SCI China Market Update – May 2013

Dear Friends,

I just returned home from Beijing on May 2nd after a two-week business trip on behalf of clients. The highlight of the trip was that, although the new Xi Jinping and Li Keqiang government is only two months young, one can already see a difference in its anti-corruption policy, enforcement and results. It really seems that government officials are becoming more and more careful about spending taxpayer's money on luxury cars, exquisite dining, and the like. Thus sales have plummeted for sky-high priced Chinese liquors, shark's fin delicacies, rare sea cucumber and abalone and similar high-end items. I visited Suzhou, Shanghai, Tianjin, Harbin and Beijing during this trip and found the high-end luxury restaurants no longer as busy and prosperous as before. Government officials seem to be genuinely afraid of losing their job simply because someone put photos of their extravagant dinner online. An online photo of someone smoking a high-priced cigarette or wearing an extremely expensive watch at a meeting may trigger a counter-corruption investigation and mean big trouble for the high-flyer.

Although this is sign that the new leadership really wants to clean up China's politics, still the challenges are daunting. China's top newspaper warned recently that some government officials were avoiding President Xi Jinping's graft-busting instructions to be frugal by actually taking banquets and other lavish activities underground, including hiding liquor in water bottles. These are typical avoidance tactics in China.

As the long coal-burning winter is over, the quality of air and weather was much improved over my February trip, when you could almost swim in the air. I really enjoyed seeing a blue and sunny sky in Suzhou, Shanghai, Tianjin, Harbin and Beijing this time. Let's also hope for the same "cleaning" in China's political and bureaucratic environment. Below is some recent market data for your info:

EC: China's economy to grow 8% in '13

The European Commission has forecast that China's economy will grow 8% this year and 8.1% in 2014, after it successfully avoided a "hard landing" in 2012. According to its spring forecast released on Friday, EC officials said China remains exposed to a possible worsening of the international environment, but its principal risk factors remain domestic.

The report said that consumption is likely to remain the principal driver of growth in 2013. It said rising wages are likely to increase household incomes while real interest rates will remain positive, implying rising earnings on household deposits and an increase in financial wealth. It said China's currency appreciation will not be helpful in increasing exports, a long-term driver of its rapidly growing economy. According to EC calculations, the real effective exchange rate of the RMB has appreciated by around 5% over the last six months, which will act as a modest drag on export growth.

China manufacturing slows in April: HSBC

Manufacturing activity slowed in China in April as exports were hit by sluggish overseas demand, HSBC said recently. HSBC said its initial purchasing managers' index (PMI) fell to 50.5 this month from a final figure of 51.6 in March. The index tracks manufacturing activity and is a closely watched barometer of the health of the economy. A reading above 50 indicates expansion while anything below points to contraction. China's 2012 growth of 7.8% was its slowest in 13 years owing to weakness at home and in overseas markets. Observers had hoped for a rebound this year that would drive a global recovery after October-December saw expansion of 7.9%, snapping seven straight quarters of slowing growth.

Shipyards enjoy big rise in Q1

The nation's shipbuilders received 9.57 million deadweight tonnage of new orders in the first quarter of the year, a 71.1% surge on last year, but analysts still expect vessel prices to remain low because of newly added capacity. The first quarter figures compare to 5.59 million DWT in the same period last year, according to the China Association of the National Shipbuilding Industry. The rising new order book is in line with global industry trends, which show that shipbuilding orders grew 44% from a year ago to 20.58 million DWT for the quarter. Industry analysts believe the global shipping industry has bottomed out and expect to see a pick up in fortunes next year and in 2015. "In a slow market, shipping companies place more orders due to lower prices, and it usually takes nearly two years to complete a shipbuilding order," said Meng Lingru, an industrial analyst with Shanxi Securities.

Despite the pickup in new orders in China, completed orders during the quarter dropped 15.6% year-on-year to 9.45 million DWT, and total ongoing order weight dropped to 107 million DWT from 141.94 million of 2012, a decline of 24.6% year-on-year. Shipbuilding costs have halved over the past two years, and many lower-tier yards in China are struggling to break even. Without a recovery in process, the industry is unlikely to enjoy any actual recovery, added an analyst from Xiangcai Securities, who spoke on condition of anonymity.

Hyundai wins order for world's biggest container ship

South Korea's Hyundai Heavy Industries said Monday it had won a $700 million deal to build the world's largest container ships for China Shipping Container Lines. Under the deal signed with China's number two shipper, the world's largest shipbuilder will build five vessels, each capable of carrying 18,400 TEU (20-foot equivalent unit) container boxes, Hyundai said in a statement.

The ships will be the world's largest, breaking the previous record of another South Korean firm, Daewoo Shipbuilding and Marine, which won an order in 2011 to build 20 18,000 TEU container ships for Denmark's A.P. Moeller-Maersk. Delivery of the mega-vessels will begin in the latter half of 2014, Hyundai said. Each ship will boast a 400 meter (yard) long deck, and stand 58.6 meters wide and 30.5 meters high. The deal takes the value of Hyundai Heavy's order book so far this year to $9.7 billion, about 40% of its annual target of $23.8 billion. Market sources said China Shipping had bought its vessels at a "much lower" price than Maersk, as the global shipping downturn has dented shipbuilding prices, but the company declined to comment.

Chinese consumers push US exports higher

China remained the United States' third-biggest export destination, behind Canada and Mexico, in 2012, having purchased nearly $109 billion worth of US goods, according to a report by the US-China Business Council. Each of 30 US states exported more than $1 billion in goods to China while 10 others shipped more than $500 million. Leading industries were agriculture, transportation and electronics, the Washington-based organization said in an annual survey released on Thursday.

Although GDP growth in the world's second-largest economy slowed last year, China still saw the value of imports from the US increase by 6.5%, or $6.6 billion, the council said. That helped boost the US economy and contribute to job creation, said John Frisbie, president of the council, which represents more than 200 US companies that do business in China. And, the Chinese middle class accounts for nearly one quarter — $6.2 trillion — of the $26 trillion in additional global consumption projected for the 15 years leading up to 2025, according to consulting firm McKinsey & Co. "As its economy and middle class expand, China will continue to play a significant role as an export market for a wide selection of US goods," Frisbie said. "Some estimates forecast that China may have nearly 600 million middle-class consumers by the end of the decade."

Chinese companies increase stake in US

China's direct investment in the United States showed strong momentum in the first three months of this year despite a weak fourth quarter of 2012 and the negative impact of "national security" concerns on some deals. During the first quarter, Chinese companies concluded eight mergers or acquisitions and nine greenfield investments — those involving construction of factories or offices — worth a total of $2.2 billion, according to a report released on Tuesday by Rhodium Group, a New York firm that tracks Chinese investment in the US.

M&A highlights were the acquisition by China National Offshore Oil Corp, or CNOOC, of the US drilling operations of Canada's Nexen Inc; auto-parts company Wanxiang Group's successful $257 million bankruptcy-auction bid for electric-battery maker A123 Systems Inc; BGI-Shenzhen's purchase of California-based Complete Genomics Inc; Hanergy Holding Group's purchase of solar technology company MiaSole; and Shanghai Fosun Pharmaceutical Co's stake purchase in Saladax Biomedical Inc. Greenfield deals included a power-generator manufacturing factory in Virginia planned by Shenzhen Superwatt Power International Co, a joint venture involving developer China Vanke Co on a San Francisco condominium project and offices in Silicon Valley for search engine giant Baidu Inc. "Those deals underscore that high-tech manufacturing and modern services are emerging as mission-critical for Chinese investors as their fast-changing home economy matures," said Thilo Hanemann, Rhodium's research director. Chinese acquisitions in the US now under discussion or awaiting regulatory approval have a total value of over $10 billion, the highest ever for the category, according to Rhodium's report. It also found that privately held Chinese companies have increased their investment in the US. Over the past 15 months, they spent more on US deals than in the previous 11 years combined. State-owned enterprises, or SOEs, have long dominated investment by China in the US, but private companies accounted for 80% of deals and 50% of deal value from January 2012 through March of this year.

Chinese SOEs major losers in 2012

China's state-owned enterprises (SOEs) lost their position as the most profitable sector and became the country's biggest losers last year, according to the annual results listed companies reported for 2012. The top market losers last year were SOEs with a combined loss of about 50 billion Yuan (8 billion U.S. dollars), their financial statements revealed. China COSCO Holdings Co., the country's largest shipping company, topped the list for the second consecutive year, losing 9.56 billion Yuan in 2012 after a deficit of 10.45 billion Yuan for 2011. COSCO was followed by Aluminum Corp. of China, the country's largest alumina producer and Metallurgical Corporation of China Ltd., which reported a loss of 8.23 billion Yuan and 6.95 billion Yuan, respectively. Half of the top 10 poor-performing companies were in the iron and steel sector, including 4.16 billion Yuan in losses for Angang Steel, 3.86 billion Yuan for Maanshan Iron & Steel, 3.83 billion Yuan for Shandong Iron & Steel, 3.5 billion Yuan for Anyang Iron & Steel and 3.25 billion Yuan for Valin Steel. All the top losing companies blamed their disappointing results on the downward trend of their industries and the broader macroeconomy.

Hundreds protest proposed China chemical plant

Hundreds of people protested against a proposed chemical plant in southwest China on Saturday, state media said, while residents in another city accused authorities of preventing a similar protest. More than 200 demonstrators gathered in the city of Kunming to protest plans for a factory which will produce paraxylene (PX), a toxic petrochemical used to make fabrics, China's official Xinhua news agency reported.

China has seen a number of urban demonstrations against proposed chemical plants in recent years, in what analysts have identified as a rising trend of environmentally-motivated "not in my backyard" protests in China. Local authorities in the coastal city of Xiamen cancelled plans for a PX plant after thousands took part in a protest in 2007. A huge protest in the northeastern city of Dalian in 2011 prompted authorities to announce a similar climbdown. The eastern city of Ningbo last year announced the withdrawal of plans for a PX plant after a demonstration involving about 200 people, while a violent protest in the southwestern city of Shifang prompted officials to shelve proposals for a metals factory.

GM makes $1.3 bn Cadillac bet on China luxury sector
US auto giant General Motors will build a $1.3 billion Cadillac plant in Shanghai after China approved the project, it said Tuesday as it seeks more luxury sales in the world's biggest car market. Construction of the plant -- which will have annual capacity of 150,000 vehicles -- will start in June, GM said in a statement. The factory, the first in China dedicated to making Cadillacs, will come under Shanghai GM, a joint venture with China's SAIC Motor. "Shanghai GM has received the NDRC's (National Development and Reform Commission's) approval to build a Cadillac plant," the statement said.

The huge investment marks a bet that GM, the largest US auto maker, will be able to win a larger piece of China's rapidly-growing luxury vehicle market, in which German brands hold an estimated 80% share. Analysts say GM is a laggard in the segment, one of China's fastest growing and most profitable given rising incomes in the country. "GM needs to build a relatively high-end brand in China in order to improve its overall product line," said Jia Xinguang, managing director of industry group the China Automobile Dealers Association. "It also sees the growth potential in China's high-end car market, so the establishment of the plant will allow it to enter the market and win a bigger share," he told AFP.

China's luxury car sector is dominated by German automakers such as Audi, BMW, Mercedes-Benz and Volkswagen though other European, Japanese and US brands are bringing greater competition, analysts say. China's market for what the industry calls "premium" cars -- costing from $32,000 to $190,000 -- was 1.25 million vehicles last year, second only to the United States, according to consultancy McKinsey. Premium car sales in China grew at an average 36% a year in the last decade, though that would slow to an annual 12% through 2020, McKinsey said in a report in March.

GM launched a Cadillac sedan, the XTS, in China earlier this year as it seeks to make inroads into the sector. That vehicle, priced from $56,800 to $92,500, is produced in China. The firm plans to introduce one new Cadillac model a year through 2016 to boost annual sales of the marque from around 30,000 vehicles last year to 100,000 by 2015, a GM official said last month.

In the first four months of this year, GM sold 11,571 Cadillacs in China, according to figures previously released by the company. GM has 12 joint ventures in China, producing passenger vehicles, commercial vehicles and light trucks with Chinese partners. Its total China sales for all types of vehicles rose 11.3% last year to a record 2.84 million units.

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,

Shiqiang Gu
Vice President & COO

Sino Consulting (SCI)
One Tower Bridge
100 Front St., Suite 1460
West Conshohocken, PA 19428
U. S. A.
Tel: (610) 828 8061
Fax: (610) 828 8801
Web: www.s-c-i.com