

# JESA INVESTMENT & MANAGEMENT CO. LTD.

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**In this issue:**

- | **News from JESA: "Made in China, Made with the World"**
- | **Investment Opportunities in Chinese Securities Market**
- | **Retail Industry in China: development and opportunities**



## NEWS FROM JESA! "Made in China, Made With the World"

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A new 30-second advertisement campaign, went on the air last November on CNN, is China's first ever global branding campaign to enhance the image of the Made in China brand. The theme of the ad "*Made in China, Made With the World*" attempts to highlight how Chinese and overseas firms work together to produce high-quality goods. Appearing in the ad are products used in daily life, including running shoes made with US sports technology, an iPod player with software from Silicon Valley, all with Made in China label. As such an ad is a clear attempt to link *Made in China* with *Designed in the West* and to illustrate China's capability and potential to manufacture quality products.

There is no doubt that this ad hits a nerve, specially in times of discussions about import duties on Chinese products, of more and more frequent seizures of *Made in China* products in Western ports, but this assertion lacks of the fundamental and more important idea: China is and will be a powerful force in shaping the future of the world. Today China is doing so much more than manufacturing and, digging a little beyond the surface, one will find tremendous innovation and creativity taking place across the nation in many areas. A wiser campaign would have challenged the World's perception of

China as a mere manufacturing base and prepare the ground for a proactive role of China in shaping the future of the world.

Seeing China actively manage its brand image is without any doubt quite an achievement, but the short-sighted approach could be a double edged weapon not dissimilar to Taiwan's "*It's very well made in Taiwan*" campaign of the early 1990s, which reinforced the island's image as a centre of quality manufacturing without any intrinsic dynamic creative force. Once China opened up, offering cheaper labour and capital, the manufacturing base began to migrate to the Mainland. Taiwan lost any relevant differentiation and has been trying for the last 20 years to find a meaningful way to position itself. If China chooses to build its national brand on manufacturing alone, it will find itself in the same trap.

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### ITALIAN VERSION

Una nuova campagna pubblicitaria e' stata trasmessa a partire da Novembre sul canale internazionale CNN e rappresenta la prima vera campagna globale per migliorare l'immagine dei prodotti "*Made in China*". Lo slogan "*Made in China, made with the World*" mette in luce come imprese cinesi e straniere collaborino alla produzione di output di qualita'. Nella pubblicita' compaiono diversi prodotti di uso quotidiano, tra i quali scarpe da ginnastica prodotte con l'ausilio di tecnologia americana, lettore MP3 con software della Silicon Valley, tutti con etichetta "*Made in China*". Lo scopo chiaro del messaggio e' quello di collegare il "*Made in China*" con la progettazione

d'oltreoceano e dimostrare la capacita' e il potenziale della Cina di produrre oggetti di qualita'.

Non c'e' dubbio che questo messaggio colpisca un nervo scoperto, soprattutto in tempi di tariffe doganali e sequestri di materiale proveniente dalla Cina, ma tale messaggio manca di una fondamentale e piu' importante idea: la Cina e' e sara' un attore importante nel futuro dell'economia mondiale. Oggi la Cina e' molto di piu' che semplice produzione e scavando piu' in profondita' e' possibile respirare aria di innovazione e creativita' in moltissime aree. Una campagna piu' attenta avrebbe forse potuto sfidare la percezione della Cina come semplice base produttiva e preparare il terreno per un ruolo piu' attivo nel prossimo futuro.

Vedere la Cina gestire attivamente la propria immagine e' senza dubbio un passo in avanti, ma l'approccio di breve termine potrebbe rivelarsi un'arma a doppio taglio, non diversa dalla campagna pubblicitaria degli anni 90 di Taiwan "*It's very well made in Taiwan*", che contribuì a rinforzare l'immagine dell'isola come centro di produzione di qualita' senza pero' creare una propria anima innovativa e dinamica. Infatti, appena la Cina aprì le sue porte al mondo, offrendo un costo del lavoro piu' basso, la base produttiva comincio' a migrare e Taiwan perse il proprio vantaggio competitivo e da allora ha continuato a cercare un posizionamento idoneo.

Se la Cina sceglie di focalizzare la propria immagine solo sulla produzione, presto o tardi si ritrovera' nella stessa trappola.



## Investment Opportunities in Chinese Securities Market

On November 23<sup>rd</sup>, the Shanghai Stock Market launched a new trading system, which, among other things expands transaction capacity, allows trading of complex financial products, such as stock options and brings foreign companies closer to launching Initial Public Offerings (IPOs) in Mainland.

This event, that comes after start-up firms were able to raise funds on a Nasdaq-style growth board in October in Shenzhen, should be considered as an important step toward the internationalization of Chinese securities market.

As above said the new system will allow foreign companies to launch IPOs, but currently the official launch of the International Board is waiting for detailed rules and regulations as well as a nod from the Central Government, although there are not technical barriers.

China is aggressively stepping up the pace of reform to modernize its financial system, particularly to transform Shanghai into an international financial centre by 2020.

The launching of the New Generation Trading System, developed in cooperation with Accenture and Deutsche Bourse, is one of the first real steps toward the international market and it also ensures an easier access to all participants both inland and abroad.

After the targets achieved during the last 9 years of development, this is a clear opportunity to become one of the

World's great international financial centres over the next decade.

Fig.1 Comparisons of China security market with other main markets

| Market           | 2000             |                      | 2008             |                      | 2009 (till Nov.30) |                      |
|------------------|------------------|----------------------|------------------|----------------------|--------------------|----------------------|
|                  | No. of Companies | Deal volume (bl USD) | No. of Companies | Deal volume (bl USD) | No. of Companies   | Deal volume (bl USD) |
| China (mainland) | 1080             | 945.03               | 1604             | 4098.7               | 1682               | 5221.43              |
| HK               | 790              | 404.07               | 1261             | 2277.55              | 1308               | 1864.32              |
| Tokyo            | NA               | NA                   | 2373             | 6481.28              | 2324               | 3919.35              |

Due to the strict control on the capitals, it is still a close market and the internationalization path is to be developed and regulated.

It is also worth saying that some international factors had already existed since the setting up of Shanghai Stock Exchange and Shenzhen Stock Exchange. In fact there are B shares which are traded in US dollars in Shanghai and in HK dollars in Shenzhen.

Because the serious control on financial capitals, the B share market is less developed than the A-shares one, which is traded in domestic currency (RMB). Comparing with hundreds of IPOs in A share markets every year, there have not been IPOs in B shares market for long time.

Fig. 2 Comparisons between Shanghai A Share Market and B share Market

| Year               | Total Market value (bln USD) | Deal Volume (bln USD) | Average P/E Value |
|--------------------|------------------------------|-----------------------|-------------------|
| <b>A Share</b>     |                              |                       |                   |
| 2005               | 335.13                       | 279.49                | 16.38             |
| 2006               | 1042.79                      | 839.37                | 33.38             |
| 2007               | 3936.91                      | 4427.57               | 59.24             |
| 2008               | 1420.46                      | 2635.81               | 14.86             |
| 2009(until Nov.30) | 2607.21                      | 4212.68               | 27.93             |
| <b>B Share</b>     |                              |                       |                   |
| 2005               | 3.52                         | 2.62                  | 12.40             |
| 2006               | 7.25                         | 8.38                  | 23.97             |
| 2007               | 19.67                        | 50.94                 | 59.30             |
| 2008               | 5.52                         | 9.79                  | 11.70             |
| 2009(until Nov.30) | 12.33                        | 13.22                 | 21.20             |

### Reasons behind the internationalization of the market

Two main reasons are driving the internationalization of the Chinese securities market.

First of all, Chinese has a huge amount of foreign exchange reserves and a saving rate that is above 60%; in this situation local investors are looking for and are eager to find new investment vehicles in the market.

Another important factor that pushes China to open the capital market is the awareness that it is very important to increase the market influence of the Country on international markets. As the direct responsibilities of administration, China Securities Regulatory Commission (CSRS) is aggressively stepping up the pace of reform to modernize its financial system.

From the point of view of the writer, according to the past reforms that have been undertaken, CSRS is more interested in increasing the range of investment vehicles without

changing the current administration structure. Figure 3 is summarizing latest reforms.

Fig.3 Events of CSRS Management on Investment Vehicles

| Time       | Events   |
|------------|--|
| 2003-7-9   | Introduced arrangement of Qualified Foreign Investor Institute (QFII)  |
| 2004-10-26 | Introduced arrangement of Qualified Domestic Investor Institute (QDII) |
| 2007-3-18  | Start-up Small-medium board in Shenzhen                                |
| 2009-10-30 | Start-up NASDAQ-style growth board in Shenzhen                         |
| Next step  | Start-up international board in Shanghai                               |

Notes:

QFII: State Administration bureau approved quota of exchange to foreign investor institutes, which are approved by CSRS, allowing foreign investors to do investments in A shares.

QDII: State Administration bureau approved quota of exchange to domestic investor institutes, which are approved by CSRS, allowing domestic investor to do investments abroad.

Fig.4 QDII's market performance

| Fund Name                 | Returns in 2008 | Returns in 2009 | Accumulated netvalue | Established time |
|---------------------------|-----------------|-----------------|----------------------|------------------|
| Nanfang Global (202801)   | -43.33%         | 38.23%          | 0.73                 | 9-Oct-07         |
| Huaxia Global (000041)    | -41.10%         | 55.51%          | 0.82                 | 9-Oct-07         |
| Jiashi Oversea (070012)   | -49.94%         | 55.91%          | 0.69                 | 12-Oct-07        |
| Shangtou Yatai (377016)   | -57.21%         | 57.96%          | 0.61                 | 22-Oct-07        |
| Gongying Global (486001)  | -44.40%         | 59.89%          | 0.89                 | 14-Feb-08        |
| Huabao Global (241001)    | -26.40%         | 48.51%          | 1.09                 | 7-May-08         |
| Yinhua Global (183001)    | -26.50%         | 30.75%          | 0.96                 | 26-May-08        |
| Haifutong Global (519601) | -1.20%          | 74.19%          | 1.72                 | 27-Jun-08        |
| Jaoyin Global (519696)    | -2.70%          | 64.65%          | 1.60                 | 22-Aug-08        |

As a consequence, more and more foreign investors would like to get reliable and complete information about Chinese securities market, considering the possibility that Multinational Companies could plan to launch IPO in Mainland. In this situation the Chinese Stock Market will be forced to build closer relationships with other markets and will draw the attention and interest of foreign analysts, observers and investors.

According to Writer's point of view, first IPOs on the International Board will be done most likely in the second quarter of 2010 and will be good investment targets for domestic investors.

Even if the official timetable has been announced for foreign companies' listings, HSBC and Banks of East Asia are both interested in launching IPO in China within 2010.

#### Advantages of IPOs on the International Boards

The main advantages that foreign companies can exploit launching an initial public offering on China International Board will be mainly related to the premium price and to the interest the IPO will create in the local market.

- **High Premium price:** IPOs in Chinese market notoriously reach a higher premium price comparing to other developed markets since it is still considered as an emerging market. The P/E ratio of the same company can be much higher in China compared to other markets where the same company is listed. For instance, China Petroleum & Chemical Corp. is

listed in New York, Hong Kong and Shanghai. On November 11<sup>th</sup>, 2009 for reference, the P/E ratio was 6.8, 20.118 and 40.01 respectively.

- **Marketing:** by the end of November 2009, 136 million of accounts were opened and operative in China Stock Market. It is reasonable to believe that if a company wants to develop its business in China, the IPO can be an efficient and relatively fast way to build its name in the market. As a consequence more and more individual investors will start analyzing the company's business model to understand the competitiveness in the market and shareholders will be eager to choose known-brands instead of unknown ones. In this perspective an IPO in China will increase the commercial benefits of the company in the same market.

The first rumours about the start-up of International Board are from the Central Government and its Minister of Commercial Department during and official speech in September 2009.

Although Shanghai Stock Exchange has already implemented the new generation trading system that will help overcome technical problems, there are still many details that have to be solved, such as unification of GAAP (General Accepted Accounting Principles), arrangement on the exchange procedures of depositing capital and paying dividend in future, etc.



CSRC had not issued RFC (Request for Comments) version on related issues up till now, thus even if the formal version would be issued within January, the timing for preparing all qualified financial reports and documents within the first half of 2010 is very tight. Mainly for this reason it is unreasonable to foresee any IPO of Foreign Company in China before the second half of 2010, but the path undertaken by the CSRC is open a window for Foreign Companies and Local Investors, that will be hardly stepping off.

### Retail Industry in China: development and opportunities

In China distribution and retail system have been among the last to be regulated. Until the mid-1990s, the modern retail trade had not been part of the central planning and foreign access to domestic retail and distribution markets was only gradually permitted, to allow local firms time to develop sufficiently to be able to meet foreign competition. The astonishing economic growth and increasing openness to the outside world have led to the rapid emergence of an urban middle class of increasingly sophisticated consumers who demands higher quality, variety and innovation. However, the retail revolution is not limited to the major urban areas; the migration from the countryside to the cities has boosted the size of the second- and third tier urban retail market, and rural markets remain significant. The complexity of this unevenly developed market and the sheer size of the country make China both an attractive and daunting market to understand

and approach.

Prior to China's accession to the World Trade Organization, foreign retailers had to accept a host of restrictions on their operations designed to slow their rate of growth. However, since 2002 most restrictions have been eased and multinational retailers enjoy unprecedented freedom, including the possibility to establish wholly-owned foreign enterprises (WOFEs) rather than operate through a joint venture (JV). As a result, confidence has increased and foreign retailers are growing both organically, by opening new stores, and also through M&A, by buying existing chains. A decision by the Ministry of Commerce (Mofcom), the industry regulator, to devolve responsibility for approving small- and medium-sized foreign-invested retail operations from Beijing to local provincial Mofcom entities from 1 March 2006 further eases the process for multinational retailers.

#### Some figures

At the end of 2009, it has been reported that total retail sales are expected to more than double by 2013. Retail sales broke through 10 trn RMB for the first time in 2008. Foreign Retail Chains that invested in China are expected to contribute to forecast annual retail sales growth of 21%. With the population increasing from 1.35 billion in 2008 to an estimated 1.40 billion in 2013, GDP per capita is predicted to grow 58.2% by the end of 2013, reaching US\$ 4,492. The assumption of consumer spending is for an increasing from US\$ 1,161 in 2008 to US\$ 2,650 in 2013. The National Bureau of Statistics (NBS) stated

that urban retail sales in 2008 accounted for nearly 70% of the total retail sales. A growing multinational retail sale has ensured the adoption of modern retail best practices, with "organized retail", such as Western-style chain outlets, department stores, supermarkets, etc, already accounting for an estimated 20% of the total retail market, far higher than India's 5%. Chinese retailers have also been expanding into secondary and tertiary cities.

For instance, by the end of 2008 Gome Electrical Appliances Holding, China's leading retailer of household appliances and consumer electronic products had 305 outlets in 171 second-tier cities, representing more than 20% of its total sales.

Partnerships between local players and multinationals are also allowing rapid development in the retail market. In November 2007, in example, Beijing Huailian Group signed a JV agreement with Costa, the UK-based coffee company, to open 300 Costa store in Beijing, Tianjin, Hebei, north-east China and other regions in next few years.

Considering the total retail value of the Asian Countries, China and India alone accounted for almost 93% of total sales, with their combined share expected to reach 94% by 2013.

China should experiences the most rapid rate of growth, followed by Indonesia and India. For China, the 2008 market share of 75.3% is expected to rise to 77.1% by 2013.

### Difficulties in China retail market

The sheer size of China, in both territory and population, makes marketing far from simple. The level of economic and social development in different regions and cities varies enormously. This leads to significant differences in the types of retail environment found in different locations, which in turn has extensive influence on consumer shopping habits.

China lacks of an efficient national distribution system. The channel infrastructure of the country is dominated by regional and provincial players whose level of organization varies hugely. There is no single distributor with national reach so manufacturers are forced to deal with large numbers of intermediaries across different regions.

Smaller cities and rural areas are poorly served by the distribution chain. The upshot for multinationals is generally higher costs and a lack of effective control over how their brands are marketed and perceived at the sharp end of the retail chain.

How do manufacturers deal with these fractured markets? Local manufacturers have been placing more emphasis on a "push" strategy to local retailers – for example, hiring sales people to approach stores directly and offering better gross margins than the international brands. Their global rivals meanwhile have more often used a "pull" strategy with higher investment in advertising.

This works well in larger cities but in smaller ones it is less effective, as the advertised products are less likely to be available. International brands tend to use advertising to project a modern urban middle-class lifestyle, which works well in establishing premium image for the brand but does not communicate much concrete knowledge about the product's advantages. This is a crucial disadvantage in less developed regions where the overall level of product knowledge is low so information and deals offered at point of sale are a lot more important. Consumer behavior in China's smaller cities is characterized by an unwillingness to 'lose face' by asking too many questions in stores. The local brands, with their "push" techniques, are well placed to take advantage of this.

### Opportunities

Chinese retail market has a huge potential of development in coming decades and it is beyond a shadow of a doubt important to be present.

Just to give a snapshot of the very last data, only in Shanghai a total of 100 large and medium sized retailers saw sales rise 37.6% on a year on year base to RMB 1.5 million on New Year's Eve and New Year's Day. Among them, Suning Appliance Co., Ltd recorded 130% year on year growth in sales on the first day of 2010. Gome Electrical Appliance Holding reported that its Beijing subsidiary recorded 198% growth in revenue during the week of holiday comparing to the same period of 2008.

### Conclusion

Among these astonishing data, one question arises: who will replace American consumers that have served the world well over the past decade? They bought in large quantities, extravagantly and indiscriminately. Who would continue to fuel the global growth that we benefited from in the last decade?

Here and there the candidacy of Chinese consumer is whispered. Can the Chinese consumers spin the same magic as the American consumer and keep us on the growth trajectory? Chinese are four times as many Chinese as Americans and this is a good starting point and makes the Chinese consumer a good potential candidate.

It is also true that there are still many barriers to consumption such as the high saving rate (one-fourth of their income) because a large number of Chinese do not enjoy social security and need to set aside for their retirement and possible medical expenses. Moreover owning a house ranks among the most important desires and goals for a Chinese and the education is a formidable expense (between one-third and half of the income of an average family), but the current situation does not present many other candidates.

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