

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

- 2/22 Close: **4,370.29**
- 3/7 Close: **4,300.52**
- Change: ↓ **1.596%**
- Since 1/1/08: ↓ **18.265%**

Shenzhen Composite Index

- 2/22 Close: **16,179.52**
- 3/7 Close: **15,560.85**
- Change: ↓ **3.824%**
- Since 1/1/08: ↓ **12.089%**

Exchange Rate

- 2/22: US\$1 = **RMB 7.153**
- 3/7: US\$1 = **RMB 7.117**
- Change: ↑ **0.503%**
- Since 1/1/08: ↑ **2.692%**

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Construction Materials

1) Chinese Firm to Build Six Cement Plants for Lafarge

France-based cement giant Lafarge signed a deal worth €600 million for the construction of six cement factories in emerging markets, three of which will be located in China. *CBMI*, a unit of mainland-based *Sinoma Group*, will build the plants, which are scheduled to be completed by the end of 2010. Sinoma is the world's largest provider of cement equipment.

One plant will be constructed in Chongqing, a large city in southwest China. The other two plants in China will be constructed at undisclosed locations. China's cement industry continues to see increasing foreign investment from multinationals, which are making inroads into the world's largest cement market. Lafarge's investment is part of the company's plan to increase its cement capacity in Asia and emerging markets to 45 million tons by 2010.

Infrastructure

2) CRCC Raises US\$5.4 Billion in Dual IPO

China Railway Construction Corp (CRCC) successfully completed the launch of its dual Shanghai and Hong Kong offering, making its US\$5.4 billion IPO the world's largest so far this year. In the Shanghai IPO, the massive state-owned construction group raised about US\$3.13 billion. Trading in Shanghai began on March 10, posting a 28% gain over the IPO price on the first day. CRCC raised US\$2.33 billion in its Hong Kong IPO, where trading of its H-shares will commence on March 13.

Despite initial delays (due to market conditions), the IPO was still highly anticipated. The listing was oversubscribed by 155X (retail) and 77X (institutional) in Shanghai and by 291X (retail) and 80x (institutional) in Hong Kong. Notable cornerstone investors include US\$50 million from Yale University (China Knowledge), as well as a combined US\$450 million in investments from two Singapore government-backed funds (Temasek Holdings, Government of Singapore Investment Corp), *CITIC Pacific*, *Bank of China Investment Management*, and *China Life Insurance*, among others.

China Railway Construction derives nearly 90% of its revenues from infrastructure construction. The group's primary focus is in road building, as well as railway and bridge construction. Funds raised will be used in a variety of ways, including the purchase of new equipment, funding for railway line construction & property projects, paying down loans, etc.

Metals

3) Russian Group Bids for Chinese Steel Company

In a move to expand into China's vast steel market, Russian steel producer Evraz has entered into an agreement to purchase a majority stake in mainland-based, Singapore-listed *Delong Holdings*. In the initial offer, Evraz has agreed to purchase 51% of Delong at a price of US\$2.80 a share, giving the company a total valuation of US\$1.5 billion. The agreement also provides Evraz with the option to purchase additional shares for the same price at a later date.

Delong, which is headquartered in Beijing, primarily manufactures and sells hot-rolled steel coils, with China as its core market. The group also operates in the trading of iron ore.

Evraz, partially owned by Russian billionaire Roman Abramovich (the well-known oil baron who owns the Chelsea football club), is a producer and distributor of steel and related products. Evraz has operations around the world, but this would be the group's first move into the Asia/Pacific region.

The deal is still subject to approval from China's *Ministry of Commerce (MOFCOM)* and *State Administration for Industry and Commerce (SAIC)*.

4) Golden Dragon Receives Capital Injection

Standard Chartered Private Equity led a US\$90 million investment into *China Golden Dragon Precise Copper Tube Group*. A unit of Standard Chartered Bank, Standard Chartered Private Equity contributed US\$50 million to the deal. The remaining US\$40 million was split between various other partners, including Lehman Brothers and Goldman Sachs. Subsequent to this deal, Golden Dragon will transform itself into a Sino-foreign JV. The company also has plans for an eventual domestic IPO.

Golden Dragon is located in central China's Henan Province. The company is the world's largest manufacturer of precise copper, turning out 200,000 tons of copper tube in 2007. In addition to the production of copper, the company engages in material research, technology development, and metals-related innovation. Golden Dragon has eight production plants and 13 output lines, located throughout most regions in China.

Ports

5) Qingdao Port Group Applies for A-Share IPO

Qingdao Port Group recently submitted its application for a domestic IPO to the *China Securities Regulatory Commission (CSRC)*. After Qingdao Port Group was unable to secure approval for a Hong Kong listing last year, it decided to list domestically on either the Shanghai or Shenzhen Stock Exchange. The group also hopes to attract foreign investment prior to its IPO.

Qingdao Port Group operates the port of Qingdao, China's third-largest port by container throughput volume. Qingdao is a large, coastal city located in Shandong province, about an hour-and-a-half's flight north of Shanghai. Last September Qingdao Port Group invested US\$971 million in the port of Qingdao, which will increase its annual container capacity by 6.4 million TEUs (twenty-foot equivalent units—the standard measurement for container throughput), up to 16 million TEUs (Reuters).

Electronics

6) CIVC Invests US\$10 Million in Electronics Manufacturer

China Israel Value Capital (CIVC) led a US\$10 million investment in Chinese consumer electronics manufacturer *Keen High Technologies*. CIVC is a venture capital partnership between China's *Shenzhen Capital Group* and Israel's *Neurone Ventures*. Specifically, *Keen High Technologies* designs, manufactures, and distributes MP3/MP4 players and other portable media players. The company's 2007 revenue reached US\$120 million. "CIVC's unique contribution to *Keen High* is its experience and expertise to match *Keen High's* needs with innovative Israeli technology that will eventually enhance *Keen High's* product line," said Arthur Wang, *Keen High's* Chairman and CEO. (Zero2IPO)

Internet

7) Electronics Manufacturer Buys Stake in Web TV Broadcaster

Tsinghua Tongfang, a mainland manufacturer of computers, will spend RMB150 million for a 40% stake in *BesTV*, China's largest Internet Protocol TV (IPTV) provider. *BesTV* is jointly run by two of China's major communications companies: *Shanghai Media Group (SMG)*—the mainland's second-largest media company to *China Central Television*, and *China Telecom*, China's largest fixed-line operator. A source said the companies are joining forces in part to resist foreign competition. "SMG has plenty of multimedia resources...and *Tsinghua Tongfang* has a leading position in the market for digital devices and technology. This is a pretty strong partnership," added the source (Reuters). In a related topic, in our last issue of the newsletter we discussed a new law in China, which further restricts the broadcasting of online video content. According to the new law, *China's State Administration of Radio, TV, and Film (SARFT)* and the *Ministry of Information Industry (MII)* will only issue new online video licenses to state-controlled entities. Already-established broadcasters will essentially be grandfathered from the new law, provided they don't broadcast illegal content.

Networks

8) Huawei and Bain Capital to Restructure Buyout Bid for 3Com

The Wall Street Journal reports that Chinese telecom equipment manufacturer *Huawei* and U.S.-based private equity group *Bain Capital* plan to resubmit their application to U.S. regulators for a buyout bid of *3Com*. In the last issue of the newsletter, we reported that *Huawei* and *Bain Capital* had withdrawn their original US\$2.2 billion joint bid, fearing that the Committee on Foreign Investment in the U.S. (CFIUS) would likely reject the deal. CFIUS is reportedly concerned with the possibility of sensitive military technology falling into foreign hands.

Under the terms of a potential new bid, *Huawei* would still hold a 16.5% stake in *3Com*, with *Bain* holding the remaining 83.5% stake. The largest difference is that the terms of the new bid would "limit *Huawei's* control over [*3Com's*] core network technologies" (*China Economic Review*).

Huawei and *3Com* originally founded a China joint venture called *H3C* in 2003 (*3Com* held 51% of the JV). *H3C* provides internet protocol (IP) networking products and solutions. At the end of 2006, *Huawei* agreed to divest its interest in the JV to *3Com*, which completed its US\$882 million purchase of *Huawei's* 49% stake in the first half of 2007.

Online Retail

9) Online Diamond Retailer Raises US\$10 Million

Online diamond jewelry retailer *Shanghai 9Diamond Jewelry* has raised US\$10 million in venture financing from multiple investors. China-based Qiming Venture Partners, Zero2IPO, and Silicon Valley-based VC group KPCB participated in the investment, along with American online diamond trading firm Rapaport. 9Diamond sells its merchandise at 30-70% discounts to retail prices in stores, with prices spanning from low-end up to about RMB400,000. "The diamond website is another Dell in the jewelry industry," said Cindy Wang, an analyst at Shanghai-based Internet consulting firm iResearch Inc. "It uses the direct-selling model, which has grown rapidly in this country with 210 million internet users" (Shanghai Daily). 9Diamond's CEO added that his company's biggest challenges are to ensure that its products and transactions are reliable and that customers have a pleasurable shopping experience.

Semiconductor

10) BlueRun Invests US\$10 Million in Fabless Semiconductor Company

Silicon Valley-based venture capital group BlueRun Ventures recently led a US\$10 million investment in *Innofidei*, a Chinese fabless semiconductor company. "Fabless" refers to semiconductor companies that design semiconductors but do not actually manufacture the chips. Innofidei specializes in designing chips for mobile TV. BlueRun partner Andrew Chen had the following to say about the investment: "We believe mobile TV broadcasting is a very attractive service to Chinese consumers, and we like the strong team from Innofidei, which has a good track record in starting up semiconductor ventures." In addition to its headquarters in Beijing, Innofidei also has offices in Silicon Valley and Taipei. The company was founded in September 2006.

Other Financial

11) Standard Chartered and JPMorgan to Underwrite Mainland Bonds

Standard Chartered Bank (SCB) and *JPMorgan Chase Bank* received approval from China's *Ministry of Finance* to act as primary dealers for Chinese government bonds. The two banks are the second and third foreign banks allowed to do so. JPMorgan is the first American bank to receive the license. HSBC was previously the sole foreign bank authorized to underwrite Chinese government bonds domestically (since 2004).

The license will give SCB and JPMorgan access to a massive pool of capital. For example, last year alone, China issued RMB2.18 trillion of government bonds on the local inter-bank market, including RMB1.55 trillion in special bonds to finance its US\$200 billion sovereign wealth fund, the *China Investment Corp.*

The two banks will, however, face stiff competition for the 58 domestic institutions that are already authorized to underwrite government bonds. Those institutions include the mainland's Big Four state-owned banks, as well as other leading financial groups such as China Life Insurance (the country's largest life insurer by premiums). Nonetheless, the announcement is another small step in the continued opening of China's financial markets. (Reuters)

12) Australian Bank Invests in Trust Company

National Australia Bank (NAB) has officially acquired a 20% stake in *Union Trust and Investment (UTI)*, a Chinese trust company. NAB is now the largest single shareholder in UTI. Financial terms were not disclosed.

Chinese trust companies have the ability to invest in an almost unlimited variety of sectors. Customers can deposit money in any number of "trust plans" offered by a trust company. Different trust plans focus on different types of investments, with each plan acting almost like its own investment fund. For instance, a trust company is allowed to have a trust plan that invests in A-shares, another that invests in mineral resources, and yet another that invests in tech companies.

John Hooper, the CEO of nabCapital (NAB's capital markets and institutional banking division), elaborated on what types of products he hopes UTI and NAB will offer in the future. He said the partnership would stress products that invest in infrastructure and construction. He also mentioned other options including QDII, pension, REIT, and other real estate products (China Knowledge). As a point of reference, a QDII license (Qualified Domestic Institutional Investor) allows a local Chinese financial institution to invest in overseas stock markets. Hooper also mentioned that he is not interested in investing in China's banking sector.

Other Financial

13) ABC, Crédit Agricole to Launch Fund Management JV

CSRC has approved the launch of a fund management joint venture that will be one-third owned by France's *Crédit Agricole*. The remaining shareholders will be the *Agricultural Bank of China (ABC)* with a 51.67% stake and the *Aluminum Corp of China (Chalco)*, which will hold a 15% stake. ABC, one of China's "Big Four" state-controlled commercial banks, is also awaiting a government bail-out ahead of a planned public listing.

The fund has been awaiting the regulatory green light for more than six months, having missed its original launch target of October 2007. The approval could signal that CSRC will soon grant licenses to other proposed new fund management ventures, some of which have been waiting for months or even a year for the go-ahead. The last new fund management company approved by CSRC was a joint venture between French insurer AXA and *Shanghai Pudong Development Bank*, which was launched last September.

Other foreign banks such as HSBC and JPMorgan have also set up fund ventures in China in the past, although overseas investors cannot own a controlling stake under current rules. About half of China's 60 fund management houses are joint ventures, some of which are Sino-foreign JVs.

14) AIM-Listed China Fund Raises Additional US\$107 Million

AIM-quoted *Pacific Alliance Asia Opportunity Fund* last week said it has completed a second round of fundraising, generating about US\$107 million to fund its current pipeline of identified investments, which are primarily in Greater China.

Pacific Alliance is a closed-end fund which listed on the London Stock Exchange's (LSE's) Alternative Investment Market (AIM) in September 2006. The fund focuses on Greater China and other opportunities in emerging Asian markets. The company stated that it had identified a strong pipeline of current investment opportunities in China, and plans to invest in these opportunities either alone or with co-investors. (Thomson Financial)

In the last few years, dozens of Chinese firms have listed on the AIM market, which is the LSE's growth enterprise board. AIM provides a number of advantages for growth companies, including relatively low (and thus less costly) listing requirements, as well as access to a diverse global investor base.

Macro

China Tops Japan to Become Third-Largest Destination for U.S. Exports

We recently reported that China had become the United States' largest source of imported goods, a fact that likely comes as little surprise.

The U.S. is certainly reciprocating, however, having surpassed Japan in 2007 to become the third-largest destination of United States exports. Last year marked the eighth consecutive year that U.S. exports to China have registered double-digit growth. Much of that growth was spurred by exports of foods, feeds, beverages, automobiles, and auto parts (China Knowledge). In fact, the total value of goods exported from the United States to China has more than tripled from only US\$19.2 billion for the year 2001 to US\$65.2 billion for the year 2007 (U.S. Department of Commerce).

Only NAFTA nations Canada and Mexico stand ahead of China as destinations for U.S. exports.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
Guangdong Midea	one of China's largest manufacturer of home appliances	Wuxi Little Swan	Wuxi-based washing machine manufacturer	US\$235 Mil	24% stake
National Australia Bank	Australia's largest commercial bank	Union Trust & Investment	Chinese trust company, focused on real estate	N/A	20% stake
Belle International Holdings	HK-listed manufacturer, retailer, distributor of women's footwear	Mirabell International	HK-listed, retailer, wholesaler, and manufacturer of footwear in Hong Kong	HK\$1.67 Bil	100% stake
CDC Software	subsidiary of Nasdaq-listed Chinese IT group CDC	Integrated Solutions Limited	HK-based company that designs and produces software for Chinese SMEs	N/A	51% stake
Tsinghua Tongfang	Chinese manufacturer of computers	BesTV	China's largest IPTV provider	RMB 150 Mil	40% stake
Motorola	major international electronics company	Dahua Digital Technology	digital cable set top box manufacturer	N/A	100% stake

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
China Pacific Insurance	China's third-largest life insurer	Hong Kong	HK\$24 Bil	UBS, Credit Suisse, CICC
Wing Fat Printing	printing unit of HK-listed Shanghai Industrial Holdings	Hong Kong	US\$100 Mil	UBS, BNP Paribas
Northern International Trust	trust company, valued at approximately RMB2.4 billion, unit of Tianjin TEDA	Shenzhen (via reverse takeover)	N/A	N/A
Xingfa Aluminum	large Chinese aluminum profile maker	Hong Kong	< US\$100 Mil	N/A
Liheng Chemical Fiber Technologies	Chinese nylon fiber producer	Singapore	US\$230 Mil	Boulton Capital Asia, UOB Kay Hian

Random Tidbits

Shanghai Hopes to Win Approval to Build Disneyland Theme Park

The Shanghai city government has applied to the *National Development and Reform Commission* (NDRC—China's top economic planning body) to build a Disneyland theme park in the city. Mayor Han Zheng said the best location for such a theme park would be in Pudong. The Walt Disney Co signed a letter of intent and established a corporate entity in China in 2002 to build a theme park on the mainland, but the plan was postponed amid fears that it would hurt business at Disneyland Hong Kong, which opened in 2005. (Shanghai Daily)