SCI China Market Update – July 2012

Dear Friends,

At the invitation of the Tianjin government, I will be leaving for China next week to explore business opportunities on July 12 and 13th. I will then travel to Shanghai, Suzhou, Beijing, Qingdao, and several other cities on client business. Before leaving for China, I'd like to share with you some very recent China market news for your information:

China cuts interest rates

China cut interest rates for the second time in a month, a surprise move that analysts said may indicate the world's second-biggest economy was slowing more quickly than expected. The changes will see the benchmark one-year lending rate drop by 0.31 points and the deposit rate fall by 0.25 points.

The cut will effectively adjust the one-year deposit rate to 3.0 % and the one-year loan rate to 6.0%, the bank said. The central bank did not immediately provide a reason for the rate cut, but analysts said China's economic planners may have acted after analyzing data for the second quarter that is due to be released next week. China's economy grew an annual 8.1% in the first quarter of 2012 -- its slowest pace in nearly three years. China last cut interest rates on June 7, which was then the first move down in more than three years, and experts said there could be similar moves in the second half of the year. China had previously hiked interest rates five times from October 2010, in an effort to control surging inflation due to worries of social unrest.

M&A cools in China, heats overseas

In the first half of this year, a total of 422 merger and acquisition deals were completed in China, down 21.3 % year-on-year, according to Zero2IPO Research Center. Among them, 366 deals disclosed prices, hitting $28.65 billion, down by 22.03 % from the same period of the previous year. Outbound M&A deals numbered 60 in the first half at a total price of $19.42 billion, up by 23.8 %.

GM says China sales at record high in first half

US auto giant General Motors said Thursday its China sales for the first half of this year reached a record 1.42 million vehicles, despite an economic slowdown in the world's biggest car market. GM's sales in the country jumped 11.3 % in the first six months from a year earlier. For June alone, its China sales rose 10.1 % year-on-year to 213,495 vehicles, also setting a new record for the month, GM said.

"Despite signs of slowing economic growth in China, demand for GM products rose in all key segments in the first half of the year," GM China Group president Kevin Wale said in the statement. "We expect sales growth to remain steady in the second half, driven by demand in China's interior provinces. "China's economy has been weakening, recording 8.1 % growth in the first quarter of this year, its slowest pace in nearly three years.

Auto sales also began to slow last year after the government rolled back purchasing incentives and some cities imposed limits on car numbers to ease traffic congestion and cut pollution. China's nationwide vehicle sales rose just 2.5 % to 18.51 million units in 2011, compared with an annual increase of more than 32 % in 2010. But foreign brands have managed to buck the trend with better brand recognition and perceptions of better quality among domestic consumers. GM sold more than 2.5 million vehicles in China last year.

Steel industry profits continue to shrink

The combined profits of China's major steel producers dropped more than 94% year-on-year to 2.53 billion Yuan ($398.39 million) in the first five months this year, amid sluggish demand as well as severe overcapacity in the sector, the Economic Information Daily reported Monday, citing statistics from an industry association. In May, the combined profits of the 77 steel mills surveyed by the China Iron and Steel Association (CISA) slid 21.7 % month-on-month to 1.4 billion Yuan, according to the report, even though the second quarter is supposed to be a peak season for the industry. Also in May, over 30 % of companies in the sector suffered losses. Leading steel producers such as Baosteel Group, Anshan Iron and Steel Group and Wuhan Iron and Steel Group have cut the July factory prices of their products by about 200 Yuan per ton. Current steel prices have dropped around 800 Yuan per ton compared with the same period in 2011. High costs of labor and raw materials have also affected steel mills' profits. Given the government's tightening policies on the real estate sector, which consumes some 30 % of total domestic steel production, no significant increase in steel demand will be seen in the near future.

China implements energy-saving electricity pricing system

China implemented a new multi-tier electricity pricing system on Monday to tackle the increasing pressure of supplying power to the world's most populous country. Under the new system, the residential electricity rate increases as the electricity consumption base amount increases. For example, Beijing has set three price brackets for residential users and will keep the current electricity rate unchanged for residents consuming 240 kwh of electricity or less a month. Households whose monthly electricity consumption falls between 241 kwh and 400 kwh will have to pay 50 Yuan (7.9 U.S. dollars) more for every 1,000 kwh of electricity, while those consuming more than 400 kwh a month will pay 300 Yuan more for every 1,000 kwh of power. The current electricity rate for Beijing households remains at 48.83 Yuan for every 100 kwh of consumption.

Different provinces have set up their own price brackets. In east China's Zhejiang province, households whose yearly electricity consumption falls under 2,760 kwh will enjoy the current price of 0.538 Yuan per kwh. Those who consume between 2,761 to 4,800 kwh a year will pay 50 Yuan more for every 1,000 kwh of electricity, while those consuming more than 4,800 kwh a year will pay 300 Yuan more for every 1,000 kwh of power. The new pricing system has been designed to have minimal impact on the poor. Households consuming less than 480 kwh per month can save at least 16 Yuan a month, according to a calculation by the Zhejiang Provincial Price Bureau. China has been pushing for reform in its pricing of resources and energy as part of efforts to better reflect market demand and save energy as power shortages are reported almost every summer.

Power generation investment falls

Investment in coal power generation fell 26 % in 2011, the first drop in the past five years, and it may lead to further power shortages over the next few years, analysts said yesterday. Investment in coal power totaled 105.4 billion Yuan ($17 billion) in 2011, less than half the amount in 2005, according to a statement released by the State Electricity Regulatory Commission (SERC) Wednesday. The top five State-owned coal power producers, which account for about half of the total market share, suffered combined losses of 15.1 billion Yuan last year, and they have debt-to-asset ratios as high as 85.7 %, the SERC said. "Power producers are losing money, and that's why investors are reluctant to continue putting money into the electricity generation business," said Cao Yin, director of energy and power business with Martec Group, a consulting firm. In 2010, the top five power producers lost 11.8 billion Yuan in coal-fueled electricity generation - their core business - according to official statistics. Their total losses reportedly reached 60.3 billion Yuan between 2008 and 2010 due to rising coal prices over the past few years.

Currently, coal accounts for about 80 % of China's total power production. China's coal prices are market-driven but electricity prices remain tightly State-controlled, for fear that rising prices could pose inflation problems. As a result, power producers are unable to pass the rising cost of coal onto the end users. Without new investment in coal power, China will face a bigger power shortage over the next three to four years, Cao told the Global Times. Renewable energy such as solar, wind energy and hydro-electric power, which is only a very small portion of the nation's power production, is less predictable and hard to control, and cannot be expected to take the leading role in power supply, he said. China had a power shortage of 30 giga watts in 2011 and the gap could widen to 50 GW this year, according to the Development Research Center of the State Council.

It is important to make the coal power business profitable so as to lure more investment, Cao said. Reforms are under way to let the market decide power prices, and China will launch a tiered power pricing scheme for residents starting July 1 nationwide. However, "it will only have a limited effect for power producers," Cao said, as the power consumption of residents only accounts for 30 % of the total. But the performance of the power firms is expected to improve, meaning lower losses this year, Wang Nengyuan, energy and power consultant and partner with Beijing-based Adfaith Management Consulting, told the Global Times. With increasing imports of coal and a high level of inventory, the prices of coal have dropped about 10 % from early this year to an average of 650 Yuan per ton, he said.

Apple pays $60 million to settle China iPad trademark dispute
Apple Inc has paid $60 million to Proview Technology (Shenzhen) to end a protracted legal dispute over the iPad trademark in China. The lawsuit had hampered some sales and delayed the introduction of the new iPad in China. Prior to the launch, Proview requested authorities in scores of Chinese cities to order resellers to take all iPads off their shelves. The court-mediated settlement, announced on the website of the Higher People's Court of Guangdong province, will allow Apple to get on with selling its popular tablet PC in one of its most important markets, analysts said.

"The settlement is great news for Apple," said Teck-Zhung Wong, a Beijing-based analyst with technology research firm IDC. "It just allows them to get on with business and stop being distracted. The new iPad has been so late to the China market that if they drag it any longer, Apple will stand to lose quite a bit more. "China is a key growth area for Apple, and Chief Executive Tim Cook has often said that the company has only scratched the surface in the region. Sales in greater China - mainland China, Hong Kong and Taiwan - increased threefold to $7.9 billion in the second quarter ended on March 31, accounting for about 20 % of Apple's $39.2 billion in revenue.
The settlement with Proview paves the way to spark iPad sales for the September quarter, Topeka Capital Markets analyst Brian White said.

For more information about today's China market and opportunities please visit our website at www.s-c-i.com or call me at the number below, or Dr. Tim Weckesser at 610-828-8060.

Best regards,

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