

Eye on China

A View from Shanghai

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

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Market Weekly

Shanghai Composite Index

- 3/7 Close: **4,300.52**
- 3/21 Close: **3,796.58**
- Change: ↓ **11.718%**
- Since 1/1/08: ↓ **27.843%**

Shenzhen Composite Index

- 3/7 Close: **15,560.85**
- 3/21 Close: **13,718.96**
- Change: ↓ **11.837%**
- Since 1/1/08: ↓ **22.494%**

Exchange Rate

- 3/7: US\$1 = **RMB 7.117**
- 3/21: US\$1 = **RMB 7.062**
- Change: ↑ **0.773%**
- Since 1/1/08: ↑ **3.445%**

Articles

Industrial & Consumer

- 1) Mindray Medical to Make US\$200 Million Acquisition in U.S.
- 2) SAIF and Local VC Group Invest in Bio Research and Mfg Company
- 3) Sinosteel Tables Hostile Bid for Australia's Midwest Corp
- 4) Sinopec Creates JV with Australian Oil Company
- 5) CIMC Acquires Stake in Marine Shipyard
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- 8) Lenovo Shareholders Approve Mobile Phone Unit Sale
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- Domestic Stock Markets Continue to Tumble, Shanghai Hits 8 1/2-Month Low
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- PBOC to Loosen Check on Outbound Investment

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Random Tidbits

Healthcare

1) Mindray Medical to Make US\$200 Million Acquisition in U.S.

In a move to expand internationally, Chinese medical device maker Mindray Medical has acquired U.S.-based Datascope Corp's patient-monitoring business for US\$202 million. Mindray is one of the leading medical device manufacturers in China; however, the company has yet to make its mark as a significant international player. Mindray will receive a valuable U.S. sales and distribution network from Datascope, a network that would have been extremely difficult to build up without an acquisition.

Mindray Medical, founded in 1991, is headquartered in Shenzhen and operates in three business segments: patient monitoring devices, diagnostic laboratory instruments, and ultrasound imaging systems.

Mindray is traded on the New York Stock Exchange (market cap: US\$2.75 billion). The company listed on the NYSE in a September 2006 IPO.

2) SAIF and Local VC Group Invest in Bio Research and Mfg Company

Shenzhen Hybio Engineering has received a total of US\$15 million in venture capital funding from SAIF (Softbank) and Shenzhen Venture Capital Co. Hybio conducts R&D and manufactures peptides. Peptides are the building blocks of proteins, which are used to make many drugs.

According to Zero2IPO, the healthcare/bio industry accounted for 12.6% of VC investment in China last year.

Metals

3) Sinosteel Tables Hostile Bid for Australia's Midwest Corp

In what would be the largest ever Chinese takeover of an overseas metal producer, *Sinosteel* has offered US\$905 million in a hostile takeover bid for Midwest, an Australian iron ore prospector. Sinosteel already owns a 19.9% stake in Midwest, and is attempting to purchase the remaining 80%, giving Midwest a total implied valuation of US\$1.1 billion. Sinosteel decided to take its all-cash offer directly to the shareholders after Midwest rejected the Chinese group's previous bid last month. Sinosteel's bid of AUD 5.60/share represents about a 35% premium to the price of Midwest's shares on the Australian Stock Exchange.

Sinosteel is China's second-largest iron ore trader, with revenues in excess of US\$8.5 billion. The state-owned enterprise mainly engages in resource development, trade & logistics, and engineering technical services for metallurgical mineral resources.

The bid has already gained approval from the Australian Foreign Investment Review Board.

Petroleum

4) Sinopec Creates JV with Australian Oil Company

State-owned petroleum giant *Sinopec* has agreed to buy a majority stake in Australian oil company AED. Sinopec will pay US\$557 million for 60% of the struggling oil producer, a deal which will mark the first JV between a Chinese and an Australian oil company. The deal will help bail out AED, a company that has recently witnessed falling production and has struggled to pay off debt. The funds will be used to settle with creditors and to fund future opportunities (Reuters). Further, the JV will continue to seek exploration into Australia's oil fields.

The deal also marks yet another stake purchase by a Chinese SOE in an Australian natural resources company. Among others, *Chinalco* last month purchased a US\$14 billion stake in mining giant Rio Tinto, while Sinosteel just bid US\$905 million for control over Australia's Midwest (see above article). China's recent overseas acquisitions in the sector demonstrate the importance the nation sees in securing important commodities to fuel its growth. Australian assets are natural target acquisitions given: (a) the country's presence in Asia, (b) corporate transparency, and (c) its abundance of natural resources.

Sinopec is listed in Hong Kong: [0386.HK], Shanghai: [600028], and on the NYSE: [SNP]. Sinopec is China's largest oil refiner, and in 2007 reached #17 on the Fortune Global 500 list, the highest ever ranking achieved by a Chinese company.

Shipping

5) CIMC Acquires Stake in Marine Shipyard

China International Marine Container Corp (CIMC) has agreed to buy a 29.9% stake in Yantai Raffles Shipyard for approximately US\$565 million. Yantai Raffles, headquartered in Singapore, produces offshore rigs and drilling platforms as well as marine vessels, including luxury yachts. The company's main production facility is in Yantai, a coastal city in northeast China's Shandong province. CIMC is the world's largest producer of shipping containers. The group said it made the acquisition of Yantai Raffles to expand into other business operations.

6) Ningbo Port to Sell US\$119 Million Stake

China Merchants Holdings has become the second-largest shareholder in the Port of Ningbo with a US\$119 million investment. China Merchants Holdings is a large company involved in the shipping industry, and is part of the massive *China Merchants Group*, one of China's biggest conglomerates. The purchase will give China Merchants Holdings a 5.4% stake in what will be a newly-established holding company. Five other groups will hold a combined 4.6% stake in *Ningbo Port Co Ltd* (the new holding company), while the remaining 90% will be held by *Ningbo Port Group*, which will inject port related assets into the venture.

The sale precedes Ningbo Port Group's planned dual listing later this year on the Hong Kong and mainland stock markets. The group will use the funds raised from the China Merchants Holdings stake purchase and from the future IPO to expand operations.

The port of Ningbo, located to the south of Shanghai and across the Hangzhou Bay, is one of China's busiest deepwater ports, with a container handling capacity of over 10 million TEU's (twenty-foot equivalent units—the standard measure for container shipping).

Digital Education

7) KPCB Invests in Digital Entertainment Education Company

Kleiner Perkins Caufield & Byers has invested US\$10 million in *Beijing GAMFE Tech Co*, a company that operates in the "digital entertainment education" sector. Specifically, GAMFE provides professional education and degree programs. GAMFE's chairman said the company will use the funds to "develop new courses, explore new markets, build a team of teachers, and explore more new teaching models." (Zero2IPO Research Center)

Electronics

8) Lenovo Shareholders Approve Mobile Phone Unit Sale

Shareholders of *Lenovo*, the world's fourth-largest maker of PCs, voted in favor of a plan to sell-off the company's mobile handset subsidiary. Along with other investors, Chinese private equity group *Hony Capital* will spend a total of US\$100 million to acquire *Lenovo Mobile Communications Technology*, which is currently not profitable. *Hony Capital* is the private equity investment arm of *Legend Holdings*, the parent company of *Lenovo*; therefore one can look at this similarly to an inter-company transaction.

The sale will allow *Lenovo* to get rid of a non-core business and focus on expanding its PC manufacturing business across the globe. *Lenovo* Chairman Yuan Yuanqing added that the disposal will "provide the group additional resources for supporting its expansion plan" (South China Morning Post). Currently, *Lenovo* is building new plants in Mexico and India for a total of about US\$30 million. *Lenovo* hopes the Mexico facility will allow it to make major inroads into the U.S. market during the next few years. From the time a customer in the U.S. makes an order, the plant will reportedly reduce the time until delivery from about four weeks to only three days.

Networks

9) Huawei and Bain Capital Give Up On 3Com Buyout

Chinese switch and router manufacturer *Huawei* and U.S. private equity group *Bain Capital* will drop their joint US\$2.2 billion bid for *3Com*, the California-based network equipment maker. *Huawei* and *Bain* will abandon the bid after encountering opposition from the Committee on Foreign Investment in the U.S. (CFIUS), which fears that some of *3Com*'s sensitive technology may be transferred abroad if *Huawei* is part of a successful buyout bid. About a month ago, *Bain* and *Huawei* postponed their initial bid for *3Com* due to CFIUS opposition, but had hoped to resubmit a revised bid that addressed those security concerns. Many experts thought that if *3Com* sold its Tipping Point business unit before the sale—Tipping Point specializes in "protecting networks from outside infiltration"—that regulators would be satisfied. "I think everyone had agreed Tipping Point would be sold. I didn't understand what the issue would be with *Huawei* participating in the rest of the deal," said Manuel Recarey, an analyst at Kaufman Bros. In a statement, *Bain* voiced its frustration with the recent developments, "Bain Capital made several alternative proposals to *3Com* that we believe could have satisfied the concerns raised by CFIUS. We regret that we were unable to agree upon an alternative transaction" (Reuters).

Banking

10) ICBC, Standard Bank Set Up US\$1 Billion Resources Fund

The partnership between *Industrial & Commercial Bank of China (ICBC—China's largest bank)* and South Africa's Standard Bank, Africa's largest lender, continues to evolve. The two parties will set up a US\$1 billion fund to invest in natural resources. ICBC, which is the world's largest bank by market value, completed the purchase of a 20% stake in Standard Bank for US\$4.6 billion earlier this month in the biggest overseas investment to date by a Chinese bank.

Standard Bank and ICBC will each contribute US\$200 million to the fund, while other investors will account for the remainder. The fund, with a return target of 20%, plans to buy commodities around the world, including in China. The partners have set up a committee to cooperate on the resources fund, as well as on investment banking and global markets initiatives. (Bloomberg)

In related news, the Associated Press reports that China and Peru (another mineral-rich nation) have agreed to significantly increase their trade with each other over the course of the next few years. China will reportedly invest up to US\$10 billion in Peru by 2015, up from about US\$2 billion today. It is likely that a good percentage of that investment will involve mineral resource assets. Additionally, Peru will increase its exports to China by 5x to about US\$15 billion by 2015, while China will increase its exports to Peru by 4x to about US\$12 billion.

11) Mainland Assets of Foreign Banks Grow 47% in 2007

The *People's Bank of China (PBOC—China's central bank)* announced that the assets of foreign banks on the mainland increased by 47% in 2007, growing to US\$171.5 billion by the end of the year. Also, the combined assets of foreign-invested banks accounted for 2.4% of total mainland banking assets. A little over a year ago, regulators opened the door for foreign banks to apply for local incorporation in China, which allows the banks to offer a full range of RMB-denominated services. As part of its commitments relating to its WTO membership, China had to open its banking sector to foreign institutions.

As a point of reference, some foreign banks have found success in marketing sophisticated private banking services to wealthy Chinese citizens. Due to the expansive branch networks of some of the largest mainland-based banks, it would be difficult for a foreign bank to compete with Chinese banks in more run-of-the-mill banking services.

12) Domestic Chinese Bank Issues Shares to Deutsche Bank

Deutsche Bank, Germany's largest bank, has signed an agreement to subscribe to 265.6 million newly-issued shares of China's *Huaxia Bank* for RMB3.9 billion. The investment will increase Deutsche Bank's stake in Huaxia to about 13.7% from 9.9%, and is still subject to regulatory approval.

The subscription is part of a private placement of shares by Huaxia—China's 12th largest bank—to its three largest shareholders: *Shougang Group*, *State Grid*, and Deutsche Bank. Technically, Deutsche Bank is Huaxia's fourth-largest shareholder, holding a 7% stake under its own name. It holds the remaining 2.88% stake through a connected company.

Huaxia plans to issue a total of RMB11.558 billion (about US\$1.65 billion) worth of new shares to the three companies. (Bloomberg)

Other Financial

13) Ping An and Fortis to Form Asset Management Partnership

Ping An Insurance and Belgian-Dutch banking and insurance group *Fortis* jointly announced the signing of a memorandum of understanding to form a global asset management partnership. According to the MOU, Ping An intends to acquire a 50% stake in *Fortis Investments*, *Fortis'* global asset management arm, for €2.15 billion. The combined entity will be renamed *Fortis Ping An Investments*.

The announcement comes in the wake of Ping An's November 2007 purchase of about 5% of *Fortis*, making Ping An the largest shareholder. Earlier, *Fortis* acquired ABN AMRO's Dutch operations and asset management unit. The consolidation of the asset management operations of *Fortis* and ABN AMRO is expected to start April 2.

Ping An, the mainland's second-largest life insurance company and third-largest property insurer, recently announced stellar 2007 financial results. Net profit rose 105.5% to more than RMB15 billion as a result of solid growth in all of the company's business lines, including insurance, banking, and securities. Revenue rose 53.1% to RMB165.20 billion. Ping An projects relatively flat profit growth in 2008.

The Chinese insurer is expected to accelerate the development of banking and investment businesses. Ping An plans to set up a private equity firm through its asset management unit and inject RMB20 billion as an initial investment. In addition, the company said it will actively seek out overseas investment deals. (Financial Times)

Macro

Inflation Hits 12-Yr High, PBOC Hikes RRR by 50 Basis Points

For the second consecutive month, inflation in China has soared to its highest level in over a decade. Prices in February were 8.7% higher than at the same time last year, representing the highest monthly inflation figure in China since 1996. As has been the case during the last nine months, food prices are the main culprit. Overall, food prices were up 23.3% year-on-year. Some basic foods, however, have fared even worse. Pork, China's staple meat, costs about 63% more than at the same period last year, while vegetable prices are up 46%.

In response to the inflation figures, the *People's Bank of China (PBOC)*, China's equivalent of the U.S. Federal Reserve Bank, raised the reserve requirement ratio (RRR) for banks by 0.5%, the third hike this year. PBOC said the rate hike is "designed to strengthen management of liquidity in the country's banking system and to guide reasonable levels of credit growth" (Xinhua News Agency). Central bank officials stress that PBOC will continue to use monetary policy to curb liquidity and fight inflation. However, measures must be taken to control food prices if the country is to get inflation under control. A number of factors are causing the price crisis, including a shortage of agricultural products, and rising prices of pig feed inputs, such as corn. Unusual weather has also put tremendous strain on China's logistics infrastructure.

Wang Yiming of the *National Development and Reform Commission (NDRC—China's top economic planning body)*, believes that "future factors" will also add to the inflationary pressures down the road. He highlighted the fluctuating prices of natural resources, which will become a larger inflationary factor as China continues to source more resources from abroad (Shanghai Daily).

In a recent survey by xinhuanews.net and sina.com, Chinese internet users listed rising prices as they're biggest concern. As a point of reference, since the beginning of 2007, PBOC has raised interest rates six times and the required reserve ratio for banks 12 times.

Domestic Markets Continue to Tumble, Shanghai Hits 8 1/2-Month Low

The Shanghai Composite Index hit its lowest point in 8 1/2 months at the beginning of last week, as shares kept falling amid the specter of a slowdown in the West and fears of continued tightening measures by PBOC. Zhou Xiaochun, the head of PBOC, recently fueled investors' fears about an upcoming rate hike, saying there is still ample room for further interest rate increases. Premier Wen Jiabao also said Beijing would make it a priority to address inflation and prevent "unstable, uncoordinated and unsustainable" development (Shanghai Daily).

Shares did, however, rebound slightly in the middle of last week. Rumors began circulating that regulators may lower the taxes on stock trades in the near future. Last summer, in an attempt to cool the Shanghai and Shenzhen exchanges (which were surging at breakneck speed), the *State Council* tripled the trading tax, bringing it to 0.3% of the value of each trade (for both buyers and sellers). Even with the aforementioned slight upturn in the markets during the middle of last week, Friday marked the end of a brutal two week period for both the Shanghai and Shenzhen markets. Both the Shanghai and Shenzhen Composite Indices fell almost 12% between March 7 and March 21.

Macro

KMT Candidate Wins Taiwan Presidential Election

Over the weekend, Kuomintang (KMT) candidate Ma Ying-jeou won Taiwan's presidential election, winning 58% of the vote to defeat Democratic Progressive Party (DPP) candidate Frank Hsieh. The victory by the KMT ends eight years of DPP presidential rule. Ma has promised to focus on improving Taiwan's struggling economy and to foster less confrontational relations with mainland China. The KMT already has a majority in parliament, so the election of a KMT president will likely reduce gridlock, and make it easier for Ma to push through some his economic reform policies.

Regulations

PBOC to Loosen Checks on Outbound Investment

The Wall Street journal reports that PBOC said it would stop checking sources of foreign exchange for outbound investment from China. No timeframe for implementation was announced. In the long run, the relaxation of foreign exchange checks would simplify the process for Chinese entities to make overseas purchases. Chinese entities need sources of foreign exchange to make purchases abroad, since such investments cannot be made abroad using RMB.

China has approximately US\$1.5 trillion in foreign exchange reserves, a number that continues to rise. Beijing is cultivating more and more outlets for that capital, such as the *China Investment Corp*, which is the country's recently-founded US\$200 billion state investment fund. Additionally, sometime this year, many expect the *State Administration of Foreign Exchange (SAFE)* to initiate the "through-train" scheme, which will allow some Chinese individuals to invest in overseas stocks for the first time (on the HK stock market).

We've entered a new era in which large amounts of influential capital are flowing from China, and into some of the world's major developed and emerging markets. The above articles that discuss large overseas iron ore, banking, and medical device-related purchases by Chinese companies serve as just a few of many examples.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
China National Building Materials (CNBM)	major Chinese building materials group	Gansu Qilianshan Cement	northwest China-based cement company, listed in Shanghai	RMB 493 Mil	20% stake
Bumiputra-Commerce Holdings Bhd	listed arm of CIMB, Malaysia's second-largest lender	Yingkou Bank	city commercial bank based in Yingkou, Liaoning province	RMB 156 Mil	19.99% stake

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
Wing Fat Printing	printing unit of HK-listed Shanghai Industrial Holdings	cancelled in Hong Kong due to lack of demand	US\$100 Mil	UBS, BNP Paribas
Evergrande	China-based property developer	cancelled in Hong Kong due to lack of demand	US\$2.1 Bil	N/A

Random Tidbits

Bus Company to Offer 16-Day Trip from London to Northwest China

UK-based ButterflyBus will offer a 16-day luxury bus tour from London to Urumqi, the largest city in far northwestern China. The trip, which travels along a large portion of the Silk Road, will stop along the way in cities like Warsaw, Kiev, and Almaty (Kazakhstan). The first bus is scheduled to leave London on September 6. Tickets will cost £795 one-way and £1,295 for a round-trip.