600332	Guangzhou Phar	广州药业	1.4%	-5.1%	601628	China Life	中国人寿	-3.0%	
000759	Wuhan Center	武汉中百	1.4%	5.8%	002031	Greatoo Molds	巨轮股份	-3.0%	-5.4%
000608	Shine	阳光股份	1.3%	0.0%	600639	Jinqiao	浦东金桥	-3.3%	0.0%
600357	Chengde Xinxin	承德钒钛	1.3%	2.9%	000568	Lao Jiao	泸州老窖	-3.7%	3.2%
600518	Kangmei	康美药业	1.3%	8.7%	000410	Shenyang Mach	沈阳机床	-3.7%	-7.6%
600195	China Animal	中牧股份	1.3%	24.4%	600888	Xinjiang Joinw	新疆众和	-3.8%	-26.8%
002071	Jiangsu Hongbao	江苏宏宝	1.2%	600418	Jianghuai Auto	江淮汽车	-4.0%	-14.7%	
002078	Shan Dong Sun Paper	太阳纸业	1.2%	600035	Chutian Exp	楚天高速	-4.2%	4.1%	
600511	China National	国药股份	1.2%	13.4%	600881	Jilin Yatai	亚泰集团	-4.3%	13.5%
600900	Yangtze Power	长江电力	1.2%	1.0%	600010	Baotou Steel	包钢股份	-4.4%	-4.4%
600596	Xinan Chemical	新安股份	1.2%	4.7%	000581	Weifu Hi-Tech	威孚高科	-4.6%	-47.8%
600271	Aerospace Info	航天信息	1.1%	7.2%	601333	Guangshen Railway	广深铁路	-5.6%	
600289	Bright Oceans	亿阳信通	1.1%	-12.6%	000063	ZTE	中兴通讯	-6.2%	-16.5%
600584	Changjiang Ele	长电科技	1.1%	10.9%	600582	Tiandi Tech	天地科技	-8.2%	8.0%
600660	Fuyao Glass	福耀玻璃	1.1%	8.4%	600740	Shanxi Coking	山西焦化	-10.3%	-10.3%
600993	Mayinglong	马应龙	1.1%	1.1%	600138	Cyts Tours	中青旅	-16.4%	-13.6%
600050	Unicom	中国联通	1.1%	4.8%	000831	Guanlu	关铝股份	-23.3%	-47.4%
600089	Teba	特变电工	1.1%	10.5%	000662	Softto	索芙特	-25.0%	-26.1%
002080	Sinoma Science & Tech	中材科技	1.0%	600601	Yanzhong Ind	方正科技	-25.5%	-26.3%	
600642	Shenergy	申能股份	0.9%	3.6%	600688	Sh Pechem	S 上石化	-26.6%	-82.3%
600598	Hlj Agriculture	北大荒	0.9%	1.6%	600831	Broadcast & Tv	广电网络	-32.6%	-46.0%
000088	Yantian Port	盐田港	0.8%	1.7%	600386	Beijing Bus	北京巴士	-36.3%	-89.5%

Source: Wind

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Table 7: Consensus earnings forecasts and valuation by sector (sorted by earnings growth)

Sectors #	Market cap US\$ bn	PE		Profit growth			
		2006 (x)	2008 (x)	06E	07E	08E	05-08 CAGR
Electronic equipment, meters	13.3	51	23	Turn +	60%	36%	Turn +
Telecom equipment	11.6	49	27	Turn +	45%	25%	Turn +
Airlines	8.9	NM	24	Loss	Turn +	124%	Turn +
Software	4.7	61	37	659%	31%	25%	132%
Conglomerate	14.6	50	12	65%	49%	171%	88%
Securities	19.2	99	55	271%	49%	20%	88%
Consumer electronics retailers, other retail	8.7	66	33	209%	41%	43%	84%
Building materials	12.3	40	21	201%	43%	33%	79%
Defense	5.5	59	23	61%	75%	44%	59%
Department store / super market	10.9	45	29	133%	22%	29%	54%
Property	45.3	36	18	84%	39%	40%	53%
Casual goods	0.5	49	20	40%	62%	55%	52%
Utilities	1.2	68	21	6%	117%	48%	50%
Auto parts	8.9	32	15	51%	33%	67%	50%
Food	19.1	37	25	121%	26%	19%	49%
Beverage	44.5	67	39	93%	33%	28%	48%
Consumer goods distributors	3.8	42	26	84%	32%	25%	45%
Bio tech	2.8	56	34	62%	35%	23%	39%
Decoration products	3.5	33	15	21%	76%	26%	39%
Chemicals	45.0	34	19	51%	45%	23%	39%
Media	8.1	73	39	36%	44%	31%	37%
Food retailers	10.5	47	29	50%	34%	22%	35%
Hotels, restaurants	8.1	39	23	47%	38%	20%	35%
Household durables	16.0	32	20	50%	33%	21%	34%
Gas	0.9	40	28	65%	16%	25%	34%
Medical equipment	0.4	48	29	43%	36%	22%	33%
Personal care	1.5	42	26	41%	27%	29%	32%
Machinery	40.5	31	20	45%	28%	22%	31%
Textile & garments	13.0	30	19	38%	37%	18%	31%
Commercial banks	74.0	37	23	40%	26%	27%	31%
Commercial services	0.3	44	25	28%	30%	32%	30%
Construction	6.4	36	22	37%	27%	25%	30%
Auto	21.1	31	22	48%	21%	18%	28%
IT services	2.6	42	26	27%	33%	24%	28%
Road transportation	5.2	32	22	37%	23%	22%	27%
Power / grid equipment	16.1	28	20	39%	25%	13%	25%
Pharmaceutical	23.2	38	24	23%	27%	24%	25%
Energy equipment	4.6	42	28	23%	23%	24%	23%
Paper & wood	6.7	21	14	20%	27%	22%	23%
Metals	108.1	16	12	32%	15%	19%	22%
Packaging	1.5	26	20	26%	25%	5%	18%
Infrastructure	60.4	30	24	28%	17%	10%	18%
Power plants	48.6	20	15	19%	17%	17%	17%
Water	5.2	27	23	20%	7%	12%	13%
Telecom	12.8	29	24	17%	15%	6%	12%
PC / peripheral equipment	4.2	35	25	-11%	23%	17%	9%
Shipping	7.9	17	13	-3%	11%	17%	8%
Logistics	1.5	20	18	3%	14%	1%	6%

Source: Wind

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Table 8: Consensus earnings forecasts and valuation by sector (sorted by valuation)

Sectors #	Market cap US\$ bn	PE		Profit growth			
		2006 (x)	2008 (x)	06E	07E	08E	06-08 CAGR
Metals	108.1	16	12	32%	15%	19%	22%
Conglomerate	14.6	50	12	65%	49%	171%	88%
Shipping	7.9	17	13	-3%	11%	17%	8%
Paper & wood	6.7	21	14	20%	27%	22%	23%
Auto parts	8.9	32	15	51%	33%	67%	50%
Power plants	48.6	20	15	19%	17%	17%	17%
Decoration products	3.5	33	15	21%	76%	26%	39%
Logistics	1.5	20	18	3%	14%	1%	6%
Property	45.3	36	18	84%	39%	40%	53%
Textile & garments	13.0	30	19	38%	37%	18%	31%
Chemicals	45.0	34	19	51%	45%	23%	39%
Machinery	40.5	31	20	45%	28%	22%	31%
Casual goods	0.5	49	20	40%	62%	55%	52%
Power / grid equipment	16.1	28	20	39%	25%	13%	25%
Household durables	16.0	32	20	50%	33%	21%	34%
Packaging	1.5	26	20	26%	25%	5%	18%
Building materials	12.3	40	21	201%	43%	33%	79%
Utilities	1.2	68	21	6%	117%	48%	50%
Road transportation	5.2	32	22	37%	23%	22%	27%
Auto	21.1	31	22	48%	21%	18%	28%
Construction	6.4	36	22	37%	27%	25%	30%
Water	5.2	27	23	20%	7%	12%	13%
Hotels, restaurants	8.1	39	23	47%	38%	20%	35%
Commercial banks	74.0	37	23	40%	26%	27%	31%
Electronic equipment, meters	13.3	51	23	Turn +	60%	36%	Turn +
Defense	5.5	59	23	61%	75%	44%	59%
Infrastructure	60.4	30	24	28%	17%	10%	18%
Airlines	8.9	NM	24	Loss	Turn +	124%	Turn +
Telecom	12.8	29	24	17%	15%	6%	12%
Pharmaceutical	23.2	38	24	23%	27%	24%	25%
PC / peripheral equipment	4.2	35	25	-11%	23%	17%	9%
Food	19.1	37	25	121%	26%	19%	49%
Commercial services	0.3	44	25	28%	30%	32%	30%
IT services	2.6	42	26	27%	33%	24%	28%
Consumer goods distributors	3.8	42	26	84%	32%	25%	45%
Personal care	1.5	42	26	41%	27%	29%	32%
Telecom equipment	11.6	49	27	Turn +	45%	25%	Turn +
Energy equipment	4.6	42	28	23%	23%	24%	23%
Gas	0.9	40	28	65%	16%	25%	34%
Department store / super market	10.9	45	29	133%	22%	29%	54%
Food retailers	10.5	47	29	50%	34%	22%	35%
Medical equipment	0.4	48	29	43%	36%	22%	33%
Consumer electronics retailers, other retail	8.7	66	33	209%	41%	43%	84%
Bio tech	2.8	56	34	62%	35%	23%	39%
Software	4.7	61	37	659%	31%	25%	132%
Media	8.1	73	39	36%	44%	31%	37%
Beverage	44.5	67	39	93%	33%	28%	48%
Securities	19.2	99	55	271%	49%	20%	88%

Source: Wind

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Table 9: Sector performance since the beginning of 2006

Sectors	Performance			PE 2008 (x)	Profit growth 06-08 CAGR
	YTD 1 st Sep, 2006 to date (%)	1 st Jan, 2006 to date (%)	1 st Jan, 2006 to date (%)		
Logistics	25	30	54	18	6%
Packaging	33	56	68	20	18%
Medical equipment	35	46	79	29	33%
Water	14	34	82	23	13%
Casual goods	25	43	87	20	52%
Decoration products	24	48	88	15	39%
Gas	41	48	90	28	34%
Power plants	23	61	92	15	17%
Paper & wood	22	50	94	14	23%
Commercial services	21	8	98	25	30%
PC / peripheral equipment	40	48	98	25	9%
Telecom equipment	16	46	99	27	Turn +
Telecom	-3	96	101	24	12%
IT services	25	31	102	26	28%
Electronic equipment, meters	31	38	111	23	Turn +
Pharmaceutical	30	51	111	24	25%
Textile & garments	28	47	111	19	31%
Food	18	43	119	25	49%
Food retailers	35	55	122	29	35%
Utilities	35	41	123	21	50%
Airlines	36	118	131	24	Turn +
Hotels, restaurants	8	48	133	23	35%
Infrastructure	25	67	134	24	18%
Household durables	29	64	137	20	34%
Power / grid equipment	26	43	138	20	25%
Chemicals	28	48	145	19	39%
Road transportation	23	59	148	22	27%
Conglomerate	24	39	148	12	88%
Auto parts	20	49	148	15	50%
Department store / super market	29	50	150	29	54%
Bio tech	27	62	164	34	39%
Construction	25	46	165	22	30%
Software	37	70	188	37	132%
Media	26	70	200	39	37%
Building materials	21	80	201	21	79%
Auto	33	77	201	22	28%
Consumer goods distributors	31	61	205	26	45%
Property	15	73	208	18	53%
Defense	31	37	217	23	59%
Metals	28	84	226	12	22%
Consumer electronics retailers, other retail	36	118	233	33	84%
Machinery	24	70	248	20	31%
Commercial banks	14	136	268	23	31%
Energy equipment	16	68	274	28	23%
Personal care	44	75	279	26	32%
Beverage	25	103	327	39	48%
Shipping	32	92	389	13	8%
Securities	45	173	765	55	88%

Source: Wind

Analyst Certification

I, Joan Zheng, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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