

Eye on China

A View from Shanghai

Week of March 24-March 30, 2007

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

CEO

Robert Theleen
Wallace Mathai-Davis

President

Jenny Hsui

Vice Chairman

William Fuller

Managing Director

Richard Wang
Eugene Zhao

Market Weekly

Shanghai Composite Index

- 3/23 Close: **3074.29**
- 3/30 Close: **3183.98**
- Change: ↑ **3.568%**

Shenzhen Composite Index

- 3/23 Close: **8489.86**
- 3/30 Close: **8549.20**
- Change: ↑ **4.204%**

Articles

Manufacturing

- 1) BMW to Build Second Plant in China
- 2) Nanjing Auto Starts Production of MG Models in China
- 3) Wonder Auto Applies for Listing on Nasdaq
- 4) Scottish & Newcastle to Increase Stake in Chongqing Brewery
- 5) China Oilfield Services Planning Shanghai IPO

Technology

- 6) China's Digital Publishing Industry Revenue Exceeds US\$2.5 Billion
- 7) Intel Funds Semiconductor College in Dalian
- 8) Micron Technology and Applied Materials Open Facilities in Xi'an
- 9) SMIC May Bring in Strategic Investor
- 10) Trial Operations Begin at Western China's First 8-inch Chip Plant
- 11) China's Mobile Handset Sales Surge 40% in 2006

Services

- 12) Beijing Airport Ranks as World's Ninth (by Passengers Traveled)
- 13) Bohai Bank Allowed to Carry Negative Positions in Forex Trading
- 14) China CITIC Bank Plans to go Public in April
- 15) Two Foreign Banks Looking to Offer RMB Services
- 16) Warburg to Invest US\$175 in Oil Logistics Group
- 17) Wal-Mart Opens 75th Store in China
- 18) COSCO Pacific May Sell Shares on Mainland

Regulations & Macro

- New Regulations Allow Financial Futures Trading
- CSRC Prohibits Listed Companies from Speculating with Funds Raised from Capital Markets

Deals in China

- M&A Activity – A Closer Examination
- IPO Pipeline

Automobiles

1) BMW to Build Second Plant in China

BMW is planning to build a second plant in China. The new plant will be located in Shenyang, in northeast China, and will be jointly run with its domestic partner, Brilliance Auto. The plant will give BMW an additional production capacity of 50,000 autos per year in China. Similar to the arrangement that the two companies have in their other plant, Brilliance will probably share the facility with BMW, using it to manufacture its own brand of automobiles. A local Shenyang government official said construction of the new plant should start in April. Last year, BMW sold 36,357 automobiles in China, a 51% jump from 2005. In other news, Brilliance Auto just won a contract to export 80,000 vehicles to Russia. The deal is worth about US\$1 billion.

2) Nanjing Auto Starts Production of MG Models in China

Nanjing Automobile Group has begun production of two MG car models, the MG7 series sedan and the MG-TF sports car. The Chinese car manufacturer acquired the rights to the MG brand in July 2005 from bankrupt British carmaker MG Rover. Nanjing Auto spent £53 million to take over the assembly lines, engine technology, and many of MG Rover's models. Although Nanjing Auto hasn't said how many cars it will produce in 2007, the new plant can produce 200,000 MG Rovers per year. Construction of the plant, which will involve an investment of RMB3.5 billion (approximately US\$450 million), began last March. Nanjing Auto's MG plant in Longbridge, England will begin producing MG-TF models in April, and will have annual production capacity of 50,000. Wang Haoliang, Nanjing Auto's Chairman commented, "the acquisition of UK MG Rover Group has put Nanjing Auto on the shoulder of a giant. We are confident we'll be able to revive the valuable MG Rover brand." In related news, Shanghai Automotive Industry Corp (SAIC) recently unveiled its Roewe 750 sedan last October, a line based on the Rover 75 model saloon. SAIC acquired the rights to MG Rover Group's 75 and Rover 25 models in 2005 after it lost the bidding process to Nanjing Auto for all of MG Rover's models and engine technology.

Auto Parts

3) Wonder Auto Applies for Listing on Nasdaq Global Market

Wonder Auto Technology, Inc, a China-based manufacturer of automotive electrical parts, has filed an application for listing on the Nasdaq Global Market. Wonder Auto went public in 2006, and currently trades on the OTC Bulletin Board. Through its subsidiary Halla Electrical Equipment Co, Ltd, Wonder Auto focuses on designing, manufacturing, and selling alternators and starters. Halla is based in Jinzhou, in northeast China's Liaoning province. "We have made significant strides as a US-traded company since becoming public in June, 2006. We continue to expand our business in both domestic and international markets and have an established competitive position with our low cost structure and competitive technology. As a growing public company, we believe that it is the appropriate time to apply for the listing on Nasdaq," said Qingjie Zhao, Wonder Auto's Chairman and CEO. While the application is being processed, Wonder Auto will continue to trade on the OTCBB.

Food & Beverage

4) Scottish & Newcastle to Increase Stake in Chongqing Brewery

The China Business News reported that Scottish & Newcastle (S&N), the world's fifth-largest brewer, will increase its stake in Shanghai-listed Chongqing Brewery. The paper cited a source as saying that S&N will invest about RMB989 million (roughly US\$130 million) in Chongqing. S&N currently holds a 17.5% stake in the brewery, which is located in southwest China. The world's largest brewers, including Anheuser Busch and SABMiller, are also focusing on solidifying and expanding their positions in the world's largest beer market. Beer consumption in China rose 16% in 2006.

Petroleum

5) China Oilfield Services Planning Shanghai IPO

Hong Kong-listed China Oilfield Services Ltd (COSL), an affiliate of the China National Offshore Oil Company (CNOOC), plans an A-share listing on the Shanghai Stock Exchange and will also issue RMB1.5 billion (approximately US\$200 million) worth of bonds to fund expansion. COSL is expected to sell 820 million A-shares, and based on its current trading price on the Hong Kong Stock Exchange, it could raise roughly RMB5 billion. The bonds would be 15-year bonds with a coupon rate of between 4.0% and 4.4%. At the moment, the company is also focusing on closing its acquisition of STU, a Russian oil services company, which it hopes to complete before the end of April. The STU deal is rumored to be worth about US\$65 million. COSL reported net profit of RMB1.13 billion in 2006, up 37% from the previous year.

Digital Publishing

6) China's Digital Publishing Industry Grew to US\$2.5 Billion in 2006

China's digital publishing industry generated sales of almost RMB20 billion last year, according to a report published by the China Book Press. It was China's first-ever report on the industry, which analyzed internet, e-book, online game, and mobile-phone related digital publishing. Digital publishing in the mobile phone medium generated about RMB8 billion in sales, taking a greater share of the RMB20 billion total than any other medium. China's State Press and Publication Administration (SPPA) compiled the report in conjunction with experts at universities including Peking University and Tsinghua University.

Semiconductor/Integrated Circuit

7) Intel Funds Semiconductor College in Dalian

Intel has reached an agreement with China's northeastern city of Dalian to establish a college specializing in semiconductor education. The college will be part of the Dalian University of Technology, and will involve investment of RMB348 million. Dalian is the site of Intel's proposed new US\$2.5 billion wafer fabrication plant, which will open in 2010. The semiconductor university, which will open in August 2008, will be China's top training center for IC professionals and will groom employees for Intel's Dalian operations. According to Wee Theng Tan, the president of Intel China, Intel will donate an 8-inch chip assembly line to the college and help train teachers and develop the curriculum. The Dalian city government estimates that the new wafer plant will create 1,700 jobs.

8) Micron Technology and Applied Materials Open Facilities in Xi'an

Micron Technology, one of the world's largest semiconductor manufacturers, opened a manufacturing facility in western city of Xi'an. The facility will focus on assembly and test operations for Micron's semiconductor products, and will involve an investment of US\$250 million. It is expected to be completed by the end of 2008 and will employ about 2,000 workers. It will be Micron's first manufacturing facility in China, and represents the largest-ever investment at the Xi'an High-Tech Zone. Additionally, Applied Materials, the world's largest manufacturer of semiconductor production equipment, has opened its new Global Development and Technology Support Center in Xi'an. "The Xi'an center is a major expansion of our capabilities and positions us strategically to benefit from growth throughout China, particularly in the western regions," said Mike Splinter, president and CEO of Applied Materials. Xi'an is aiming to become one of China's largest semiconductor production bases. NYSE-listed Micron Technology has market cap of about US\$9 billion, while Nasdaq-listed Applied Materials has market cap of about US\$26 billion.

Semiconductor/Integrated Circuit

9) SMIC May Bring in Strategic Investor

NYSE- and Hong Kong-listed Semiconductor Manufacturing International Corporation (SMIC) has reportedly hired major investment banks Morgan Stanley and Deutsche Bank to solicit a sale to strategic or financial investors. Private equity firms are regarded as likely candidates, as an investment of this magnitude in Shanghai-based SMIC would give them a major presence in China's growing technology sector. Investors could spend up to US\$500 million for a 20% stake in SMIC. According to a Financial Times report, sources close to the situation said that SMIC wouldn't have to seek full shareholder approval if its share capital is enlarged by less than 20%. Experts say that SMIC is in need of capital to fund expansion, as it must keep up with competitors such as Taiwan Semiconductor Manufacturing Corporation (TSMC). Interestingly, an SMIC spokesman denied that the firm is seeking investors, saying the company simply hired the investment banks to provide advice on SMIC's routine investments. SMIC's shares in Hong Kong jumped 6% on Monday, March 26, the day after the report was released.

10) Trial Operations at Western China's First 8-inch Chip Plant Begin

Sources at Sichuan Chengxin Semiconductor Manufacturing Company said that trial operations of its 8-inch semiconductor manufacturing plant had started by the end of March. The plant is located in southwest China's Sichuan province, and will be the first 8-inch chip plant to operate in western China. Mass production at the plant is slated to begin in June, after which the plant's annual output value is expected to top RMB1 billion.

Telecommunications

11) China's Mobile Handset Sales Surge 40% in 2006

Sales of mobile handsets in China grew 40% in 2006 to 120 million and a recent market study expects that number to rise to 150 million in 2007. Last year's growth was not only attributable to new mobile service subscribers on the mainland (which grew 25% last year), but also to Chinese consumers' willingness to upgrade to more advanced models. On average, Chinese mobile phone users buy a new phone every 21 months. About 450 million handsets were manufactured in China last year, 350 million of which were exported. Motorola and Nokia led the way, while only 50 million domestic branded handsets were sold worldwide.

Air Travel

12) Beijing Airport Ranks as World's Ninth (by Passengers Traveled)

According to the Airports Council International (ACI), Beijing Capital Airport ranked ninth in the world in terms of number of passengers in 2006. The airport handled a total of 48.5 million passengers, and cracked the world's top 10 for the first time. An airport expansion project will begin in early 2008 and will prepare for Beijing Capital for future annual passenger throughput of 70 million. The airport also ranked 21st in 2006 in cargo and mail volume, at 1.03 million tons. Atlanta's Hartsfield-Jackson International Airport ranked first in passenger throughput, with almost 85 million last year.

Banking

13) Bohai Bank Allowed to Carry Negative Positions in Forex Trading

China's State Administration of Foreign Exchange (SAFE) has given Tianjin's Bohai Bank the go-ahead to hold net negative positions in foreign exchange purchases and sales. Bohai Bank, whose overseas strategic partner is UK-based Standard Chartered Bank, will be the first Chinese bank with such permission. Currently, Chinese regulations dictate that a bank's daily foreign exchange sales must not exceed its foreign exchange purchases. China's desire to make the city of Tianjin into northern China's financial center is a major reason SAFE has given this special authorization to Bohai Bank. The goal is to turn Tianjin's Binhai area into a financial services center similar to Shanghai's Pudong New Area.

14) China CITIC Bank Plans To Go Public in April

China CITIC Bank, the country's seventh-largest commercial bank, is planning a dual listing on both the Shanghai and Hong Kong Stock Exchanges on April 27 to raise between US\$2.8 billion and US\$3 billion. The bank will sell about 2.30 billion A-shares and 4.95 H-shares, and has already received approval to list from the Hong Kong Stock Exchange. The China Securities Regulatory Commission (CSRC) will review CITIC Bank's application to list in Shanghai on April 2. The shares on both exchanges will be offered at the same price. CITIC Bank will become the second Chinese bank to go public using a dual listing. The first was Industrial and Commercial Bank of China (ICBC), which simultaneously listed on the Hong Kong and Shanghai exchanges last October in the world's largest IPO. Spanish banking group BBVA recently spent RMB4.89 billion to acquire a 4.83% stake in CITIC Bank, and will purchase the necessary amount of shares in the IPO to maintain its current percentage stake. At the end of 2006, China CITIC Bank's capital adequacy ratio was 9.41%, up from 8.11% a year before, and its non-performing loan ratio stood at 2.50%, down from 4.14% at the end of 2005.

Banking

15) Two Foreign Banks Looking to Offer RMB Services

Two major foreign banks have indicated that they are submitting applications to the China Banking Regulatory Commission (CBRC) to incorporate banking subsidiaries in China. Germany's Deutsche Bank and France's BNP Paribas are seeking to become foreign banks that can offer RMB-denominated commercial banking services on the mainland. Deutsche Bank would headquarter its local commercial banking operations in Beijing, while BNP Paribas would set up in Shanghai. Just recently, the first four foreign banks were approved to set up local banking subsidiaries (five others' applications are still under review by CBRC). The first four were HSBC, Citibank, Standard Chartered Bank, and Bank of East Asia. China has started opening up its banking sector to foreign players as part of its WTO commitments. Previously, foreign banks could only offer foreign currency-denominated commercial banking services on the mainland.

Logistics

16) Warburg to Invest US\$175 in Oil Logistics Group

Warburg Pincus will invest US\$175 million in Hong Kong-listed oil logistics company Titan Petrochemicals Group and its subsidiary China StorageCo. For US\$75 million, Titan will sell 9.8% of its existing ordinary shares to Warburg, plus new preferred shares and warrants, which will allow the private equity group to increase its holding to 22% of Titan's shares if it exercises all of its rights. Warburg will also buy a 49.9% stake in China StorageCo, which operates onshore oil storage terminals in China, for US\$100 million. In 2006, Titan's profits decreased by about two-thirds from 2005.

Retail

17) Wal-Mart Opens 75th Store in China

On March 24, Wal-Mart opened a 19,000-square-meter store in Xiangfan City in China's Hubei province. The store is Wal-Mart's 75th in China and its third in Hubei province. Wal-Mart also recently beat out major international rivals in agreeing to acquire a 35% stake in a Taiwanese company that controls 101 Trust Mart markets in China. Wal-Mart's largest foreign competitor is French chain Carrefour, which has 76 stores in China and 47 in Taiwan.

Shipping

18) COSCO Pacific May Sell Shares on Mainland

Bloomberg News reported that COSCO Pacific Ltd, Asia's third-largest container-terminal operator, may fund its expansion plans through a domestic IPO. COSCO Pacific, whose shares currently trade in Hong Kong, is one of the listed subsidiaries of the COSCO Group, the Chinese state-owned shipping conglomerate. "We hold a very positive and active view on a share sale," COSCO Pacific Vice President Xu Minjie said. According to the Bloomberg report, COSCO Pacific plans to add an average of 20 berths a year until 2010, while also opening oil and bulk-cargo facilities. The company also saw a 26% rise in container throughput at its terminals last year. It operates 16 terminals worldwide, and had estimated 2006 net income of about US\$155 million.

Regulations

New Regulations Allow Financial Futures Trading

The government just released new regulations that cover the trading of financial futures and options contracts in China. The previous set of regulations, released in 1999, only covered commodities futures. The new laws allow the trading of financial futures such as indices, bonds, interest rates, and exchange rates. The 1999 regulations prevented domestic financial firms from conducting futures trading, from raising capital to be used for trading, and from providing futures trade-related guarantees. The new regulations overturn these provisions, while also allowing domestic financial institutions to start futures brokering activity outside of China. The new rules also set the stage for the introduction of stock index futures, which are expected to debut on the China Financial Futures Exchange (CFFE) in Shanghai within a few months. Under the new rules, securities houses, fund management companies, and commercial banks can conceivably undertake financial futures trading. However, they must have at least RMB30 million in registered capital and must have a history of sustained profitability in their business activities. Financial futures were last traded in China in 1995 but were subsequently shut down by the government.

CSRC Prohibits Listed Companies from Speculating with Funds Raised from Capital Markets

The China Securities Regulatory Commission (CSRC) recently issued a new regulation that prevents listed companies from using funds raised via the sales of stocks and bonds to speculate in the capital markets. The regulation was enacted because the government became aware that certain listed companies have been using funds to speculate in the markets rather than for core business activities. The regulation states that publicly listed companies and their relevant employees will be held responsible for serious violations of the new rules.

Deals in China

M&A Activity

| Acquirer | Description | Target | Description | Amount | Deal details |
|----------------|--|---|---|----------------------|----------------------------|
| PetroChina | mainland-based petroleum giant | Zhuhai City Commercial Bank | city commercial bank based in Zhuhai City | RMB 2 Bil | controlling stake |
| Warburg Pincus | private equity group | Titan Petrochemicals Group and subsidiary China StorageCo | HK-listed oil logistics group | total of US\$175 Mil | 9.8% stake and 49.9% stake |
| China Vanke | large mainland-based listed property developer | properties owned by Hangzhou Iron | mostly land that will be used for construction in Shenzhen | RMB 1.01 Bil | N/A |
| Scotiabank | Canada-based bank | Bank of Dalian | city commercial bank based in Dalian | N/A | 19.9% stake |
| Hony Capital | private equity arm of Legend Holdings (Legend is the parent of Lenovo) | Shijiazhuang Pharmaceuticals | state-owned pharmaceutical group with RMB 8 billion in assets | N/A | N/A |

Deals in China

IPO Pipeline

| Company | Description | Exchange | Size | Financial Advisors |
|----------------------------|--|-------------------------|------------------------|--|
| China CITIC Bank | China's seventh-largest commercial bank | HK and Shanghai | total of US\$2.8-3 Bil | several major investment banks |
| China Railway Construction | state-owned railway company | HK and Shanghai | up to US\$2 Bil | CITIC Securities, Citigroup, Macquarie |
| China Metallurgical | Chinese construction giant | HK and Shanghai | total of US\$3 Bil | Morgan Stanley, Citibank, China International Capital Corp (all rumored) |
| COSCO Pacific | HK-listed container-terminal operator, subsidiary of COSCO Group | stock exchange in China | N/A | N/A |
| China Oilfield Services | HK-listed unit of CNOOC | Shanghai | up to RMB 5 Bil | N/A |
| Jinling Hotels | Nanjing-based hotelier | Shanghai | RMB 467.5 Mil | Huatai Securities |