



# Eye on China

## A View from Shanghai

Merchant Banking Advisory In China for Over Twenty Five Years

### ChinaVest

#### Senior Management

Robert Theleen  
Wallace Mathai-Davis  
Jenny Hsui  
William Fuller  
Eugene Zhao  
Tao Tao  
Alex Lee

#### Editorial

Erik Bethel [ebethel@chinavest.com](mailto:ebethel@chinavest.com)  
Patrick Kelly [pkelly@chinavest.com.cn](mailto:pkelly@chinavest.com.cn)

### Market Weekly

#### Shanghai Composite Index

- 11/2 Close: **5,777.81**
- 11/9 Close: **5,315.54**
- Weekly Change: ↓ **8.001%**
- Since 1/1/07: ↑ **98.677%**

#### Shenzhen Composite Index

- 11/2 Close: **18,564.34**
- 11/9 Close: **17,160.12**
- Weekly Change: ↓ **7.564%**
- Since 1/1/07: ↑ **158.16%**

#### Exchange Rate

- 11/2: US\$1 = **RMB 7.469**
- 11/9: US\$1 = **RMB 7.432**
- Weekly Change: ↑ **0.495%**
- Since 1/1/07: ↑ **4.936%**

### Articles

#### Industrial & Consumer

- 1) AirMedia Lists on Nasdaq
- 2) CSRC Nixes Goldman Sachs' Stake Purchase in Fuyao Glass
- 3) ChemChina, Blackstone Team Up to Acquire Nufarm
- 4) Macquarie Infrastructure Fund Buys Guangdong Toll Road
- 5) China's Largest Drugstore Chain Debuts on NYSE

#### Technology

- 6) Private Equity Investors Profit from Sale of Lenovo Shares
- 7) Alibaba.com Lists in Hong Kong in US\$1.5 Billion IPO

#### Finance

- 8) SW Chinese Bank to Introduce Malaysian Strategic Investor
- 9) U.S. Approves New York Branch for China Merchants Bank
- 10) AIG Close to Buying Stake in Credit Guarantee Company

#### Regulations & Macro

- Rough Week for A-Share and Hong Kong Markets

#### Deals in China

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

#### Random Tidbits

## Advertising

### **1) AirMedia Lists on Nasdaq**

Chinese digital TV company *AirMedia* listed on Nasdaq on Wednesday, November 7, raising US\$225 million in a much sought-after IPO. The company originally expected to raise only US\$150-165 million, but raised the IPO price just before the listing amid strong demand. Additionally, AirMedia's shares closed up 38% after the first day of trading. The company mainly operates digital TV programming in Chinese airports (about 2,000 LCD TV screens in airports) and on airplanes (16,000 LCD screens in airplanes). The programming includes advertising, news, weather, sports, etc. AirMedia's business is similar to the LCD screen advertising model of *Focus Media* (Nasdaq, market cap: US\$7 billion), except AirMedia focuses solely on air travel locations. AirMedia's ad screens are currently located in 37 airports, including China's five largest. The company is contracted to put its screens in a total of 52 airports, and provide in-flight screens and programming for nine airlines. The out-of-home advertising model is flourishing with China's booming consumerism. In addition to the LCD screen model, in-store audio advertising, centrally controlled via the internet, is attracting attention from investors. For reference, AirMedia recorded H12007 revenues of US\$15.9 million and profits of US\$4.1 million.

## Automotive

### **2) CSRC Nixes Goldman Sachs' Stake Purchase in Fuyao Glass**

As expected, the *China Securities Regulatory Commission (CSRC)* rejected Goldman Sachs' purchase of a 10% stake in *Fuyao Glass*, a Fujian province-based company specializing in auto glass. Goldman Sachs agreed last year to purchase the stake for RMB8 per share, for a total of RMB890 million (roughly US\$115 million). In the year since the two sides agreed on the purchase price, Fuyao's share price (Shanghai Stock Exchange) has quadrupled. This year, the government vowed to stop allowing stake purchases at deeply discounted prices. In addition, CSRC said it would not allow stake purchases in listed Chinese companies at greater than a 10% discount to the share price. This measure made it unlikely that the Fuyao deal would go through.

Goldman Sachs recently experienced the same fate in its attempted acquisition of a 10% stake in *Guangdong Midea*, a top Chinese appliance manufacturer. In 2006, Goldman agreed to purchase a 10.7% stake in Midea for RMB716.6 million, but Midea's stock price then quintupled, prompting CSRC to strike down the deal.

## Chemicals

### **3) ChemChina, Blackstone Team Up to Acquire Nufarm**

Blackstone has again made the news in China. The private equity giant has teamed up with Chinese state-owned chemical producer *China National Chemical Corp (ChemChina)* to purchase Australian agricultural chemical producer *Nufarm* for US\$2.75 billion. ChemChina reportedly invited Blackstone, along with Fox Paine, another U.S.-based private equity firm, to participate in a bid for Nufarm. The ChemChina-led trio will take a 100% stake in Nufarm for a 25% premium to Nufarm's share price on the Australian Stock Exchange (purchase price set in October). According to the South China Morning Post, the new ChemChina/Nufarm entity will be the world's largest "generic farm chemicals" company. Nufarm is currently No. 2.

The deal marks Blackstone's third big splash in China this year. In June, the Chinese government took a 10% stake in Blackstone for US\$3 billion. In September, Blackstone agreed to pay US\$600 million for a 20% stake in state-owned chemical company *China National BlueStar Group*, which is a subsidiary of ChemChina. US\$600 million is a sizeable sum for a private equity deal in China. In fact, all mainland private equity deals in 2007 in the first eight months of the year only totaled about US\$750 million (Thomson Financial). At this point, most mainland private equity deals are investments in private enterprises for under US\$150 million, as large-sized deals in big state-owned firms are often less accessible and face strict regulatory scrutiny.

And we mustn't forget that regardless of Blackstone's presence, this investment is another major outbound investment by a Chinese company. The Nufarm deal will be one of the largest-ever outbound acquisitions, the largest being the ICBC/Standard Bank deal we discussed two weeks prior. The deal also marks the first time a state-owned firm has teamed with a private equity group for a buyout deal. However, most believe it won't be the last. "You'll see more of the giant state-owned firms teaming up with the big boys in the buyout industry," said Vincent Chan, CEO of Spring Capital Asia, a Hong Kong-based buyout firm. "The benefits are complementary. It helps Chinese companies go overseas to seek growth, and boosts returns for buyout firms" (Shanghai Daily)

## Infrastructure

### **4) Macquarie Infrastructure Fund Buys Guangdong Toll Road**

A Macquarie private equity fund, the *Macquarie International Infrastructure Fund*, spent RMB4 billion (roughly US\$540 million) for an 81% stake in a toll highway in south China. The Macquarie fund will reportedly gain a share of the highway's revenues until 2026. The 19-mile toll highway is located in the city of Guangzhou (population: about 12 million), south China's largest city. Macquarie said the road has seen 13% annual traffic growth since 2004. The road is strategically located, connecting the city to an industrial and port area. As a result, the road should remain an important logistics road for years to come.

Transportation and infrastructure projects remain a point of emphasis for the government, and this sector will prove a profitable area for investment over the next decade. China must continue to improve its infrastructure to support its rapidly-growing economy. "According to the World Bank, goods lost to poor or obsolete transportation infrastructure amount to 1% of China's GDP" (South China Morning Post). The need for infrastructure projects is often greatest in China's more underdeveloped central and western regions.

## Retail

### **5) China's Largest Drugstore Chain Debuts on NYSE**

*China Nepstar*, the country's largest drugstore chain with almost 1,800 stores nationwide, began trading on the New York Stock Exchange on November 9. The company raised US\$334 million in the IPO. Nepstar's drugstores include pharmacies, while they also sell OTC drugs, personal care products, supplements, and a host of other items. Essentially, Nepstar is China's version of Walgreens or Rite-Aid in the United States. Nepstar is currently trading at about 15% above the IPO price. The company will use a large portion of the IPO proceeds to add new stores. "Even with China Nepstar being the largest drugstore in China, there are definite plans to vastly increase its size," said Scott Sweet, managing director of research firm IPO Boutique (Associated Press). The rest of the funds will be used for potential acquisitions and other operational initiatives. In the first half of 2007, Nepstar recorded US\$4.6 million in earnings on US\$124.3 million in sales.

## Electronics

### **6) Private Equity Investors Profit from Sale of Lenovo Shares**

Last week three well-known private equity groups, TPG, Newbridge Capital, and General Atlantic, sold off US\$368 million worth of shares in Chinese computer manufacturer *Lenovo*. The sale, which was priced 4.5-6.5% below Lenovo's trading price on the Hong Kong stock market, came as no surprise to most investors. In May 2005, the three PE groups purchased a 12.3% stake in Lenovo for US\$350 million, buying the shares for HK\$2.73 apiece. Lenovo used the US\$350 million to fund its purchase of IBM's PC business in a US\$1.75 billion deal. Two-and-a-half years later, TPG, Newbridge, and General Atlantic sold about one-third of their holdings in Lenovo for HK\$8.16 to HK\$8.33 a share, reducing their collective stake to around 8%. The sale earned the PE groups a solid 3x profit, and allowed them to recoup their original investment while holding on to the majority of the shares they purchased.

Lenovo's operations have turned a corner this year, with the company starting to realize some significant profit growth. On a 20% rise in sales, third-quarter profits grew 178% from a year earlier. Furthermore, during the first six months of 2007, Lenovo's worldwide PC shipments have increased 23% YoY, beating the industry average of 15%. Lenovo is the world's No. 4 PC maker, with an estimated 8.2% of the global market (FinanceAsia). The company also just announced plans to drop the IBM name from its ThinkPad notebook series. The computers will be re-branded to "Lenovo ThinkPad". Lenovo CEO William Amelio said, "By making substantial progress on all of our critical priorities over the past few quarters, we are now a stronger, healthier company, leading to the decision to completely transition our Think products from the IBM brand to the Lenovo brand two years earlier than planned."

## Internet

### **7) Alibaba.com Lists in Hong Kong in US\$1.5 Billion IPO**

*Alibaba.com* wrapped up its first week of trading in Hong Kong after its sparkling IPO. The B2B website raised US\$1.5 billion in the listing. Its share price was up 2.5x on the first day (Nov. 6), and finished the week up 2.2x. According to Thomson Financial, Alibaba.com accounts for 70% of China's "online commerce market". Specifically, the website is used as a marketplace for small- and medium-sized enterprises to trade their goods. Alibaba.com is part of the *Alibaba Group*, China's top e-commerce group. Alibaba Group also runs China's leading online auction site (*Taobao.com*), the country's top online payment system (*Alipay*), and the *Yahoo! China* website (Yahoo bought a 40% stake in Alibaba Group in 2005 for US\$1 billion).

One reason for the spike in Alibaba.com's share price is investors' understanding of the growth potential of China's e-commerce market, which is still extremely under-saturated compared to developed countries. Investors also understand that Alibaba Group's clear No. 1 position in China's internet commerce sector bodes well for Alibaba.com's competitive positioning. "Many anticipate that its parent, Alibaba Group, will be injecting assets into the company and that's why many investors are still buying the stock despite the high price," noted Castor Pang, a strategist at Sun Hung Kai Financial (Thomson Financial). And finally, overseas IPOs by Chinese companies are generally very well received.

## **Banking**

### **8) SW Chinese Bank to Introduce Malaysian Strategic Investor**

*Hong Leong Bank*, Malaysia's sixth-largest bank, will pay RMB1.95 billion (US\$262 million) to acquire a 19.99% stake in *Chengdu City Commercial Bank (CCCC)*. CCCC serves Chengdu, one of China's largest cities and the capital of Sichuan province (in SW China). The bank operates 29 branches and 115 outlets in the city. In the long-term, CCCC wants to become a larger banking presence by expanding into other Chinese cities. The introduction of Hong Leong will give CCCC access to international banking expertise, while the capital injection will immediately help the bank improve its capital adequacy ratio. A number of Chinese city commercial banks, which are generally restricted to their home regions, realize it is becoming more difficult to compete with larger banks if they don't expand. The small banks are first introducing foreign strategic investors, and eventually plan to list on the domestic stock market to raise more capital. Three city commercial banks have listed thus far, with *Bank of Nanjing* and *Bank of Ningbo* becoming the first two in July of this year. Chengdu City Commercial Bank will likely list within 2-3 years.

For reference, a 19.99% stake is the maximum stake a single foreign investor can own in a Chinese bank.

### **9) U.S. Approves New York Branch for China Merchants Bank**

*China Merchants Bank (CMB)*, one of China's seven largest lenders, reportedly received approval from the U.S. Federal Reserve to open a branch in New York. According to the Fed, CMB will be permitted to "engage in wholesale deposit-taking, lending, trade finance, and other banking services" (Xinhua News Agency). This is a major development for CMB and Chinese banks in general, which are eager to expand into overseas markets. Many Chinese banks aren't short on cash, and can easily afford to extend their international reach by adding branches in other countries or buying stakes in foreign banks. Two weeks ago, we discussed *Industrial and Commercial Bank of China's (ICBC—China's largest commercial bank)* US\$5.56 billion acquisition of a 20% stake in *Standard Bank*, the largest banking group in South Africa. By establishing a presence in other countries, Chinese banks not only gain access to more lending opportunities, but also increase their ability to accommodate and finance the foreign operations of multinational Chinese clients.

Even with an abundance of cash, however, CMB and ICBC have experienced difficulty in securing approval from the Fed to open branches in the United States. Some in the U.S. believe that mainland banks are still relatively high-risk (even though they are raking in record profits today, many Chinese banks were insolvent only a few years ago). ICBC, which also wants to open its first U.S. branch in New York, has yet to gain approval. Two other Chinese banks already have branches in the United States: *Bank of China* and *Bank of Communications*.

Interestingly, the head of the *China Banking Regulatory Commission (CBRC)*, Liu Mingkang, recently hinted that a more open policy from the U.S. toward Chinese banks may help foster smoother bilateral relations between the two nations on financial matters. It is worth noting that CMB is a very profitable lender, and is unlikely to run into operational problems within the immediate future. Additionally, Chinese banks, including CMB, generally had negligible exposure to sub-prime debt.

CMB's only current international presence is in Hong Kong. The bank is an affiliate of the *China Merchants Group*, one of China's most important state-owned conglomerates.

## Other Financial

### **10) AIG Close to Buying Stake in Credit Guarantee Company**

Insurance giant AIG is in negotiations to buy a stake in a small credit guarantee company in southwest China's Sichuan province. The company is called *Chengdu Small Enterprise Credit Guarantee Company (CSECG)*. Credit guarantee companies act as guarantors on loans for small- and medium-sized enterprises (SMEs), and receive about a 3% commission on the loan. Without the credit guarantee company to guarantee the loan, banks are often unwilling to extend credit to SMEs. The government wants to encourage more lending to small businesses, and hopes foreign investment in credit guarantee companies can kick start the sector. AIG understands that with an injection of foreign capital, CSECG can guarantee larger loans, and thus receive larger commissions. Interestingly, CSECG is already 43.5%-owned by the Swiss state economic planning body, which originally invested US\$3 million. (Shenzhen Daily)

## Macro

### **Rough Week for A-Share and Hong Kong Markets**

Last week was turbulent for the stock markets in Greater China. The week began with the Hong Kong market falling 5% on Monday, November 5. The drop was mainly caused by comments from China's Premier Wen Jiabao regarding a government program that will eventually allow Chinese citizens to invest in the Hong Kong stock market (currently, except for select financial institutions, domestic Chinese cannot invest outside the mainland). Wen's comments implied that the scheme, which was originally scheduled to start last month, will be further delayed. Hong Kong stocks had been surging in anticipation of the inflow from China. Since Beijing announced its intentions for the plan in August, HK's benchmark Hang Seng Index had increased by 40% in just over two months.

Wen and other high ranking Chinese officials are apprehensive about launching the program due to problems it could create. Allowing a significant outflow of money to Hong Kong could destabilize the domestic stock markets. By adding liquidity, Hong Kong could become the next Shanghai and Shenzhen market, wherein an influx of speculative money drives up prices. That could in turn cause speculators to move money from the Chinese markets to Hong Kong, further threatening an already precarious mainland bubble. Regulators also worry that Chinese investors don't properly understand risk, and are unprepared for investing in overseas markets. There is no word on exactly when the program may begin, but it certainly seems like it won't be in 2007.

Later in the week, the Chinese markets took a major hit of their own, falling about 5% on Thursday, November 8. That drop was partly caused by instability in Western markets due to continuing credit worries (HK's Hang Seng Index also fell on Thursday by about 3.2%, after having rebounded somewhat on Tuesday and Wednesday from Monday's hit). The Shanghai Composite Index's 4.9% fall Thursday was the largest single-day drop in four months. In addition to sub-prime debt issues in the West, investor worries about inflated prices on the Shanghai and Shenzhen exchanges are contributing to a malaise in the domestic stock markets. In fact, with the Shanghai Composite Index falling 8% for the week, it now stands where it did more than two months before.

# Deals in China

## M&A Activity

| Acquirer        | Description   | Target                       | Description  | Amount       | Deal details |
|-----------------|---|------------------------------|--|--------------|--------------|
| ChemChina       | China's largest state-owned diversified producer of chemicals | Nufarm                       | Australia's largest producer of farm chemicals     | US\$2.75 Bil | 100% stake   |
| ArcelorMittal   | world's largest steel producer                                | China Oriental Steel         | HK-listed steelmaker based in northern China       | US\$647 Mil  | 28% stake    |
| Hong Leong Bank | Malaysia's sixth-largest bank                                 | Chengdu City Commercial Bank | city commercial bank located in SW China           | RMB 1.95 Bil | 19.99% stake |
| Chalco          | state-owned, China's largest producer of aluminum             | Yunnan Copper                | China's third-largest copper producer              | RMB 7.5 Bil  | 49% stake    |
| Mitsubishi      | Japanese conglomerate   | Shenhua Energy               | China's largest coal producer, listed in HK and SH | US\$136 Mil  | 0.2% stake   |

# Deals in China

## IPO Pipeline

| Company                    | Description  | Exchange  | Size               | Financial Advisors                                |
|----------------------------|--|-----------|--------------------|---|
| Xiashun Holdings           | Chinese manufacturer of aluminum foil  | Hong Kong | US\$400 Mil        | UBS   |
| Zhong An                   | Hangzhou-based property developer, majority of properties are low-rise residential | Hong Kong | HK\$3.4 Bil        | Deutsche Bank, JPMorgan                           |
| Sinotruk                   | Chinese manufacturer of heavy trucks   | Hong Kong | up to HK\$9.04 Bil | China International Capital Corp, JPMorgan        |
| JSE International Holdings | shipyard in Jingjiang city in east China's Jiangsu province                        | Singapore | US\$200-250 Mil    | ABN Amro Rothschild, Oversea-Chinese Banking Corp |

### **Beijing Begins Construction on World's Tallest Ferris Wheel**

On November 5, Beijing began building what will be the world's tallest Ferris wheel. The wheel will tower 682 feet above the ground (208 meters). The 208-meter height is to commemorate the 2008 Olympic Games, even though the wheel will not be finished until 2009 due to numerous delays in the beginning of construction. The wheel will have 48 air-conditioned observation pods, each of which will hold up to 40 passengers, for a total capacity of 1,920 people. According to the *Singapore Great Wheel Company*, which is developing the project, passengers will be able to see the Great Wall of China from the wheel on a clear day. Great Wheel is also the developer of a Ferris wheel in Singapore that will become the world's tallest when it opens next March. Its height will reach 541 feet (165 meters), surpassing the Star of Nanchang (525 feet, 160 meters), which opened in May 2006. The Star of Nanchang is located in Nanchang city, the capital of south-central China's Jiangxi province. Before the Star of Nanchang, the London Eye was the world's tallest Ferris wheel, standing 443 feet high (135 meters). It opened to the public in March 2000.