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SCI China Market Update – November 2013

Dear Friends,

I am traveling in China on business. One of our clients has come to China to pursue several new sales opportunities and to install its “Made in USA” taping machine for a major Chinese cable and wire company in Shenzhen. Another client is coming to inspect products from a Chinese supplier in Hebei Province that we secured for them 3 years ago. Over the entire 3-year period, all shipments from this first-class supplier have been fully qualified and on time, even when additional urgent orders were placed. So we will visit the manufacturer to express our gratitude and expand the relationship for next year. Yet another client has installed an advanced electron beam processing system for a Chinese customer in Guangzhou.

We are seeing that while China continues to import large quantities of highly technical products from Western nations, Chinese companies are increasingly exporting more sophisticated components and equipment to Western companies – for example, highly engineered 10,000 ton hydraulic presses. It is clear to us that China is continuing its rapid climb up the value chain. And we think that China will surely need to import even more advanced technologies to improve manufacturing efficiency, reduce energy consumption and address the severe pollution issues. Here is some very recent China market news from various sources:

China official PMI seen hitting 18-month high in October

China's manufacturing activity in October likely grew at its fastest rate since April 2012, a Reuters poll showed, adding to signs of stabilization in the world's No. 2 economy as the government readies a series of key economic reforms. The official manufacturing purchasing managers' index (PMI) is forecast to reach 51.2 from September's 51.1, according to the median estimate of 11 economists, remaining well above the 50-point line separating expansion from contraction.

Currency swap signed with the EU a 'landmark'

China and the European Union signed a currency swap agreement to boost trade and financial stability in a move that also marks a landmark step for the Yuan's internationalization. The three-year swap line with a maximum value of 350 billion Yuan ($57 billion) is the largest the People's Bank of China has signed with a foreign central bank outside of Asia, higher than the 200 billion Yuan agreement with the Bank of England.

The European Central Bank said in a statement that the agreement has been established in the context of rapidly growing trade and investment between the eurozone and China. The swap is intended to serve as a backstop facility to ensure the Yuan's liquidity and financial stability in the eurozone. The swap is likely to significantly boost the Yuan-denominated bond market in Europe and will help consolidate Paris' position as a major platform for Yuan trading and transactions in the eurozone. Since 2008, China has signed currency swap agreements with 23 regions and countries with the total value reaching 2.48 trillion Yuan, according to the People's Bank of China.

Five Chinese tech giants investing in Silicon Valley in 2013

It has been predicted that more Asian tech giants will try to acquire Silicon Valley startups. In China, that trend is already picking up momentum. China wants Silicon Valley's talent, and Silicon Valley is more than happy to take China's cash. China's foreign direct investment into the US overall is exploding, and the IT industry is ripe for the picking. To sum it up, here are 5 Chinese companies that have invested heavily into Silicon Valley this year.

Baidu

In April, Baidu (BIDU) opened its Institute of Deep Learning in Cuptertino, California, right next to Apple.

Innovation Works

Innovation Works has accumulated 10 US-based portfolio companies so far, most of which are in seed stage. $10 million of the Beijing-based incubator's $180 million fund was specifically allocated for US companies late last year. Most of the companies in Innovation Works' US portfolio fit into one of four categories: developer tools, enterprise tools, online education, and connected devices.

Tencent

Tencent (0700.HK) began investing in Valley startups around October last year, many of them from Y Combinator. Tencent president Martin Law announced at the Global Mobile Internet Conference in Silicon Valley that his company has invested more than $2 billion overseas. Not all of that is going toward startups, but much of it is and will likely end up in the Valley.

Alibaba

Alibaba has just announced it will set up a San Francisco office for investing in US companies. The e-commerce titan revealed that its team has already completed a few investments in US companies. Earlier this month, Alibaba led a $206 million investment in ShopRunner, which is similar to its domestic Tmall e-store. A week earlier, it led a $50 million investment in Quixey, a search engine for apps.

InnoSpring
Santa Clara-based InnoSpring isn't exactly from China, but it is an incubator backed mainly by Chinese investors. Last year, Innospring grew to house 40 companies and invested $2 million in 12 of them. The incubator places an emphasis on green tech, but isn't limited to it.

De Niro plans property project on Shanghai's mean streets
A US consortium that includes famed actor Robert De Niro plans to develop a huge property project in a historic area of China's commercial hub Shanghai. "Project 179" near the city's waterfront Bund district will transform four vacant buildings into an 850,000-square-foot (76,500-square-metre) complex, the partners said in a news release recently. Set to open in 2016, the complex will include a boutique hotel, retail stores, a cinema and a performing arts center, the statement said. The project will also construct a new building. The US consortium is cooperating with the government-backed Shanghai Bund Investment Group, which won the right to develop the property in 2011. The four existing buildings mainly date from the 1920s and 1930s, it said.

China offers rewards to six regions to fight air pollution
China would give rewards amounting to 5 billion Yuan ($816.91 million) for curbing air pollution in six regions where the problem is serious, underscoring government concern about a source of public anger. The Finance Ministry said the regions eligible for the rewards were Beijing and its neighboring city of Tianjin, the provinces of Hebei, Shanxi and Shandong, as well as the Inner Mongolia Autonomous Region.

The awards would be made at the end of the year, and would be determined by pollution reduction targets, investment in tackling the problem and falls in PM 2.5 particles, which are especially bad for health, the ministry said on its website. The provinces of Shanxi and Inner Mongolia are among China's top coal-producing provinces and have been a major source of air pollution. State media said in July the government planned to invest 1.7 trillion Yuan ($277 billion) to fight air pollution over the next five years.

Beijing to ban half of private cars on high-pollution days
Beijing will ban half of its private cars and 80 percent of public vehicles from the roads if a red alert is issued on days of persistent pollution, the capital's information office said recently. Private vehicles will be barred from using the roads, based on odd and even license plate numbers, when pollution is predicted to linger in the city for three or more days.

Public transport, including buses and subway trains, will extend service time by 30 minutes and increase the number of backup vehicles and trains on days of persistent pollution to meet the increased demand. The authorities have blamed vehicle emissions for being a major source of PM2.5 — fine particulate matter measuring 2.5 microns or less in diameter that can enter the respiratory system. Other measures, including a ban on outdoor barbecues and fireworks, are included in the emergency plan. Kindergartens and middle school classes will be halted on days of high pollution to protect students' health.

China's capital to replace some coal-fired heating plants

China will replace four coal-burning heating plants in the capital Beijing with natural gas fired units by the end of next year as it steps up efforts to clean up pollution. The report, citing the city's Municipal Commission of Development and Reform, said the four plants and some 40 other related projects would cost around 48 billion Yuan ($8 billion) and cut sulphur dioxide emissions by 10,000 metric tons. It did not detail the related projects.

The plan is the latest step by authorities to deal with a persistent smog crisis in China's big cities that is fuelling public anger. The new plants will replace four coal-fired ones that provide heating for homes in the city's central urban area as well as generating electricity, Xinhua said. The four burned 9.2 million metric tons of coal in 2012, or 40 percent of the 23 million metric tons the city consumed in the year, it added."

China's rich get richer despite slowing economy

China's 400 richest people became $150 billion wealthier this year, Forbes magazine said recently, despite a slowdown in the world's second largest economy. The vast increase -- an average of almost $400 million each -- highlights the growing inequality between the Communist country's superrich and the millions who still live in poverty. The net assets of the top 100 richest people in China soared 44 percent from a year earlier to $316 billion, the magazine said, while the number of dollar billionaires rose to a record high of 168.

China milk powder crackdown is tough medicine for doctors, sales reps

A crackdown on corruption in China's infant milk formula sector has made sales representatives and hospital doctors fearful of talking to each other, putting a brake on marketing and possibly hitting revenue growth for foreign firms. Chinese media have repeatedly accused foreign milk powder makers, notably France's Danone SA , of paying bribes to medical staff in return for recommending their brands to new and expectant mothers.

The French food maker said this week it will appoint new management at its Dumex infant formula operation in China following a bribery scandal at hospitals in the country's north. China is a magnet for foreign infant milk formula makers, with the $12.4 billion market expected to double by 2017. But

investigations by Chinese authorities and reports in state media, often quoting whistleblowers, have curtailed marketing activity at hospitals. "Since the 'First Drop of Milk' expose, no matter what brand of milk powder, none of the reps have been coming," said a nurse at a top Shanghai hospital.
The nurse, who declined to be identified, was referring to a recent report by official China Central Television (CCTV) that claimed milk powder firms were bribing doctors to recommend their brands as the first milk substitute a baby tastes.

Overseas M&A deals reach record high in 1st half
Chinese companies' overseas merger and acquisition (M&A) activities reached a record high in the first half of the year, and the deals may continue to increase rapidly in the coming 12 months, a report from Deloitte China said on Tuesday. From January to June, there were 98 outbound M&A deals from Chinese companies, worth a total of $35.5 billion, compared with 97 agreements worth $22.9 billion in the first six months of 2012. Mega deals, which are those worth more than $1 billion per transaction, accounted for 13 percent of all successful deals, also a record high since 2005, according to Deloitte.

Chinese oil firms, Europe's giants win Brazil auction
China's CNOOC and CNPC, Anglo-Dutch giant Royal Dutch Shell and France's Total joined Brazilian state operator Petrobras in winning production rights to the huge "Libra" Atlantic oilfield. The five firms won 35-year concessions, with Petrobras taking a 40 percent stake, more than the minimum required by the terms of Brazil's offer, which has been controversial at home. Shell and Total both earned a 20 percent stake, with CNOOC and CNPC securing 10 percent each. Their consortium was the only bid to offer the Brazilian state the minimum 41.65 percent of oil to be extracted from the site, which holds an estimated eight to 12 billion barrels of oil. To put that into context, Brazil currently has 15.3 billion barrels of proven reserves and is already the second largest in South America after Venezuela.

CCB to acquire majority stake in Brazil's BicBanco
China Construction Bank Corp will acquire 72 percent of the shares of a Brazilian bank, Banco Industrial e Comercial SA (BicBanco), for 1.62 billion reals ($726 million), BicBanco has announced. The BicBanco deal still requires regulatory approval in both countries.

BicBanco, which is based in Sao Paulo, mainly lends to small and medium-sized domestic enterprises. It's also involved in consumer credit and foreign exchange, among other activities. CCB, China's second-largest lender by assets, hasn't completed any offshore acquisitions for seven years, since it bought Hong Kong-based BA Asia Ltd for HK$9.71 billion ($1.25 billion). Wang Hongzhang, president of CCB, said last year that the bank had allocated 100 billion Yuan ($16.4 billion) for overseas expansion.

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China media hail Russia ties after $85 billion oil deal

Chinese state media hailed the "huge potential" of ties with Russia on Wednesday after a $85 billion oil deal, with analysts saying the cooperation masks Moscow's unease at Beijing's surging influence in Central Asia.

The framework arrangement between Rosneft, the world's biggest listed crude oil producer, and Chinese oil giant Sinopec was announced during a visit by Russian Prime Minister Dmitry Medvedev, when around 20 agreements in various fields were signed. Medvedev said in an online chat with Chinese Internet users: "That means 100 million tonnes over the next decade, worth a total of $85 billion. "This is a large sum of money for any single country, even for China," he added.

Home prices still rising in major cities

Some top-tier cities are likely to miss targets set at the beginning of the year to stabilize home prices, as prices in China's 100 major cities continued to rise in October, a survey showed on Friday. Despite government measures to tame runaway home prices and prevent housing inflation from eroding residents' spending power and living quality, prices have not shown any sign of a downward correction, according to a report from the China Index Academy, the research arm of SouFun Holdings Ltd, the owner of the nation's biggest real estate website.

In October, the average price of new homes in China's 100 major cities stood at 10,685 Yuan ($1,741) per square meter, up 1.24 percent month-on-month and rising for 17 consecutive months since June 2012. Out of the 100 cities, 75 saw price hikes compared with last month, 24 reported declines, and prices were only flat in one city. On a year-on-year basis, the average home price in the 100 cities rose 10.69 percent in October, with the growth rate up 1.21 percentage points from September.

According to the report, the average new home price in top-10 cities, including Beijing and Shanghai, was 18,533 Yuan per sq m in October, up 1.95 percent from September and 15.69 percent from the previous year, both exceeding national levels. On the secondary housing market, the major 10 cities also saw bullish transaction prices. In October, Shenzhen topped the list for increases in pre-owned home prices, with a 2.31 percent rise from September and a 24.09 percent year-on-year hike.

I will return to Philadelphia in Mid-November. 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 call Dr. Tim Weckesser at 610-828-8060.

Best regards,

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