

Eye on China

A View from Shanghai

Week of April 21-April 27, 2007

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

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Market Weekly

Shanghai Composite Index

- 4/20 Close: **3,584.20**
- 4/27 Close: **3,759.87**
- Change: ↑ **4.901%**

Shenzhen Composite Index

- 4/20 Close: **10,258.64**
- 4/27 Close: **10,688.55**
- Change: ↑ **4.191%**

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Aircraft

1) Airbus Takes Majority Stake in Aircraft Assembly JV

Airbus gained approval to hold a majority stake in its JV aircraft assembly plant located in China's northern city of Tianjin. The European aircraft manufacturer will control 51% of the JV with newly-formed *Tianjin Zhongtian Aviation Industry Investment Co.* The facility will be Airbus' first outside of Europe, and the current plan is to begin operating in 2009. By 2011, the plant expects to assemble four Airbus A320 airplanes per month. *China Aviation Industry Co. II (AVIC II)*, the Chinese state-owned aircraft manufacturer, will provide the majority of the capital for Zhongtian. Airbus insisted on a majority stake since signing the JV plant agreement last October.

Automobiles

2) Domestic Car Brands Jump into Sales Lead

In February, China's local car brands surpassed Japanese brands in mainland sales by taking a 29.1% market share. Japanese brands now have 28.3% of the market, while European and American brands have smaller percentages. Most foreign autos sold in China are made at local Sino-foreign joint ventures. Increased competition, especially from domestic brands, has driven prices down by roughly 5% in the first quarter. The top-selling Chinese brand on the mainland was *Chery*, which was No. 3 overall (Shanghai GM is No. 1 and Shanghai Volkswagen is No. 2). Chery is also China's largest car exporter, selling about 50,000 vehicles outside of China last year, a number that is expected to rise to 70,000 this year. The WSJ quoted Yin Tongyao, Chery's chairman, as saying, "There's no timetable for the U.S. market. But it is very attractive." China's overall car exports in 2006 topped 100,000, tripling last year's figure, with Russia as the leading export market. Currently, China is the world's third-largest auto manufacturing nation and the world's second-largest auto market. Separately, rumors persist that Chery is interested in acquiring ailing U.S. automaker Chrysler.

3) Toyota, Nissan Aim for Growth in China

Japanese automaker Toyota said it wants to increase its sales in China to more than 400,000 units in 2007, representing a 30% increase over last year's sales. Toyota currently has a 4% market share in China, but would like to increase that to 10% by 2010. As a signal of the company's seriousness, it showcased 31 models at this week's Shanghai Auto Show. Toyota also just opened its second engine factory with major Chinese automaker *FAW*, its Sino-foreign JV partner. The US\$270 million factory is located in the northern Chinese city of Tianjin, and will produce 220,000 engines a year. Meanwhile, Nissan's Chinese JV, *Dongfeng Nissan*, said it want to increase sales to 300,000 in 2007 after selling 200,000 vehicles in 2006.

Food & Beverage

4) Anheuser Busch Further Expanding China Presence

Anheuser Busch's two operations—Budweiser and Harbin Beer—saw solid growth during the first quarter in China, with volume and profits increasing in the "high single-digits," according to CFO W. Randolph Baker. Profits seemed robust despite costs associated with introducing the two brands into some new Chinese markets. Brewers like Anheuser Busch are pushing their premium brands into new cities, selling to more eager consumers in the world's largest beer market, which is growing at 15% a year. Earlier this month, Anheuser-Busch announced the construction of a new brewery in the Guangdong province city of Foshan to support the growth of their premium brands in China. Once construction is complete in 2008, AB will own and operate 15 breweries in China. In the first quarter, Anheuser Busch also began distributing Corona beer in China.

Metals

5) China Molybdenum Soars on Stock Debut

China Molybdenum listed its shares in Hong Kong on Thursday, April 26. They closed at HK\$10.84, 66% above the IPO price. The offering raised HK\$7.37 billion. China Molybdenum's listing is one of the most well received Hong Kong IPOs so far this year. The offering had been characterized by high demand throughout the road show, receiving HK\$296 billion in subscriptions, more than twice as much as China CITIC Bank's IPO. The two largest uses of molybdenum are stainless steels and alloy steels (i.e. tool steels, for things like bearings, dies and machining components). Major producing countries are China, Chile, and the United States.

6) Chinese SOEs Make Massive Middle Eastern Aluminum Investment

Two Chinese state-owned companies will invest in a US\$4 billion aluminum production facility in Saudi Arabia next to the Red Sea. *China National Machinery Industry Corp* (Sinomach) and *China National Machinery Industry Corp* (NFC) will invest with Saudi firm Western Way for Industrial Development (WWIDC). This is the biggest Chinese investment in the Middle East to date. "What we have fits very well with what China is looking for," said Amr Al-Dabbagh, governor of the Saudi Arabian General Investment Authority. "We have cheap energy and we have a strategic location."

Pharmaceuticals

7) Chinese Pharmaceutical Firm Lists on NYSE

Shares of Chinese firm *Simcere Pharmaceutical Group* began trading on Friday, April 20 on the New York Stock Exchange. A week later (on 4/27), shares closed at \$16.20, 11.7% above the IPO price of US\$14.50. The offering raised US\$226.5 million. Simcere manufactures and sells generic medicines in China. It will use the IPO proceeds for R&D, expansion, and loan repayment. In 2006, the company had revenues of US\$121.4 and earnings of US\$22.1 million.

Diversified

8) Bay Area Council Creating Yangtze Delta Tech Fund

The Bay Area Council, a San Francisco Bay Area business association, is setting up a venture capital fund to invest in technology companies in the Yangtze River Delta region. The fund will invest in environmental protection technology, IT, biotech, and logistics. LP investors have reportedly already committed more than US\$250 million to the fund. The Yangtze River Delta, which includes Shanghai and other cities like Nanjing and Hangzhou, has less than 6% of China's population but accounts for 20% of GDP.

Electronics

9) Lenovo Shares Rise on Rumor of China Listing

The South China Morning Post reported that regulators may soon approve plans by Lenovo, China Mobile, CNOOC, and China Netcom to offer A-shares in China. The companies are not currently permitted to list in China, since they are actually red-chip companies that are incorporated outside of the country. Lenovo's shares on the Hong Kong exchange jumped 5.1% on April 23 in response to the news. The first three IPOs are expected to raise between US\$1 billion and US\$2 billion.

Semiconductor

10) SMIC Reports Q1 Profit

China's *Semiconductor Manufacturing International Corp (SMIC)* reported a first quarter net profit of US\$8.8 million, compared with a loss of US\$9.6 million during the same period in 2006. The company attributed the profit to improved sales, gross margins, and management fees from certain projects. SMIC's revenue reached US\$383.3 million, up 11% from a year ago. The company aims to turn a profit for the first time in 2007, as it lost US\$44.1 million last year. The Shanghai-based integrated circuit foundry company was created in 2000, and is the largest mainland-based semiconductor producer. SMIC is listed on the NYSE and in Hong Kong. It has a stock market valuation of about US\$2.7 billion.

Telecommunications

11) China Mobile's Profit Up 22% in Q1

China Mobile posted profits of RMB17.56 billion in the first quarter, an increase of 22% from the same period a year ago. Revenue was also up roughly 20%, as China Mobile added close to 15 million subscribers in the first quarter. These 15 million subscribers, when added to the 14 million new subscribers in the fourth quarter of 2006, exceed the population of New York, New Jersey, and Delaware combined. The world's largest mobile operator now boasts a total subscriber base of 316 million (as of the end of Q1). Separately, in "Millward Brown's global brand rankings," China Mobile placed fifth, behind Google, General Electric, Microsoft, and Coca Cola.

Air Travel

12) Grand China Airlines Planning US\$2 Billion Hong Kong IPO

Hainan Island-based Grand China Airlines plans to raise up to US\$2 billion in a Hong Kong stock listing later this year. The airline, which is China's fourth-largest, was formed by merging Hainan Airlines with three other carriers. Hainan Island, located in southern China, is a major beach vacation destination. It is sometimes compared to Hawaii in terms of climate and geography.

Banking

13) CITIC Shares Rise on Debut, Soar in Shanghai

Shares of China CITIC Bank, the mainland's seventh-largest commercial bank, began trading on April 27 in a Hong Kong/Shanghai dual listing. On the Hong Kong Stock Exchange, shares closed on their first day of trading at HK\$6.68, up 14% over the HK\$5.86 IPO price. However, shares in Shanghai closed at RMB11.37, a jump of 96% from the IPO price of RMB5.80. Part of the reason for the disparity is that the number of shares floated in Hong Kong was more than double that in Shanghai. However, this offering serves as another indicator of the excess liquidity, caused by capital controls, in the Chinese domestic stock markets. The bottom line is that Chinese nationals have few other outlets in which to invest their money. They cannot invest overseas. CITIC Bank raised a total of US\$5.4 billion in the offering, about US\$1.7 billion of which was raised in the Shanghai market. The Shanghai portion of the listing received a record US\$181 billion in subscriptions. The offering was 105x oversubscribed. The H-share portion received about US\$38 billion subscriptions. It was about 10x oversubscribed. It is still impossible to arbitrage the shares from one market to the other.

14) Breakthrough for Foreign Banks

Four foreign banks finally began offering yuan-denominated services to Chinese customers this week. This represents a major milestone—the final step in the long-awaited opening of China's banking sector to foreign players as mandated by WTO commitments. The four banks are Citigroup, HSBC, Standard Chartered, and HK-based Bank of East Asia. The banks are initially tailoring their services for wealthy customers, as their branch networks are still too limited to compete in the markets for small deposits and loans. Some of these banks have been in China for decades, but the government restricted the services foreign banks could offer. Although regulators have, over time, permitted foreign banks to offer increased services to Chinese customers, it wasn't until this week that things changed substantially. By offering commercial banking services in yuan, foreign banks can now tap into China's estimated US\$2-4 trillion in household savings. In order to offer yuan-denominated deposits and loans, foreign banks must receive regulatory approval and set up locally incorporated subsidiaries (as opposed to just branches). More foreign banks are expected to offer local currency services in the near future.

Insurance

15) China Life Negotiating Acquisition of Stake in Trust Company

China's largest life insurer, *China Life*, is negotiating the purchase of a stake in *China Credit Trust Co*, one of China's leading trust companies with about RMB1.2 billion in capital. Shanghai Securities News reported that China Life Insurance Co or its parent, China Life Group, could pay RMB1.4-1.6 billion for a majority stake in China Credit Trust. The deal would push China Life in the direction of a financial holding company. Trust companies often have subsidiary businesses in securities, fund management, and futures. Insurance companies and other financial institutions in China are attempting to become financial holding companies serving as one-stop shops for a wide range of financial services. China Life Insurance is listed on the NYSE, Hong Kong Stock Exchange, and Shanghai Stock Exchange. The insurer's market cap is approaching US\$32 billion.

Media

16) Tokyo Stock Exchange Gets First Chinese Listing

Beijing-based Asia Media, which provides TV guide listings, became the first mainland-based company to list in Tokyo. On April 27, the company's shares began trading on the Tokyo Exchange's "Mother Market" for startups. The offering raised about US\$25.3 million, which the company will use to expand operations in China and possibly into Japan. Asia Media became the 26th foreign company listed in Tokyo, a far cry from the 100 foreign companies the TSE boasted in 1991. The exchange is actively courting Chinese firms, as it sees these companies as its best hope to reassert its global status. "We hope to increase the number of Chinese firms listed into the double-digits by 2009," said a TSE official. However, with competition from domestic markets and other overseas exchanges, such a task may prove difficult to achieve.

Other Financial

17) CITIC's Private Equity Arm Closes First China Investment Fund

CITIC Capital Partners, the private equity arm of China International Trust & Investment Corp (CITIC), closed its first China buyout fund. The fund raised US\$425 million, exceeding its US\$250 million target. It will invest in state-owned and private firms, focusing on the manufacturing and consumer products sectors. CITIC Capital Partners manages US\$750 million and has two other funds, a Japan fund and a US middle-market fund. The private equity arm's parent, CITIC, is China's largest state-owned investment group which also controls China CITIC Bank.

18) Kleiner Raises US\$360 Million China Fund

American venture capital firm Kleiner Perkins Caufield & Byers raised a US\$360 million China fund. It will be the firm's first fund outside the United States focusing on a variety of growth sectors, including high-tech, wireless communications, and healthcare. The firm hired people with China experience including an individual previously with Softbank Asia Infrastructure Fund and three others who were formerly with TDF Capital, a VC firm in Shanghai. "Our partners' experience in China will be a significant advantage to our U.S. investment perspective and U.S. ventures in this increasingly global market," said Ted Schlein of Kleiner Perkins. The blue chip VC firm made its reputation in the U.S. backing home runs such as Google, Amazon, Sun Microsystems, and Netscape.

Ports

19) Lianyungang Port's A-Shares Sky High on First Day of Trading

Jiangsu Lianyungang Port Group's A-shares began trading on the Shanghai Stock Exchange on Thursday, April 26. Lianyungang Port raised RMB722.16 million by selling 150 million A-shares at RMB4.98 apiece. The shares closed at RMB14.31, a frenzied 187.35% first-day gain. Thursday's closing price represents a PE multiple of 79.5x 2006 diluted earnings. This is yet another example of a domestic stock market gone wild. As mentioned in earlier newsletters, Chinese nationals need more outlets in which to invest their growing wealth. As China's stock markets head toward ever higher valuations, we should brace for a potential correction. Lianyungang is located in the northernmost part of Jiangsu province on China's east coast.

Regulations

CSRC to Issue Licenses to Trade Index Futures

The Financial Times reported that the China Securities Regulatory Commission (CSRC) will issue the first financial futures trading licenses within a month. CSRC will issue licenses to an initial group of 10 brokers. Trading should start on Shanghai's China Financial Futures Exchange (CFFE) in June or July. Stock-index futures will be the first products to trade, and will initially be based on the Shanghai Shenzhen 300 Index. CSRC recently released the new regulations allowing financial futures trading. The scope of financial futures products traded on the CFFE will grow to include futures based on interest rates, exchange rates, etc. With the hedging capabilities provided by financial futures, their development in China is a key part of the maturation of the capital markets. However, China is rolling out financial futures methodically, as it must curtail too much speculative activity, given the already volatile nature of China's developing markets. Financial futures were last traded in China in 1995, when the government shut down the practice due to "risk issues."

Macro

China Surpasses U.S. as Japan's Largest Trading Partner

Japan's trade with China totaled US\$214.8 billion in the first quarter. The figure surpassed Japan's Q1 trade with the United States, which totaled US\$212 billion. According to the Japanese Finance Ministry, this marks the first time China has been Japan's largest trading partner since World War II.

Forty-One First Quarter IPOs Raise US\$14 Billion for Chinese Companies

In the first quarter, 41 Chinese companies listed on public exchanges, raising a total of about US\$14 billion. Of these offerings, 27 listed on domestic exchanges, while 14 listed on overseas exchanges. On the domestic front, the listings of Ping An Insurance, China Life, and Industrial Bank (not to be confused with Industrial & Commercial Bank of China—ICBC) on the Shanghai Stock Exchange accounted for US\$10.8 billion, or about 90% of the domestic proceeds raised. Although 21 of the 27 domestic IPOs were on the Shenzhen Stock Exchange, those 21 only accounted for 7% of the total proceeds raised. As far as Chinese overseas offerings, 7 IPOs listed on the Hong Kong Stock Exchange, 3 listed in Singapore, 3 listed in the United States, and one listed on London's AIM market. In the U.S., JA Solar's IPO on the Nasdaq in February raised about US\$186 million. Its shares are currently trading at an 82% premium to the IPO price. In March, Xinhua Finance Media listed on the Nasdaq, raising US\$300 million. XFM's shares haven't fared as well since the IPO, trading down 20%. And also in March, Tongjitang, a traditional Chinese medicine company, raised about US\$99 million in a NYSE listing. Shares currently trade at, or around the IPO price.

Macro

SASAC Considering SOE Investment Fund

The State-Owned Assets Supervision and Administration Commission (SASAC) may set up a RMB10 billion fund that would be used to restructure state-owned enterprises. China wants its state-owned firms to restructure so they can compete with the increasing number of private and foreign firms. However, some state-owned firms are still struggling to attract the necessary investment. SASAC's plan calls for central government-owned firms to take a 40% stake in the fund, local government-owned companies a 20% stake, foreign investors a 30% stake, and private investors a 10% stake. Buyout and venture capital firms could comprise some of the 30% foreign stake to add management expertise. One SASAC official was also quoted as saying that the fund could grow to RMB70 billion.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
China Life Insurance	China's largest life insurer	China Credit Trust Co	China-based trust company with RMB 1.2 billion in capital	RMB 1.4-1.6 Bil	more than 50%
Heng Tai Consumables	HK-listed, Chinese nationwide distributor of food, beverages, fresh fruit, and other products	Jin Tao Dalian Fresh Produce Logistics Co	operator of fresh produce logistics center in city of Dalian	HK\$156 Mil	80% stake in a JV that will control Jin Tao
Stone Group	HK-based and HK-listed conglomerate, majority of business in electronics manufacturing and media communications	China Cable Media Group	China-based cable TV network operator with profit of RMB 35 million	US\$13.9 Mil	36.12% stake
Softbank Investment International (Strategic)	HK-based and HK-listed venture capital and investment banking firm	Renji Hospital Group	mainland operator of medical facilities, focusing on cancer treatment centers	HK\$641 Mil	100% stake

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
China Yuanbang Property Holdings	Guangdong province-based property developer	Singapore	SGD 60 Mil (approx US\$39.5 Mil)	CIMB-GK Securities (based in Singapore)
Datong Coal	China's second-largest coal producer (measured by output)	Hong Kong	HK\$5.6 Bil	HSBC and others
Grand China Airlines	China's fourth-largest airline	Hong Kong	US\$2 Bil	N/A
CEC Telecom	mobile phone unit of Chinese telecom equipment manufacturer Cosun Group	NYSE	up to US\$217 Mil	UBS, CIBC World Market, Cowen