

Eye on China

A View from Shanghai

Merchant Banking Advisory In China for Over Twenty Five Years

ChinaVest

Senior Management

Robert Theleen
Jenny Hsui
Alexander Lee
Wallace Mathai-Davis
William Fuller
Erik Bethel
Eugene Zhao
Tao Tao

Editorial

Emily Eliot
David Greer
Patrick Kelly
Rajith Sebastian

Market Weekly

Shanghai Composite Index

- 4/30 Close: **3,693.11**
- 5/16 Close: **3,624.23**
- Change: ↓ **1.865%**
- Since 1/1/08: ↓ **31.119%**

Shenzhen Composite Index

- 4/30 Close: **13,504.89**
- 5/16 Close: **13,314.38**
- Change: ↓ **1.411%**
- Since 1/1/08: ↓ **24.780%**

Exchange Rate

- 5/2: US\$1 = **RMB 6.999**
- 5/16: US\$1 = **RMB 7.006**
- Change: ↓ **0.100%**
- Since 1/1/08: ↑ **4.218%**

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Metals

1) Chinalco to Invests in Latin American Copper Mine

Aluminum Corp of China (Chinalco) has made another overseas investment this year, committing US\$2.16 billion for the Toromocho copper mine in Peru. The investment, which is being funded by China Development Bank, was increased from the initially planned US\$1.5 billion. The mining operation will become Peru's largest copper mine, and is expected to increase the country's exports by 25%. Peru already ranks 3rd worldwide in copper production, while China ranks 1st in copper consumption. The Toromocho copper mine is located approximately 85 miles from Lima, Peru, and expects to produce over 210,000 metric tons of copper annually by 2012, with estimated reserves to last for roughly 30 years.

Investment between Latin America and China has become increasingly common as ties between China and the region have strengthened in recent years. In 1978, China invested a mere US\$200 million dollars in the region, but by 2000 that figure had risen to US\$10 billion. According to the Commerce Ministry of China, by the end of 2006, China's direct investments abroad surpassed US\$90 billion, and 25% of that was directed towards Latin America. At present, Chinese enterprises are engaged in approximately 30,000 projects in the region.

In related news, earlier this year Chinalco offered US\$14 billion for a stake in mining giant, Rio Tinto. Chinalco also signed agreements with Malaysia's MMC Intentional Holdings Ltd and Saudi Binladin Group for investment in a Saudi Arabian aluminum project. The total investment of US\$ 4.5 billion will include aluminum production and electricity generation facilities, in which Chinalco will own a 40% and 20% stake, respectively.

Automotive

2) Toyota Increases China Investment

Toyota Motor Corp, Japan's largest car manufacturer and China's third largest foreign car brand, announced plans to increase investments in auto manufacturing plants around China. In order to increase their production capacity, the company will invest RMB3.6 billion (US\$506 million) to expand the Changchun operations of its joint venture with *First Automobile Works Group (FAW)*. After the expansion, FAW Toyota will be able to produce 470,000 units a year, up from 420,000 units. Toyota also plans to inject an additional RMB1.5 billion (US\$215 million) to boost production capacity at their facility in the Tianjin Municipality in Northern China. With the new funds, the Tianjin plant is expected to increase production capacity by 50% to 150,000 vehicles a year by 2009. These expansions, combined with additional increases at other factories, will allow Toyota to have an approximate annual production capacity of 690,000 vehicles in China.

In related news, Toyota was forced to suspend production at their joint venture plant in Chengdu due to last week's earthquake. Toyota will decide when to resume operations at the factory only after inspections are completed.

Cement

3) Asia Cement (China) IPO's in Hong Kong

Chinese cement producer *Asia Cement (China) Holdings Corp.* successfully raised US\$238 million in a Hong Kong IPO last week, with trading set to start on May 20 under the symbol of "723." The company is selling 375 million shares, representing 25% of its enlarged share capital, priced at HK\$4.95 a share, the low end of an indicated range of HK\$4.85-HK\$6.45. Intuitional and retail public offerings were oversubscribed 3 times and 4.3 times respectively.

Asia Cement (China) is a spin off of the Taiwan-listed Asia Cement Corporation. The Chinese company produces cement and clinker mostly in Jiangxi and Hubei provinces, along the Yangtze River. Proceeds from the IPO will be used mainly for plant expansion and loan repayment; specifically to increase annual clinker capacity from 5.5 million tones to 12.5 million by 2010.

Logistics

4) Sinotrans to Merge with Changjiang Shipping

China logistic companies *Sinotrans Group* and *Changjiang Shipping Corp (CSC)* have announced plans to merge, with Sinotrans Group to take the lead in the deal. The merger, which has already received approval from the *State-owned Assets Supervision and Administration Commission (SASAC)*, will create the country's second largest logistics firm. The two companies are currently in the process of setting up a working team to complete the deal, which will likely be finalized within the next two months. Sinotrans Group, China's largest logistics service provider, is the parent company of the Hong Kong-listed Sinotrans Ltd. and indirectly controls Shanghai-listed Sinotrans Air Transportation Development Co Ltd. (SHA 600270). Wuhan- based CSC Group is China's largest river shipping company and controls two listed arms: Shenzhen-listed Changjiang Shipping Group Phoenix Co Ltd. (SZA 000520) and Shanghai-listed Nanjing Water Transport Industry Co. Ltd. (SHA 600087).

After completion of this deal, China will have a total of four state-owned shipping companies: China Ocean Shipping (Group) Co. (COSCO), China Shipping Group Co., China Merchants Group, and the new entity.

Telecom

5) Huawei Considering Sale of Stake in Mobile Devices Unit

Huawei, the Chinese network switching equipment giant, is reportedly exploring the sale of a stake in its mobile devices division. The sale could be worth multiple billions of dollars. Multiple sources report that the assets up for bidding specifically include the mobile handset business, routers for use in homes, and PC wireless internet cards. Huawei is not looking to dispose of the business, but rather to find a strategic partner, which among other things would help the mobile services division further increase its international presence. A deal would also provide cash for the company's overall expansion plans.

The mobile services division has already made a splash abroad, having signed an agreement in 2006 to provide 3G handsets to Vodafone. Six months ago, Huawei also signed a deal with U.S.-based MetroPCS Communications to provide handsets to the U.S. market (Wall Street Journal).

The plans for a sale of a stake in the unit are still in the early stages, and it remains unclear whether a "strategic partner" could be another industry player or a private equity firm. A number of the major international PE firms will surely show serious interest.

In related news, earlier this year, PC maker *Lenovo* announced it would sell its mobile handset division for US\$100 million. The division is not currently profitable, and the company said would sell the division to concentrate on its core PC business.

6) London-based Mobile Marketing Firm Buys Into Chinese Company

Velti plc, an AIM-listed company that provides mobile advertising solutions, has entered the Chinese mobile ad market. The group will spend up to US\$6 million to take up to a 50% stake in *CASEE*, China's top mobile advertising exchange. *CASEE*'s technology matches bids from advertisers with mobile web portals operated by companies like Yahoo, Baidu, and Sohu. The service reportedly serves about 500 million ads a month. Alex Moukas, Velti's CEO, said of the deal: "Our investment in *CASEE* is in line with our strategy of supporting the global needs of our clients and being a leader in developing the mobile marketing channel. Partnering with *CASEE* gives Velti an early foothold in China's rapidly growing mobile market." *CASEE* was formed in 2006 in Beijing, and currently has 25 employees. The company plans to expand to 40 employees by the end of 2008.

Private Equity

7) Carlyle Signs Agreement with Shandong Provincial Government

Carlyle Group, the Washington-based private-equity firm, has signed a memorandum of understanding with the *Shandong Department of Foreign Trade and Economic Cooperation*, a division responsible for connecting local companies to foreign investors and promoting their enterprises overseas. For Carlyle, the agreement is a bid to secure priority access to private equity deals in Shandong Province. Grappling with a surge in foreign speculative capital and protective of the country's strategic industries, the Chinese government has recently been cautious about opening deals to overseas investors. So far this year, private equity firms have deployed US\$512.4 million in China, down 18% from deals done in 2007.

Shandong, with a population of over 100 million people, is China's second largest province in terms of economic output and is best known for its strength in the chemicals and household appliances industries, as well as Tsingtao beer. To date, Carlyle has made two investments in Shandong Province: US-based conveyor belt maker Veyance Technologies, Inc., owned by Carlyle, has invested roughly US\$100 million in a local joint venture, and Carlyle itself has invested in a property venture in Qingdao.

While in New York to negotiate deal with Carlyle, Shandong Vice Governor Cai Limin also signed an agreement with Caterpillar Inc., which has invested in a Shandong machinery company, and one with Governor Jon Corzine of New Jersey on bilateral investment between the province and the state.

Insurance

8) China's ICBC to buy into Taiping Life

Industrial and Commercial Bank of China (ICBC), the world's largest bank by market value, announced plans to acquire a stake in *Taiping Life Co.*, the country's sixth largest life insurance company, via a complex equity deal. ICBC will pick up the holding by buying into a joint venture to be formed between *China Insurance International Holdings* and Fortis Insurance International, a Belgian-Dutch financial services group. China Insurance International and its parent now control 75% of Taiping Life, while Fortis holds the remaining 25%. Ultimately, ICBC and China Insurance International will each control 43.5% of the joint venture, which is expected to take full control of Taiping Life, Taiping Insurance, Taiping Pension and Taiping Asset Management. Fortis Insurance will hold the remaining 13%.

Earlier this year, the Chinese banking and insurance regulators agreed to grant permission to commercial banks to invest in existing insurers. Earlier this month, China Merchant Bank announced that it would spend RMB141.9 million to buy a 50% stake in local firm CIGNA & CMC Life Insurance. Similarly, in our last issue we included the details of HSBC's announcement of its first life insurance joint venture that it plans to launch in China in July or August with local partner, Bank of Communications.

Banking

9) Bank of East Asia to Issue First Foreign RMB Debit Card

Bank of East Asia Ltd. (BEA) announced last week that its RMB-denominated debit card has passed central bank testing and will be officially issued in mainland China on Tuesday, May 20th. BEA will launch the yuan card in Beijing with *China Unionpay Co.*, the country's only bank-card payment network provider. The Hong Kong-based bank will be the first foreign lender to issue yuan debit cards in mainland China since Beijing agreed to allow locally incorporated foreign banks to offer the services last May. BEA, along with competitors Citigroup Inc., HSBC Holdings PLC, and Standard Chartered, set up its locally incorporated unit last year and received the China Banking Regulatory Commission's approval in September to issue the debit cards. HSBC announced last week that it expects to issue its own debit cards this year after system preparations are completed. Similarly, representatives from Citigroup have said that preparations are currently in process for the debit cards, and Standard Chartered has said that it hopes to issue its yuan cards as soon as possible (Reuters).

As per the current law, foreign banks that are not locally incorporated in China are limited to issuing co-branded credit cards through local partners, something both Citigroup and HSCB have already done. HSBC has issued over 6 million dual currency cards through their local partner Bank of Communications, and Citigroup has issued a similar card through Shanghai Pudong Development Bank, of which Citi owns almost 4%. Neither BEA nor Standard Chartered offers such services in China.

According to data from the People's Bank of China, by the end of 2007, 1.47 billion bank cards had been issued in China, up 30% from 2006. The total included 70 million credit cards and 1.38 billion debit cards, as well as other types of bank cards.

Other Finance

10) Yangtze China to raise \$20m via AIM

Yangtze China Investment is planning to raise US\$20 million, including US\$3 million from the management, through a share listing on London's Alternative Investment Market (AIM). The firm seeks to raise the fund to back companies that are expected to benefit from the growing affluence of the middle class in China. The fund will initially spend US\$9.39 million to acquire a portfolio of investments secured last year in three companies, including a home shopping business that broadcasts on local television, a technology for three-dimensional flat screen displays, and a technology being developed for the Chinese tax authorities. The fund also has a pipeline of further investment opportunities, including memorandums of understanding to invest a further US\$4.5 million.

Yangtze China will take up to 45% of each company it invest in as well as seeking board representation. All the fund's investments will be spun off or sold on to trade buyers after three to five years.

Macro

Food Prices Continue to Fuel Inflation, PBOC Raises Reserve Rate Again

Mainland inflation remained high in April at 8.5%, an increase of 20 basis points over March's CPI growth figure of 8.3%. As has been the case since mid-2007, skyrocketing food prices are the chief cause. Overall, food prices were up 22.1% over the same period last year. Some common food items, however, have risen at much higher rates. Prices of pork, the country's staple meat, are up 68.3%, while overall meat prices have increased 48%. Cooking oil prices are up 46.6%. As purchasing power has risen in China, food consumption has increased, and preferences have shifted toward the increased consumption of meat. Demand has not kept up, which, among other factors, is creating the upward pressure on prices.

Despite the fact that the CPI has registered consistently high growth figures every month in 2008 thus far (January: 7.8%; February: 8.7%, a 12-year high; March: 8.3%; April: 8.5%), there may be some relief on the horizon. A Lehman Brothers report predicts that due to increased domestic food output as the year progresses, inflation should fall to around 4.3% in the third quarter, and could even fall below 2% in Q4. The report placed its predicted full year 2008 CPI growth figure at 5.5%, which is not too far in excess of Beijing's full year target of 4.8%.

In response to the release of April's economic data, the *People's Bank of China* (PBOC—China's central bank) announced it will once again raise the required reserve ratio (RRR) for banks by 50 basis points. The hike, the fourth this year and the 14th since the beginning of 2007, will bring the RRR to 16.5%. "We believe the April inflation data suggests that it is still far too early to claim success in the battle against inflation. As underlying inflationary pressures remain undiminished, it is vital for the government to keep its tightening policy stance to anchor inflationary expectations," Goldman Sachs recently commented on the subject (Xinhua News Agency). However, as we have stated over the past few months and as the Lehman Brothers report supports, raising interest rates and the RRR alone won't provide major relief to inflationary pressure. Only an increase in food supply will begin to bring prices back down.

Beijing to Encourage Farmland Purchases in Latin America and Africa

The Financial Times reports that China is preparing a policy that will encourage domestic companies to purchase farmland overseas, especially in Africa and Latin America, in order to guarantee food supply. As we touched on in the previous article, China is already having difficulty with food price increases, and as time passes, the issue will only become more pressing. In fact, China has about 40% of the world's farmers, but only 9% of the world's arable land. "Some Chinese scholars argue that domestic agricultural companies must expand overseas if China is to guarantee its food security and reduce its exposure to global market fluctuations" (Financial Times). The new proposal, which was drafted by China's *Ministry of Agriculture*, will likely face little to no opposition in Beijing before gaining approval.

However, considering that food prices are rising rapidly around the globe, some experts are predicting that acquiring overseas farmland could face opposition from some foreign governments that want to protect their own food sources. Additionally, China isn't the only nation exploring options for overseas farmland; other countries that lack the ability to satisfy their own demand, such as Saudi Arabia, are undertaking similar initiatives.

As an aside, the Xinhua News Agency recently pointed out that China has directed 25% of its overseas investment into Latin America. Wang Jinzhen, vice president of China's International Trade Promotion Committee, stated the obvious at a recent conference, saying that investments in Latin America will only increase as ties between China and the region strengthen. Wang added that Chinese enterprises are currently engaged in 30,000 projects in Latin America. Along with China's excellent business relationship with some African nations, the increasing cooperation with Latin America should be a promising sign for the aforementioned farmland initiative.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
CNinsure	leading independent insurance agency and brokerage company operating in China	Guangxi Xingfu Insurance Agency Co. Ltd.	primarily engaged in property and casualty insurance	N/A	60% stake
China Merchants Bank	China's top retail bank	CIGNA % CMC Life Insurance	life, health, and accident insurance services	RMB141.8 7 Mil.	50% stake
FDS Networks Group	an investment holding company that offers audio conferencing services in Hong Kong, Singapore and Bangkok, provides managed audio conferencing services to multinational banks, and offers a range of teleconferencing and media services to major corporations	Long Concept Holdings	Hong-Kong based company that owns businesses engaged in environmental protection engineering and wastewater treatment in China.	US\$20.8 Mil.	100% stake
Eurasian Natural Resources Corp (ENRC)	the worlds largest ferro-chrome producer by content	Xianjiang Tuoli Taihang Ferro-alloys Co.	one of China;s largest ferro-chrome plants	RMB101.2 5 Mil.	100% stake
Hainan Airlines	China's fourth-largest airline in terms of fleet-size, based in Haikou, Hainan	Shenzhen Financial Leasing	Shenzhen-based leasing company with experience in aircraft purchase and leaseback deals	US\$74 Mil.	6.4% stake

Deals in China

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
Shandong Chenming Paper Holdings Ltd	manufacturer and distributor of machine-made paper, paper stock and papermaking machinery	Hong Kong	HK\$3.9 Bil.	N/A
Central China Real Estate Group	Mainland-based residential property developer	Hong Kong	US\$200 Mil.	Morgan Stanley, BOC International
Asia Cement (China) Holdings Corp.	cement maker, spin-off of Taiwanese conglomerate Far Eastern Group	Hong Kong	US\$238 Mil.	BNP Paribas, ABN Amro Rothschild
Pou Sheng International Holdings	Mainland retailer	Hong Kong	US\$300-500 Mil.	Merrill Lynch, Morgan Stanley
Xtep International Holdings	sports casual apparel, footwear and accessories manufacturer and distributor	Hong Kong	US\$300-400 Mil.	UBS, JP Morgan
Chongqing Machinery and Electronics Holding	state-run machine tool maker	Hong Kong	US\$300 Mil.	Credit Suisse
A8 Digital Music Holdings Ltd.	Shenzhen-based wireless value-added service provider	Hong Kong	HK\$301 Mil.	SBI E2-Capital Asia Securities
Golden Dragon Precise Copper Tube Group Inc.	China's biggest copper tube producer by output, major exporter of key components for air conditioners	Shanghai	RMB\$1.5 Bil.	N/A

Major Earthquake Strikes China's Sichuan Province

On Monday, May 12, at 2:28 pm Beijing time, a major earthquake registering 7.8 on the Richter scale struck China's southwestern Sichuan Province. The disaster is the most severe earthquake China has experienced since the Tangshan quake in 1976. Huge tremors from the first wave were felt throughout the country, including in Beijing and Shanghai, and smaller shocks were felt as far as Thailand and Vietnam. The places most severely affected by Monday's earthquake are in Sichuan Province in the areas surrounding Wenchuan, the quake's epicenter, although parts of Shaanxi, Gansu, Yunnan and Chongqing Provinces were also affected. As of 2pm on Sunday, the emergency headquarters of the State Council, China's Cabinet, reported that the confirmed death toll from the quake had reached 32,476, with over 220,000 injured. The council expects, however, that that number will continue to rise as rescue workers gain more access to the full extent of damages, and the thousands of victims who remain buried are found.

The Chinese government has mobilized more than 130,000 soldiers and police in the relief effort, and has welcomed foreign aid workers from Japan, Russia, South Korea and Singapore. China had so far received international aid worth more than \$100 million and materials worth more than \$10 million, although more is still needed.

For any readers who wish to make a donation to the relief operation, ChinaVest recommends viewing the website of the Shanghai American Chamber of Commerce for suggestions on several channels through which cash and material donations can be made. A link to the site is provided below.

[AmCham Shanghai Earthquake Relief Donation Information \(www.amcham-shanghai.org\)](http://www.amcham-shanghai.org)

Random Tidbits

Recycling Machine in Shanghai a Big Hit

A new recycling machine on Shanghai's East Nanjing Rd. pedestrian street has drawn quite a bit of attention from passers-by. The machine, which costs about RMB30,000, accepts plastic drinking bottles and aluminum cans, and returns RMB0.1 (about 1.5 US cents) to the person who deposits the drinking container. The machine understands that the item is a drinking bottle or can by reading the bar code. We hope the machine can reduce the number of waste collectors in the pedestrian street," said an official with the Nanjing Road Pedestrian Street Management Office. "The scheme will raise the public's awareness of environmental protection issues." During the first week the machine was on the street, it collected more than 3,000 bottles and cans. (Shanghai Daily)



(Shanghai Daily)