

Eye on China

A View from Shanghai

March 2-March 7, 2007

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

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Market Weekly

Shanghai Composite Index

- 3/1 Close: **2797.19**
- 3/7 Close: **2896.59**
- Change: ↑ **3.554%**

Shenzhen Composite Index

- 3/1 Close: **7804.35**
- 3/7 Close: **8140.33**
- Change: ↑ **4.305%**

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Agriculture

1) Grain Unit to List in Hong Kong

China Agri-Industries Holdings, a unit of China's largest grain trader, is planning to raise as much as HK\$2.6 billion in a Hong Kong IPO. The shares are set to be priced on March 14 and are scheduled to begin trading on March 21. China Agri-Industries is a unit of Hong Kong-listed COFCO International. China Agri will sell 697.8 million new shares (a 20% stake), and each share will be priced between HK\$3.10 and HK\$3.72. Mitsubishi has will pay HK\$510 million to acquire about 20% of the IPO stake, depending on where the shares are priced. BOC International and Goldman Sachs are handling the IPO.

Automobiles

2) Chinese Auto Manufacturers Deny Rumors of Interest in Acquiring Chrysler

Chinese auto companies First Automobile Works (FAW), Chery, and SAIC have all been rumored to be interested in buying DaimlerChrysler's Chrysler unit. However, executives from the car manufacturers have denied the reports. An executive with Jilin-based FAW said, "We do not have an overseas acquisition plan in the short term." He also said that he was surprised when he saw a media report that FAW is interested in Chrysler. According to the Wall Street Journal, a Chery executive has said that Chery is in talks with Chrysler over an alliance, but that Chery has no plans to purchase Chrysler. A source close to Shanghai-based SAIC said that it would be extremely difficult for SAIC to pursue overseas manufacturing bases, and that the company's focus is on designing its own vehicles and selling them in the domestic market. Last year, Chrysler recorded a loss of €1.1 billion.

3) Honda JV Planning New Chinese Home-Grown Brand

Guangzhou Honda Automobile Corp, a 50/50 JV between Honda and Guangzhou Automobile Corp, will create a new car brand in China. The brand will be original and will be without the Honda logo. A top executive with the JV said the new brand's intellectual property will belong to the JV, not Honda. He said the plan for the brand would be announced in March or April, and said this would be the first home-grown brand from a Sino-foreign auto venture. Currently, foreign auto brands make up three-quarters of China's passenger car market, and the government has been urging Chinese automakers and their foreign partners to speed up creation of home-grown brands. John Bonnell, an analyst with consulting firm Automotive Resources Asia, said of Guangzhou Honda's announcement, "Guangzhou Honda seems to be working the way policymakers intended. Government policy is meant to develop independent automotive companies, not companies that depend on the foreign technology source in perpetuity." The Chinese government would like the passenger car market to be 60% Chinese brands by 2010. Guangzhou Honda was China's most profitable car maker in 2006, selling 260,000 vehicles and making after-tax profit of RMB5.16 billion. The venture is targeting production of 310,000 vehicles in 2007. Recently, Sino-foreign auto manufacturing JV Beijing Hyundai also announced that it would manufacture and sell a home-grown branded vehicle, which it plans to do in 2008.

Energy

4) Westinghouse Signs Deal with China for Four Nuclear Power Plants

Westinghouse Electric Co has signed a framework agreement with China's State Nuclear Power Technology Co (SNPTC) to provide four nuclear power plants. Analysts say the deal for the four Westinghouse AP1000 nuclear reactors is probably worth between US\$5 billion and US\$8 billion. The framework agreement represents the next step after SNPTC chose Westinghouse as its technology partner in China's next generation of nuclear power plants about two-and-a-half months ago. Westinghouse could be involved in the construction of as many as 26 nuclear plants in the next 30 years. As far as the initial four plants, contracts are expected to be finalized by the middle of this year. Construction is expected to begin in 2009 and the four should go into operation in 2013. "Reaching the framework agreement in such a timely manner demonstrates the positive and growing relationships between SNPTC and the Westinghouse consortium. It also proves the commitment of all parties to bring these first four plants on line in a timely and efficient manner," said Jim Fici, Westinghouse's vice president of Customer Relations and Sales.

Petroleum

5) CNOOC Plans Domestic Listing in 2007

The China National Offshore Oil Corp (CNOOC) plans to list in Shanghai in 2007, according to Chairman Fu Chengyu. "Our goal is to turn to the mainland market this year," he said. Hong Kong-listed CNOOC is China's largest offshore oil producer, and China's third-largest oil company overall. CNOOC expects production to recover in 2007 after it missed its targets in 2006, mainly due to the shutdown of its Liuhua oilfield last May after it was hit by a typhoon.

Electronics

6) Chinese Software Outsourcer and American Firm Merge

Beijing-based hiSoft Technology International Ltd., a software outsourcing services provider, has merged with California-based Envisage Solutions. "This merger is the first step of our overseas strategy," said Loh Tiak Koon, hiSoft's CEO. hiSoft did not reveal the value of the deal. "We also expect to list our shares on an overseas bourse in 2008, either in the United States or Japan, where most of our customers are based," said Loh. hiSoft is one of China's largest IT outsourcing services providers. It offers services such as testing and application development to clients including Microsoft, Toshiba, and Symantec. Established in 2000, Envisage Solutions has worked with Fortune 1,000 companies such as Novell and General Electric in the automotive, telecom, hi-tech, pharmaceutical, and financial sectors.

7) Neusoft's Software Outsourcing Revenue more than US\$100 Million

China's software outsourcing industry reached US\$1.43 billion in 2006, a 55.4% increase over 2005. Neusoft remained No. 1 in the industry, achieving offshore outsourcing revenues of US\$101 million, becoming China's first company with US\$100 million in software outsourcing revenues. Neusoft's 2006 outsourcing revenue grew 61.1% over 2005. These statistics were published in a report by CCIC Consulting, a leading market survey consulting company China's information industry.

Telecommunications/Internet

8) TOM Online to go Private from Nasdaq

Hong Kong-listed TOM Group Limited will take its Nasdaq-listed subsidiary TOM Online private. TOM Group will offer HK\$1.57 billion to buy the shares of Tom Online it doesn't already own. TOM Online, which specializes in wireless value-added services, has struggled, especially since China Mobile and China Unicom imposed restrictions on what types of messages TOM Online could send to users. Its shares on the Nasdaq dropped 42% between July 2006 and March 2007. However, things could be looking up, as TOM Online will restructure and further diversify its operations. These new areas include its instant communication joint venture with Skype, which is already seeing some success, and its e-commerce JV with eBay. TOM Group originally listed TOM Online on the Nasdaq three years ago.

Advertising

9) Focus Media Buys Allyes for US\$225 Million

Nasdaq-listed Focus Media, the Chinese out-of-home lifestyle media company, said it had acquired China-based Allyes Information Technology Company, an Internet advertising service. The acquisition will enable Focus Media to enter China's growing internet advertising market. Focus Media will acquire a 100% equity stake in Allyes for US\$70 million in cash and US\$155 million in the form of newly-issued Focus Media ordinary shares. Additional payment of up to US\$75 million in Focus Media ordinary shares will be paid contingent upon Allyes meeting certain earnings targets during the 12-month period from April 1, 2007 to March 31, 2008. The transaction is expected to close by the end of March 2007. Focus Media is known in China for its LCD advertising screens in office buildings and other high-traffic areas.

Air Travel

10) China's Hainan Airlines to Merge with Subsidiaries and List Overseas

Hainan Airlines, China's fourth-largest airline, is likely to merge with its subsidiaries and list overseas sometime this year. Hainan Airlines Group has received approval from China's civil aviation regulator to establish a new airline by merging Hainan Airlines with its subsidiaries, Xinhua Airlines, Chang'an Airlines, and Shanxi Airlines. The new airline will be called Grand China Airlines, and is expected to raise RMB4 billion-5 billion with the listing. Hainan Airlines' board chairman Chen Feng said the funds will allow it to better compete with China's three largest airlines, Air China, China Eastern and China Southern. Hainan Airlines operates 500 domestic routes, as well as a few international routes. In other news, the China Daily reported that Hainan Airlines has signed a US\$2.7 billion deal with Brazilian aircraft manufacturer Embraer to buy 100 planes. Delivery of the planes is scheduled to begin this year.

Banking

11) Citibank to Increase Stake in Shanghai Pudong Development Bank

Citibank is set to increase its influence in China's banking industry by increasing its stake in Shanghai Pudong Development Bank (PDB). Citibank, which currently owns 3.78% of PDB, has agreed with the Shanghai lender to increase its stake to up to 19.9%, the maximum percentage foreign investors can own in a Chinese bank. However, the planned increase is at the mercy of Chinese regulators, who must approve the investment. Late last year, a Citibank-led consortium beat out rivals (most notably a consortium led by France's Société Générale) to purchase an 85% stake in Guangdong Development Bank (GDB), essentially giving Citibank operational control of GDB. That deal endured a long approval process. Citibank's cooperation with PDB thus far has mainly been in the credit card area, and has been successful as their cooperative cards have seen very high per-card consumption.

Insurance

12) China Pacific to List in HK; Carlyle to Take 19.9% Stake

China Pacific Insurance Group has reached an agreement with Carlyle Group that will result in China Pacific pursuing a US\$1 billion Hong Kong IPO and Carlyle taking a 19.9% stake in the Chinese insurer. Carlyle had purchased a 25% stake in the insurer for US\$410 million in December 2005, which it will convert into shares equaling a 19.9% stake. The new deal will also involve an additional investment of an undisclosed amount from Carlyle. Negotiations between the two had been holding up China Pacific's IPO plans; now that an agreement has been reached, the offering is expected to take place later this year. China Pacific is China's third-largest life insurer, behind China Life and Ping An.

13) Ping An's Shares up 38% on Shanghai Debut

Shares of Ping An Insurance began trading on the Shanghai Stock Exchange on March 1. The shares jumped 38% on the first day of trading to close at RMB46.79 per share, after being sold in the IPO at RMB33.80 apiece. However, Ping An, which was already listed on the Hong Kong exchange, saw its H-shares fall 3.24% on March 1 to close at HK\$34.30. The closing price in Shanghai represented an almost 40% premium over the closing price in Hong Kong. The surge on the Shanghai exchange is yet another example of Chinese residents' eagerness to pour their money into the Chinese stock markets, with little regard for the actual valuations of companies. Ping An raised RMB38.87 billion in the IPO by selling 1.15 billion A-shares, representing China's second-largest IPO and the world's largest ever for an insurer. The Shanghai IPO was 28 times oversubscribed.

Real Estate

14) Morgan Stanley Planning New Property JV in Shanghai

The South China Morning Post reports that Morgan Stanley will continue to expand in Shanghai's property market by partnering with Yongye Enterprises on a development project. The office and retail project will reportedly cover 100,000 square meters. This development would mark the first time Morgan Stanley has purchased land for a project in mainland China. Morgan Stanley has previously invested in two of Yongye's projects in Shanghai.

Retail

15) Acorn Appoints New Bookrunners for US\$125 Million Nasdaq Listing

Acorn International, the Chinese home shopping TV network, has appointed new bookrunners for its scaled-back US\$125 million Nasdaq listing. Acorn has hired Merrill Lynch and Deutsche Bank as replacements for Credit Suisse and Morgan Stanley, the bankers previously appointed to handle the IPO. Acorn had initially planned a US\$200 million Nasdaq IPO for the middle of last year.

Retail

16) Intime Increases H-Share IPO Size

Zhejiang-province based Intime Department Store has increased its Hong Kong IPO size to up to HK\$2.4 billion. The company will sell 450 million H-shares at a price between HK\$4.36 and HK\$5.39, representing about 23.5 to 29 times projected 2007 earnings of RMB395 million. Intime and IPO sponsor Morgan Stanley had initially planned to price the shares between HK\$4 and HK\$5.20, or 18 to 24 times projected 2007 earnings. By comparison, China's top national department store chain Parkson Retail Group trades at about 37 times projected 2007 earnings, while Jiangsu-province based regional chain Golden Eagle currently trades at about 28 times. Intime has also included an option for the arranger to sell an additional 67.5 million existing shares that are currently owned by private equity group Warburg Pincus. In 2005, Warburg invested US\$86 million to take a 35% stake in Intime at an effective cost of HK\$1.47 per share. After the IPO, Warburg's stake will be reduced to 26%. Intime currently has three stores, all in Zhejiang province. It plans to open two more in Zhejiang, as well as one in Beijing with South Korea's Lotte Shopping.

Regulations

Two Major Laws up for Approval at NPC

At this year's meeting of the National People's Congress (NPC), China's highest legislative body, the two headline laws up for approval are the draft Property Rights Law and the draft Enterprise Income Tax Law. This year's session began on March 5.

The overarching purpose of the Property Rights Law is to define property rights and ensure equal protection of personal, state, and collective property, while keeping property rights in line with China's socialist market economic system. Although the state will own land, the law states that buildings, possessions, and income can be owned and used for profit, and ownership can be individual, collective, by a state-owned entity, or by a private business. The law also aims to ensure equal compensation for all parties when their property or land-use rights are expropriated by the government. Expropriation will be overseen by the central government, and will be conducted with the idea of promoting development that benefits China as a whole and fosters a harmonious society. In the past, local and regional governments expropriated property for their own projects, modernizing their regions but leaving many Chinese, often poorer citizens and farmers, out in the cold. The new law will finally bring property rights from a concept into a legal framework under which disputes can be settled.

Another major law up for approval is the draft Enterprise Income Tax Law, which will unify the corporate income tax rate for domestic and foreign invested enterprises (FIE). The rate will be unified at 25%. Domestic enterprises currently pay 33% tax, while FIEs, benefiting from tax breaks and deductions, only pay an average of 15%. The new law will standardize tax deduction procedures and preferential policies. Currently, tax preferential policies are rather arbitrary and are often handed out by different regions and localities to lure businesses. The new law will focus tax breaks more in industries that central government targets for growth, and less on regional preferences. The unification should result in a more transparent tax system and increase the competitiveness of domestic firms.

Both laws have been under development and debate for years (the Property Rights Law having been the most hotly debated), and are finally expected to pass at the NPC this year. Both laws will be key steps forward for China's legal and economic environment.

Regulations

IASB Considering China's New Accounting Rules

The International Accounting Standards Board (IASB) has published proposals to amend international accounting rules, which could become more like China's new regulations, which were issued by the Ministry of Finance on January 1. IASB's major proposed change is to reduce the amount of disclosure required for related-party transactions. The IASB proposals say that entities that are related "only because they are each state-controlled or significantly influenced by the state" will not have to disclose transactions between them. This essentially mirrors China's new accounting regulations, in which state-controlled entities are not necessarily regarded as related parties, and transactions between them don't have to be reported. "The proposals aim to remove a significant burden of disclosure from some entities, particularly in jurisdictions with extensive state control of, and significant influence over, business," said IASB Chairman David Tweedie. IASB Director of Research Wayne Upton added, "The new international accounting standards will use China's new accounting rules as a reference, as they are more cost-effective." The new international rules should make it easier for Chinese companies to comply with accounting rules when attempting to go public. As a point of reference, one-fourth of Hong Kong-listed PetroChina's half-year report in 2006, before China's new accounting regulations came into effect, was devoted to information about related-party transactions.

Macro

China Plans to Introduce Stock Index Futures in H1 2007

The China Securities Regulatory Commission (CSRC) is aiming to allow trading of stock index futures in the first half of the year. The stock index futures will be traded on the China Financial Futures Exchange (CFFE) in Shanghai, which was opened last September. The CFFE is China's first financial derivatives exchange. The index futures are expected to provide a much-needed hedging tool for investors, but regulators hope it doesn't lead to a rash of further speculation in China's already volatile capital markets. International financial giants have reportedly been lobbying Chinese regulators to include them in the first batch of investors that can trade the new futures.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
Worldbest Group	Shanghai-based state-owned company	Worldbest Canada	subsidiary of Shanghai Worldbest Industry Development, the listed apparel and fiber products maker	US\$15 Mil	95% stake
hiSoft Technology International	private China-based technology company	Envisage Solutions	private US-based IT services company	No more than US\$20 Mil	Undisclosed
Matsunichi Communication Holdings	Hong Kong-listed digital and communication technology products manufacturer	Tianjin Hi-Tech Sunshine Investment and Tianjin Hi-Tech New Star Investment	core assets of these two companies are the rights to use certain land in Tianjin	US\$259 Mil	N/A
Focus Media	China-based multiplatform lifestyle company	Allyes Information Technology Company	internet advertising service also based in China	US\$225 Mil	100% stake

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
Acorn International	mainland-based TV network for home shoppers	Nasdaq	US\$125 Mil	Merrill Lynch and Deutsche Bank
Chongqing Lifan Group	mainland-based automaker	Hong Kong	US\$128 Mil	N/A
Shanghai Cred Real Estate	mainland-based developer	Hong Kong	US\$200 Mil	N/A
Shanghai Stock Exchange	one of mainland China's largest exchange operators	Shanghai	N/A	N/A
Yangzijiang Shipbuilding	China-based shipbuilder	Singapore	US\$800 Mil	UBS AG, Singapore
Gateway Group	Hong Kong-based property developer planning to launch a REIT IPO comprised mainly of office buildings in China	Hong Kong	US\$500 Mil	Deutsche Bank and HSBC Goldman Sachs
Xinjiang Gold Cattle Biology	Mongolia-based cattle breeding company	Hong Kong	US\$100 Mil	Everbright Securities