

# JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

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**NEWS FROM JESA! Talking about China**

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

At a macroeconomic level the World is now separated in two parts: one that grows at a fast pace, with millions of people that can now rely on higher income and that change constantly their consumptions needs increasing the pressure on raw material demand, the other one that is facing a lower or almost none growth rate. This has an impact on the inflation in both parts and the consumptions in the Asian countries are more and more self-sustained.

To discuss about the opportunities of China we must go through the 12<sup>th</sup> Five Year Plan that marks the shift from an economy based on export to a system focused on internal consumption, thus an internal growth. Chinese population is five times bigger than US but the GDP per person is on 1/6, thus a country with marked contradiction but a "country plan" that has been working for 30 years. The country is forced to grow to keep the development plan and the windows of opportunities are countless.

The industry where Italy can excel today are different from the one of 10-20 years ago and in 10 years will be different as well. In the 90's China was buying chemical plants, today we are

talking about advanced infrastructures, aerospace and telecommunication.

The internal market is thus the main driver that pull investors in the country as an opportunity to enlarge the commercial network, better if put side by side with a production facility in the country. To compete on the market is thus necessary to define the strategy, and the risks maximizing the degree of control sustained by a detailed financial planning.

When entrepreneurs ask us support to enter China, our evaluation is not always positive, because not all the industries and activities are no longer welcome in the country. Our suggestion is to look at China aware that a presence in Asia may help our industrial environment to grow.

Also other countries are offering interesting windows of opportunities and their market will always be more demanding, such as Turkey, Egypt, Vietnam, Mongolia, Saudi Arabia, Brazil.

\* \* \* ITALIAN VERSION \* \* \*

A livello macroeconomico il mondo è attualmente separato in due parti: una che cresce a ritmo sostenuto, dove milioni di persone con livelli di reddito sempre più elevato cambiano ed evolvono nei loro consumi, aumentando la pressione

sulla domanda di materie prime, l'altra afflitta da una crescita quasi piatta. Tutto questo spinge a pressioni inflazionistiche in entrambe le aree. I consumi nei paesi asiatici sono sempre più auto-sostenuti, di tipo endogeno.

Per discutere delle opportunità della Cina, si deve leggere tra le righe del 12mo piano quinquennale che segna il passaggio da una economia basata sulle esportazioni ad un sistema incentrato sui consumi interni. La popolazione della Cina è 5 volte maggiore di quella degli Stati Uniti, ma il reddito procapite è pari a 1/6 di quello degli USA. La Cina presenta ancora forti contraddizioni ma ha dimostrato di essere in grado di crescere negli ultimi 30 anni attraverso una pianificazione ben precisa. Un paese quindi "condannato" a crescere per poter mantenere il proprio programma di sviluppo e le opportunità che si creano sono quindi innumerevoli.

I settori dove l'Italia può ora eccellere sono diversi da quelli che si profilavano 10 o 20 anni fa e fra 10 anni saranno ancora diversi. Negli anni '90 si compravano impianti chimici in occidente, oggi si parla di infrastrutture avanzate, aerospazio, telecomunicazione. Lo sviluppo del mercato interno è diventato quindi il *driver* decisivo per spingere e convincere l'imprenditore italiano a guardare verso la Cina. Questa è un'opportunità di sviluppo per l'espansione

commerciale, che deve essere accompagnata e sostenuta da presenza produttiva, pena l'esclusione dal sistema nel medio termine. E' da qui che nasce l'esigenza di definizione delle strategie da adottare, ancor prima del rischio, cercando di massimizzare il grado di controllo dell'impresa, sostenuto da una sana pianificazione finanziaria.

Quando un imprenditore si rivolge a noi con l'intento di entrare in Cina, non sempre le nostre valutazioni sono positive, proprio perché non tutti i settori e attività sono più benvenuti in questo paese.

Quello che suggeriamo alle aziende italiane è di guardare alla Cina sempre più consapevoli che la sopravvivenza della nostra industria non può prescindere dalla sua presenza in Asia e in quei paesi che ad oggi offrono espansioni e mercati sempre più esigenti, come Turchia, Egitto, Vietnam, Mongolia, Arabia Saudita, Brasile.

**RenRen goes public: fears and behind Chinese IPO gold rush.**

In what was expected to be an impressive IPO, **RenRen Inc.**, sometimes referred to as the "Facebook of China", doesn't let everyone's expectation down.

On the 3th of May 2011, it debuted on the New York Stock Exchange, surging 28% from its US\$ 14 IPO price in the first day of trading. With an issuance of US\$ 53 million American Depositary Shares (ADS) the total raise for the company was US\$ 734 million, that implies a valuation of around US\$ 5,1 billion for the whole company. RenRen combines indeed two of the hottest Internet stock concepts: **social networking and group purchasing.**

While the social network model is an household concept for everyone, the group purchasing business is maybe less recognized. The idea behind this is simple: they use the purchasing power that only a group of buyers can exercise to purchase a wide range of goods such as food, appliances, clothes and even cars, at costs significantly lower than their retail prices.

Rather than this IPO being a real indication of the market interest in these sectors, it is more likely a sign of the ongoing **enthusiasm for growth stocks in China.**

In fact, despite this astounding IPO, RenRen's financial fundamentals seem not to match up with such a strong market reception.

Total net revenues grew 64% from US\$ 46,7 million in 2009 to US\$ 76,5 million in 2010. According to the IPO result, it implies that investors are valuing the company at 66x its 2010 net revenues, almost twice as expected as Facebook, which revenues multiple is 35x.

Another important parallel with the American peer must be revenues per user. With 117 million users, RenRen's revenues are US\$ 0,65, more than six times lower than Facebook's ones, US\$4.

	RENREN	FACEBOOK
Market Value	5,1 US\$ Bln	70 US\$ Bln
Revenues	77 US\$ Mln	2 US\$ Bln
Revenues Multiple	<b>66x</b>	<b>35x</b>
Users	117 Mln	500 Mln
Revenues/user	<b>0,65 US\$ per user</b>	<b>4 US\$ per user</b>

Source: Reuters.com

This simple financial comparison, together with an unclear corporate governance, a risky revenues breakdown and a net loss of US\$ 61,2 million in 2010, lead us to ask an obvious question: Why does RenRen warrant such a generous valuation based on modest financial indicators? **“Investing in Chinese companies is equivalent to invest in China’s future”**, said Pang Ruifeng Senior Vice President of New York-based Guerrilla Capital Management. China, as one of the world’s largest economies, ensures very bright investment prospects, and US stock investors have seen successful examples over the past years.

The most impressive one is for sure **Baidu** (web search engine, Chinese version of Google) who went public in 2005 and it is still outperforming the market and its American competitor.

Indeed analysts say the successful debut of **DangDang** (online retailer, Chinese version of Amazon) and **Youku.com** (online video site, Chinese version of Youtube) in 2010 might have encouraged more Chinese internet companies to go public in the US. In fact they raised in 2010 respectively US\$ 272 million and US\$ 202 million, ranking second and third largest among Chinese companies’ IPOs.

On the heels of these spectacular debuts, 41 Chinese companies completed IPOs at the

Nasdaq and the NYSE, rising nearly US\$ 3,9 billion, making up a quarter of the total of the US IPO market in 2010. The mere mention of “China” and “internet” has investors in a frenzy. A second explanation for this new IPO “gold rush” is for sure the particular market conditions Chinese internet firms are experiencing. Clearly investors view many of the leaders in China’s internet space as having **strong competitive advantages** and limited (to no) competition from American market leaders. Without the fear of outside competitors bringing their operative expertise and financial resources, the first mover are considered in a strong position to remain at the top for the years to come. Therefore investors are willing to bet that many of these Chinese firms will maintain their dominant position and so they will have lots of room to refine their business models and to finance R&D projects.

Thirdly, a reason for this phenomenon is for sure the **American listing legal environment**. Compared to Mainland’s stock market, the NYSE and Nasdaq don’t require the listing candidates to have a profit record for several consecutive years. Indeed their requirements on profitability are replaceable if candidates can meet other standards, which make U.S. IPOs a better choice for companies with great growth potential but in urgent need of funds to spur growth. According

to this, about seven of the 41 Chinese companies listed in the United States last year posted negative net profits in 2009.

Despite this euphoric climate some dangerous threats are waiting in ambush. An IPO is just the beginning of a new journey. “Chinese companies have to prove they can live up to their names after being successfully listed,” said Fang Sanwen, founder of Imeigu.com, a website dedicated to information about U.S.-listed Chinese companies.

Indeed the U.S. Securities and Exchange Commission (SEC) began investigating Chinese listings, focusing on accounting violations, tax auditing practices and IPOs through “reverse takeovers,” or back-door mergers with dormant shell companies. American bourses have in fact much stricter requirements for **accounting accuracy** and **transparency issues**. U.S. investors have accused more than 20 Chinese companies of accounting fraud.

For example China’s online apparel retailer Me-cox Lane Ltd., which was listed on the Nasdaq in late October 2010, faced three class action litigations for inaccurate and misleading information in its IPO registration statement. This has led to its stock falling below the issue price.

“About 10-20 percent of Chinese companies are involved in accounting violations, but more than

80 percent of them live up to the standards of U.S. stock markets," added Mr Sanwen.

Furthermore the rush of internet companies going public has led many investors thinking that should be a **bubble growing up**, akin to the catastrophic internet boom of a decade ago, which wiped out thousands of companies and investors after he popped.

Indeed the main concern is that, as in any bubble, investors are not frightened at all but actually excited by all the talk about irrational Chinese IPO fever.

On the contrary, Deutsche Bank analyst Alan Hellawell said the scarcity of NYSE listed Chinese stock will diminish as more Chinese internet companies go public in the US, lowering IPO prices in the future.

Will 2010s experience the second crisis in its short life because of a new Chinese .com bubble? The market will give soon the answer.

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### Chinese car market: unbridled growth.

There is a year that will be remembered in Chinese car market history: 2009 is the year of the overtaking. For the first time in the history Chinese car market is bigger than American one. And growth has not been stopping yet: in the

month of January 2010 China has recorded more than 1,2 million of new registers with a growth rate of +84% compared with January 2009. In 2010 new cars registered totalled about 18 millions, growth supported by incentives of government for the purchase of a new car.

In fact, policy is trying to create a friendly society in which the automobile industry has a heavy responsibility. And this has opened an incredible market for all car producers.

Of the automobiles produced, 44.3% are local brands (BYD, Lifan, Chang'an (Chana), Geely, Chery, Hafei, Jianghuai (JAC), Great Wall, Roewe, etc.), the rest being produced by joint ventures with foreign car makers such as Volkswagen, Mitsubishi, General Motors, Hyundai, Nissan, Honda, Toyota etc. Most of the cars manufactured in China are sold within China, with only 369,600 cars being exported in 2009.

To have an outlook, GM improved its revenues by 38% in 2009, it doubled the market.

Volkswagen announced an improvement in direct investments in 2011 from 4,4 billion € to 6 billion. Target is to sell in 2012 more than 2 million cars per years, making in this way China as first market for the car producer of Wolfsburg. Nissan – Renault increased its investments in China of 70% with the target of 900.000 units

sold in 2012.

German car producers found a sort of "El Dorado" inside Chinese market: for example BMW sold more than 15.000 "7 series" in China, more than in the US and UE market together (15.000), Mercedes has grown at 120%, Audi at 64%. With these numbers European producers have recovered decreasing sales and revenues in progress in Europe, caused by financial crisis in 2009. Cars demand is in peak period higher than supply: many people have to wait for weeks or even months to get their cars.

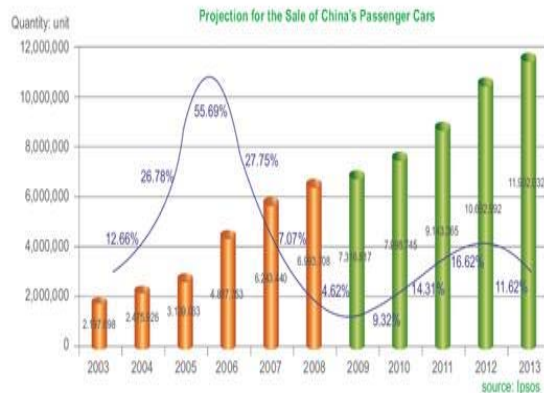
Foreign car manufacturers have a **chain to be subordinate to**, that is the **establishment of JV** at 50% with local producers to set up a plant in China: GM is in JV with Wuling, VW, market leader (17,5 % of the market ) with SAIC and FAW.

But how is possible to grow in at this rate? With the help of the government: vehicle sales was largely boosted by the government's stimulus policies for lifting market demand, which included tax cuts on small-displacement automobiles, subsidies for trade-ins and subsidies to encourage the replacement of outdated vehicles with high emissions and unstable driving performance.

Secondly economic wealth is going to reflect in the demand of a status symbol more distinctive

and sophisticated: car is commonly considered a luxury good, symbol of wealth, richness and economic stability, and this popular western idea, has now docked China. Economic growth has so directly translated into growth in automobile sales. Moreover expansions of China's road and highway network coupled with the expanding middle class is a formula for robust car sales in the years to come.

This trend is not going to reduce: McKinsey & Company estimates that China's car market will grow tenfold between 2005 and 2030.



The number of registered cars, buses, vans, and trucks on the road in China reached 62 million in 2009, and is expected to exceed 200 million by 2020. General Motors also predicts the China's car market will be twice the size of the United States by 2020.

The Chinese Government should **recognize the risk** of pursuing the American models that will lead the Chinese cities to a collapse if the number of cars will grow so fast. To overcome such a problem it will be necessary **to shift to next generation energy-efficient and emission-free vehicles**, without excluding hydrogen and air compress technology (Italian know how later developed in France). But undoubted is that this market boom has opened and will open many business opportunities for all equipment, logistic, transportation, metal treatment companies. In fact local companies have stopped to buy components outside and started to look for local suppliers. In this environment Italian companies that produce components and aim to enter the market, the only feasible solution is to **localize the production** close to the main important car manufacturers. In our opinion FIAT is approaching the market not considering the need to adapt the products to Chinese drivers expectations instead of hoping to change the market with the proposed models, that are Idea, Palio, Siena , instead of more appealing Alfa Romeo, 500 and others. **The analysis of the models and types of cars the market wants is essential to be successful considering the history of our brands.**

### Notice for Italian Tax Payers

*Invitation to donate part of the taxes for an association that takes care of medical treatments for immigrants without medical rights in Italy and for the start up of an hospital in Rwanda*

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