

Eye on China

A View from Shanghai

Week of June 30-July 6, 2007

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

Senior Management

Robert Theleen
Wallace Mathai-Davis
Jenny Hsui
William Fuller
Eugene Zhao

Editorial Staff

Erik Bethel ebethel@chinavest.com
Patrick Kelly pkelly@chinavest.com.cn

Market Weekly

Shanghai Composite Index

- 6/29 Close: **3,820.70**
- 7/6 Close: **3,781.35**
- Weekly Change: **↓ 1.030%**
- Since 1/1/07: **↑ 41.334%**

Shenzhen Composite Index

- 6/29 Close: **12,546.45**
- 7/6 Close: **12,395.35**
- Weekly Change: **↓ 1.204%**
- Since 1/1/07: **↑ 86.476%**

Exchange Rate

- 6/29: US\$1 = **RMB 7.625**
- 7/6: US\$1 = **RMB 7.608**
- Weekly Change: **↑ 0.223%**
- Since 1/1/07: **↑ 2.685%**

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Random Tidbits

Automobiles

1) Chrysler and Chery Enter Into Significant Cooperation Agreement

Chinese auto manufacturer *Chery* just signed a cooperation agreement with Chrysler. The two parties will now team up to manufacture and sell compact cars manufactured by Chery. The two issued a joint statement saying that Chrysler will launch several Chery models in North America and Europe under Chrysler Group brands. Experts say that the Chery A1 hatchback, introduced in April, will probably be the first vehicle Chrysler sells. In late 2007, the car could potentially sell in Mexico and Southern Europe as a Dodge (a brand owned by Chrysler). In the future, Chrysler and Chery will jointly develop new small car platforms. "Young and promising, Chery is the best partner Chrysler could have found anywhere," said Chrysler chairman Tom LaSorda. Chrysler formed the first Sino-foreign auto making JV in China (Beijing Jeep) 25 years ago. Currently, Chery is China's seventh-largest automaker.

2) Fiat and Nanjing Auto to Salvage JV

Fiat and *Nanjing Auto* will attempt to rejuvenate their auto making joint venture by injecting RMB3 billion each (close to US\$400 million). Recently, it looked as though Fiat would call it quits with Nanjing Auto and attempt to find another JV partner. This seemed likely because Nanjing Auto is currently committing significant resources to its MG project (it acquired the rights to the famous British brand in 2005 and expects to sell its first Chinese-made MG vehicle next year). Since its establishment in 1999, the Fiat-Nanjing relationship has proven to be one of China's most unsuccessful auto making JVs. It only sold 30,000 vehicles in 2006. Given the JV's problems, the government of the city of Nanjing had to step in and loan Nanjing Auto a large amount of capital. The JV with Fiat is the city of Nanjing's *only* Sino-foreign auto JV, and the government doesn't want to see a major foreign auto manufacturer choose another partner. It was rumored that Fiat was also seeking cooperation with Chery. By law, a foreign auto company can have two passenger car JV's in China and the Italians could still seek a second Chinese partner (despite the new injection of capital into the Nanjing Auto JV). Separately, the Chinese government has reportedly given Fiat the go-ahead to conduct auto financing business in China which Fiat is expected to begin in 2008.

Clothing

3) Chinese Shoe Manufacturers Continue to List in Hong Kong

Anta Sports Products, a Chinese manufacturer of athletic shoes and apparel, raised US\$406 million in its Hong Kong IPO. Many investors were excited by this stock offering. The retail portion of the IPO was 300x oversubscribed. Even Leslie Alexander, the American owner of the Houston Rockets basketball team (Chinese superstar Yao Ming's team) purchased US\$30 million worth of shares in the offering. Anta is closely associated with basketball. It produces basketball products and also sponsors the Chinese Basketball Association (the country's main basketball league).

Another shoe manufacturer, *Stella International* (market cap: HK\$14.38 billion), listed in Hong Kong on Friday, July 6. Stella makes shoes in China, but its main business is supplying those shoes to overseas luxury brands (e.g. DKNY) and casual brands (e.g. Rockport). Its shares did well on the first day of trading, closing up 19% over the IPO price. Stella is the third shoe company to list in Hong Kong in quick succession. China's leading shoe retailer, *Belle International* (market cap: HK\$81.4 billion), listed in May in one of Hong Kong's hottest IPO's ever (where it raised US\$1.27 billion). In early June, another shoe company, *Walker Group* (market cap: HK\$3.26 billion), raised US\$85 million. Investors like these consumer plays, as sectors such shoe manufacturing and retailing are expected to grow in proportion with the rapidly increasing spending power of the Chinese consumer.

Energy

4) Shenhua Energy to List in Multi-Billion-Dollar Shanghai Offering

We can add China's largest coal producer, *China Shenhua Energy*, to the list of enterprises that plan multi-billion-dollar Shanghai IPOs in the near future. Shenhua Energy, which is already listed in Hong Kong (market cap: HK\$104 billion) will issue 1.8 billion A-shares in Shanghai. According to its current share price in Hong Kong, the Shanghai listing could raise US\$7 billion. It isn't clear exactly when the listing will take place. The announcement comes at a time when the *China Securities Regulatory Commission (CSRC)* is encouraging China's largest companies, which are often only listed overseas (usually Hong Kong), to float shares in the domestic stock market. The government hopes the large companies will improve the overall quality of shares listed in China and that their shares will soak up some of the excess liquidity. In the next two months, other firms will list in the Chinese stock markets such as *China Mobile* (which will likely raise US\$10 billion-plus). Additionally, *China Construction Bank (CCB)* and *PetroChina* will list this year, and they plan to raise about US\$6 billion and US\$4 billion respectively. At the end of June, China's largest shipping company *COSCO* raised US\$2 billion in its Shanghai listing. One gains some perspective on the scale of these IPOs when considering that Blackstone's US\$4.8 billion NYSE offering was the largest on a U.S. exchange in over five years.

Energy

5) Chinese Environmental Engineering Firm to List in Tokyo

Japan attracted a third mainland Chinese company to IPO in on its stock markets, as *China Boqi Environment Solution Technology* will list on the Tokyo Stock Exchange (TSE) in the near future. Boqi is an engineering firm specializing in environmental applications designed to lower factory emissions. The first Chinese company to list in Japan (April 2007, on the TSE) was *Asia Media*, a firm that provides TV guide listings. The next firm, *9you*, a Chinese online game operator, will list in Osaka later in mid-July. In 1991, 100 foreign companies traded on the Tokyo Stock Exchange. By 2007, that number dwindled to 26. The exchange plans to attract at least 10 Chinese companies by 2009.

Mining

6) Two Chinese Groups Buy Stakes in Foreign Mining Companies

The Chinese continue to acquire overseas natural resource companies. Recently, two more large Chinese enterprises purchased overseas mining assets. The country's largest gold miner, *Zijin Mining*, bought a 75% stake in a firm called Zeravshan for US\$55.1 million. Zeravshan is the largest gold producer in Tajikistan, a former Soviet republic. Zijin will actually purchase the stake through a UK-based holding company. In the May 18 newsletter, we also discussed Zijin's purchase of 54% of Monterrico Metals for close to US\$190 million. London AIM-listed Monterrico owns copper and molybdenum mining assets in Peru. In separate news, *CITIC*, a Chinese financial conglomerate, signed a significant deal this week. CITC Resources Australia spent almost US\$100 million to increase its stake in Australia's Macarthur Coal from 11.6% to 20%. "CITIC has been patiently waiting for the right opportunity to increase its shareholding in Macarthur Coal.... Macarthur Coal has an outstanding portfolio of mines, development projects and exploration properties," said an official with CITIC's Australian operations.

Diversified

7) IDG and Accel Raise US\$510 Million China Fund

Silicon Valley VC firm Accel Partners and IDG Technology Venture Investment created a US\$510 million fund to invest in Chinese companies. The fund will target internet and mobile phone investments. A partner with Accel said it took about a month to raise the money for the new fund, called the IDG-Accel China Growth Fund II. IDG Technology Venture Investment is headquartered in China, and has operated on the mainland since 1992. Two years ago, the same two parties raised a US\$310 million China investment fund.

Internet

8) Mainland VC Firm Invests in Online Game Advertising Company

GSR Ventures has invested about US\$10 million in NGI in a Series A round of financing. Beijing-based NGI is an online game advertising company. It currently has partnerships with about 50 Chinese online games, which, according to NGI, cover about 70% of Chinese online gamers. The company will use some of the US\$10 million to acquire an online game advertising system from a French company. GSR Ventures is a Chinese VC firm that invests in technology companies. In the June 8 newsletter, we outlined another VC investment in this sector. *Qiming Venture Partners*, a US\$200 million Chinese VC fund, invested an undisclosed amount in Captiv8. Captiv8 places ads in online games and provides an ad system for online videos.

Semiconductor/Integrated Circuit

9) Semiconductor Developer Lists on Nasdaq

Chinese semiconductor company *Spreadtrum* listed on Nasdaq on June 27, raising about US\$100 million. Spreadtrum is a "fabless" company (meaning it designs and develops chips but doesn't actually manufacture them). It specializes in developing chips for 3G mobile handsets based on China's homegrown TD-SCDMA standard. China hopes to fully unveil 3G services sometime in 2008. Earlier reports had said that Spreadtrum would IPO later this year instead of summer 2007. The company's stock price currently trades at about 8% above the IPO price and its market cap stands at US\$1.88 billion. It is the first mainland 3G stock listed in the United States.

Telecommunications

10) China Approves Sale of BlackBerry Handsets

China's *Ministry of Information Industry (MII)* has finally given Ontario-based Research In Motion (Nasdaq and Toronto-listed; market cap: US\$40 billion) approval to sell its BlackBerry devices on the mainland. The move could lead to significant revenues for RIM in the future. The company hopes to start selling the devices sometime this summer. They will retail for about US\$600-650. Apparently customers have already pre-ordered about 5,000 Blackberries in anticipation.

Banking

11) ICBC Raises Large QDII Fund to Invest in Overseas Stocks

Industrial and Commercial Bank of China (ICBC) raised a RMB4.45 billion (about US\$585 million) fund to invest in overseas equities and other products. It is the largest Qualified Domestic Institutional Investor (QDII) fund to date and will have one of the first pools of money to invest in stocks abroad after the Chinese government extended the QDII program in May to allow domestic banks to invest in foreign equities. "The product was well received by investors," ICBC said. In fact, it took ICBC exactly one month to raise the fund. Before May, Chinese investors had shown barely any demand for QDII products because domestic financial institutions could only invest in foreign fixed-income products and other low-yield instruments. Now, with returns in the domestic stock markets slowing down, investors are more eager to diversify into overseas equities, especially in shares of Chinese companies trading in Hong Kong. ICBC said its new fund will invest about half of its money in Hong Kong-listed equities, and half in fixed-income products in Asia to help offset the depreciation of other currencies relative to the Yuan. For more information, ChinaVest has covered the latest advancements in the QDII program in recent newsletters. As the domestic stock markets are still quite high, China's government is making a concerted effort to allow financial institutions (and therefore Chinese citizens) to invest money overseas through QDII. By law, Chinese citizens cannot *directly* invest their money outside the mainland.

12) HK Bank Intends to Take Larger Stake in Chinese City-Level Lender

Hong Kong's *Dah Sing Bank* will reportedly seek to acquire 19.99% of *Chongqing Bank* instead of the 17% it had previously planned to buy. At the end of 2006, Dah Sing and the Carlyle Group agreed to purchase 24.99% of Chongqing Bank for about RMB1 billion (Dah Sing: 17%, Carlyle: 7.99%). However, the China Securities Regulatory Commission (CSRC), the regulatory body in charge of such transactions, approved Dah Sing's stake purchase but blocked Carlyle's bid. It did this mainly because Carlyle is a financial investor with little expertise in commercial banking operations. This gives Dah Sing the opportunity to purchase 19.99%, the maximum stake a foreign investor can own in a Chinese bank. A 19.99% stake would cost about RMB800 million, based on the RMB1 billion valuation for a 24.99% stake. Chongqing Bank is a city commercial bank in southwest China's Chongqing municipality. It plans to list in Shanghai before the end of the year. In last week's newsletter, we discussed city commercial banks in China and the upcoming domestic listings of Bank of Nanjing and Bank of Ningbo, which would become the first two city commercial banks to go public.

Hospitality

13) Private Equity Group and Deutsche Bank Arm Set Up Hotel Fund

RREEF, Deutsche Bank's property investment arm, formed a property investment JV with private equity group H&Q Asia Pacific. The venture will develop about 25 Hilton Garden Inn hotels in China. These are serviced hotels that target business travelers. The two parties will each hold a 50% stake in the JV, which is capitalized at US\$550 million (US\$225 million from each). The JV hopes to prosper in the relatively underserved area between five-star hotels and unbranded low budget hotels. According to AsianInvestor.net, only 10% of hotels in China are a part of a well known international brand, compared to 60% in North America. RREEF said branded hotels generally perform about 60% better than unbranded ones. In other news, RREEF listed a China REIT on the Hong Kong stock exchange last month (refer to the June 22 issue of the newsletter). The IPO raised US\$287 million, becoming the second China REIT to list in Hong Kong.

Logistics

14) YRC Worldwide to Acquire Large Chinese Trucking Firm

YRC Logistics will expand its China operations through the acquisition of *Shanghai Jiayu Logistics*, a major transportation provider in China focusing on the "less-than-truckload" sector of the market. Jiayu's fleet includes over 3,000 vehicles. YRC Logistics is a subsidiary of YRC Worldwide (Nasdaq, market cap: US\$2.15 billion), the largest American road transportation service provider for bulk goods. YRC Worldwide, which includes iconic trucking brands "Yellow" and "Roadway," is also the U.S.'s largest "less-than-truckload" transport group. "Initially this acquisition will allow us to build a service network that will provide greater reliability for our customers as they move shipments within China," said YRC Worldwide chairman Bill Zollars. YRC Logistics currently has about 70 vehicles operating in China. The acquisition will significantly deepen YRC's presence in China's relatively immature and fragmented ground transportation sector.

Other Financial

15) UK Government Fund Invests in Chinese Private Equity

UK-based CDC Group will invest US\$100 million in two leading Chinese private equity funds. CDC is a UK-government backed enterprise that invests in funds that focus on emerging markets. It holds net assets of US\$4 billion. CDC will invest US\$75 million in *CDH*, China's largest domestic private equity firm. It will also invest US\$25 million in a private equity fund managed by *CITIC Capital Partners*, which among other investments, funds state-owned enterprises. It seems mildly interesting that, having privatized in the 1970's and 1980's, the UK government could inevitably own stakes in Chinese state-owned enterprises.

Real Estate

16) Singaporean Property Group Raises US\$500 Million China PE Fund

The Ascott Group raised a US\$500 million private equity fund that will purchase and develop serviced residences (such as apartments) in China. Ascott Group is one of the world's leading owners and operators of serviced residences. It is an arm of Singapore-based property giant CapitalLand. Ascott Group said institutional and individual investors from all over the world subscribed to the fund, called the Ascott Serviced Residence (China) Fund. Ascott Group itself also put US\$165 million in the fund. The fund will buy and operate properties and, opportunistically, sell them for a profit. The Ascott Group will have the first right of refusal to purchase properties from the fund.

Regulations

CSRC Close to Releasing Rules Allowing Red Chips to List on Mainland

The China Securities Regulatory Commission (CSRC) is circulating the draft regulations that will allow red chip companies to list on mainland stock markets. Red chips are companies that have operations in China but are incorporated abroad. Currently, they are only allowed to list abroad. According to the new rules, a red chip's shares must trade in Hong Kong for at least a year before they can list in China. The company's market cap must also be at least HK\$20 billion (about US\$2.56 billion) and the company must have achieved net profits of HK\$2 billion (about US\$256 million) in each of the three previous years. CSRC is expected to release the final rules in July or early August. After CSRC releases these rules, *China Mobile* will become the first red chip to list on the mainland. The world's largest mobile operator is planning to raise US\$10.5 billion in a Shanghai IPO, which would be a record for the Chinese stock exchanges. A host of other red chips will certainly list in the next half-year or so, including *CNOOC*, China's largest offshore oil company.

Macro

Busy Week for Chinese Listings in Hong Kong

It was a busy week on the Hong Kong stock exchange, which witnessed a flurry of IPOs by Chinese companies. In addition to Stella International's listing, there were three other IPOs worth discussing. *China High Speed Transmission*, the mainland's largest producer of wind-power transmission equipment, listed on July 4 after raising US\$272 million. China High Speed had the most successful first day of any Hong Kong listing this year, with its share price more than doubling. Investors had been extremely eager to get a piece of the IPO, as it was 691x oversubscribed. They were clearly excited to invest in another alternative energy play in China's growing green energy sector.

Property developer *KWG Property* listed on July 3, raising US\$583 million in the IPO. KWG specializes in developing mid- to high-end residential properties in south China's Guangdong province. Its share price closed out the week at a 6% premium to the IPO price. KWG expects its earnings to increase nearly 5x this year to almost RMB1 billion.

And finally, *Centron Telecom*, China's third-largest wireless coverage solutions provider (extending mobile phone signals to areas with little or no reception) listed on July 5. It raised about US\$100 million in the IPO. Its stock price ended the week slightly above the IPO price.

Quite a few other Hong Kong IPOs by Chinese companies are coming up in July. They are headlined by the red-hot listing of *Fosun International*, a major Shanghai-based conglomerate (see details in last week's newsletter). That IPO has drawn a record HK\$500 billion in subscriptions.

Macro

Commissions from Trading on the Domestic Markets Soar in H1

In the first six months of 2007, the value of trades on the Shanghai and Shenzhen exchanges hit RMB27.3 trillion (RMB23.3 trillion for stocks alone). The surge of money into the markets and rampant speculative trading fueled the frenzy. The RMB27.3 trillion in trades for the first 6 months of the year was three times greater than the transaction value for *all of 2006*. Those high transaction values meant Chinese securities houses enjoyed a prosperous first half, earning more than RMB54.6 billion in commissions, according to Xinhua Press. The Securities Association of China mentioned that *CITIC Securities* has a 7.81% share of the market, which would imply that it raked in RMB4.2 billion in commissions in the first six months. In previous newsletters, we've discussed the pace at which the Chinese have been opening new trading accounts. Although the pace has slowed lately with the recent cooling of the market, Chinese individuals still managed to open 18.6 million new accounts from January to June. They only opened 3.08 million in all of 2006.

In other news, the markets fell again this week, although both the Shanghai and Shenzhen Composite Indices only slid by about 1%. Two factors we spoke about in last week's newsletter are currently affecting the domestic market. The first factor is the measures the government will continue to take to soak up more liquidity. China will issue RMB1.55 trillion worth of T-bonds and will reduce or eliminate the tax on interest earned on savings to encourage people to save more money. The second factor is the recent changes to the QDII program (also discussed earlier in this newsletter), which should funnel more money into shares of Chinese companies in Hong Kong, especially since valuations are significantly lower on the Hong Kong exchange. These factors have probably had a slight cooling effect as investors believe money will flow into the domestic stock markets at a slower pace.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
YRC Logistics	subsidiary of the United States' largest provider of road transportation for bulk goods	Shanghai Jiayu Logistics	large Chinese less-than-truckload transportation company, has about 3,000 vehicles	N/A	controlling stake
China International Marine Container (CIMC)	HK- and Shenzhen-listed, one of the world's largest shipping container manufacturers, subsidiary of China shipping conglomerate COSCO	Burg Industries	Netherlands-based container manufacturer, makes specialized tanks, such as for beverages and fuel	€86.4 Mil	80% stake
Zijin Mining	HK-listed, one of China's largest mining companies	Zeravshan	the nation of Tajikistan's largest gold producer	US\$55.1 Mil	75% stake
CITIC Resources Australia	natural resources arm of Chinese conglomerate CITIC	Macarthur	a leading Australian coal producer	US\$96 Mil	additional 8.38% stake
Xinhua Finance Media	Nasdaq-listed finance and entertainment media enterprise	Convey Advertising	outdoor advertising operator in southern China and Hong Kong	US\$33 Mil	100% stake

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
Fosun International	Shanghai-based conglomerate, involved in steel, real estate, mining, retail, pharmaceuticals, financial services	Hong Kong	US\$1.5 Bil	Morgan Stanley, UBS, CICC
Anta Sports Products	China's largest manufacturer of athletic shoes	Hong Kong	US\$406 Mil	BOC International
R H Energy	China-based, provides services for oil and gas equipment (pipelines, refineries, etc.)	Singapore	US\$15.2 Mil	CIMB-GK Securities
Angel Foods	China's leading producer of traditional foods (such as special foods eaten during holidays)	Singapore	US\$19.1 Mil	N/A
New World Department Store	Hong Kong-based, operates department stores on the mainland	Hong Kong	HK\$2.36 Bil	HSBC, Deutsche Bank

Report Says Pollution Causes 750,000 Annual Deaths in China

The World Bank recently released a report stating that about 750,000 people die prematurely each year due to pollution in China. Most of those deaths are due to air pollution in large cities. The World Bank produced the report in cooperation with Chinese government bodies, namely the *State Environmental Protection Agency (SEPA)* and the *Ministry of Health*. The report also stated that China is home to 16 of the world's 20 most polluted cities.