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# China News Alert Issue 317

## Capital Markets

### Huijin is likely to seek less from lenders

Central Huijin Investment Company, an investment arm of China's sovereign wealth fund, is likely to ask State-run lenders to pare dividend payouts, or reinvest the dividend proceeds accrued to it in any likely new share sales undertaken by the banks next year, a source with knowledge of the matter said.

This is the investment unit's latest effort to help augment the capital position of major Chinese lenders, which are reportedly facing a capital shortage due to the massive lending spree seen so far this year.

"As the largest shareholder of the nation's three biggest listed banks, Huijin may propose to lower the proportion of dividends to be allocated to shareholders at the board meeting of these banks next year," the source said on condition of anonymity due to the sensitive nature of the matter.

Conventionally, the nation's three major State-run lenders―the Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB) and Bank of China (BOC)―distribute some 40 per cent of the profits they earn to shareholders. Central Huijin takes a dominant position on the board of these banks on behalf of the Chinese government.

Another option Central Huijin may take would be to use the dividends it receives to buy new shares issued by the banks next year, according to the source.

"However, it is still premature to get down to the details, as a final decision is likely only in April next year after the banks release their annual results," the source said.

The capital positions of major State-controlled banks have been watched closely by the market, as there are widespread concerns that the credit flood this year may have strained Chinese lenders. Bank of China, for example, saw its capital adequacy ratio drop to 11.6 per cent by the end of September from 13.4 per cent at the beginning of the year.

Wang Han, a Hong Kong-based analyst at Guotai Jun'an Securities, said in a research note that if the three banks could be exempt from paying dividends to Central Huijin this year, then the retained surplus could help them boost capital adequacy ratios by some 50 basis points. "This is definitely good news for the banks. Although the move is not officially confirmed, the potential capital infusion from Central Huijin is in line with the government's tone of maintaining a moderately loose monetary policy and will be conducive to credit expansion next year," Wang said.

Recently, it was reported that major Chinese banks were likely to raise several billion yuan to replenish their capital through share and bond sales. The news hurt investor sentiment, and the Shanghai Composite Index plunged 3.43 per cent on that day.

BOC and CCB press officers contacted said they were not aware of any such moves by Central Huijin. An ICBC spokesman cited by Bloomberg said the development was a possibility.

The A shares of ICBC, CCB and BOC gained 1.33 per cent, 0.84 per cent and 0.72 per cent after the news broke.

Chinese banks, under pressure from regulators to shore up their finances, were mulling over plans to replenish their capital through share sales or bond issuance, sources had said. However, ICBC, CCB and BOC all said that there were no specific fund-raising plans that could be shared at the moment.

The China Banking Regulatory Commission, the country's top banking regulator, has repeatedly warned Chinese banks against the risk of rapid lending, and urged them to lift the bad loan provision ratio to beyond 150 per cent by the end of the year.

[Source: China-cn](http://en.china.cn/content/d683409,0867e6,2839_13978.html) (Link no longer active)

### China to scrutinise state-owned firms' hedging deals

China's state-owned firms looking to hedge their losses from rising crude oil prices will be supervised more stringently, China Daily reported.

The State-owned Assets Supervision and Administration Commission (SASAC) has required companies under its control to scrutinise hedging deals more closely while signing financial derivatives contracts.

The move follows rising book losses from hedging contracts suffered by such state-owned firms as China Eastern Airlines and Air China, who have only recently begun to reduce such losses-on-paper from former hedging deals.

SASAC tightened the rules during a recent budget meeting convened by state-owned enterprises.

The futures trading volume should not exceed 90 per cent of the spot volume. The percentage for those who are inexperienced in such trades or those who have reported significant losses previously will be no higher than 50 per cent, the newspaper said, citing Shen Ying, director-general of the SASAC Statistics Evaluation Bureau.

SASAC also clarified that it would defend the legal interests of hedging firms through negotiations with investment institutions in case there are misleading clauses in previously signed deals.

[Source: Xinhua](http://news.xinhuanet.com/english/2009-10/21/content_12286302.htm) ([see archive](China_to_scrutinize_state-owned_firms_hedging_deals.pdf))

### Venture Capital firms show interest in the bio-pharmaceutical sector

Spurred on by the healthcare reform launched by the central government, healthcare has now become the hot destination for domestic and foreign venture capital (VC).

The trend has been most obvious in the bio-pharmaceutical sector which has raised funds to the tune of nearly US$130 million in the first half of the year.

The sector accounted for 20 per cent of the investment deals signed in China during the same period, according to a report by Zero2IPO, a leading domestic service provider for the venture capital and private equity industry.

"The ratio is pretty high. The passion [for bio-pharmaceuticals] has been ignited by the predictable growth potential in China's healthcare industry and the growing demand for biopharmaceuticals," said Zheng Yufen, senior manager for healthcare at the investment banking division of Zero2IPO. "Talks are also on for a number of other investment deals in the bio-pharmaceutical sector and hopefully they would be completed by the end of the year," she said. "The bio-pharmaceutical segment often sees mega deals and should continue to catch the fancy of venture capitalists for some time to come."

In January, Kerry Bio-Science, a Zhejiang-based life science research pharmaceutical company, raised its second round of funding worth US$13 million from KPCB China and some institutional investors. Kerry Bio-Science will use the funds to set up a new development and research center and expand its output capacity.

The Kerry Bio-Science deal sparked a flurry of investments in the bio-pharmaceuticals sector. Macrostat, a clinical research data provider on bio-pharmaceuticals, received investment, with no details available, from Tigermed Consulting and Qiming Venture Partners. In May, KPCB China made its second investment of the year, in Nanjing-based Genscript Corporation, a leading bio-pharmaceutical research outsourcing company, at a price of US$15 million, the largest this year.

According to Xiao Jun, executive vice-president of Genscript, the company received funding due to its "inherent strength in biotechnology research and its comprehensive service system". "GenScript needs capital and mature management experience to help fulfill its goal of becoming a leading contract research outsourcing company," Xiao said.

Bio-pharmaceutical companies are those producing drugs using bio-technology. In early 2000, investors began to show interest in the sector, but the investment was not sizable given the then limited scope of the medical market.

"After China unveiled its healthcare reform, a huge potential for these products was unleashed," said Zheng.

Over the next few years, China's bio-pharmaceutical sector will continue to grow by 12 to 15 per cent annually, and by 2010, the market will reach US$100 billion.

With its strong talent pool, China is in a much better position to attract investment by international medical companies for research and development (R&D) centers. In November, drug major Merck Serono and IBSA, a Switzerland-based bio-pharmaceutical company, announced plans to set up R&D centers in China.

Maurizio Dattilo, director of Strategic Marketing at IBSA, said: "China has a very strong scientific research team and employees to work for the R&D center."

This year, venture capital firms like International Data Group and SAIF are bolstering their teams and hiring more employees from hospitals and domestic bio-pharmaceutical companies.

"Both the companies are in negotiations for deals of over US$10 million," said Zheng.

[Source: China-cn](http://en.china.cn/content/d683683,8ff835,2839_13978.html) (Link no longer active)

## Corporate & Commercial

### China issues measures to further encourage foreign investment

China's State Council has issued measures through its website to supervise foreign enterprises or individuals who establish partnership enterprises within China. The aim of the new measures is to encourage overseas investors with advanced technology and management experience to set up joint ventures in China, and promote the development of industries such as a modern service sector.

According to a staff member of the State Council Legal Affairs Office, who wished to remain anonymous, the ‘Measures for the Administration of Partnership Business Establishment within Chinese Territory by Foreign Enterprises', targets two or more foreign enterprises or individuals who establish partnership enterprises.

These measures can also be used when a partnership is established by foreign enterprises (or individuals) together with Chinese enterprises (or individuals) within China.

Foreign enterprises or individuals, who become partners via stock purchases or partnerships, would also be covered under the measures.

The measures also state that money used by foreign enterprises or individuals to invest in partnerships should be "convertible currency," or be renminbi acquired within the law.

The measures also apply to partnership enterprises established in the Chinese mainland by companies or individuals from the Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan.

The measure will take effect on 1st March 2010.

According to the source, the newly-released measures are different from laws and regulations enacted previously to supervise foreign-funded enterprises, including Chinese-foreign joint ventures, Chinese-foreign cooperative businesses and solely foreign-owned enterprises. "The partnership enterprise is a totally different form of foreign investment, as previously released laws aimed at foreign-funded companies cannot be applied. That's why we issued these measures," said the source.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90861/6830687.html) ([see archive](China_issues_measures_to_further_encourage_foreign_investment.pdf))

### ICBC enters negotiations to acquire a stake in Cathay Financial

Industrial and Commercial Bank of China (ICBC) is in talks to buy a stake in Taiwan's Cathay Financial, sources said, in a deal that could be worth more than US$3 billion.

The talks come amid an easing of cross-Straits relations between the mainland and Taiwan, in hopes of boosting both economic and political ties.

One source said that ICBC was interested in buying roughly a 20 per cent stake in Cathay Financial, Taiwan's top listed financial holding group, which has a market capitalisation of around US$17 billion.

The two firms have met five or six times in the past two months. The talks are getting very serious," said the source.

Another source said that the talks were in their early stages. ICBC, the world's largest bank by market capitalisation, and Cathay Financial declined to comment.

The sources did not want to be identified because they were not authorised to speak publicly about the deal. Mainland-Taiwan trade relations have thawed since Taiwan leader Ma Ying-jeou took office last year, with bilateral deals promoting tourism and shipping links already concluded.

ICBC and Cathay hope to make an announcement soon after Taiwan and the mainland sign a free trade pact, which Taiwan aims to sign early next year, the source said.

Cathay Financial Group was established in Taiwan on 31st December 2001, with a registered capital of NT$120 billion. The company has become a full-functioning financial conglomerate composed of insurance, securities, banking and other financial institutions.

[Source: China-CN](http://en.china.cn/content/d683465,640b35,2836_13976.html) (Link no longer active)

### KKR and Fubon bid for a stake in CICC

Kohlberg Kravis Roberts & Company (KKR) and Fubon Financial are among the bidders for Morgan Stanley's stake in Chinese investment bank CICC, people familiar with the matter said, in a deal that could be worth more than US$1 billion.

Fubon, Taiwan's number five financial conglomerate, has made no secret about its intention to grow in the mainland, especially now that cross-Straits relations are thawing.

When CICC was founded around 14 years ago, Morgan Stanley paid just US$37 million for a 34.3 per cent piece of the Chinese bank. CICC is now one of the biggest and most successful investment banks in the Chinese mainland.

While the stake has been profitable for Morgan Stanley, the New York bank lacks control of management decisions at CICC.

In December 2007, Morgan Stanley signed an agreement with China Fortune Securities, in an effort to attain a Chinese joint venture that gave it more control over management.

China bars foreign firms from having more than one investment banking venture and limits their holdings to a third of the total. Morgan Stanley's ability to move ahead with the China Fortune deal has been held up by its failure so far to sell the CICC stake.

Last year, Morgan Stanley tried to sell the stake, but the auction failed. It recently re-launched the sale, seeking between US$1.2 billion and US$1.5 billion, a separate source previously told Reuters.

Other private equity firms that have joined the bidding include Bain Capital and General Atlantic, sources previously told Reuters. Two other buyout firms, TPG and JC Flowers, had also expressed interest in the stake.

Bain Capital's Jonathan Zhu, one of the firm's managing directors in Hong Kong, is a former top banker for Morgan Stanley in Asia.

Morgan Stanley, KKR and Fubon declined to comment. The other private equity firms have also declined to comment. The sources have asked not to be identified because they are not allowed to speak on the record about the deal.

Any deal is likely to take several months, as the buyer of the stake in the government-backed bank would have to win official approval.

For Fubon, the purchase of a CICC stake would increase its footprint in the mainland. Its subsidiary, Fubon Bank (Hong Kong), owns a 19.99 per cent stake in the mainland's Xiamen Commercial Bank.

Fubon's attempt at CICC comes as Taiwan and the mainland have pledged to open their financial markets to each other, highlighting the improving business ties across the Taiwan Strait.

Though both sides have recently signed a financial memorandum of understanding, investors are still waiting for the signing of a wider trade agreement that will allow banks in the mainland and Taiwan to buy stakes in each other.

Fubon and the private equity investors, should any of them sign a deal, would likely want to gain more control over CICC than Morgan Stanley had.

There is also the possibility that CICC will go public some day. The buyer of the 34.3 per cent stake may therefore lack control, but could see a hefty payout later if CICC follows through with its previously stated plans to go public

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-12/03/content_9106259.htm) ([see archive](CICC_stake_catches_KKR_Fubon_fancy.pdf))

### China's Zijin Mining announces takeover bid for Australian gold company

Zijin Mining Group Company, China's largest gold producer and third-largest copper producer, announced that it would pay AUS$545 million (US$500 million) to take over Indophil, an Australian gold and copper company.

The Fujian-based Zijin Mining would make a conditional cash off-market takeover bid for all of the issued shares in Indophil for AUS$1.28 per share, according to a statement on the company website.

Indophil Resources NL, with its registered office in Victoria, Australia, owns a 34 per cent operating interest in Sagittarius Mines, Incorporated, a Philippine mineral exploration and development company which controls the world-class Tampakan Copper-Gold Project in the Southern Philippines.

The Tampakan Project's mineral resource is the largest undeveloped copper-gold deposit in Southeast Asia. The latest confirmed mineral resource estimate is 2.4 billion tonnes containing 13.5 million tonnes of copper and 15.8 million ounces of gold at a 0.3 per cent copper cut-off grade, the company said in the statement.

The deal is still waiting for regulatory approval from both the Chinese and Australian governments, the company said.

Zijin Mining shares surged 6 per cent to 10.6 yuan (US1.56) after the deal was announced.

[Source: Xinhua](http://news.xinhuanet.com/english/2009-12/01/content_12569542.htm) ([see archive](Chinas_Zijin_Mining_announces_takeover_bid_for_Australian_gold_company.pdf))

### Economic recovery underway in Hong Kong

The International Monetary Fund (IMF) said that economic recovery is underway in Hong Kong, fueled by economic growth in the Chinese mainland, supportive government policies and accommodative monetary conditions imported from the United States.

The IMF also recognised the efforts of the Hong Kong Special Administrative Region (HKSAR) government to aid economic recovery, suggesting it further modernise the current budgetary management system.

Prudential Measures

In its staff report on Hong Kong, the IMF said the economy should steadily strengthen and unemployment should decline in the coming months. Consumer price inflation is projected to be close to zero by the end of 2010.

Noting that Hong Kong's financial system has withstood the downturn well, the Fund said banks in Hong Kong should be readily able to absorb the decline in profits that is likely to result from higher provisioning and tighter interest margins in the coming months.

To mitigate the risk of a credit-asset price cycle, the Fund suggests introducing measures in addition to the continued strict enforcement of the existing regulatory regime in maintaining financial stability.

The Fund also agreed with the increase of the deposit protection limit and commended the steps taken to co-ordinate with Singapore and Malaysia on the exit from the blanket deposit guarantee.

Fiscal Outlook

Expecting that the fiscal outturn for this year could involve a much smaller deficit than planned, the Fund said the risks to the global economy argue for a supportive fiscal stance to be maintained in the 2010-11 Budget. It also supported the contribution of private financing sources to a larger share of healthcare spending.

Maintaining its long-standing support of the linked exchange rate system, the IMF said that maintaining a high degree of flexibility in the economy, particularly in the labour market, will be essential for the real exchange rate to adjust to external shocks.

Expecting that the accommodative monetary conditions will remain in place for an extended period, the Fund said the recent extraordinary expansion in the aggregate balance will be unwound at some future point, leading to capital outflows. Communicating the authorities' policy actions during this period will be critical to avoid any disruptive market movements.

Economic Uncertainties

Welcoming the report, Financial Secretary of the HKSAR government, John Tsang, said that the global economic outlook remains subject to considerable uncertainties. "We are mindful of the prevailing risks in the external environment and will continue to adopt necessary measures to sustain economic growth," Tsang said.

Hong Kong Monetary Authority Chief Executive, Norman Chan, welcomed the fund's continued support of the linked exchange rate system. "We remain firmly committed to the link, which has served Hong Kong extremely well since 1983 as the anchor for monetary and financial stability," Chan said.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90859/6831792.html) ([see archive](Economic_recovery_underway_in_HK_IMF.pdf))

## Other

### Chinese official warns of overcapacity amid industry recovery

Senior Chinese officials have warned of increasing industrial overcapacity, saying that expansion of some Chinese industries has outrun the growth of market demand.

Boosted by government policies, domestic market demand has increased rapidly, but industrial capacity has expanded faster, Jia Yinsong, inspector of the raw materials division under the Ministry of Industry and Information Technology (MIIT), told a press conference. The situation has made industrial overcapacity more serious and caused price fluctuations, he said.

Steel, cement, and flat glass industries were highlighted as among those with overcapacity problems.

In the first 10 months of 2009, crude steel production reached 472 million tonnes, up 10.5 per cent year on year. This is compared to a 13.5 per cent fall in global steel production of 982 million tonnes during the same period.

Cement production was up 18.7 per cent at 1.34 billion tonnes while production of flat glass was up 2.5 per cent to 469 million boxes, each weighing about 50 kilograms, Jia said.

Total capacity in China's steel industry hit 660 million tones by the end of 2008. By October 2009, excess capacity in the sector had reached 200 million tonnes with another 58 million tonnes under construction, according to MIIT figures released on 27th October.

The cement sector also saw huge excess capacity. Total capacity in the sector was 1.87 billion tonnes by the end of last year, but only 1.4 billion tonnes of cement was produced in 2008. By the end of September this year, another 600 million tonnes of capacity were put to use or under construction, MIIT figures show.

The rising capacity was accompanied by expanding investment in those sectors. Investment in the cement industry grew 64 per cent while investment in flat glass grew by 35.3 per cent and in steel by 3.8 per cent year on year in the first 10 months of 2009, Jia said.

He gave no exact figures for investment.

About 27 per cent of capacity in the country's cement sector was obsolete, according to Jia. Jia said the government would push forward mergers and acquisitions in the steel sector to increase industrial concentration.

Xiong Bilin, an official with the Industrial Coordination Division under the National Development and Reform Commission (NDRC), the country's top economic planning body, said at the press conference that the NDRC would join with the MIIT and other government departments to strictly control overcapacity in some sectors.

Xiong said government documents were expected to be released soon regarding industrial readjustment. He said projects involving new capacity building or expansion in the steel industry would be refused approval and support by the government.

In January 2009, the central government unveiled a support package for the auto and steel industries, which also highlighted eliminating outdated capacity, promoting technological advancement, while warning against establishing new projects in the steel sector.

[Source: Xinhua](http://news.xinhuanet.com/english/2009-12/03/content_12580920.htm) ([see archive](Chinese_official_warns_of_overcapacity_amid_industry_recovery.pdf))

### Individual investors move into the property sector

As property developers' profits around the country continue to soar, a group of individual investors have joined forces to buy land on their own.

The Individual Land Bidders Club was recently founded in Shanghai, and it has attracted more than a dozen members, each with an investment of no less than 1 million yuan (US$146,500), said Qian Shenghui, founder of the club and general manager of Shanghai QianShengHui Investment Consulting.

"We want to provide a platform for individual investors to participate in real estate development other than through land or property speculation," Qian said.

The establishment of the club comes after increasing efforts by individual investors to get involved in real estate around the country.

In Shanghai last month, an individual investor bid nearly US$25 million for a 31,438-square-meter plot of land in the city's thriving Pudong District. A week earlier, another individual investor placed a bid of US$63 million on a 124,559-square-meter piece of property in Wuhu, in Central China's Anhui Province.

Analysts said property developers have gained large profits from land reserves, and individual investors are now trying to follow suit.

About one third of Chinese property developers obtain their profits from holding land in reserve rather than from building houses, Pan Shiyi, chairman of SOHO China, a Beijing-based property developer, told CCTV in November.

Property developers often hoard land until it rises in value and then resell it. Officially, companies are only allowed to hold onto undeveloped land for two years, but the rules are only loosely enforced.

PCCW, a Hong Kong telecommunications company, sat on property in Beijing for three and a half years before selling it this summer at almost a 60 per cent mark-up.

Bidding on land is much cheaper than buying property, said Yan Wei, a member of the club. "I can get more profit from real estate development than buying property."

"Bidding for land will bring risk to individual investors, as land speculation is not allowed and individuals also lack experience in property development," said Yang Hongxu, director of E-house China R&D Institute.

Qian, the club founder, said they will use the investment to bid on land at reasonable prices and build low- and middle-end residential buildings to meet market demand, which could help ease the surging housing prices in metropolises such as Shanghai and Beijing.

However, Yang from E-house is skeptical about the impact a handful of people can make on the market. Individual investment in property development is still too small to affect housing prices in the short term, he said.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90860/6831807.html) ([see archive](Individual_investors_move_into_property.pdf))

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