

Eye on China

A View from Shanghai

Week of April 7-April 13, 2007

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

CEO

Robert Theleen
Wallace Mathai-Davis

President

Jenny Hsui

Vice Chairman

William Fuller

Managing Director

Richard Wang
Eugene Zhao

Market Weekly

Shanghai Composite Index

- 4/6 Close: **3323.58**
- 4/13 Close: **3518.27**
- Change: ↑ **5.858%**

Shenzhen Composite Index

- 4/6 Close: **9268.23**
- 4/13 Close: **10,019.92**
- Change: ↑ **8.110%**

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- 3) Wahaha Calls Danone's Takeover Plan Hostile; Danone Threatens Legal Action
- 4) Chinese Mining Company Launches HK IPO; Shipbuilder Launches Singapore IPO
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Bottling

1) Private Equity Fund Uses PIPE to Invest in Chinese Bottling Company

Private equity fund *CVC Asia Pacific* recently paid a reported US\$214 million for a 29% stake in Shenzhen-listed *Zhuhai Zhongfu Enterprise Co*, one of China's largest bottling companies. According to the *Asia Venture Capital Journal*, those involved with the transaction said the deal is, "the largest announced PIPE investment by a private equity fund in a PRC-listed company to date." The transaction will still have to gain regulatory approval. CVC Asia Pacific reportedly paid a 20% premium over Zhuhai Zhongfu's share price. Zhuhai Zhongfu is quoted in a recent statement as saying, "Introducing foreign strategic investors can help our company absorb international management skills." The bottling company is located in the southern city of Zhuhai, which is on the mainland just north of Macau. Zhongfu's customers include Coca-Cola and Pepsi.

Consumer Products

2) Johnson & Johnson Acquires Dabao for RMB2.3 Billion

Johnson & Johnson has made a major acquisition in China, buying Chinese cosmetics maker *Dabao* for RMB2.3 billion (approximately US\$300 million). *Dabao*, which focuses on the low- and medium-end markets, has been China's leading seller of skincare products for eight years. The *China Business Post* reported that the Beijing-based firm will maintain its proprietary brand after the acquisition. Interestingly, 41% of *Dabao*'s employees are handicapped.

Food & Beverage

3) Wahaha Calls Danone's Takeover Plan Hostile; Danone Threatens Legal Action

France's Groupe Danone, which holds a 51% stake in a JV with China's largest beverage maker *Wahaha*, plans to pay RMB4 billion (approximately US\$513 million) to gain controlling stakes in *Wahaha*'s direct subsidiaries. The proposed acquisition would give Danone's JV the exclusive right to produce, distribute, and sell products under the *Wahaha* brand name. *Wahaha* rejected the plan, calling the proposal a hostile takeover bid. "The price is undervalued and the contract has almost no obligations for Danone. It is a vicious takeover and Chinese companies need to develop on their own," said *Wahaha* chairman Zong Qinghou. Zong said the subsidiaries have total assets of RMB5.6 billion, and generated RMB1.04 billion in profit in 2006. *Wahaha* has also asked for government assistance to ensure the deal does not go through. Meanwhile, Danone announced that it intends to seek legal action against *Wahaha*, alleging the company had breached the JV contract by selling *Wahaha* brand products outside the JV, thereby violating the non-compete agreement. The French firm said Zong "is using public opinion to serve his interests," and that he has received handsome salary and bonus payments over the last ten years in exchange for agreeing not to compete. Danone added that it prefers to solve the dispute amicably. The JV contributed about 3% of Danone's profits in 2006. Danone also owns stakes in other important Chinese food and beverage companies, including 22% of *Huiyuan*, China's largest juice producer.

Industrial

4) Chinese Miner Launches HK IPO; Shipbuilder Launches Singapore IPO

Molybdenum miner *China Molybdenum* will raise between HK\$5.4 billion and HK\$7.2 billion (about US\$694-934 million) in its Hong Kong IPO, which will close on April 18. Shares will begin trading on April 26. China Moly will use 40% of the proceeds to acquire mines, 20% to expand molybdenum production, and 20% to develop its tungsten production and processing capabilities. The remaining 20% will be used to pay off bank loans and for working capital. Meanwhile, *Yangzijiang Shipbuilding*, a shipbuilder located on the Yangtze River in east China's Jiangsu province, has launched a Singapore IPO, which could raise up to SG\$943.4 million (US\$622 million). Shares are scheduled to start trading on April 18. The company will use SG\$180 million (about US\$119 million) to fund construction and working capital at a new shipyard, with most of the rest earmarked for other corporate finance-related uses. Yangzijiang's said its revenue increased at a rate of 53% per year between 2004 and 2006.

5) Regulators Approve Alstom's Acquisition of Wuhan Boiler

The Ministry of Commerce (MOFCOM) and the State-Owned Assets Supervision and Administration Commission (SASAC) both approved France-based Alstom's acquisition of Chinese boiler manufacturer *Wuhan Boiler*. The deal stipulates that Alstom will pay RMB339 million for a 51% stake. Since China's new M&A regulations went into effect last September, it has become significantly more difficult for foreign investors to acquire majority stakes in Chinese companies. MOFCOM is the most stringent review body. Its job, among others, is to evaluate the potential ramifications of transferring control of Chinese companies to foreigners. Alstom had originally submitted a marginally smaller bid of RMB329 million for the 51% stake last April.

Machinery

6) DMG to Open Two More China Tech Centers

The China Daily reports that German machine tool company DMG will deepen its roots in China by establishing two more technology centers which will be located in China's northeastern cities of Shenyang and Dalian. The company already has three China technology centers. DMG, the world's second-largest machine tool maker, wants China to be its top global market within five years. China is currently its third-largest market, behind Germany and Italy. Board member Thorsten Schmidt said DMG has seen 30-35% growth in China over the past three years. "We expect the figure to be between 35% and 40% in 2007. We occupy only 6-7% of China's machine tool market but hope to double it to 15% within three years," he told China Daily. DMG also opened its China manufacturing base in Shanghai in 2002. In other industry developments, China's largest machine tool manufacturer, Shenyang Machine Tool Group, has put a 49% stake up for sale. Foreign investors will not be allowed to acquire more than 30% of the company.

Electronics

7) Foxconn Starts Building US\$1 Billion Industrial Park in Central China

Taiwan-headquartered Foxconn, the global OEM giant for products like mobile phones, computers, iPods, monitors, and a host of other electronics devices, has begun building a US\$1 billion technology park in Wuhan, in central China's Hubei province. The site will become a major R&D and production base for products such as digital cameras, computers, and monitors. In the fourth quarter of last year, Foxconn also announced plans to build two additional manufacturing sites in China, each involving investment of at least US\$1 billion. Foxconn OEMs for some of the world's major manufacturers. Some of its operations include making cell phones for Motorola, iPods for Apple, computer products for Dell and HP, and video game consoles for Sony.

Information Technology

8) EDS to Open First China Outsourcing Service Center

Global IT outsourcing leader EDS will open its first IT outsourcing service center in China, located in the city of Wuhan. The center will be the fourth of its kind—the first three are located in India, South America, and Eastern Europe—and will provide outsourcing services to EDS's customers around the world. The new Wuhan center will hire 700 employees in 2007, and is projected to grow to 3,000 employees within three years, according to Derek Sharp, vice president of EDS Asia. EDS currently has two representative offices in China, but a company representative said that the offices mainly serve as receivers of orders rather than as service centers. China's burgeoning software outsourcing industry grew to US\$1.43 billion last year, a 55.4% increase over 2005.

Internet

9) Electronic Arts to Purchase Stake in The9

American video game producer EA is expected to sign an agreement to purchase a 19.9% stake in Chinese online game distributor *The9* for about US\$200 million. EA said no deal has yet been signed, but the two firms are apparently working on an agreement. It has been reported that as part of a deal, *The9* would likely operate the online version of EA's popular FIFA soccer game in China. *The9* currently focuses on distributing multiplayer operation role-playing games (MMORPG) in China. Last year it acquired the rights to distribute such titles as "Guild Wars," "SUN," and "Hellgate: London." However, over 99% of *The9*'s turnover is from one game, "World of Warcraft," which it licensed from Blizzard (Now Vivendi) in 2005. Both EA and *The9* are listed on the Nasdaq. EA's market cap stands at more than US\$16.5 billion, while *The9*'s is almost US\$1 billion.

Software

10) Oracle to Open Xi'an Branch

Oracle will open a branch in the northwest Chinese city of Xi'an in an attempt to increase its presence in the growing western China market. The branch will be Oracle's fifth in China. Yan Xuan, vice president of Beijing Oracle Systems, said the company will work with local partners to develop IT products and solutions, as well as give college students internships and training opportunities. He added that Oracle also wants to open further branches in Shenyang, Nanjing, and Jinan. On the training/educational front, Oracle also just signed an MOU with China's Ministry of Education, pledging to invest more than US\$200 million over the next five years to help schools and universities in China.

Telecommunications

11) Chinese Telecom Equipment Firms Win Contracts to Build First 3G Network

Chinese companies have won the vast majority of contracts to build China's first 3G network, which is based on the homegrown TD-SCDMA standard. China Mobile is reported to have awarded about 47% of the total value of the contracts to Shenzhen-based *ZTE*, about 35% to *Datang Mobile*, and about 13% to *TD-Tech*, a JV between Nokia Siemens Network and Chinese firm *Huawei Technologies*. The total value of the contract is about RMB26.7 billion (approximately US\$3.4 billion). Eight companies took part in the bidding, which also included Alcatel Shanghai Bell, Ericsson, and *Potevio*, a Chinese firm which is also reported to be winning a small percentage of the bids. The initial TD-SCDMA-based network will be built in eight cities. ZTE is expected to build the network in Beijing, Datang is expected to take care of the construction in Shanghai and Guangzhou, and TD Tech will focus on Shenzhen and Xiamen. According to China Mobile, the TD-SCDMA testing network is expected to begin operating by the end of October. The government has placed high priority on offering 3G services to customers by the time the 2008 Olympic Games begin.

Banking

12) CITIC Narrows Indicative Price Range for Dual Listing

China CITIC Bank, the mainland's seventh-largest lender, has narrowed the indicative price range for its upcoming dual listing in Shanghai and Hong Kong. The bank will sell 4.885 billion H-shares at HK\$5.06-5.86, which was narrowed from the previous range of HK\$4.72-6.17. CITIC Bank will also offer 2.3019 billion A-shares in Shanghai, pricing each share at HK\$5.00-5.80, narrowed from HK\$4.66-6.10. The dual listing could raise as much as HK\$42 billion. HK\$1.6 billion worth of H-shares have already been sold to institutional investors. Shares will begin trading on both exchanges on April 27, and the IPO will be the world's largest so far this year.

Insurance

13) China Union Life Considering Sale of Additional 5% Stake after Stake Sale to Eurizon

China Union Life, the country's 10th-largest life insurer, is considering selling an additional 5% stake to foreign investors. The Wuhan-based insurer recently sold a 19.9% stake to Eurizon Financial Group, an asset management and insurance subsidiary of Italian banking group Banco Intesa. Eurizon purchased the stake for about €90 million, gaining two seats on the board and making it the second-largest shareholder in Union Life. Chinese insurance companies are limited to 25% foreign ownership, with no single foreign investor holding more than a 20% stake. "The introduction of foreign investors can not only strengthen our management and solvency, but also enhance our capabilities in product development and risk management," said Dai Hao, the chairman of China Union Life. The Chinese insurer also wants buy into China's banking sector. "To be a financial holding group is our target," said Dai. "And we would like to do it before 2010." The company is not sure whether it will sell the remaining 5% to a banking or insurance group (Note: some sources have erroneously reported that the Eurizon deal was worth €800 million, as opposed to €90 million).

Other Financial

14) Private Equity Firm Permira Plans to Set up in Greater China

European private equity firm *Permira* said it plans to open an office in Shanghai or Hong Kong to prepare to make direct investments in China. Chairman Paolo Colonna told the Shanghai Securities News that Permira wants to invest in merchandise distribution for China's large- and medium-sized enterprises. Colonna also said that Permira generally acquires majority stakes in companies in Europe, and intends to do the same in China, without being overly meddlesome in operations. The private equity firm claims to have raised 19 funds since 1985, totaling about €22 billion.

Ports

15) Ningbo Port Group May Revisit Plan for US\$500 Million IPO

The South China Morning Post reports that *Ningbo Port Group* is reviving a plan for a US\$500 million IPO, which was originally abandoned in 2005 when the group couldn't come to an agreement with underwriters on a valuation. The original plan was to list in Hong Kong, but now the port operator is undecided on whether to list in Hong Kong or Shanghai. Ningbo is China's fourth-largest port as measured by container throughput, and is located just across the Hangzhou Bay to the south of Shanghai. However, Ningbo Port may have to fight for investor funds, as other top 50 ports in China also plan to list this year. South China's *Guangzhou Port Group* is planning a US\$750 million IPO and northeast China's *Qingdao Port Group* is planning a US\$500 million offering.

Real Estate

16) Commercial Developer Soho China to Raise HK\$4 Billion in Hong Kong Listing

Beijing-based commercial property developer *Soho China Ltd* is planning a US\$4 billion Hong Kong IPO. Initial plans set the trading date for some time in June. Currently, Soho is developing a 470,000 square meter project in Beijing that will include five shopping malls and nine commercial and apartment buildings. Separately, Guangdong-province based property developer Country Garden just completed its own successful Hong Kong IPO, raising HK\$12.9 billion in a record offering for a China-based real estate developer.

17) Morgan Stanley to Acquire RMB1 Billion Stake in Shimao Property's Wuhan Project

Morgan Stanley will spend RMB1 billion to acquire a 29.99% stake in *Modern Way Holdings*, a unit of Hong Kong-listed property giant *Shimao Property Holdings*. Modern Way owns a major 1.82 million square meter property project in Wuhan, which includes a five-star hotel in addition to residential, office, and retail space.

18) Shanghai's Real Estate Market Continues to Grow

The office and industrial sectors led Shanghai's commercial real estate market into record territory in the first quarter. Prices for office space were up 0.7%, while the vacancy rate stayed below 5%. Anthony Couse, managing director for Jones Lang LaSalle (Shanghai), told China Daily that office rent is expected to continue to rise leading up to World Expo 2010. The industrial sector posted even stronger growth, with rents up 11% this quarter. The top renters of industrial property were retailers, logistics companies, and automotive companies, with the highest surge in rent prices recorded at bonded logistics facilities. The retail sector also saw falling vacancy rates and rising rents. In the residential sector, sales of high-end apartments fell while rental activity increased. Jones Lang LaSalle reported that in 2006, direct real estate investment in China reached US\$9.91 billion, a 70% increase over 2005.

Retail

19) McDonald's and KFC Setting up more Unions in China, Cleared of Labor Violations

McDonald's and KFC were cleared of allegations that they broke labor laws in south China's Guangdong province. Widespread reports said that the fast food restaurants paid part-time workers up to 40% less than minimum wage. However, the companies were cleared of any wrongdoing as an investigation revealed that the lower wages were only paid to students, which according to Chinese laws, are not part of the workforce and thus are not required to sign labor contracts. The allegations did put McDonald's and KFC on the defensive regarding their union policies in China, especially as the All-China Federation of Trade Unions (ACFTU) pressured the fast food restaurants to set up unions in Guangdong. McDonald's China spokesman George Gu said, "We have been negotiating with local labor authorities in Guangdong province since last November on setting up trade unions in our subsidiaries there." He also said unions already existed in other places like Beijing, Shanghai, and Jiangsu province. Yum! Brands, which owns KFC and Pizza Hut, also said that most of its China subsidiaries had joined the ACFTU. It released a statement saying, "The remaining [subsidiaries] will handle the issue according to Chinese regulations." In the wake of the incident, students in China are being urged to insist on signing labor contracts with employers to protect their rights.

Macro

US Files Two WTO Complaints Against China

The United States filed two new complaints to the WTO over copyright piracy and restrictions on the sale of American books, music, and films. "China has taken numerous steps to improve its protection and enforcement of intellectual property rights, [but] we have not been able to agree on several important changes to China's legal regime that we believe are required by China's WTO commitments," said US Trade Representative Susan Schwab. WTO rules state that the two sides have 60 days to consult and settle the issue. If not solution is reached, a WTO panel would judge the case. The US did indicate its intention to solve the issue through consultations. "Achieving comprehensive IPR protection requires concerted efforts on many fronts," Schwab added. China Ministry of Commerce (MOFCOM) spokesman Wang Xinpei stressed that China has shown a significant effort to improve IPR protection, and pointed out that solid progress has already been made. He also said he believed the conflict could be solved through consultations. A big factor in the United States' increased willingness to take action to solve trade qualms with China is the trade deficit. The US just imposed antidumping tariffs on glossy paper from China, claiming that Chinese paper companies are receiving subsidies from the government. That said, the trade deficit did fall from US\$12.3 billion in February to US\$9.5 billion in March. Wang said the decrease was due in part to the government cutting or eliminating export rebates on certain products, but it could have also been affected by the long Chinese New Year holiday.

Nasdaq to Create China Index

Nasdaq announced that it will create a new large-cap China index, which will consist of Chinese companies trading on the Nasdaq, NYSE, and AMEX. "It will be a key benchmark to track the performance of innovative companies that have stimulated China's rapidly growing economy," Nasdaq President and CEO Bob Greifeld said. The index will include stocks with market caps above US\$200 million, and seems readymade for an exchange-traded fund (ETF). The most similar index is the Halter US China Index, which consists of about 60 Chinese companies listed in the US. The US\$360 million PowerShares Golden Dragon Halter USX China Portfolio ETF is based on that index. Nasdaq's index will supposedly be different from any indices tracking Chinese companies listed on the Hong Kong Stock Exchange, as a higher percentage of the Chinese companies listed on US exchanges are technology companies.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
Johnson & Johnson	US-based producer of personal care products	Dabao	leading Chinese cosmetics company	RMB 2.3 Bil	controlling stake
Morgan Stanley	US-based investment bank and financial services group	Modern Way Holdings	Shimao Property Holdings' unit for a major development project in Wuhan	RMB 1 Bil	controlling stake
Electronic Arts	US-based video game software company	The9	Chinese online game operator	US\$200 Mil	19.9% stake
Fraport	Operator of Frankfurt airport	Xi'an Airport	airport in northwest Chinese city of Xi'an	€50 Mil	25% stake
Tree Island	British Columbia-based manufacturer of wire products	Baoan International Investment and United Metal New Material	wire products businesses that are majority-owned by China Baoan Group	US\$18.5 Mil	controlling stake
Oceanbase Group	unit of HK-listed Waison Meters; Waison produces electronic power meters and data collection terminals	Sinowise industries	Chinese producer of electronic power meters	up to RMB 210 Mil	100% stake
ABN AMRO	Netherlands-based bank	Huishan Bank	Bank in China's Anhui province	N/A	minority stake (by Chinese law, can't be more than 19.99%)

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
Soho China	Beijing-based commercial property developer	Hong Kong	HK\$4 Bil	Goldman Sachs and HSBC
Ningbo Port Group	Operator of port of Ningbo in Zhejiang province	Hong Kong or Shanghai	US\$500 Mil	N/A
Everbright Bank	China's eighth-largest bank	Hong Kong	US\$2-3 Bil (rumored)	N/A