
JESA INVESTMENT & MANAGEMENT CO. LTD.

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NEWS FROM JESA!

By Saro Capozzoli, Founder and GM of JESA Investment & Management Co., Ltd

The end of 2009 is at the door step and it is the time for thinking over the past year, the achieved results and upcoming year.

Italian Companies are probably not in the best shape ever and for many of them in several industries the upcoming 2010 will not be necessarily the booming year after the financial crisis.

The after-effects of such a crisis will not cease to affect the market of many of them especially those that have not been ready for structural and/or strategic remake.

The internationalization is the inevitable path wise companies should undertake. For internationalization we are not meaning only delocalization but mainly risk diversification on different markets heading to those rich of opportunities.

Developing markets, such as China or Brazil, have better stand the crisis and for many companies they have been the last hope.

On the contrary the companies that till now have only put their eggs in US or European markets are struggling with a slow recovery.

We do believe Italian companies can improve, but our Government cannot depart from giving boost to our economy.

Besides the structural changes that a crisis may force any company to undertake we do believe some of them are necessary to ensure Italian companies re-emerge even stronger and healthier:

- Investment in training and education (foreign languages and knowledge of foreign markets);
- Better exploitation of young and fresh graduated generation, offering appealing opportunities to those with international experiences;
- Managerial transition by merit and competences and not only by ties.

Only the joint effort of public and private can ensure results and both companies and Government share the duty to shape a Country where it's worth living, studying, investing and a Country that is able to exploit abroad its competitive advantages.

ITALIAN VERSION

La fine del 2009 e' ormai alle porte ed e' tempo per riflettere sui risultati raggiunti durante l'anno passato e su obiettivi e propositi per il nuovo.

Le imprese italiane non sono probabilmente ancora nella loro forma migliore e per molte il 2010 non sara' ancora l'anno del boom dopo la crisi.

Gli strascichi di questa crisi non smetteranno di colpire molte imprese, soprattutto quelle incapaci di cambi strutturali e strategici.

L'internazionalizzazione e' un percorso inevitabile. Per internazionalizzazione non intendiamo solamente delocalizzazione ma soprattutto diversificazione del rischio in diversi mercati puntando a quelli ricchi di opportunita'.

Mercati in via di sviluppo come Cina o Brasile hanno meglio sopportato la crisi e per molte imprese sono state l'ancora di salvezza. Al contrario le imprese che hanno sempre e solo puntato tutto sui mercati americani ed europei combatteranno ancora con la ripresa lenta.

Riteniamo che le imprese italiane siano in grado di migliorare, ma le Istituzioni non possano derogare dal continuare a dare impulsi forti all'economia.

A parte i cambiamenti strutturali che una crisi puo' causare, riteniamo alcuni di essi fondamentali per assicurare che le nostre imprese possano riemergere piu' forti e sane:

- investimento in formazione (sia lingue straniere che conoscenza di mercati esteri);
- valorizzazione dei giovani e creazione di opportunita' per giovani laureati con esperienze internazionali;
- transizione manageriale delle imprese per merito e competenze e non solo per affiliazione.

Solo l'impegno congiunto tra pubblico e privato puo' consentire tali risultati ed entrambe le parti hanno il dovere di creare una Nazione dove valga la pena vivere, studiare e investire e una Nazione capace di portare all'estero il proprio vantaggio competitivo

Second Board feast in Mainland Stock Market, high premium or concerns about a potential bubble?

In 2009, the most important event in the Mainland China Capital Market has been the listing debut of ChiNext, the Nasdaq-style second board for start-ups, held in Shenzhen Stock Exchange (SZSE) on October 31st, 2009. It underlines Beijing's determination to support SMEs, and offering a new capital platform tailored for the needs of enterprises engaged in independent innovation and other growing venture enterprises, also reducing capital barriers for entering into the Stock Exchange Market. The difference between ChiNext and the main board lies in their mechanisms of financing, investment and risk management for issuers at various stages of development, rather than simply the sizes.

The first trading day 28 companies' stocks were listed at once, exhibiting a 75% average increase on opening price; the highest increase was of 209.73%. Other figures worth to be mentioned: the average turnover rate was beyond 86% and the average Price/Earning ratio (P/E) over 100. All the 28 companies' stocks were temporarily suspended by SZSE (some of them for 3 times) due to increase higher than the expectation and for the sake of preventing elevated speculation on the first trading day.

From a ChiNext buyer's analysis, individuals and speculators are the mayor actors on the market, while institutions only take 2.63%; for the sake of comparison, institutions usually

represent more than 50% in the European and American Second Board Market experience.

Currently, in the Mainland China Second Board market there are 9.6 mln accounts, including both individuals and institutions. Only a tenth of those have taken part in trading operations throughout the week after the debut.

Previous operations on Mainland China Stock Market matched results. 5 years ago, during the Small and Medium Board's debut day, 8 companies' stocks were listed at once and the situation was comparable: an extremely intense trading day, although the investors that had bought those stocks the first day and held them, took 569 days of transaction to recover their lost.

Taking into account that the value of 20 of the 28 ChiNext listed companies dropped of 10% in the second trading day, a very similar situation is likely to happen nowadays.

During the 6 following trading days, the loss of capitalization touched 16 bln RMB; each stock evaporated on average 100 mln RMB a day. A way back to the opening value might be quite long.

Reasons for a high premium

From the global market experience the average P/E of Second Board is around 20 to 30, but ChiNext's P/E is about 100.

Reasonable explanations for this figure can be:

- High growth of Chinese companies: China Economy has been the first one economy in the world to recover from the financial crisis. In the Autumn Session of 2009 Guangdong Trading Import and Export Fair, the contract amount increased by 19.6% compared to the Spring Session. This seems to be a light beyond the darkness of the crisis. The recovery of China has been led by the Government Investment and the efficiency of the policy aimed to push domestic consumption and every analyst agrees that GDP will reach the 8% target.

- Monetary policy: RMB Foreign Exchange System is linked to the US dollar. In the future, the pressure of revaluation of the local currency may lead to the revaluation of assets in China considering the losing currency policy in the domestic market, in which, the main financial institutions have already been listed: the listing of Agricultural Bank, the last biggest state-owned bank in China, is currently under process. The forecast of future liquidity is loosing and can lead to inflation, so the international hot money and international institutions are currently increasing even more their portfolio of Chinese assets.

- Circulation System in Mainland Second Board: This year the IPO market capitalization in China has overreached 90 bln RMB. This figure makes China the 2009 biggest IPO stock market in the world. If the forecast of liquidity doesn't vary, it is reasonable to believe that the money supplied to the stock market will represent richness. This year, only in the Mainland stock market the money for subscription of new shares has been around 1.3 to 1.5 trillion RMB.



Circulation System situation is the most reasonable factor behind the high value of P/E in the second Board market.

Main Differences between China and Overseas Stock Market

Mainland stock market has several differences compared to overseas stock markets; explained below:

- Dealing system: Mainland dealing system is order driven style (individual places order directly without dealers), while overseas stock markets have a dealer system (the dealer is the intermediary for any transaction)

- Locking period: In Mainland Second Board the shares' locking period is different from Hong Kong where it is 6 months; in the US Stock Market, according to the law, there are no limitations to the locking period, while it should be decided by the issuer and by the sponsor (investment banking). In Mainland the adopted locking period adhere to the rules of the primary market and Small and Medium Board, but generally every issuer must refer to the following rules: shares cannot be transferred within one year after the IPO; the majority shareholder of a company cannot transfer or trade its shares within 3 years after the IPO. In case of not-majority shareholder or controller but of a shareholder within 6 months before IPO, the shares transferred or trade cannot exceed 15% of the total shares within 2 years after IPO. Within 1 year after IPO, the premium is very high due to the small size of the liquidity.

- Issued system / Launched system: in Mainland it is based on examinee and approval system while in other countries is based on registration and recording system. In China the qualification of listing companies is very difficult and the approved number is very small. For instance, in the Small and Medium Board, even after 5 years of development the number of listed companies is only 300. The difficulties faced during the listing also lead to delisting difficulties. In case of several negatively performing companies, the majority shareholder gets benefits higher than the one from an IPO after the companies' reconstruction. In economic terms, these are bad money driven out of good money.

- Financial situation of listing companies: The 28 companies on the ChiNext not only respect the requirements of Small and Medium Board but also their financial situation is often better. Net profit of several enterprises on the Second Board Market exceeds 100 mln RMB in 6 months; it means that these companies have already surpassed the earlier stage period, although these come from special industries and sectors (IT, medical sectors, etc) that don't have earlier stage characteristics. Moreover, in the Second Board the listing examination period requires 4 accounting years.

- Foreign exchange controlling system: Mainland Stock Market is a closed stock market, due to controls on exchange currency system. Foreign institutions that want to invest in Mainland Stock Market must do it through the Qualified Foreign Invested Institutions (QFII). Up to the end of September only 78 foreign institutions have got approval and their total QFII quota

amounted to 15.72 bln USD. Concerning foreign individual investors, they can only invest in Mainland B Shares Stock Market (whose development has been stopped for many years and in the future will be probably merged with other indexes).

Concern for a bubble

Common characteristics of Chinese Economy should require a high premium for local enterprises, but it is important to understand from where the premium comes from. In fact, if it is led by the limitations of system (not complete and mature), it couldn't last too long, especially in Mainland Stock Market where hedge financial products don't exist. This means that there is only a way to earn money, only when the prices of shares increase. The stock index future is now under approval but there is not detailed information about the timing. Before the end of next year shares will circulate on the domestic stock market after market split shares reform; this will give more pressure on the revaluation of the total market capitalization. Therefore, a high premium based on a high growth can last long time and be considered reasonable and acceptable by the Market, otherwise it should move back to its real value.

Beyond the topic

Besides the concerns about the 28 listed companies on second Board, there are 23 companies supported by PE investors and, according to the existing capitalization, returned between 10 and 50 times the original investment. These fortunes considerably inspired local and Foreign PE institutions.

Chinese M&As in Italy

Strategy

The strategy behind Chinese M&A deals carried in Italy depends on the type of competition that players face within the business arena. Most common drivers are the access to technology (design, technician skills, and patents), distribution channels, brand, and managerial know-how. As general rule, Chinese companies rely on productive capacity and intense economy of scale, but lack technical and managerial knowledge. In the pre-acquisition evaluation, a major role is played by the sector. For instance, each industry has its own peculiarities that need to be investigated and understood.

In the automotive industry, Chinese are interested in technological know-how and industrial design with the aim of acquiring competences to develop their own model. So far, their automotive industry lack of originality and players are eager to create their own style to appeal new customers. The best way is to acquire experienced designers and technician directly in the field. In this sense, Italy has a long tradition and the value of its designers is world known.

In the fashion industry, Chinese players have production capacity, since most of them already supply European brands, but lack brand name and solid distribution channels. Therefore, are interested in the acquisition of well-known brands and reach the market with a pre-established and efficient distribution system. In this way they can achieve two goals: to enter the Italian market (which otherwise would be difficult

without brand) and appeal Chinese consumer in the homeland market (with the image of design, quality and life style). The case of Kappa has been emblematic, in fact, when the brand for the first time arrived to China after the acquisition, they decided to modify the label by adding an Italian flag on the top right side. This underlines the Italian connotation and increases sales. Among others in the fashion industry there is Sergio Tacchini and Fila. Both of them were strong brands with solid distribution channels in Italy and have been brought to China after the acquisition.

In the white good industry, Chinese are interested in logistic access to the market. Production remains in China, but components will be shipped to Italy, assembled and sold by applying a European label. The example is the company named Haier that accessed in Europe thanks to the acquisition of a competitor.

Deal

Relationship between buyer and target often already exists. Most commonly, Chinese company already supplies the Italian one, and decides to acquire for the knowledge of the target's business. In the industry, players know the competitor's products, distribution channels, operative margins, brands and suppliers. Furthermore, Chinese entrepreneurs are becoming more and more aware of their Italian counterparts, and they gain information also through preliminary due diligence. In this sense, the advisor is only needed to smoothen the process, but does not play a major role to introduce the parties.

The financial situation before the deal is that the Chinese buyer rely on substantial amount of cash (due to the growing economy, low debt payment and government support), while the Italian target is often close to bankruptcy or in need of new fund to relocate, open new lines of business, internationalize in China or dealing with generation changes. Most of the time heavy competition on the market reduces margins and often the product are already in their maturity phase. Basically, the Italian companies have strong name and expertise but needs fresh fund to foster the business.

When acquiring, Chinese buyers are in search of good prices. Unfortunately, this strategy can lead to huge mistakes, because often, when the price is low in the beginning, it probably means that more investment are required in the future to restructure the business. Chinese buyers may not understand this issue and, in this case, the advisor can play a major role to analyze the financial situation of the target and discover how much in terms of funds is needed to recover the business.

Evaluation process focuses on target's financials, but also with an eye to operative considerations. The acquired business has to find a good positioning among existing activities and create value through operative synergies. Therefore, is important to give more attention to products, brand value, distribution channel, positioning and how these issues all together can add value to the company. In conclusion, strategic more than financial consideration has to be made during the evaluation process.

Main difficulties after the deal

Once the acquisition has occurred, Chinese buyers have to deal with the restructuring process. The regulation plays a major role in it, as in Italy business law are complicated and in constant change. Moreover, during the post merger phase, cultural problems represent the other potential pitfall to be aware of.

In China labor law and labor union activities, which at the end influence workforce's mobility and flexibility, are not as complicated as in Italy. As an example, in Italy you cannot close companies, relocate them in other areas, cut labor force or retire personnel without incurring in high costs and time consuming activities. Liquidation issues, social security policies and business permit achievement are major reasons that transform the restructuring process into a nightmare.

What makes it even more difficult is that, in Italy, there are many public entities to which refer in order to request permits, pay taxes and so on. Bureaucracy is the major problem affecting foreign companies when entering the Italian competitive arena. Therefore, the entrepreneur feels abandoned and not supported by Italian authorities.

About HR problem, selecting the right people to run the business is often complicated. Chinese side lacks the necessary experience to deal in the Italian market, while Italian side lacks to understand cultural differences. The integration issue turns the initial enthusiasm into regret. Supporting Chinese

managers during this phase would be strategic in order to increase the performance of the post merger entity.

In most cases, the outcome after the merger has been lower than expected in terms of both economic and strategic goals. This is due to lack in understanding the business in different countries, but also for the underestimation of regulatory and cultural integration issues.

End of Chinese Accounting Year: upcoming deadlines

On Dec 31st, all Chinese Companies have to close the balance and the accounting year is declared closed. The beginning of the New Year brings with itself the compulsory deadlines of the Chinese Government concerning declarations, auditing and inspections.

TAX DECLARATION AND LIQUIDATION

Within the end of April the companies have to declare and liquidate the Enterprise Income Tax.

Physical persons with an annual income above 120.000 RMB have to liquidate the Individual Income Tax within the end of March.

Every kind of Foreign Invested Enterprises (FIE) is required to accomplish such declaration and liquidations.

ANNUAL AUDIT

Within the end of April, the companies have to appoint a Chinese Certified Public Accountant Firm to accomplish the audit of financial statements. The CPA Company has to issue two formal reports: Annual Audit Report and Annual Foreign Currency Report. These two documents will then be used during the Annual Joint Inspection.

All kinds of FIE are required to accomplish such an audit.

ANNUAL JOINT INSPECTION

The inspection involves seven different Public Bureaus:

- Bureau of Foreign Trade and Economic Cooperation (BOFTEC)
- State Administration for Industry and Commerce (SAIC);
- Economic Committee;
- Financial Bureau;
- State Administration of Taxation;
- State Administration of Foreign Exchange(SAFE);
- China Custom.

The companies who receive the Business License must accomplish this Annual Joint Inspection between March, 1st and June 30th. Newly-set up companies may be exempted if they are established toward December.

The Representative Offices of Foreign Companies are not required to comply with this inspection, while the other kind of FIE must do it.

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