CHINAVEST 中國

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Market Weekly

Shanghai Composite Index

- 9/28 Close: **5,552.30**
- 10/12 Close: **5,903.26**
- Weekly Change: ↑ **6.321%**
- Since 1/1/07: ↑ **120.64%**

Shenzhen Composite Index

- 9/28 Close: **18,864.55**
- 10/12 Close: **19,135.20**
- Weekly Change: ↑ **1.435%**
- Since 1/1/07: ↑ **187.87%**

Exchange Rate

- 9/28: US$1 = **RMB 7.524**
- 10/12: US$1 = **RMB 7.515**
- Weekly Change: ↑ **0.120%**
- Since 1/1/07: ↑ **3.868%**

Articles

Logistics and Transportation

1) Sinotrans to Buy Assets Worth RMB 1 Billion

Sinotrans Ltd, the Hong Kong-listed arm of the Chinese logistics giant of the same name, has agreed to buy a set of assets from its parent for RMB 1.11 billion. The listed firm, partner of global players such as DHL and Korean Air, said on Thursday it was eyeing assets related to the freight forwarding, shipping agency and warehousing businesses.

Many of the assets are along the Yangtze River, where the company stands to benefit from China's massive investments intended to increase traffic flow. To highlight those investments, China's *Ministry of Communications* recently said it would invest RMB 15 billion to improve transport on the river. Sinotrans expects the amount of trade along the river to increase significantly. The loading capacity per vessel on the Yangtze River is expected to increase by 300 tons to 400 tons after completion of a dredging project.

The target assets that Sinotrans is buying from its parent are located in Sichuan, Chongqing, Anhui, Jiangxi, Shandong and Hong Kong. Net profits of those assets amounted to RMB 76.4 million last year, down 27 percent from a year earlier, according to a filing with the Hong Kong stock exchange last week. (South China Morning Post)

Electronics

2) Schneider IPR Offense Receives Record Fine

A Chinese court ordered *Schneider Electric SA* of France to pay a Chinese firm US$45 million in damages for infringing its patent, representing the largest sum ever awarded in an IPR case in the country. In most intellectual property litigations, the Chinese firm is almost invariably the defendant with the vast majority of IPR cases initiated by foreign firms.

Schneider was ordered to stop making five types of miniature circuit-breakers by the Intermediate People's Court in the eastern Chinese province of Zhejiang, which ruled that the circuit breakers were based on patents held by low-voltage equipment maker *Chint Group* of Wenzhou. Schneider has stated its intentions to appeal and is challenging Chint's patents in a separate case. (China Economic Review)

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Food & Beverage

3) Chongqing Brewery to Invest US$64 Million in Expansion

Chongqing Brewery, one of China's four listed beer producers, will invest US$64 million to build production lines with a total production capacity of 500,000 KL beer. The construction is scheduled to start in October 2007 and finish in roughly a year's time.

Hunan Chongqing Grandman Beer Co. Ltd, of which Chongqing Brewery holds an 85.6 percent stake, will be investing US$27.5 million (RMB 207 million) to reconstruct its production lines. When the project finally commences operations, the production capacity for beer will be expanded by a further 200,000 KL. Chongqing Brewery is reconstructing and expanding to meet the surging demand for beer in China. The firm also plans to acquire stakes of its non-beer subsidiaries, including a 13 percent stake of *Chongqing Longhua Print Co. Ltd* and a 40 percent stake of *Chongqing Wanda Plastics Co. Ltd*. The firm is also expected to purchase the operational assets of a non-alcoholic drink company owned by Chongqing Wanda Plastics to expand its business in non-alcoholic drink sectors. (China Knowledge) It is not unusual in China for companies to be involved in a number of unrelated sectors, as is the case with Chongqing Brewery.

4) Goldman Cedes Control of Meat Consortium

Only weeks after it secured final approval for the takeover, Goldman Sachs will apparently cede control of the consortium that owns China's largest meat processor, *Shineway Foods*.

Goldman's principal investment arm last year teamed up with CDH Investments, an overseas-registered Chinese private equity firm, to set up a takeover vehicle called Rotary Vortex, in which Goldman holds a 51 percent stake. Rotary Vortex acquired full control of Shineway Group, owner of the meat processor, from state-backed interests this summer following a year of intense regulatory scrutiny. This recent turn of events has raised eyebrows among dealmakers in China, who are sensitive to signs that Beijing may be restricting foreign ownership of high-profile domestic assets. (Financial Times)

Property

5) US$4 Billion Metal Industrial Park to be Built

China's largest state-owned metal trader and producer, *China Minmetals Corp*, will invest US$4 billion (RMB 30 billion) to build an industrial park in Liaoning Province, located in Northeast China. The Minmetals Yingkou Industrial Park is expected to cover an area of 20 sq km and is scheduled for completion in 15 years.

Minmetals' "mid-width steel plate manufacturing plant" will be located in the metallurgy manufacturing area of the park. From this location, the company will be setting up a supply platform for raw materials and equipment, to meet the demand in the northeast region. It will also partake in real estate development and logistics services. Three other companies have entered into a US$798 million (RMB 6 billion) agreement with Minmetals for a stake in the industrial park.

Internet

6) Yahoo to Acquire 10 percent of Alibaba IPO Shares

YAHOO! indicated that it will buy 10 percent of the shares to be sold in the Hong Kong initial public offering of *Alibaba.com*, the B2B unit of China's largest e-commerce company. As for the rest of the offering, 75 percent of the IPO shares are allocated to global investors and 15 percent for Hong Kong retail investors.

It is estimated that Alibaba.com's IPO will raise US$1 billion, which would make it the largest IPO ever by a Chinese internet company. The IPO process is expected to begin in mid-October, with the shares listed by early November. In 2005, Alibaba absorbed Yahoo's China business, and Yahoo bought a 40 percent stake in Alibaba for US$1 billion. (China Economic Review)

Telecommunications

7) Huawei to Buy Large Stake in 3Com

A regulatory filing disclosed last week that *Huawei*, the major Chinese telecommunications equipment maker, could acquire up to 21.5 percent of *3Com* and hold three of the 11 board seats. This proposed transaction for Huawei would be as part of a consortium led by *Bain Capital*, a U.S. private equity group. Together the Bain/Huawei consortium plans to pay US$2.2 billion to completely take over 3Com. However, the consortium would reportedly have "no ability to make decisions" for 3Com.

The Bain/Huawei proposed takeover bid, which would initially take a 16.5 percent minority stake, has come under substantial scrutiny in Washington. Lawmakers have expressed alarm at Huawei's allegedly close ties to the Chinese government. The fear is magnified by the fact that the Pentagon is believed to have recently come under cyber-attack by Chinese hackers.

In its review of the proposed deal, the U.S. government will likely scrutinize the extent of control Huawei could gain over 3Com. As mentioned earlier, in order to allay fears, 3Com has issued multiple recent statements saying that Huawei, its largest customer, will have no say in the running of the company. (Reuters)

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Banking

8) First Chinese Banking Acquisition in U.S.

China Minsheng Banking Corp said last week that its board has approved a proposal to invest in US-based *UCBH Holdings*. Minsheng plans to buy a 9.9 percent stake in the latter for between US$212 million and US$317 million. China's first U.S. bank deal seems to have made it "below the radar screen" without ruffling too many feathers in Washington.

UCBH Holdings is a San Francisco-based community bank serving Chinese family businesses. There are two phases to the deal: the initial 4.9 percent is priced at the previous 90-day average closing price; the second may command a slim premium. UCBH is roughly one-tenth the size of Minsheng Bank in terms of assets, and the initial 4.9 percent stake purchase will have little impact on the Chinese lender's healthy capital adequacy ratio. Minsheng Bank said it also has option to increase its stake in UCBH to 20 percent in the future. Minsheng's Shanghai-listed shares have almost doubled this year, despite a massive block sale in March, and it is mulling a listing in Hong Kong.

This deal may have appeased U.S. regulators as Minsheng Bank is looking for a minority stake. Additionally (and ironically), the cash raised from China will soon return there, to fund UCBH's purchase of Shanghai-based *Business Development Bank*. (Financial Times)

9) ING seeks Partnership with China Postal Savings Bank

ING Group NV has confirmed reports that it is seeking a partnership with the *China Postal Savings Bank*, the country's fifth-largest bank. Although it is not clear at the moment whether ING will be a partner or a strategic investor in the cooperation deal, Hans van der Noordaa, the Dutch bank's Asia-Pacific chairman for insurance and investment management, said he hopes ING could become a strategic investor in China Postal Savings Bank. He however said that this could possibly meet with policy restriction.

ING is interested in China Postal Savings Bank mainly for its many municipal and rural outlets across China, and the fact that ING has engaged in a similar project in Japan (with *Japan Post)*. ING bought a 19.9 percent stake in *Bank of Beijing* in March 2005, in an effort to gain channels for its insurance business as well as experience in banking in China. (Thomson Financial)

Other Financial

10) China to Launch Stock Index Futures

According to a statement released by *China Securities Regulatory Commission (CSRC)*, China is likely to introduce stock index futures by the end of November. Stock regulators will formally introduce the stock index futures late in November, and foreign investors will be allowed to trade them under the Qualified Foreign Institutional Investors (QFII) scheme. Under the QFII scheme, which allows select foreign financial institutions to invest a limited amount of capital in China's domestic capital markets, foreign investors' futures trading will be limited to 10 percent of their QFII quotas. Stock index futures are expected to help China bring in more derivatives trades (and possibly the ability to mitigate the boom-bust cycles) related to its surging stock markets.

Other Financial

11) Boom in Demand for Offshore Funds
Driven by an overpriced domestic stock market and a lack of investment options at home, retail demand for China's first offshore mutual funds has exceeded all expectations and provoked a flurry of new offerings from local and foreign-invested fund managers. At least four huge offshore investment funds are expected to launch under Beijing's Qualified Domestic Institutional Investor (QDII) scheme before the end of the year and over a dozen more are expected next year.

China Southern Fund Management received more than RMB 50 billion (US$7 billion) in subscriptions in just one day in early September for its *Southern Global Enhanced Balanced Fund*, the first Chinese mutual fund allowed to invest in overseas equities. That was followed at the end of September by China *AMC's Enhanced Global Equity Fund*, which attracted more than RMB 60 billion. Out of that total of almost US$15 billion, nearly half of it had to be returned to investors because the government only granted quotas of US$4 billion to each firm, up from the original US$2-US$2.5 billion quota they had requested. *Harvest Fund Management Co. Ltd*., in which Deutsche Bank AG owns a 19.5 percent stake, has raised the quota of US$4 billion investment under the Qualified Domestic Institutional Investor (QDII) scheme on the first day issuance last week.

Jing Ulrich, chairman of China equities at JPMorgan, estimates that about US$90 billion of Chinese money will be invested in global markets under QDII over the next year. (Financial Times)

Macro

China's Ballooning Trade Surplus Hits Record Highs

China's trade surplus jumped 69 percent to US$186 billion for the first nine months of the year, surpassing the amount for the whole of 2006, and giving further ammunition to critics of the country's currency policies. After three record monthly trade surplus figures in June, July and August, last month's US$23.9 billion dollar surplus was the fourth-largest ever, and was up 56 percent from a year earlier.

Last week, Washington filed its fourth WTO complaint against China, challenging its restrictions on imports of copyright-intensive industries such as films and music. However, the U.S. is not the only region calling foul. The 13-nation Eurozone's ministers broke new ground this week with a statement that identified the RMB as a greater source of concern to Europe than the dollar or the Japanese yen. Europe became China's biggest export market this year, and Chinese exports to the European Union in the first nine months of this year expanded 30.8 percent from the same period last year, outpacing the 15.8 percent growth in exports to the U.S. And while China's currency has risen about 3.9 percent against the U.S. dollar this year, it has dropped 2.9 percent against the euro.

Since breaking from the dollar peg, China pledged to manage the RMB against a basket of global currencies. However, the currency since then has appeared to track the greenback. While few economists believe that a stronger RMB will transform bilateral trade relations with Beijing, the RMB has become a political symbol in Washington, and now Brussels, of what many say is Beijing's policy to keep its currency low to support exports. (Financial Times)

Household Savings Substituted Out for High Growth Investments

Growth in China's household savings continues to slow down as people keep plowing money into the red hot stock market under lingering inflationary pressures. Household savings in the country grew by RMB 762.1 billion (US$101.6 billion) in the first nine months, compared with an increase of RMB 1.73 trillion in the same period a year ago, according to latest statistics from the *People's Bank of China* (China's central bank).

Investment and savings options have shifted from bank deposits to investment funds and stocks as the most important financial assets for Chinese families. A survey by the central bank showed a record high of 35.6 percent of the 20,000 respondents in the third quarter rated investment funds and stocks as their most important assets, while 50.4 percent thought so about bank deposits, down from 70.4 percent at the beginning of last year. One-year deposits currently carry an interest rate of 3.87 percent in China, but the actual yield is much lower than the full-year inflation rate of 4.5 percent. (Xinhua)

Macro

Communist Party's 5-Year Congress Begins October 15

This upcoming week, China's most important and anticipated political event of the year will take place, as the 17th National Congress of the Communist Party of China will be held in Beijing from October 15-21. The Party Congress convenes once every five years, and will lay out the Chinese government's plan for the country's development until 2012. That includes deciding on the members of China's highest leadership positions for the new five-year term. The Party Congress will also focus on some different issues than in years past, such as corruption, the environment, rising prices, and other social issues related to the widening income gap. "Nowadays the delegates are keener on issues concerning the ordinary people's lives such as employment rate and medical care," said CPC delegate Xie Shijie, 73, who was also a delegate in the previous three Party Congresses. "In the past we always talked about GDP and investment" (China Daily). In next week's newsletter, we'll detail how the event has unfolded, and what it may mean for China's future.

Deals in China

M&A Activity

Acquirer	Description	Target	Description	Amount	Deal details
China Minsheng Banking Corp	Shanghai-listed, one of China's largest banking groups	UCBH Holdings	SF-based community bank catering to Chinese businesses	up to US$317 Mil	9.9% stake
ARC Capital Holdings	AIM-listed, Greater China-focused investment fund	Beijing Pypo Technology	Chinese mobile phone distributor with 2006 revenue of RMB 992 mil, net income of RMB 105 million	US$90 Mil	33% stake
General Electric	well-known international conglomerate	Wuxi Little Swan & GE	unit of home appliance maker Wuxi Little Swan, makes OEM washing machines for GE (despite the name, GE previously held no stake)	US$7.1 Mil	30% stake

IPO Pipeline

Company	Description	Exchange	Size	Financial Advisors
Alibaba.com	online B2B platform of Alibaba Group, China's largest e-commerce company	Hong Kong	US$1 Bil	Deutsche Bank, Goldman Sachs, Morgan Stanley
Guoyuan Securities	Chinese securities brokerage with 2006 revenue of RMB 1.74 billion	Shenzhen (via reverse takeover)	N/A	N/A
China Oilfield Technology Services	China-based provider of oil recovery equipment and technology	Singapore	US$86.6 Mil	Hong Leong Bank, Kim Eng Securities
Noah Education	Chinese producer and distributor of electronic dictionaries and digital learning devices	NYSE	US$116 Mil	Deutsche Bank, CIBC World Markets, Thomas Weisel Partners, First Shanghai Securities
Ming Fai	supplier of bathroom and personal care products to hotels and airlines	Hong Kong	HK$700 Mil	DBS Capital
Excellence Group	largest property developer in Shenzhen's central business district	Hong Kong (H1 2008)	US$1 Bil	Morgan Stanley, UBS

China Billionaire Boom

As the stock market reaches new highs, and property prices continue to rise, China's list of dollar billionaires has increased at exponential rates. China now has more billionaires than any country except the United States, researcher Rupert Hoogewerf said on Wednesday. The number of Chinese worth US$1 billion or more jumped to 108, from 15 last year, growing much faster than in western countries, Hoogewerf said in his 2007 China "rich list," which ranks the 800 wealthiest individuals in the country. The average wealth of those on the list doubled from a year earlier to US$562 million.

Yang Huiyan, 25, tops the list after receiving US$17.5 billion from her property developer father, the report said, echoing another China rich list published by Forbes magazine on Tuesday. Last year's champion, Zhang Yin, fell to second place even as her wealth tripled to US$10 billion after a surge in the share price of Nine Dragons Paper (Holdings) Ltd, in which she holds a 72 percent stake. Zhang, the world's richest self-made woman, continues to widen the wealth gap with western counterparts such as U.S. television host Oprah Winfrey, eBay Inc founder Margaret Whitman and Harry Potter author J.K. Rowling.

In a sign that China's economic growth is largely driven by construction and manufacturing, rather than by science and technology, seven of China's 10 richest people are mainly or partly in the real estate business. Nine made the list due to shareholdings in *Minsheng Banking Corp*—the most prominent of all Chinese companies in creating the super-rich. (Reuters)