KPMG
cutting through complexity

毕马威全球中国业务
KPMG Global China Practice

Investment in China: Numbers and Trends

Third Quarter, 2012

Table of Contents

Executive Summary

In the third quarter of 2012, Chinese economic growth continued to slow. Gross Domestic Product (GDP) fell to 7.4% growth year-on-year, marking the lowest level of GDP growth since the 2008 financial crisis. Although there is weakness in the latest GDP growth number, and other primary third quarter indicators are still declining, there are signs of stabilization and positive leading market indicators that point to future growth.

With the further implementation of fiscal and monetary policy, the Chinese economy should pick up in the short to medium term, and a U-shaped reversal can be expected.

- The increases in major economic indicators exceeded expectations. The potential for expansion in domestic investment, as well as current consumer demand, are both encouraging.
- Current CPI inflation appears under control, providing additional options to loosen monetary policy and support economic growth.
- The effects of stable growth policies are gradually becoming apparent, and the outlook is bullish for fourth quarter economic growth to increase slightly.

In the first three quarters, China's outbound direct investment (ODI) increased rapidly. Due to the continued slowness of the global economic climate, Chinese companies are seeing more opportunities to buy real assets of foreign companies, sometimes at a large discount to market prices. We see this outbound direct investment trend from Chinese companies continuing, as they look to go out and diversify asset and revenue streams.

In the first three quarters of 2012, foreign direct investment (FDI) flows into China saw a 3.8% decline from the same period one year ago. Foreign firms invested a total of USD 83.4 billion for the first nine months of 2012 vs. USD 86.7 billion for the first nine months of 2011. The decline continued a downward trend stretching back to November of last year, with the exception of May, when FDI eked out a marginal gain of 0.05%.

- The decline in FDI is mostly due to stagnant economies abroad and lower tolerances for risk and capital investment.

- Foreign direct investment from Europe will continue to be limited as long as the sovereign debt crisis in Europe remains a threat; FDI from the USA was reported to have almost no change. The USA's economy is showing modest signs of growth.

- Other emerging and developing markets are attracting FDI growth rates at a faster pace than China. This is mainly due to the favorable local cost structure of those particular emerging and developing markets against the rising costs of raw materials and labor in China.[1]

Although most of the mature global economies seem to be stuck in an indefinite economic malaise, this is not a plausible long-term economic conclusion. China will continue to accelerate the process of industrialization, information technology, urbanization, and will provide more opportunities for foreign investors. This will stimulate FDI and increase the demand for M&A deal flow in China. Institutional investment interest in China is still very high from across the globe. Large acquisitions and deal flow are still occurring at a very fast pace; in fact, the largest leveraged buyout on record in China occurred in Q3'2012

[1] http://www.china.org.cn/opinion/2012-09/21/content_26601505.htm

Part I: Macroeconomic Analysis

China's Economic Data

Table 1.1 Economic Data for the First Three Quarters of 2012		
Economic Data	**Value**	**Year-on-Year**
GDP (Trillion RMB)	35.3	7.7%
National fixed asset investment (Trillion RMB)	25.7	20.5%
Retail sales (Trillion RMB)	14.9	14.1%
Outbound direct foreign investment (Billion USD)	52.5	28.9%
Inbound direct foreign investment (Billion USD)	83.4	-3.8%
Property development investment (Trillion RMB)	5.1	15.4%[2]
Financial Data	**Value**	**Year-on-Year**
M2 money supply (Trillion RMB)	94.4	14.8%
M1 money supply (Trillion RMB)	28.7	7.3%
Customs imports (Trillion USD)	1.3	4.8%
Customs exports (Trillion USD)	1.5	7.4%
Fiscal revenue (Trillion RMB)	9.1	10.9%
New RMB loans (Trillion RMB)	6.7	18.3%
RMB deposits in financial institutions (Trillion RMB)	90	13.3%
Foreign currency deposits in financial institutions (Trillion RMB)	92.6	14.3%
RMB loans in financial institutions (Trillion RMB)	61.5	16.3%
Foreign currency loans in financial institutions (Trillion RMB)	65.5	16.4%
Foreign exchange reserves (Trillion USD)	3.3	2.8%
Cross-border RMB settlements (Trillion RMB)	2.1	N.A.[3]

Sources: National Bureau of Statistics, the People's Bank of China, State Administration of Foreign Exchange, General Administration of Customs

The data issued by the National Bureau of Statistics on October 18 showed that, over the last three quarters, year-on-year GDP growth was 7.7 percent. Third quarter 2012 year-on-year GDP growth was 7.4 percent, which was a 0.2 percent drop compared to the second quarter of 2012. It represented a new low for the last 14 quarters. However, compared to the previous quarter GDP actually increased 2.2 percent, creating a new high for the last four quarters: the economy is showing signs of stabilization.

The September PMI showed an increase of 0.6 percentage points to 49.8 percent, compared to the previous period: the first increase after four consecutive months of decline. However, PMI is still lower than 50 percent, which is the baseline level for expansion. This shows that the manufacturing industry is still contracting, but the contraction is less severe than the previous period.

Year-on-year growth of fixed asset investment is displaying the effects of the stabilizing measures. Nominal year-on-year growth in fixed asset investment in the previous three quarters was 20.5 percent, an increase of 0.1 percentage points compared to the first half of the year. With a significant increase in capital construction investment as the primary driver, year-on-year growth increased from 15.1 percent in August to 25.8 percent in September, cancelling out the effects of the decline in property investment. Manufacturing investment is predicted to recover and stabilize, as it rebounded from 18.8 percent in August to 21.5 percent in September. We predict that a recovery in investment growth will support economic stabilization in the fourth quarter.

Consumer demand is stable. In the first three quarters, retail sales increased 14.1 percent year-on-year; after adjusting for inflation, actual growth increased to 11.6 percent. The growth rate dropped 0.3 percentage points compared to the first half of the year. September nominal growth was 14.2 percent year-on-year; after adjusting for inflation, actual growth was 13.2 percent, which increased 1 percentage point over August. This was primarily driven by a resurgence of property market transactions and the sales of furniture and related products. We predict that fourth quarter retail sales growth will maintain its current level. Consumption growth has slowed further and still lags far behind investment growth, showing that internal demand for stimulus and increasing consumption is still an important task for the foreseeable future.

Industrial value-added growth rises. Propelled by an increase in heavy manufacturing, scale industrial value-added increased 9.2 percent year-on-year in September, which is a slight improvement from 8.9 percent in August. Compared to the previous period, there was an increase from 0.71 percent to 0.79 percent, showing signs that the economy may have indeed bottomed out. However, from the difference between end-demand and industrial value-added, we can see that companies are under pressure from high levels of inventory.

September net exports show better than expected rebound. From January to September, Chinese imports and exports totaled USD 2.8 billion, an increase of 6.2 percent versus the same period last year. The accumulated trade surplus of USD 148.3 billion is already approaching last year's USD 155.1 billion, indicating that this year's surplus might exceed the surplus from last year. According to the monthly data, September imports and exports increased by 6.3 percent year-on-year, with exports increasing by 9.9 percent year-on-year, 7.2 percentage points higher than August exports. After adjusting for seasonal factors, exports increased 10.9 percent, in

[2] Nominal year-on-year growth was 15.4 percent. Real growth after adjusting for inflation was 13.8 percent. http://www.stats.gov.cn/english/pressrelease/t20121019_402843790.htm

[3] The 2011 official figures have not been issued.

contrast to the previous two months of negative growth. The primary reason for exports exceeding expectations was a significant improvement in exports to emerging markets. In September, Chinese exports to ASEAN countries and Russia grew more than 20 percent year-on-year.

Inflation data meets expectations. In September, the Producer Price Index (PPI) continued to drop, with a year-on-year decrease of 3.6 percent, decreasing 0.1 percent compared to the previous period. The year-on-year Consumer Price Index (CPI) growth rate is 1.9 percent, which has essentially met expectations. Following the continued implementation of certain policies, such as structured tax reductions, export stimulus, and various kinds of investment, we predict that inflation will continue to be in-line with forecasted data thru the end of this year.

Table 1.2 Third-Quarter 2012 Economic Indicators

Economic Data		July	August	September
Consumer price index (CPI)	Y/Y	1.8%	2.0%	1.9%
	M/M	0.1%	0.6%	0.3%
Producer price index (PPI)	Y/Y	-2.9%	-3.5%	-3.6%
	M/M	-0.8%	-0.5%	-0.1%
Purchasing managers index (PMI)	Value	50.1	49.2	49.8
	Y/Y	-0.1%	-0.9%	0.6%
Non-manufacturing business activity index	Value	55.6	56.3	53.7
	Y/Y	-1.1%	0.7%	-2.6%
Industrial value-added growth	Y/Y	9.2%	8.9%	9.2%

Data Source: National Bureau of Statistics

New loans lower than expected, private lending expands. In September, RMB-denominated loans increased RMB 623.2 billion, a year-on-year increase of RMB 153.9 billion. However, compared to the RMB 703.9 billion increase in August, the increase in September was relatively smaller. This shows that the central government is maintaining a balanced seasonal rhythm, making many slight intra-month adjustments. At the same time, September financing from non-state owned entities (private institutions, stock and bond markets, private equity), had expanded compared to the previous month and to the previous period last year. The expansion of bond market financing reflects a gradual move towards balancing the private finance structure compared to the state-owned finance structure.

Money supply increase marks new 2012 highs. At the end of September, the M2 figure was RMB 943.7 trillion, a year-on-year increase of 14.8 percent, 1.3 and 1.2 percentage points higher than the previous month end and year end, respectively. The M1 figure was RMB 286.8 trillion, a year-on-year increase of 7.3 percent, 2.8 percentage points higher than the previous month end. September increases in M1 and M2 created new highs for the year, showing that liquidity conditions may be improving. The spread between M2 and M1 contracted compared to August, and this implies an increase in current deposits and a possible improvement in industrial production.

Fiscal revenue continues to decline. In the first three quarters this year, national fiscal revenue totaled RMB 9.06 trillion, a year-on-year increase of 10.9 percent and a year-on-year decrease in the growth rate of 18.6 percentage points. There was a noticeable drop in tax revenue, primarily due to slow economic growth, decreased corporate productivity, falling prices, and structured tax reduction measures. Non-tax revenues showed a rather large increase, a total year-on-year increase of 27.1 percent from the last three quarters.

Foreign exchange reserves return to positive quarterly growth. By the end of September, Chinese foreign exchange reserves were USD 3.29 trillion, relatively flat versus Q2, 2012 foreign exchange reserves of USD 3.24. Q2, 2012 was China's first ever quarter-on-quarter foreign exchange reserves decline. The current quarter-on-quarter slight uptick was primarily influenced by a moderate increase in the trade surplus. Q3 year-on-year foreign currency reserves were also relatively flat (USD 3.29 trillion vs. USD 3.20 trillion).[4] This tells us that China is not buying as much foreign assets, as in previous years. By not continuing to grow the foreign exchange reserves, China has created a stronger currency, as the Renminbi approaches all-time highs versus the dollar.

Outbound foreign investment continues to grow, inbound foreign investment stabilized then decreased. In the previous three quarters, China's total non-financial outbound direct investment was 52.52 billion USD, a year-on-year increase of 28.9 percent. Actual inbound foreign investment was 83.42 billion USD, a year-on-year decrease of 3.8 percent.

After looking over the previous three quarters of economic data, there is evidence that leads us to believe a moderate recovery is under way. Although the primary third quarter indicators have decreased, other leading indicators mentioned above tell a story of stabilization and future growth. With the further implementation of domestic and foreign policies, we believe the Chinese economy is headed for a U-shaped recovery in the near to medium term.

Overview of Economic Policies

Finance

Approval of Shenzhen Qianhai Zone, a pilot for China's financial industry. On July 3rd, the "Reply on Relevant policies in Supporting the Development and Opening-up of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone of the State Council" was officially published. According to the State Council, support is offered to aid the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone and implement policies that are more specific than those of the economic zones. Under such support, Qianhai could be a pioneer in financial reform innovations and a pilot window for China's financial industry. Twenty-two policies were approved by the State Council, covering six major areas including: finance, taxation, law, human resources, medical care and

[4] www.safe.gov.cn

telecommunications. Eight policies set out favorable financial and capital market policies. These policies include: permission for Qianhai to explore and expand return channels for overseas RMB funds, the construction of a cross-border RMB business innovation experimental zone, support for banking institutions in Qianhai in the issuance of RMB loans for overseas projects, the active study of Hong Kong banking institutions' RMB loan deals made to enterprises or projects in Qianhai and support for qualified enterprises or financial institutions registered in Qianhai in the issuance of RMB bonds in Hong Kong within the threshold limit set by the State Council for the purpose of helping Qianhai's development and construction.

Relaxing requirements for qualified overseas investors to attract overseas long-term funds. On July 27th, the China Securities Regulatory Commission (CSRC) published the "Relevant Issues on the Implementation of 'Measures for the Administration of Securities Investment within the Territory of China by Qualified Foreign Institutional Investors (QFII)' (the 'Measures')". The guiding principles are based on "relaxing controls while enhancing supervision'; lowering QFII qualification requirements to encourage the inflow of overseas long-term investments; satisfying requirements by QFII in the selection of multiple securities traders, adding to operational convenience; allowing QFII to invest in the interbank bond market and SME private equity (PE) financing; and finally raising the share holding percentage limit of foreign investors from 20 percent to 30 percent. According to the 'Measures', PE investment institutions can apply for QFII qualifications as asset management institutions.

In the next three years, China will utilize a USD 5.5 billion World Bank loan on 44 projects. In July, the State Council approved China's alternative project planning of World Bank loans from 2013-2015. The Communist Party planned and arranged forty-four projects with a total loan value of USD 5.495 billion. According to the plan, nine projects are for agriculture (agriculture, forests and water) with a total loan value of USD 1 billion, accounting for 18.2 percent of the total loan value; nine projects are for transportation with a total loan value of USD 1.5 billion, accounting for 27.3 percent; six projects are for energy with a total loan value of USD 600 million, accounting for 10.9 percent; sixteen projects are for urban construction and environmental protection with a total loan value of USD 2.03 billion, accounting for 37 percent; four projects are for social development and other sectors with a total loan value of USD 365 million, accounting for 6.6 percent of the total loan value. Loans made to traditional industrial bases in the mid-west and north eastern areas account for around 81.4 percent of the total; loans to eastern areas account for around 18 percent; other areas account for 0.6 percent.

Cross-Straits currency clearing cooperation memorandum signed. On August 31st, monetary authorities on both sides of the Taiwan Straits signed the "Memorandum on Currency Clearing Cooperation across the Straits" (the "Memorandum"). Both parties agreed to set up a cross-Straits currency clearing mechanism based on the principles and cooperation structure confirmed by the Memorandum. According to the Memorandum, both parties agree to select one currency clearing institution respectively to provide settlement and clearing services for the other party when one engages in businesses involving local currency, and the currency clearing institution can proceed in cross-Straits cash currency transportation following relevant supervisory regulations by both parties. Both parties agree on enabling the use of currencies from either side in the settlement and payment for economic and business activities such as commodities trading, services and investment, and financial institutions from both sides can mutually offer agency accounts in relevant currencies to proceed with settlement services in various forms as well as other business activities permitted by the regulations. Both parties agreed to ensure the stable operation of cross-Straits currency clearing mechanisms under relevant regulations and administrative requirements, clarify related mechanisms for mutual supervision and cooperation, including requirements for currency clearing institutions, information exchange, confidentiality requirements, business inspection, risk management, and communication mechanisms.

Official launch of the 12th Five Year Plan for the development and reform of the financial industry. On September 17th, the "12th Five Year Plan for the Development and Reform of Financial Industry" (the "Plan") approved by the State Council, and co-drawn up by BOC (Bank of China), CBRC (China Banking Regulatory Commission), CSRC (China Securities Regulatory Commission), CIRC (China Insurance Regulatory Commission) and SAFE (State Administration of Foreign Exchange) was officially published. The "Plan" specified major tasks for the development and reform of the financial industry during the 12th Five Year Plan period, which includes: completion of financial control and management, optimization of the organizational structure, construction of the financial market, and further reform of the financial industry. The "Plan" requires that, during the 12th Five Year Plan, the added value from the financial industry shall be maintained at 5 percent of GDP, and a moderate rate of social finance growth; financial services will fundamentally cover the entire country during the 12th Five Year Plan period, and the support for technological innovation and economic structural reform will be further enhanced, with the loan growth rate for "agriculture, rural development and farmers" and SMEs overtaking the average growth rate of all loans. By the end of the 12th Five Year Plan period, significant development will be achieved in financial structural reform, with the proportion of direct financing from non-financial enterprises accounting for more than 15 percent of social (non-government originated) finance.

Trade

Foreign exchange administrative measures are being implemented for commodity trading. On 1st August, SAFE, GAC (General Administration of Customs) and SAT (State Administration of Taxation) co-implemented the reform of foreign exchange administrative measures for commodity trading on a nationwide scale. Since December 1st, 2011, the three departments have set up pilot trials in seven provinces/cities including Jiangsu and Shandong. After the reform, the core contents of foreign exchange administrative measures for commodity trading will be the review of total trade volume, real-time supervision, and management by categories; and the actual method for the core contents involves the use of a collective country-wide commodity and foreign exchange monitoring system to collect complete information regarding the collection and payment of foreign exchange by enterprises and commodity flow of imports/exports, the conduction of off-site reviews of the total volume of an enterprise's cash flows and commodity flows, and the conduction of on-site inspection of suspicious enterprises arising from an off-site review of total volume, followed by real-time supervision and management by categories of enterprises. Meanwhile, the reform aims to: enhance inter-departmental data and information exchange between supervisory bodies, strengthen coordination mechanisms, and reinforce co-supervision and administration. The overall target for these administrative measures for commodity trading is to further improve trade convenience, enhance enterprises' competitiveness in foreign trade, and promote stable growth of foreign trade; meanwhile, there will be further strengthening of supervisory and control through optimization and upgrading of inter-departmental information sharing mechanisms between supervisory bodies, so as to improve the pertinence, effectiveness and deterrence of supervision and control, and prevent economic and financial risk.

The Ministry of Commerce makes final decision alleging US renewable policies violate WTO regulations, prompting Chinese enterprises to use trade barrier investigation rules wisely. On August 30th, the Ministry of Commerce of the People's Republic of China announced that multiple US renewable energy-supporting policies have violated relevant WTO regulations, distorting regular international trade and posing a trade barrier for Chinese renewable export commodities to the US market. According to the rulings of "Investigation Rules on Foreign Trade Barriers", the Ministry of Commerce will take relevant measures to request the US to abolish contents in the measures being investigated that are violating the relevant WTO regulations, and restore fair treatment for Chinese renewable energy commodities. This is the second time Chinese enterprises have attempted to use the trade barrier investigation mechanism to solve trade frictions after the first case of China's export of agar products to Japan encountered 'trade barriers'. The trade barrier investigation mechanism has become a new channel for solving export related problems, and it is likely that additional Chinese enterprises may take advantage of this.

The second round of Sino-German government consultations focuses on economic and trade cooperation. On August 30th, Premier Wen Jiabao of China and Chancellor Merkel of Germany co-hosted the second round of Sino-German government consultations in the Great Hall of the People, and co-issued a "Joint Statement". Among the over forty government consultation mechanisms between China and Germany, the Sino-German consultation mechanism is the highest in terms of class, largest in terms of scale and broadest in terms of topics. In June 2011, the first round of consultations was held in Berlin, Germany. This mechanism is the first inter-governmental mechanism set up between China and a Western power. It has deepened the bilateral relationship between China and Germany after both countries confirmed their strategic partnership, which has effectively enhanced communication and cooperation between the two countries. During these consultations, China and Germany have reached consensus over cooperation in advanced manufacturing industry, the establishment of a Sino-German economic advisory committee, the building of a strategic renewable energy partnership, the expansion of maritime and polar cooperation, as well as hosting a Sino-German language year – which resulted in the signing of over 10 inter-governmental agreements.

General Office of the State Council publishes opinions on promoting steady growth in foreign trade. On September 8th, the General Office of the State Council published "Several Opinions on Promoting Steady Growth in Foreign Trade" (the "Opinions"), outlining sixteen specific opinions across five areas, involving topics of most concern to foreign enterprises such as: export rebate, export credit insurance, trade financing, etc. These Opinions are expected to stimulate the development of foreign trade for China. The Opinions specified that the export rebate procedure must be sped up based on the reform of foreign exchange administrative measures for commodity trading; expanding the trade financing scale, the export credit insurance scale must be expanded, export credit insurance coverage must be broadened, and credit insurance for SMEs must be developed; the trade convenience level must be further raised, where approval procedures must be further simplified, and customs clearance efficiency must be improved; charges on various import/export links must be standardized and reduced, and a new quarantine charge standard featuring a new reduced charge rate will be effective starting from 1st January 2013; trade frictions must be actively dealt with while the trade environment must be improved; the trade structure must be optimized, with focus on increasing the import of advanced technologies and equipment, key components and articles for daily use that are closely related to the public's life, expanding the export of technology and finance intensive mechanical and electrical products, high tech and high value-added products and environment protection and energy conservation products.

Economics

National Development and Reform Commission (NDRC): using price leverage to encourage and guide private investment. On July 6th the NDRC published "Implementation Opinions on Using Price Leverage to Encourage and Guide Private Investment Development" (the "Opinions"), and further specified the price policy measures for the facilitation of private investment development. The "Opinions" will mainly implement supportive price policies through further reform in prices for power, natural gas and water conservation and supply projects, in public utility areas such as urban water, gas and heat supply, housing for the low-income, railways and medical care, and enable private capital to participate in investment and operation in relevant areas; meanwhile, the government will increase the pace of fee reduction, standardize financial service pricing behavior, enhance market price monitoring, promote the publicity of pricing and charging information, and optimize the development environment for private enterprises.

Plan to use foreign fund and overseas investments during the 12th Five Year Plan published. On July 17th, the NDRC published the "12th Five-Year Plan on Utilizing Foreign Investment" (the "Plan"). The "Plan" specifies that, during the 12th Five Year Plan, China will effectively use foreign loans, stabilize the size and flow of loans, and distribute the loans more effectively across regions; collectively arrange for overseas financing such as overseas borrowing, financial leases, and issuance of bonds so that foreign funds can play an active role in the coordination of regional development. According to the "Plan", China's major tasks regarding the use of foreign funds and overseas investments during the 12th Five Year Plan are to maintain loans at an appropriate and stable level and properly utilize investments in specific industries and regions. China will explore fund options with an investment emphasis in: resource conservation, energy saving and emission reduction, ecology enhancements, comprehensive road and infrastructure construction, balanced development of urban and rural areas, and a coordinated development between regions.

Government's 12th Five Year Plan on strategic emerging industries officially launches. On July 20th, the State Council officially published the "12th Five Year Plan for the Development of National Strategic Emerging Industries" (the "Plan"). The "Plan" specifies focused development directions in seven areas including: the energy conservation and environment protection industry, biological industry, high-end equipment manufacturing, new energy industry, new material industry, and new energy auto industry. It further specifies a development roadmap, setting landmark targets for various sectors, as well as action plans, such as raising overall innovation ability and exploration for market applications. The "Plan" also introduces policy measures to further facilitate the development of emerging industries through enhancing financial and taxation policy support, completing human resource policies, and fostering a sound market environment.

The 12th Five Year Plan for rural economic development officially launches. On August 6th, the NDRC published the "12th Five Year Plan for Rural Economic Development" (the "Plan"), setting targets for the 12th Five Year period: to ensure cultivated land stock of around 45 million acres, cultivate new land with effective irrigation acreage of around 988,386 acres, and integrate a grain production capacity of over 540 million tons, ensuring grain security for the whole country. The "Plan" suggests that more supporting efforts must be made for rural financing policies, expanding rural financing channels, and speeding up the construction of a rural financial system that combines commercial financing, cooperative financing, and policy financing with ample capital, full functionalities, complete services, and safe operation. Meanwhile, the "Plan" has also raised the target to achieve a more reasonable internal and industrial structure for agriculture, as well as an employment structure, so that farmers' income would continue to grow.

Part II: Industry Analysis, Foreign Direct Investment into China

The purpose of this summary is to provide transactional data for foreign investors, for the industries in China that are receiving the most FDI traction: Metals & Mining, Capital Markets, Financial Services, Industrial, Technology/Media/Telecom, Government, Marketing, Biotech/Healthcare, and Retail. These areas were chosen based on the significance of quarterly transactions. Thus, investors can identify the trend in each industry, and understand where the most interesting developments inside China are occuring.

Metals/Mining

Expanding cooperation in China's rare earth industry

Since China's reform and opening-up, the mining industry has been a major sector for foreign investment. China has actively encouraged foreign investment in prospecting, mining, and development. Ongoing efforts have been made to improve the policy and legal environment for foreign mining companies and foreign investment, especially pertaining to commodities in short-supply. Rare earth is one of those commodities and remains a particularly interesting case within the realm of metals and mining. Rare earth metals are essential for making high-tech goods including hybrid cars, military weapons, batteries, flat-screen TVs, mobile phones, mercury-vapor lights, and camera lenses. They are a vital component of virtually any technologically enhanced, consumer-driven product on the market.

Recently, rare earth has become a very hot topic globally. China produces around 95 percent of the global supply of rare earth. In the last few years, China has been seen tightening its quota on how much rare earth can be mined, produced, and exported. Quotas have gone from around 50,000 tons of mined, exportable rare earth in 2009 to around 30,000 tons in 2011 and 2012. Su Bo, Technology Vice-Minister for The Ministry of Industry and Information Technology (MIIT), stressed that "China has never tightened quotas to reap any kind of economic or political advantages; it has tightened because of the very small rare earth supply available in China." However, Su Bo also maintains that "rare earth production should be monitored because of the problems that rare earth mining causes to China's environment."

Despite the recent tightening policies on rare earth, China wishes to partner with foreign companies. The MIIT will continue to encourage foreign investment in the rare earth industry from The United States, Germany, France, Canada, Japan and other countries, as well as continue to encourage foreign investment in China's rare earth industry thru sole proprietorship, joint ventures, M&A, etc. In our opinion, it is the MIIT's intent to create relationships with the rest of the world and forge partnerships in the rare earth industry, but also balance the output of rare earth against the negative effects that rare earth mining has on China's environment.

Industrial/New Energy

Challenges ahead for foreign auto manufacturers to develop new energy cars in China

In July, the State Council officially released The Energy-saving and New Energy Automotive Industry Development Plan (2012-2020). The plan points to China speeding up the development of energy-saving and new energy auto industry, and promoting the transformation of the auto industry. According to the current policy, the Chinese government will issue a series of subsidy programs for new energy vehicles. The plan includes producing and selling a target of 500,000 units by 2015 and five million units by 2020 of pure electric cars and hybrid vehicles. Imported new energy cars are excluded from this program and government procurement.

The future looks bright for the Chinese auto market. The gigantic Chinese auto market, combined with China's incentive policies for new energy vehicles have created an irresistible attraction for foreign automakers. Most of them have initiated or sped up their plans to sell new energy vehicles in China. Yet, they face a steep challenge due to the Chinese government favoring domestic automakers in the new energy vehicle field. Therefore, to win business in China, not only do they have to partner with domestic automakers on production, but also transfer a significant amount of technology to these local partners.

Automakers have already started to fall in line with Chinese policy, and are partnering with local Chinese automakers to take advantage of this market. Japanese carmaker Nissan has introduced its electric car LEAF to China and promised to build it using its joint venture Dongfeng-Nissan Passenger Vehicle Company, under the local brand Venucia (启辰). Nissan will bring its electric vehicle technology and platform to China, and collaborate with local suppliers on core technology, including batteries. Volvo also said it is trying to build hybrid and electric cars in China as early as possible. We expect that foreign automakers will step up their presence in the new energy vehicle businesses in China to further solidify their market share in the world's largest auto market. Establishing local production under local brands with local partners, as well as transferring technology to the local partners, will be the major strategies to cross the policy barriers in China.

Tourism and Hotels

International hotel groups expanding in China

With China being one of the best business and tourism destinations in the world, and domestic travel becoming more common for Chinese, many world-famous international hotel groups have accelerated their pace to invest in China. Brands such as Hilton, Starwood, Marriott and Accor have all recently announced their expansion plans for the China market.

Some international hotel groups have gained significant market share in China, depending on their brand and management experience. These groups have particularly enjoyed much of their success in the first and second tier cities, where the major guest base includes business travelers from around the world that favor international brands. These hotel groups have also enjoyed success with local Chinese, who are experiencing increasingly higher discretionary income levels as well as a willingness to travel around China. However, to cover all consumer classes, international hotel groups have started to adopt a multiple sub-brand layout. They have started to introduce sub-brand hotels with different brand positioning, or even issuing new brands specifically aimed at China's market. A lot of them have penetrated into the third and fourth tier cities and upgraded some of the sub-brands to a higher class locally. For instance, the first Hilton Garden Inn in China will be opened in Shaoxing, Zhejiang province in December, 2012. Hilton Garden Inn is positioned as an affordable and focused service hotel outside of China, while in China it will be made into an upscale and full service hotel.

Although international hotel groups have gained some advantages in China, they are facing some challenges as well. One challenge is attracting and maintaining well-trained personnel that excel in multi-lingual communication and international culture. Another challenge is that local Chinese hotels are catching up fast and creating a threat to the foreign players. Local Chinese hotels not only narrowed the gap with international brands, in terms of hotel management, but also carry the unique local characteristics into the hotel design and operation. Thus, to retain and grow market share in China, international hotels need to prioritize talent management functions and offer incentives for the employees that bring knowledge of international culture and extraordinary customer service skills into their hotel model.

Capital Markets

Foreign Banks Accelerate Joint Investment in China's Capital Market

On August 6th, Citigroup Global Markets Asia and Orient Securities Company Ltd. jointly announced the official opening of their securities joint venture in China. Known as Citi Orient Securities Company Ltd (东方花旗证券有限公司), the joint venture is registered and principally located in Shanghai and has registered capital of RMB 800 million. The joint-venture will engage in investment banking business in the Chinese domestic market. Orient Securities will have a 66.7 percent stake in the new entity, with the remaining 33.3 percent owned by Citigroup Global Markets Asia.

With the new development, reform, and innovation of China's capital market, more and more international investors and institutions are looking to participate in the investment banking business in China. Chinese capital markets are still in the initial stages of growth, so it is quite possible for Chinese securities firms to make mistakes due to lack of experience. It would be very costly (both financially and cooperatively) for Chinese securities companies to make risky judgements and decisions based on a lack of experience and/or knowledge of the financial product. Thus, it would add tremendous value to partner with a foreign firm that is more experienced in financial products, underwriting, IPOs, and the global capital market functions.

The joint-venture model will benefit both foreign banks and Chinese security firms. On one hand, Chinese security companies will learn international operations to improve knowledge, processes, and risk-control abilities from foreign banks. On the other hand, foreign banks will have access to a broader market, where Chinese security institutes' deep local network and strong domestic track record can benefit their existing revenue creating abilities. Thus, it would benefit both parties to expedite the learning and growth processes that must take place, and try to create synergies with a growing Chinese capital market that may soon look to purchase financial products offered by these investment banks.

TMT – Technology, Media, Telecom

Low-cost smart phone market presents opportunities and challenges to foreign players

Statistics released at the end of August showed that in the second quarter of 2012, the sale of smart phones in China surpassed basic use cellular phones for the first time, accounting for 51 percent of the total market. Three major smart phone manufacturers - Lenovo, ZTE and Huawei - entered into the top five suppliers for the first time. Foreign brands Samsung and Apple were in first and fourth place respectively.

Smart phone sales growth has been driven by the smart phone market becoming more and more affordable to the Chinese population. Among the 900 million mobile phone users in China, 90 percent are using phones priced less than RMB 2,000. Many mobile phone manufacturers have launched smart phone models around RMB 1,000 to seize this huge market. As of the end of August, all major mobile phone brands, excluding Apple, have launched low-cost handsets.

The low cost smart phone market also brings huge business opportunities for phone component vendors. U.S. micro wafer maker Broadcom recently announced that they are actively establishing good relationships with Chinese smart phone manufacturers, and hope to aide in the development of the low-cost smart phone market in China. Broadcom is also expanding its product categories and developing wafers compatible with mobile phones sold by China Mobile. Currently, Broadcom's wafers are only compatible with China Unicom's cell-phone products.

In regards to high-end phones, some brands may continue to see margin pressures and eroding market share. They commonly entered China's market through partnerships with carriers. These carriers provided subsidies that were passed on to the customers who purchased a high-end phone. As the subsidies increasingly become a burden against carrier net profits, carriers' interest in high-end smart phones may gradually fade and the carriers may start to provide more cost efficient options for lower-end smart phone users. Also, consumer choice and behavior have become more rational and value-based. There are larger screen models and higher grade performance phones available that maintain lower prices in the market. To challenge the lower-end market, the high-end mobile phone manufacturers, such as Apple and Samsung, need to strengthen brand value, increase investment in product designing, and improve the user experience in order to distinguish themselves from their lower-end competition.

Marketing

E-commerce becoming a new channel for foreign brands to develop China market

Data released by China e-Business Research Center in early August showed that China online retail transactions reached RMB 511.9 billion in the first half of 2012, an increase of 46.6 percent year-on-year. Many foreign brands have realized the huge potential of online retail transactions, and begun to enter into this e-business arena.

At the end of August, the international fashion brand, Dazzle, reached an agreement with Rkylin (an e-commerce supplier) to provide hosting services for Dazzle's Taobao Tmall flagship store. The store is currently offering 112 products (as of September 7, 2012). Recently, India's KGK group, one of DeBeers DTC sight holders, announced they will cooperate with China's diamond e-commerce platform Worldmarte to start a wholesale business - expecting to further develop China's market via their online channel. Also in August, China regulators approved Wal-Mart's plan to increase investment in Yihaodian, which makes Wal-Mart the controlling-interest party of the online retailer. In addition to Wal-Mart, other foreign retailers including Metromall, Carrefour, and Tesco have also opened their online stores.

The e-commerce market has large scale and huge development potential; however, issues like credit absence, price wars, and lack of high quality post-sales services are also emerging. Recently, 360buy, Suning, and Gome have all been investigated for fraud and price fixing. Thus, in order to promote a healthy development of e-commerce and online shopping markets, the Ministry of Commerce has released regulations to protect consumers and purchasers. These regulations can be found under the E-commerce Business Model Standards and Online Transaction Service Standards. In addition, the Online Shop Credit Evaluation Indicators and E-commerce Marketing Operation Standards will also be issued in the near-term.

Online operations are a challenge for traditional players who are not familiar with e-commerce in China. Foreign companies involved in this business not only need a deep understanding of these regulations, but also a plan to deal with the challenges of payment setup, supply chain and logistics system, and cost control. Therefore, foreign players need to clearly set up a strategic objective, an action plan, and certain risk control measures before commencing online business in China.

Financial Services

China has officially opened its motor vehicle insurance business to foreign insurers

By September 11th, four foreign/joint venture asset insurance companies (Liberty Mutual, Allianz, and Groupama) have officially been granted permission to operate in the Mandatory Third-Party Liability Insurance business by the China Insurance Regulatory Commission (CIRC). It is the first time that China has opened its motor vehicle compulsory insurance business to foreign insurers.

Currently there are 20 foreign-invested insurance companies that have a presence in China. Before this permission, only three of them had operations in the commercial motor vehicles insurance market. This is because foreign insurers were only allowed to operate motor vehicles insurance under a joint venture with Chinese companies, or with agencies. Some people expressed discontent that if foreign insurers had the ability to enter the compulsory motor vehicles insurance market, the pressures on China's local asset insurance company could be tremendous. However, this may not be the case in the short term because the service network of foreign insurance companies is limited and IT support is not yet sufficient.

Thus, even with the recent permission, these hardware inadequacies restrain the scale of foreign insurers' business. In addition, the initial investment for entering the Mandatory Third-Party Liability Insurance market is huge, thus the potential risk of loss on investment may make foreign insurers very hesitant to enter this market. Therefore, in the near term, we do not see foreign insurance company market share growing rapidly in China's motor vehicle insurance market. However, in the long-term, local insurance companies will need to upgrade their services to prepare themselves for a more competitive market.

Biotech/Healthcare

Foreign medical technology companies boost their strength in China

On September 6, Medtronic, a leading global medical technology provider, announced the official opening of its Innovation Center in Shanghai. The new facility, located in the company's China headquarters, represents the company's initial step toward creating local product research and development in China. The center will work closely with the company's global research and development teams, as well as local universities and research institutes and more importantly, partner with Chinese physicians to create innovative solutions for patients.

China has become the fastest healthcare growth region among all the emerging economies and within the next decade, China will be the largest health care market in the world, outpacing the US. Besides the growing scale of the market, the National Health Service (NHS) and medical institutions have a positive attitude towards new medical technology, and are willing to take additional steps with new product trials. This type of support is conducive for medical technology research and development, as well as for the new products coming to market. Furthermore, foreign R&D centers can take advantage of the expertise and insight of Chinese employees, to create innovative products that suit the needs of Chinese patients. The innovation of medical technology relies heavily on the clinical experiences of the doctors. Compared to developed countries, China's doctors usually deal with a larger amount of patients; the diversified patient base could be a welcome addition for clinical studies and input.

Given the market growth rate, the government's supportive position, and talented Chinese human capital, we believe in the next few years, a larger amount of medical technology companies will strategically align with China by establishing or adding R&D centers and headquarters in key locations. However, the competition within China's market will also be quite fierce, thus providing additional medical services, rather than solely providing medical technology, may be a good strategy for those who want to capitalize on China's healthcare market.

Real Estate

Real estate investment in China continues to slow

Q3'2012 a notably weaker trend has persisted in regards to China's Real Estate FDI. The accumulated year-on-year growth rate of FDI in real estate industry has already shrunk significantly from 297 percent in August 2010 to -53 percent in August 2012. According to the statement of the Ministry of Commerce, "the decrease of FDI inflow in the real estate industry is also a key reason for the shrinking overall FDI in China, over the past several months." Some of the causes of the decrease in real estate FDI are that the RMB, although continuing to appreciate, is not appreciating as fast as historical trends, and home prices have stabilized due to strict government policies.

Since 2007, the RMB has appreciated substantially versus the major global currencies (Pound, USD, and Euro). However, in 2012, the Chinese economy has softened quite a bit. One of the primary reasons real estate in China has received vast FDI inflows was due to the 'expectation' of the RMB appreciating[5]. Now that the path of the RMB seems to be a bit less known, there is less and less demand to own Chinese real estate. Furthermore, foreign and local investors are finding value elsewhere. For example, in America, where prices are still depressed, local and foreign investors alike are becoming more attracted to low price, high value real estate investment purchases.

In addition, strict government policies within China have limited the appreciation of real estate prices. Restrictions and quotas, such as how many purchases can be made have capped the market and limited price appreciation. Thus, China's real estate growth model has leveled off, and investors are either not investing in China's real estate industry or taking their money elsewhere.

If the expectations of these strict government policies are unchanged, and the RMB continues to remain flat versus other currencies, we believe the FDI outflow from real estate industry will continue in the near future – affecting FDI in real estate and the aggregate FDI figure, as well.

[5] http://www.chinalawandpractice.com/Article/1690175/Foreign-Investment-in-Real-Estate-in-China.html

Infrastructure

Foreign investors favor Chinese port construction

After the financial crisis, Chinese foreign trade was seriously affected by the weak overseas demand, but port investments show no sign of slowing down. According to the data from the Ministry of Transport, the coastal port investment increased to RMB 80 billion in 2011. Other than the active participation of state-own and domestic private enterprises, there is also a clear trend that foreign investors are also showing a very high enthusiasm towards port construction in China. In June 2012, Maersk group and Ningbo port signed a $4.3 billion agreement to mutually invest and manage the No. 3, 4 and 5 berth of Meilong pier at the Meishan bonded harbor area. Through August 2012, Maersk's investment in the Ningbo port reached an annual growth rate of 8.5 percent, despite the weaker global economic climate and shrinking foreign trade in China.

Maersk is one example of a successful mutual partnership in China. Yet, Chinese ports are not without some serious issues that need to be considered. For example, low service quality, excessive competition, and high homogeneity. Furthermore, it would be expected that China's port investment is likely to shift from high growth to a relatively moderate growth model. In addition, the cooperation between ports needs to be further expanded, in order to achieve the integration of regional ports. Thus, foreign investment in Chinese port construction not only needs to pay more attention to local government policies and the future trend of foreign trade, but also needs seriously consider the target port's geographic location, management capability, as well as other issues with differentiation and integration.

We feel that for merger and acquisition activity to continue in this industry, strategic alliances with surrounding small port and the development with and cooperation from larger ports must be utilized. Special consideration must also be given to a port's location and geographic or regional advantages that the port possesses. Thus, mergers and acquisitions between ports may also be a key trend for the purpose of resource integration, demographic value-added, and/or complementary functions associated with different sized ports.

Energy and Utilities

China seeks Foreign Investment in Shale Gas

China plans to put 20 domestic shale gas blocks up for auction in October, with foreign funded joint ventures allowed to bid for the exploration rights. The country is estimated to have over 25 trillion cubic meters in recoverable reserves of the unconventional gas, making it the world's richest shale gas region, followed by the United States.

As one of the world's top energy consumers, China hopes to tap the potential of shale gas and other unconventional energy resources in the next few years, in a bid to reduce its dependence on imported energy. It seems determined to copy the success of the US, the country that produced 137.8 billion cubic meters of shale gas in 2010, up from virtually nothing in 2000, and relied less on natural gas imports as a result. China expects its shale gas production to reach 6.5 billion cubic meters by 2015 and 60 billion by 2020.

China's shale gas ambition provides good business opportunities for energy companies, especially those from abroad with mature exploration technologies. Royal Dutch Shell has a plan to invest USD $1 billion a year in China's shale gas over the coming few years, eying a Chinese shale gas boom. Some American energy companies, such as ConocoPhillips, are also weighing the options to expand their shale gas investment in China.

To invest in China, the government requires foreign firms to align with domestic companies. This is critical for local companies' to gain access to training on advanced technologies and engineering know-how needed to prosper. In addition, China's shale gas projects are usually located in regions with complicated geological features, making it difficult to transport and also may generate safety and environmental issues. Foreign companies may need local Chinese assistance in these areas. Thus, local partners may be a key value driver pertaining to cost management, safety and environmental issues, and foreign developers may be a key value driver for local partners, pertaining to technology improvements. Thus, we view foreign partnerships with local Chinese companies to be value-adding to both sides of this market.

Retail

Paul Smith Returns to China

Paul Smith, a luxury brand in the U.K., plans to open 20 retail stores in China over next five years, with a 465 square meter flagship store launched in Shanghai by June of 2013, as part of the brand's second attempt to crack the Chinese market. Paul Smith said that its first China attempt failed five years ago, due to a combination of unfavorable market situations, as well as conformist, conservative Chinese tastes.

Only five years later, Paul Smith is in a rush to make a comeback in China as it looks beyond traditional markets in the West for growth. In contrast with the unfavorable market conditions in 2007, the current Chinese luxury market is bigger and looks more promising. With years of increases in per capita disposable income, the middle class has emerged as a major force on the market, creating huge demand. Now China is the second largest luxury market in the world and is expected to be the largest by 2015, which means double digit annual growth over next few years.

Chinese consumers' increasingly high-end taste is contributing to the retail market boom. Today's white collar workers want products that indicate their social status or personal taste. Foreign luxury brands, such as Paul Smith, could address the needs of affluent Chinese consumers from various angles, making the luxury goods consumption not only a symbol of improved living standards, but also an expression of personality and self-confidence. This represents a major strength for these foreign companies against their local retail competitors.

Part III: Overview of Foreign Capital Utilization

A General Overview of China's Foreign Investment and Utilization of Foreign Capital

Source and Use of Foreign Direct Investment

For the first 9 months of 2012, FDI into China was USD 83.4 billion, down 3.8 percent year-on-year. There were 18,025 newly established foreign-invested enterprises reported in quarter 3, also down 11.7 percent from a year earlier. The service sector was the sector attracting the most FDI, accounting for USD 39.5 billion, 47 percent of the total national amount as of September 30, 2012. The manufacturing sector was the second largest sector, accounting for USD 37 billion, 44.3 percent of the FDI in China. The services sector, excluding real estate, actually rose 1.8 percent year-on-year, while the manufacturing sector declined by 7.5 percent year-on-year. Foreign investment in the real estate sector dropped by 5.6 percent year-on-year amid the country's efforts to rein in property prices and mitigate speculative price movements (Source: Ministry of Commerce).

Breaking down FDI by the three largest global regions shows a modest slowdown of foreign demand, with some areas of stability and growth. The EU-27 FDI investment to China was reported at USD 4.83 billion, a year-on-year decline of 6.3 percent, as the sovereign debt issues continue to handicap foreign investment from the EU. However, investments from Germany, the Netherlands and Switzerland rose rapidly, increasing by 29.1 percent, 38.9 percent, and 142.3 percent respectively. The USA contributed USD 2.37 billion, a year-on-year decline of only 0.63 percent. This data shows that U.S. FDI to China is relatively flat and that a possible economic recovery or any sign of future stability in the United States could further positively influence future FDI growth rates in the long-term. The capital flows from 10 Asian countries and regions including Hong Kong, Japan, the Philippines, Malaysia, Singapore and South Korea declined by 4.9 percent year-on-year in the period to $70.99 billion. However, it should be noted that while the 10 largest Asian countries contributed to a decrease in FDI, FDI from Japan surged 17 percent from a year earlier, to USD 5.62 billion, and FDI from Singapore also surged, up by 21.7 percent to USD 5.24 billion. Investments from Hong Kong registered at USD 52.08 billion, decreasing 8.7% year-on-year.

From a Chinese FDI regional point-of-view, we observed that from January to September, 2012, the central region of China's utilization of foreign capital maintained its rather rapid growth. FDI into the central region was USD 6.99 billion, up 16.5 percent year-on-year, accounting for 8.4 percent of the national total. The western region had FDI of USD 6.22 billion, down by 1.8 percent year-on-year, accounting for 7.4 percent of the national total. The eastern region had the lion's share of national FDI: USD 70.22 billion, down 5.6 percent year-on-year, but accounting for 84.2 percent of the national total. (Source: Ministry of Commerce)

The data shows that the world economy remains fairly weak, but also has some areas that show stability as well as encouraging FDI growth. Ministry spokesman Shen Danyang concluded that "China was in an 'adjustment stage' in terms of receiving foreign funds, but that the government remains optimistic about the country's long-term appeal to overseas investors. Although the FDI inflow saw slight declines, there have not been any substantial declines.

FDI Q3'2012 Analysis: Total FDI continues to decline, but China is expected to remain a top investment location

Q3'2012 China's foreign direct investment (FDI) inflows fell 3.8 percent to USD 83.4 billion in the first 9 months of the year, versus a year ago. FDI in the month of September fell 6.8 percent to USD 8.43 billion.

China has been the most attractive FDI destination among developing nations for more than a decade. Last year, the nation's FDI hit a record high, surpassing USD 116 billion. However economic conditions, both at home and abroad, have slowed. This has contributed to China's FDI decreasing in the first 9 months. It marks the 10th time in 11 months China's FDI has contracted. Due to this continued weakness, analyst sentiment towards FDI has also become increasingly negative. Some analysts view China's investment environment is deteriorating, losing the attractiveness of foreign investment, and becoming too costly for foreign companies. In contrast, others may infer that the decline is temporary and the long-term attractiveness of China's investment opportunities remains strong. Thus, to examine the recent slowdown of FDI, we have identified two key drivers that seek to explain why China's FDI seems to be lower this year.

First, external factors continue to be one of the primary reasons for the year-on-year decrease of FDI in China. It is no secret that the rest of the world's developed economies (Europe and the USA) have been, at best, operating in an economic malaise in the last 4 years, impacting their overseas investment appetite. For example, the EU continues to struggle with sovereign debt issues. As a direct effect, EU-27 FDI to China fell by 6.3 percent in the first 9 months of 2012. The United States has also been slow to recover from the economic crisis in 2008. The US has been growing by 1 percent and 2 percent annually; FDI to China has been relatively flat, decreasing just .63 percent year-on-year.

Furthermore, emerging economies such as Africa, India, Brazil and Russia continue to boast increasing FDI growth rates. Operating in these countries has continued to present opportune cost advantages for multinational companies. Therefore, these countries pose an increased competitiveness with China, potentially drawing FDI away from China and into other low cost opportunity areas around the globe.

Second, internal factors (or policies specific to China) also continue to be a primary reason for the year-on-year decrease of FDI in China. Internal factors are a significant driver behind the decreasing FDI in China. Looking at internal factors, according to China's "Twelfth Five-Year" plan, China will continue to accelerate the process of industrialization, information technology, urbanization, and will provide more opportunities for foreign investors. What does this mean? It means that as China supports more progressive infrastructure and technological advancements, costs of labor, costs of land, and general operating costs should continue to trend higher. Despite government intervention to slow the property market, these land prices in China's developed and developing cities, such as Beijing and Shanghai, continue to rise, and continue to negatively influence FDI. For example, the regulation of the real estate industry has led to a slowdown in demand for steel and decoration materials. This uncertainty or continued volatility in the Chinese market has had a negative effect on FDI flow into China. Secondly, as supported by China's government, labor costs have and will continue to rise. This initiative supports the development of the Chinese middle class, but may initially direct some foreign investment away from China and towards Southeast Asia.

To maintain an attractive FDI proposition, the central government will continue to improve the investment environment in China. Specifically, according to China's "Twelfth Five-Year" plan, China will "accelerate the process of industrialization, information technology, and urbanization, which will in turn provide more opportunities for foreign investors." The government's intent is a pledge to treat foreign and domestic companies similarly, broaden tax incentives that will influence foreign companies to continue to invest in China, and allow more industries to receive foreign direct investment. Some of these newly encouraged industries that have government support are: service sectors including venture capital, intellectual property rights protection, vocational training, clean energy autos, vehicle charging stations, water treatment plants, offshore oil pollution cleanup facilities, and new technology for anything from textiles and machinery to chemicals and biotech. These industries will gain preferential treatment from the government, and should continue to recruit foreign capital for benefits of future growth.

The trend clearly indicates that China's government will support investments in industries that continue to help China develop as an economic power, while keeping business and environmental protection in mind. China will continue to support increases in technology, energy efficiency, and healthcare, but will also limit or prohibit investments in industries that may harm the economy or environment in the future.

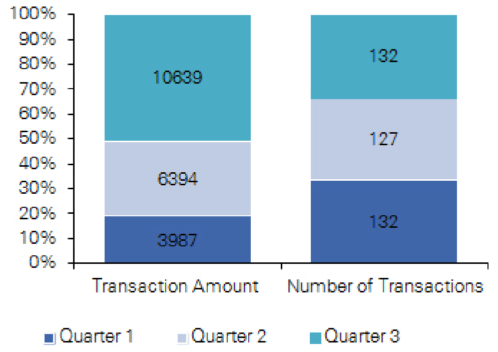
Last year, China drew a record USD $116 billion in FDI, which marked a record year for China FDI. Despite this year's decline in FDI growth, China is expected to remain a top destination for FDI into the foreseeable future. This is predicated on a practical investment rotation that is already occurring in China; FDI is shifting from the developed cities in China to the less developed cities and is viewed as a positive shift in quality and structure by the Ministry of Finance. The ministry's FDI target remains unchanged. China aims to attract an average of US$120 billion in each of the next four years; it is roughly on course to hit that target in 2012.

Merger and Acquisition Investment in China

General Overview

During the first 9 months of 2012, there were 391 announced or completed inbound transactions totaling USD 21 billion. This compares unfavorably to 2011, which saw nearly 500 transactions totaling approximately USD 26 billion (Source: Thomson One). Both transaction size and volume are showing a 20 percent decline, year-on-year. One favorable sign is that quarter-on-quarter M&A activity for 2012, or "Transaction Amount" (Figure 3.1), continues its brisk increase. Quarter 2, 2012 saw a 57 percent increase over quarter 1, likewise quarter 3 saw a 65 percent increase over quarter 2. The main transactions contributing to this increase were The Carlyle Group, a private equity and investment company in The United States, acquiring Focus Media Holding Group in a deal worth USD 3.5 billion, as well as The Abu Dhabi Group and the Government of Singapore acquiring China Pacific Insurance group in a deal worth USD 1.3 billion (table 3.3). Lastly, the "Number of Transactions" has stayed relatively consistent throughout the course of this year (Figure 3.1).

Figure 3.1 YTD Foreign M&A, by Transaction Amount (USD Million) and Total Transactions



Sources: Thomson ONE、Mergermarket, KPMG analysis

M&A Regional Analysis

For the first 9 months of 2012, a total of 27 countries and regions (22 shown below) invested in Chinese companies via M&A. These M&A transactions originated mainly from the US, Hong Kong, Singapore, Taiwan, the U.K., and South Korea. The largest transactions, however, came from the US, Hong Kong, and Singapore. As shown in Figure 3.2, Hong Kong generated the most total transactions, with 186 transactions, totaling USD 6.98 billion YTD. The US reported far fewer transactions YTD, but has been shown to have much larger transactions of monetary size - the US engaged in just under 50 transactions YTD, but total value of the transactions exceeded USD 7 billion.

Figure 3.2 YTD Inbound M&A in China, by Country, Amount, and Number of Deals

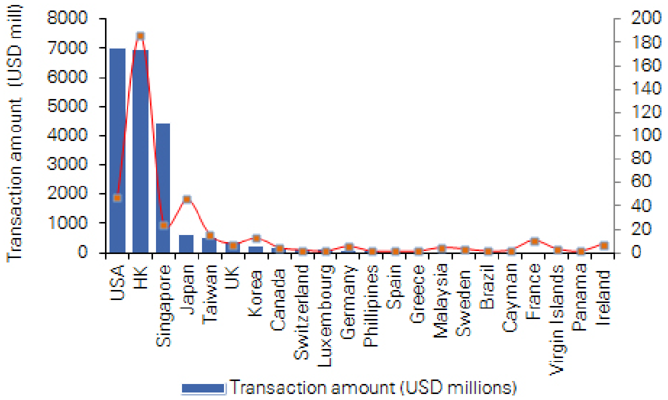


Table 3.1 lists the transaction and number of foreign acquisitions in China, sorted by region, for the first 9 months of 2012. The Asia Pacific region is the main source of M&A into China, as it accounted for over half of the YTD activity (USD 12.95 billion). Asia Pacific also accounted for nearly 75 percent of the total number of transactions (289 transactions). Hong Kong, Macau, and Taiwan accounted for over a third of total YTD M&A transaction dollars (USD 7.5 billion). The Americas accounted for the second largest investment by region. This was anchored by North America (USA and Canada), which accounted for over one-third of total M&A investment into China (USD 7.16 billion) with only 51 total transactions YTD. The key takeaway is that the majority of inbound M&A investment activity is coming from the most developed neighbours of China, as well as the North America region.

Table 3.1 2012 YTD, Geographical Distribution Table and Transaction Amount of Foreign Investment in China M&A

Region	Transaction amount (USD millions)	# of Transactions
Global	**21,021**	**391**
Asia	**12,949**	**289**
HK, Macau, Taiwan	7537	201
Southeast Asia	4560	29
Japan & South Korea	852	58
South/Central Asia & Middle East	0	1
America	**7207**	**58**
North America	7159	51
Central, South America	48	7
Europe	**864**	**40**
EU Member Countries	344	31
Non-EU Member	520	9
Oceana	**1**	**3**
Africa	**0.4**	**1**

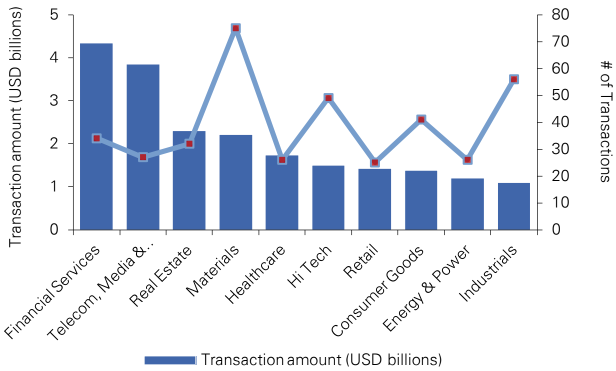
Sources: Thomson One, MergerMarket, KPMG analysis

M&A Industry Analysis

Figure 3.3 displays the 10 major industries in China involved in M&A activity, for the first 9 months of 2012. These industries represent the target firm, not the purchasing firm, as purchasing firm industries may differ significantly. The industry that received the largest inbound M&A flow was 'financial services'. Financial services in China received over USD 4 billion, with over 30 M&A transactions pending or completed year-to-date. Telecom, media, and entertainment (TM&E) was a close second receiving just under USD 4 billion, and just under 30 total transactions year-to-date.

The materials industry is an interesting sector to analyze. It includes the following sub-industries: metals and mining, containers and packaging, chemicals, construction materials, and paper & forest products. It received over USD 2 billion in M&A investment, but the number of transactions was far greater than the three preceding industries. This signifies that smaller companies were targeted for acquisition in this industry, with acquiring firms looking to take advantage of specific industrial or demographic advantages of the Chinese materials companies. The same can be inferred with the 'industrials' sector, which saw many deals, but typically small transaction sizes.

Figure 3.3 YTD inbound M&A in China , by Industry

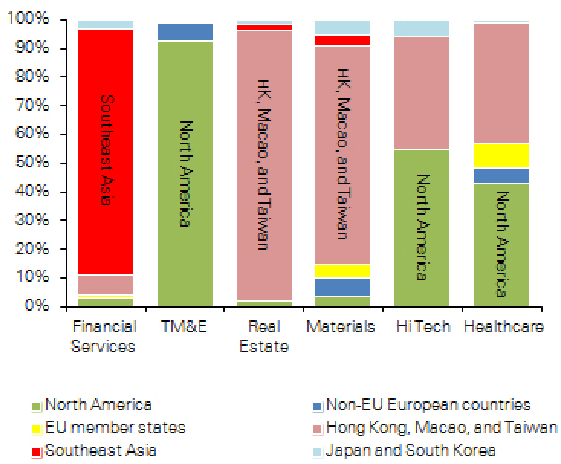


Source：Thomson One, MergerMarket

Figure 3.4 displays the top 6 M&A industries in China, as well as the main region of acquirers. It should be noted again that these categories reflect the target (Chinese) firm industry, not the foreign firm industry. Financial services is the top industry of M&A activity in China, thru Q3'2012 (see figure 3.3), with Southeast Asia the most significant investor. The most significant investor was Singapore, which had two large deals valued at approximately USD 3.7 billion (refer to table 3.3 below). Telecom, media and entertainment (TM&E) was transactionally dominated by North America, but with one specific transaction that represents about 90 percent of total TM&E deals for the entire year.

For a more diversified M&A view, we can observe the healthcare sector. Hong Kong and North America accounted for a large portion of YTD M&A healthcare activity, however both EU and Non-EU countries were active participants in healthcare M&A. Real estate and materials were dominated by Hong Kong, Macau, and Taiwan investors, with very little investment coming from western countries.

Figure 3.4 Top 6 M&A Industries and Regional Acquiror



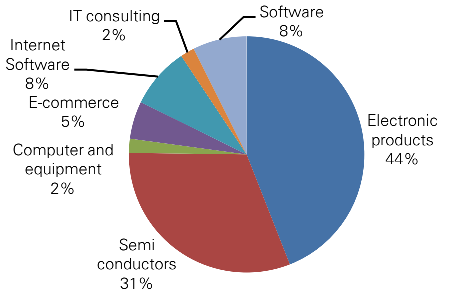
Sources: Thomson One, Mergermarket, KPMG analysis

We can further break down some aggregate industries into "sub-industries". For example, the financial services industry had several sub-industries of acquisition interest, and thus can be broken out into sub-industries that include: banking, insurance, asset management, and other transactions. However, the financial sub-industry had a small number of very large transactions in banking and insurance, skewing the data. As a matter of fact, there were many more M&A transactions completed or pending in the asset management segment of finance, but with much less capital being committed. This is also true for the real estate industry and the TM&E industry. However, based on the diversity of sub-industry investment there are two industries noted in figure 3.5 and 3.6 that had sub-industries worth detailing.

The hi-tech and healthcare sub-industries (refer to figure 3.5 and 3.6) were not dominated by one or two large M&A transactions, but instead exhibited several transactions from several outside investors. They are also desirable to examine due to the importance they are given in China's 12th 5-year plan.

One of the primary objectives of China's 12th 5-year plan (the "plan"), set in 2011, was to fuel the growth of technology and healthcare sectors through M&A transactions. This analysis breaks down the sub-industries within technology and healthcare, and identifies any such trends within the sub-industries that are in accordance with China's 12th 5-year plan.

Figure 3.5 Hi-Tech industry transaction by sub-sector



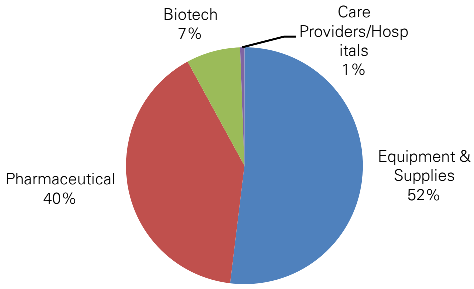
Sources: Thomson One, MergerMarket, KPMG Analysis

As provided by the plan, some key development directions of the central government are specifically related to technology. The plan states that new generation information technology, high-end software, and high-end manufacturing will be (from 2011-2015) the key drivers of growth and as such, will be supported and facilitated by the central government.

As shown in figure 3.5, the largest technology sub-industry M&A activity occurred in electronic products and semiconductors, which received 44 percent and 31 percent of M&A FDI investment, respectively. This is in-line with the 5-year plan to support more efficient and highly effective technological equipment and products in China. Analysis suggests that a larger amount of FDI M&A activity will continue to occur in the technology sector (specifically in products and hardware), due to central government support of this industry.

The largest single transaction amongst the sub-industries was in the electronics industry, an M&A deal valued at USD 536 million. This was the General Electric/China XD Electric deal, in quarter 2.

Figure 3.6 Energy & Power industry transactions by sub-sector



Sources: Thomson One, MergerMarket, KPMG analysis

Also stated in the plan, was the importance of developing the healthcare industry in China. According to the 12th 5-year plan, the government specifically emphasized foreign investment in the development of the healthcare sector. Shown above, the beneficiaries of M&A activity are reflected by purchases in both pharmaceuticals and medical equipment and supplies. The 12th 5-year plan aims to further grow research & development and manufacturing through M&A strategies targeting both Chinese and western medical technologies. [6]

As shown in figure 3.6, "Equipment Sales" and "Pharmaceuticals" received 52 percent and 40 percent of M&A FDI investment, respectively. This is in-line with the plan to support an overhaul of the healthcare industry in China, which includes higher quality equipment and technology, as well as diverse investments in bio-tech and bio-pharmaceutical engineering. Analysis suggests that a larger amount of FDI M&A activity will continue to occur in the healthcare sector due to central government support of this industry as well as China's general need for healthcare reform

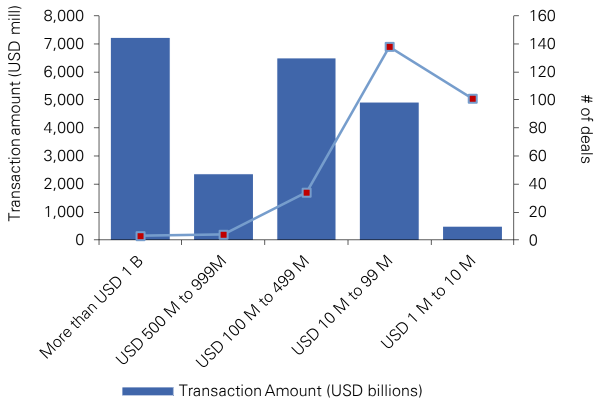
The largest transaction amongst the sub-industries was in the equipment and supplies industry, an M&A deal valued at USD 720 million. This transaction was the Medtronic/China Kanghui Holdings deal, in quarter 3.

M&A Analysis of Transaction Size

Table 3.2 shows all M&A transactions for the first 9 months of 2012, broken out into 6 categories based on size. The key takeaways from this table are: the financial industry transactions spanned all transactional categories, while healthcare and real estate were mainly transactions of mid to large size, and hi-tech transactions mostly occurred in the smaller size subset (1 hi-tech transaction in USD 500m-1b in Q2). Based on these transactions of size, one can surmise that smaller companies were acquired in the hi-tech area, while much larger acquisitions were made in the financials and media sectors.

Figure 3.7 breaks the information out graphically. As expected, there were few deals in the 'greater than USD 1 billion' range: 3 deals with an aggregate transaction value of USD 7.3 billion. The most deals were in the 'USD 10 million to USD 99 million' range: TM&E, financials, hi-tech, energy & power, retail, and real estate, with 138 deals worth USD 4.92 billion in the first 9 months of 2012.

Table 3.7 YTD Transaction amount grouped by size of transaction



Source: Thomson One, MergerMarket

Table 3.2 YTD
Distribution of Foreign Investment in China, by Range, Main Investor Countries, and Industry

Scope of the Transaction Amount	Main Investor Countries	Target Industry
More than 1 billion	Singapore, USA	Financials, Media
500 million to 1 billion	HK, USA	Financials, Consumer Goods, Healthcare, Real Estate, Hi-tech
100 million to 499 million	HK, Taiwan, USA, UK, Singapore	Media, Financials, Materials, Consumer Goods, Industrials, Energy & Power, Healthcare, Real Estate
10 million to 99 million	HK, Singapore, Japan, South Korea, USA and EU	Financials, Media, Energy & Power, Industrials, Hi-Tech, Consumer Goods, Financials, Healthcare, Real Estate
1 million to 9.99 million	HK, Japan, Singapore, Taiwan, USA	Hi-Tech, Energy & Power, Financials, Industrials, Materials
Less than 1 million	HK, Japan, Taiwan,	Industrials, Media, Hi-Tech, Materials, Energy & Power, Financials

Analysis of Top 10 M&A deals

Table 3.3 lists the top 10 YTD M&A deals in China. The acquirers who participated in these top 10 deals were from 3 different countries/regions: USA, Singapore, and Hong Kong. The key trend to notice is the absence of the EU-27 from any acquisitions of size. The EU, and its member countries and businesses, is China's largest trading partner by total trade (Exports + Imports) and is likely not participating in any M&A deals of substantial size due to the ongoing uncertainty regarding the member nations and their respective sovereign debt dilemma.

[6] http://www.kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Documents/China-12th-Five-Year-Plan-Healthcare-201105-3.pdf

Table 3.3 2012 YTD Top 10 Foreign M&A Inbound deals to China						
Rank	Acquirer			Target		Transaction Value ($ mill)
	Acquirer	Industry	Country	Company	Industry	
1	Carlyle Group	Financial services	USA	Focus Media Holdings	**Telecom, Media, Entertainment**	3,503
2	Temasek Holdings	Financial services	Singapore	Industrial and Commercial Bank of China	**Financial Services**	2384
3	Abu Dhabi / Govt of Singapore	Financial services	Singapore	China Pacific Insurance Group	**Financial Services**	1340
4	Medtronic	Healthcare	USA	China Kanghui Holdings	**Healthcare**	720
5	TPG Holdings	Financial services	USA	HCP Holdings Inc	**Consumer Goods**	600
6	General Electric Company	High tech	United States	China XD Electirc Co., Ltd.	**Hi-Tech**	536
7	Dynamic Grand Ltd	Financial services	Hong Kong	Grandday Group Ltd	**Real Estate**	500
8	China Data Broadcasting Holdings Ltd	Media and Entertainment	Hong Kong	Sufficient Value Group Ltd.	**Retail**	451
9	Sinocop Resources (Holdings) Limited	Material	Hong Kong	South China Mining Invest Ltd.	**Material**	402
10	Enzio Investments Ltd	Financial services	Hong Kong	Greentown China Holdings Ltd.	**Real Estate**	329

Sources: Thomson One, MergerMarket, KPMG analysis

The largest inbound M&A deal in 2012 belongs to the Carlyle Group's acquisition of Focus Media Holdings, a Chinese Media and Entertainment company. This was Carlyle's bid, along with several other smaller firms, to take Focus Media Holdings private. This deal was announced in the 3rd quarter of 2012, is valued at USD 3.5 billion, and when completed it will rank as the largest leveraged buyout on record in China. The second largest transaction was Singapore's Temasek Holdings acquiring a share of Industrial and Commercial Bank of China (ICBC). ICBC is currently the world's largest bank by market cap, valued around USD 250 billion. The third largest transaction also comes from Singapore. The government of Singapore, along with two other investors, purchased a stake in China Pacific Insurance Company. This deal was valued at USD 1.34 billion, and is yet another strategic play by Singapore (government and private equity stakeholders) to partner with local Chinese companies in the Chinese insurance/financial market.

Appendix： List of M&A Activity for 3Q 2012

Interpretation of the data sources

Data source: Mainly Thomson ONE data, including some cases from Merger Market that were not listed in Thomson ONE, with all data verified through other public information channels, and the Chinese names of the companies cross-checked.

Thomson ONE standards for inclusion of M&A cases:

- Acquired shares exceed 5 percent of the total assets of the target party of acquisition;
- Or, acquired shares exceed 3 percent of the total assets of the target party of acquisition, and the value of the transaction exceeds 1 million USD;
- Or, if the value of the acquisition is less than 3 percent of the total assets of the target party of acquisition, the acquiring party has expressed intention to acquire the entire target party of acquisition, or the underlying M&A causes the acquiring party to possess over 50 percent of the shares of the target party of acquisition;
- Or, regardless of the value of the underlying acquisition and the transaction, the underlying acquisition causes the acquiring party to acquire the remaining shares of the target party of acquisition, and thereby hold 100 percent of the shares of the target party of acquisition.

MergerMarket standards for inclusion of M&A cases:

- The acquisition value exceeds 5 million USD;
- Or, if the acquisition value is less than 5 million USD, the underlying acquisition causes the acquiring party to possess more than 50 percent of the shares of the target party of acquisition;

We have categorized the industries of M&A enterprises into the following 13 groups:

I. Consumables and service industry, including education, employment services, household services, legal services, tourism, professional services and 7 sub-groups under other consumables;

II. Energy and electricity, including fossil fuels and natural gas, electricity, replacement energy, petrochemical products, oil pipelines, water and waste treatment and 7 sub-groups under other energy and electricity;

III. Financial services, including banking, brokerage, insurance, credit agencies, asset management, other financial investments, diversified financing, government-sponsored entities and 9 sub-groups under other financial services;

IV. Government institutions, including state governments, state offices, municipal governments, municipal offices, district governments, district offices, public institutions, transnational and 9 sub-groups under other governmental institutions;

V. Medical care, including bio-technology, medical instruments, medical service providers, hospitals, pharmaceutical manufacturing and 6 sub-groups under other medical care;

VI. Hi-tech, including computers and peripheral equipments, E-business, electronic products, internet infrastructure, software and services, ICT technical consulting services, semi-conductors, software and 9 sub-groups under other hi-tech;

VII. Industry, including aviation, aerospace and national defense, automobiles and parts, construction/building and engineering, industrial groups, mechanics, transportation and infrastructure and 7 sub-groups under other industries;

VIII. Materials, including chemical products, building materials, mining, containers and packaging, paper-making and forestry products, and 6 sub-groups under other materials;

IX. Media and entertainment, including commercials and market promotions, broadcasting, cable, casinos and games, hotels and accommodation, entertainment and leisure, video and audio, publishing and 9 sub-groups under other media and entertainment;

X. Real estate, including residential, non-residential, real estate management and development, real estate investment trust funds and 5 sub-groups under other real estate;

XI. Retailing, including garment retailing, automobile retailing, computer and electronic product retailing, discounts and department store retailing, food and beverage retailing, home products retailing, internet and catalogue retailing and 8 sub-groups under other retailing;

XII. Commodities, including agricultural products and raised products, food and beverages, home and personal goods, textiles and finished garments, tobacco and 6 sub-groups under other commodities;

XIII. Telecommunications, including space and satellites, telecommunication equipment, telecommunication services, wireless and 5 sub-groups under other telecommunications.

List of 3Q 2012 M&A deals

The following is the aggregate list of merger and acquisition deal activity, sorted by most transactions per target industry, then sorted by size of transaction in that industry, to include every announced or completed deal from 7/1/2012 to 9/30/2012:

2012 Third Quarter Announced Inbound China Mergers and Acquisitions

	Announce Date	Acquirer	Target	Acquirer Country	Deal Amount (USD mil)	Equity %
INDUSTRIALS						
1	2012.9	Investor Group	Guangqi Mitsubishi Automobile	Japan	219.5	-
2	2012.7	Warburg Pincus LLC	China Auto Rental Hldg Inc	United States	200.0	-
3	2012.8	China Merchant Hldg (Pac) Ltd	Beilun (HK) Invest Ltd	Singapore	139.6	-
4	2012.8	Hyundai Dymos Inc	Beijing Mobis Transmission Co	South Korea	107.8	-
5	2012.9	Daetwyler Holding AG	Anhui Zhongding Taike Auto	Switzerland	63.7	-
6	2012.8	Mitsubishi Logistics Corp	Warehouse In Shanghai	Japan	37.8	-
7	2012.8	Swire Pacific Cold Storage Ltd	Guangdong Swire Cold Chain	Hong Kong	27.3	-
8	2012.8	Neijiang Chuanwei Special Steel	Longwei Metal Product Co.	Singapore	23.9	100
9	2012.7	Singamas Depots Holdings Ltd	Shanghai Huasing Intl Transp	Hong Kong	17.4	-
10	2012.7	Fresh Water Group Ltd	Park Wealth International Ltd	Hong Kong	10.1	-
11	2012.8	Kingtec Enterprise Co Ltd	Li Sun Hardware (Shenzhen) Co	Taiwan	6.9	39.85
12	2012.9	APL Logistics	APLL-ZHIQIN	USA	5.8	51
13	2012.8	Ally Thrive Investments Ltd	Jiangsu Xinzhong Environmental	Hong Kong	4.9	-
14	2012.7	CWT Ltd	CWT Commodities Shanghai	Singapore	0.8	31.6
15	2012.8	Isuzu Motors Ltd	Undisclosed Subsidiary Of JMCG	Japan	-	-
16	2012.8	MANN+HUMMEL GmbH	Bengbu Haoye Filter Co Ltd	Germany	-	-
17	2012.9	Valeo Ichikoh Holding Ltd	Valeo Lighting Hubei Technical	Ireland-Rep	-	-
18	2012.9	Valeo Ichikoh Holding Ltd	Wuhu Valeo Automotive Lighting	Ireland-Rep	-	-
19	2012.9	Ichikoh Industries Ltd	Hubei Valeo Auto Lighting Co	Japan	-	-
20	2012.9	Valeo Ichikoh Holding Ltd	Foshan Valeo Ichikoh Auto	Ireland-Rep	-	-
21	2012.9	Valeo Ichikoh Holding Ltd	Shenyang Valeo Auto Lighting	Ireland-Rep	-	-
22	2012.9	Investor Group	Hengji-Chuangfu (Foshan) Metal	Japan	-	-
23	2012.9	Headland Capital Partners Ltd	Undisclosed Luxury Car	Hong Kong	-	-
FINANCIAL SERVICES						
1	2012.9	Abu Dhabi Singapore Investor Group	China Pacific Ins (Grp) Co Ltd	Singapore	1,339.9	-
2	2012.9	Talent Grp Dvlp Ltd	Housden Holdings Ltd	Hong Kong	58.8	-
3	2012.9	Golden Dragon Century Ltd	Cangxi County Datong Nature	Hong Kong	14.2	-
4	2012.7	Profit Keen Holdings Ltd	Concord Capital Investment Ltd	Hong Kong	10.6	100

2012 Third Quarter Announced Inbound China Mergers and Acquisitions						
	Announce Date	Acquirer	Target	Acquirer Country	Deal Amount (USD mil)	Equity %
5	2012.8	China Innovation Invest Ltd	Grand Far Sky Ltd	Hong Kong	9.9	-
6	2012.9	Culture Landmark Invest Ltd	Media Sound Tech Ltd	Hong Kong	7.2	-
7	2012.7	China Financial Intl Finance	Shenzhen City Shenglianfeng	Hong Kong	7.1	-
8	2012.9	Rich Century Development Ltd	Aotelaisi Renowned Brand	Hong Kong	5.5	24
9	2012.7	China Financial Intl Finance	Tianjin Guojin Small Loan Co	Hong Kong	4.7	-
10	2012.7	China Financial Intl Finance	Tianjin Jiuzhij Small Loan Co	Hong Kong	4.7	-
11	2012.9	Fidel International Ltd	Nice Grace Group Ltd	Hong Kong	3.2	20
12	2012.7	Talent Step Investments Ltd	Kailong REI Holdings Ltd	Hong Kong	3.1	-
13	2012.8	Cosmo & Company Inc	Cosmo China Investment Co Ltd	South Korea	2.6	-
14	2012.7	China Finl Intl Invest Ltd	Harbin City Nangang District	Hong Kong	2.4	-
15	2012.7	Mandrin Master International	AVY International Ltd	Taiwan	2.1	51
16	2012.7	Glory Wing Investments Ltd	Miracle True Investment Ltd	Hong Kong	1.2	-
17	2012.7	AF Ocean Invest Mgmt Co	Endeavour (Shanghai) Bus Svcs Co	United States	0.4	100
18	2012.8	Richard Barrett	Treasury Hldgs (Shanghai) Ppty	Ireland-Rep	-	100
REAL ESTATE						
1	2012.9	Dynamic Grand Ltd	Grandday Group Ltd	Hong Kong	500.5	49
2	2012.9	China International Holdings	Triumph Kind Investment Ltd	Hong Kong	71.0	-
3	2012.9	EC-Founder (Holdings) Co Ltd	Hong Kong Tianranju Hldg Ltd	Hong Kong	69.5	-
4	2012.7	Even Dragon Ltd	Splendor Sheen Ltd	Hong Kong	58.2	-
5	2012.7	Ascott Residence Trust	Hong Kong Yong Zheng Grp Co	Singapore	49.9	-
6	2012.9	Bliss Ally Investments Ltd	Chinney Trading Co Ltd	Hong Kong	47.5	-
7	2012.7	Mount Kellet Capital Mgt LP	Tospur Real Estate Consulting	United States	47.3	-
8	2012.9	Keen Gate Developments Ltd	Forward Investment (PRC) Co Ltd	Hong Kong	38.7	-
9	2012.8	Mitsui Fudosan Residential Co	Glory Land Investment Ltd	Japan	35.3	-
10	2012.9	Silver Reach Ltd	Best Surpass Ltd	Hong Kong	35.1	-
11	2012.9	Worldwide Renowned Brand	Guangdong Guansheng RE Ltd	Hong Kong	25.6	-
12	2012.8	Kings Haul Ltd	Power City Investments Ltd	Hong Kong	15.4	-
13	2012.9	Aotelaisi Renowned Brand	Guangdong Jingsheng RE Dvlp Co	Hong Kong	6.5	-
14	2012.8	Richard Barrett	Treasury Hldgs RE Pte Ltd	Ireland-Rep	2.9	100
15	2012.8	Champ Mark Holdings Ltd	Head Crown Development Ltd	Singapore	-	-
16	2012.9	Grand Creation Investments Ltd	Beijing Cemetery Holdings Ltd	Hong Kong	-	-
17	2012.9	EC-Founder (Holdings) Co Ltd	Hong Kong Tianhe Holdings Ltd	Hong Kong	-	-

2012 Third Quarter Announced Inbound China Mergers and Acquisitions						
	Announce Date	Acquirer	Target	Acquirer Country	Deal Amount (USD mil)	Equity %
18	2012.9	South Trend Holdings Ltd	Ai De Investments Ltd	Hong Kong	-	-
CONSUMER GOODS						
1	2012.7	TPG Capital LP	HCP Holdings Inc	United States	600.0	100
2	2012.8	McCormick & Co Inc	Wuhan Asia-Pacific Condiments	United States	141.5	-
3	2012.7	Warburg Pincus LLC	China Kidswant Invest Hldg Co	United States	55.0	-
4	2012.8	Hon Chuan Holding Ltd	Hon Chuan (China) Holdings Co	Taiwan	48.6	-
5	2012.7	Anxin-China Holdings	Tech Praise Ltd	Hong Kong	39.6	-
6	2012.8	Mysteriously Time Invest Ltd	Revenue Synthesis Ltd	Hong Kong	25.5	-
7	2012.7	Fleur Capital (S) Pte Ltd	China Gaoxian Fibre Fabric	Singapore	21.4	-
8	2012.7	Baring Private Equity Asia V	Magic Holdings Intl Ltd	Hong Kong	18.9	5
9	2012.7	Wisehand Planning Co Ltd	Fuss-Animal Feed Business	South Korea	16.0	-
10	2012.9	Victory Land Investments Ltd	Poly Fortune Enterprises Ltd	Hong Kong	12.9	-
11	2012.8	Waikari Sdn Bhd	Yihai Kerry (Zhengzhou)	Malaysia	10.3	-
12	2012.7	Speedy Full Enterprise Ltd	Jiangxi Hongfeng Textile Co	Hong Kong	2.2	-
13	2012.8	Legend Whistler Ltd	China Household Furniture Hlgd	Hong Kong	-	-
14	2012.8	Seamless Green China (Hldg) Ltd	Full Pace Holdings Ltd	Hong Kong	-	-
15	2012.8	Seamless Green China (Hldg) Ltd	Great China Outdoor Media Hldg	Hong Kong	-	-
MATERIALS						
1	2012.7	Pu'er Hengyi Mining Co	China Precious Metals Resource Holdings	Hong Kong	312.3	-
2	2012.7	Up Energy Mining Ltd	Champ Universe Ltd	Hong Kong	203.7	-
3	2012.9	Bright Chance Intl Ltd	Ray Tone Ltd	Hong Kong	36.4	-
4	2012.8	Revenue Generator Ltd	Tai Xin Minerals Ltd	Hong Kong	32.2	-
5	2012.9	Autometal SA	Nanjing Automobile Forging Co	Brazil	22.2	-
6	2012.9	HK Yuchuang Invest Co Ltd	Chengdu Dongsheng Packing	Hong Kong	3.4	-
7	2012.7	China Resources Dvlp Grp Ltd	South Sea Graphite (Luobei) Co	Hong Kong	2.1	-
8	2012.8	Tanaka Sekkai Kogyo Co Ltd	Anhui Hong Ri Mining Co Ltd	Japan	0.3	10
9	2012.7	Q Capital Partners Co Ltd	Jilin Hanzheng Ginseng Co Ltd	South Korea	-	-
10	2012.8	McVicar Industries Inc	Anhui Linghua Co Ltd	Canada	-	100
11	2012.8	SGL Carbon SE	Undisclosed China Needle Coke	Germany	-	-
12	2012.9	L&L Energy Inc	GuangYeh Coal Sales-Operations	United States	-	100
13	2012.9	Air Products & Chemicals Inc	Guizhou-Air Separation Unit	United States	-	100
HI-TECH						

2012 Third Quarter Announced Inbound China Mergers and Acquisitions						
	Announce Date	Acquirer	Target	Acquirer Country	Deal Amount (USD mil)	Equity %
1	2012.7	Investor Group	E-Surfing Video Media Co Ltd	Hong Kong	59.9	-
2	2012.8	China Gogreen Asts Invest Ltd	GCL Energy Storage Tech Hldg	Hong Kong	33.9	-
3	2012.7	Leader Sky Holdings Ltd	Grandway Investment (Group) Ltd	Hong Kong	20.0	-
4	2012.7	Ever Union Medical Svc Grp Ltd	Shenzhen Touhe Invest Dvlp Co	Hong Kong	12.1	-
5	2012.9	Jiangsu Nandasoft Technology	Jiangsu Chengtian Zhiyuan Transportation Technology Co Ltd.	Hong Kong	7.3	51
6	2012.8	UniBest Holding Ltd	Futurepower Holding Ltd	Taiwan	6.2	-
7	2012.7	Fuji Soft Inc	Vinculum China Corp	Japan	2.2	22.4
8	2012.8	Leung Ngai Man	Media Hong Kong Investment Ltd	Hong Kong	1.2	100
9	2012.8	LINCO Technology Co Ltd	Lingyang Vacuum Tech (Shanghai)	Taiwan	1.1	-
10	2012.8	SE Printing (M) Sdn Bhd	Guangzhou Super Serigraph	Malaysia	0.6	-
11	2012.8	Mitsubishi Materials CMI Corp	Maruzen Instrument Parts	Japan	-	95
12	2012.8	Ad-Sol Nissin Corp	Weavesoft Ltd	Japan	-	-
MEDIA & ENTERTAINMENT						
1	2012.8	Carlyle Group, USA	Focus Media Holding Ltd	United States	3,503.6	-
2	2012.7	Aegis Group PLC	Beijing Catch Stone Ad Co Ltd	United Kingdom	149.0	-
3	2012.7	Aegis Group PLC	Shanghai Catch Stone Culture	United Kingdom	86.3	-
4	2012.8	Intralot International Ltd	Precious Success Holdings Ltd	Greece	35.7	-
5	2012.7	Aegis Group PLC	Pin Zhong Interactive Ad	United Kingdom	3.8	-
6	2012.9	mMAX Communications Pte Ltd	Nanjing Hoperun Digital Co Ltd	Singapore	0.6	-
7	2012.9	Kai Corp	Great Works China	Japan	0.0	-
8	2012.7	Carlyle Asia Partners III LP	Mandarin Hotel Holdings Ltd	South Korea	-	49
9	2012.8	Cheil Worldwide Inc	Bravo Asia	South Korea	-	100
10	2012.8	China Trends Holdings Ltd	Jurassic Intl Invest Grp Inc	Hong Kong	-	-
ENERGY & POWER						
1	2012.9	Morgan Stanley, Olympus Capital	Zhaoheng Hydro Power Ltd	USA	150.0	
2	2012.9	China Ruifeng Galaxy	Hebei Hongsong Wind Power Co	Hong Kong	123.7	-
3	2012.8	Rockwell Automation Asia	Harbin-High Voltage Inverter	Singapore	83.3	-
4	2012.7	Schlumberger Ltd	Anton Oilfield Services Group	United States	81.9	20.099
5	2012.7	Energy Link Investments Ltd	Panva Gas Holdings Ltd	Hong Kong	34.9	-
6	2012.8	Mitsubishi Heavy Industries	Shanghai MHI Turbocharger Co	Japan	7.3	-
7	2012.7	United Envirotech	Shenyang Shenfei	Singapore	2.4	-

2012 Third Quarter Announced Inbound China Mergers and Acquisitions						
	Announce Date	Acquirer	Target	Acquirer Country	Deal Amount (USD mil)	Equity %
		Ltd	Dayen Ltd			
8	2012.8	Stanley Black & Decker Inc	Shanghai Yingaisen-Asts	United States	2.0	-
9	2012.8	UE UMC Pte Ltd	Hengyang City UE Meiya Songmu	Singapore	0.2	10
10	2012.8	Mitsubishi Heavy Industries	Shanghai MHI Turbocharger Co	Japan	-	-
HEALTHCARE						
1	2012.8	Fresenius SE & Co KGaA	Huangshi Lishizhen Medicine	Germany	-	70
2	2012.9	Medtronic Inc	China Kanghui Holdings	United States	719.6	-
3	2012.9	Alliance Boots Gmbh	Nanjing Pharmaceutical Co	Switzerland	88.7	12
4	2012.9	Investor Group	China Animal Healthcare Ltd	Hong Kong	38.8	-
5	2012.9	SK Global Hong Kong Ltd	Xi'an Tianlong Science&Tech Co	Hong Kong	20.6	-
6	2012.8	China Cord Blood Corp	China Stem Cell (South) Co Ltd	Hong Kong	16.8	-
7	2012.7	Daito Pharmaceutical Co Ltd	Anhui Weina Life Science & Tech	Japan	7.0	-
8	2012.8	MEDINET Co Ltd	Beijing BioOne Medical Tech	Japan	-	-
RETAIL						
1	2012.7	Blackstone	Top Young Auto	USA	300.0	54
2	2012.8	Taubman-TCBL Xian (Hong Kong)	Xi'an Wangfujing Bus Op Mgmt	Hong Kong	47.2	-
3	2012.8	KKR & Co LP	Novo Holdco Ltd	United States	30.0	-
4	2012.7	SAIF Partners	Element Fresh	Hong Kong	10.0	0.15
5	2012.7	Share holders	Wanjia Group Holdings Ltd	Hong Kong	-	-

International definition of foreign direct investment

According to the International Monetary Fund's (IMF) definition, Foreign Direct Investment (FDI) refers to an investment by an investor from one country, in the production and business operations located in another country, with the investor holding a certain amount of control over the business operations. In other words, FDI is an investment made by residents or entities (foreign direct investors or parent companies) of one country (region) in enterprises (foreign direct invested enterprises, branch enterprises or overseas branch offices) in another country, where the investors establish long-term relationships with the invested enterprise and hold a permanent interest in and control over the invested enterprise. According to the United Nations Conference on Trade and Development (UNCTAD), Foreign Direct Investment can be categorized into Outward Foreign Direct Investment (Outward FDI) and Inward Foreign Direct Investment (Inward FDI) according to the direction of the relevant cash flow.

According to the UNCTAD's definition, FDIs can be categorized into two types according to the nature of the investment transaction: Greenfield FDIs and Cross-border M&As. Greenfield FDI projects require the establishment of new entities overseas, including offices, buildings and factories. Greenfield FDIs involve capital flow. Cross-border M&As involve taking over or merging with the overseas enterprise's cash, assets and liabilities. In the past few years, Cross-border M&As have been the main driving factor for FDIs, particularly in developed countries and in some developing countries, where the value of many large-scale M&As account for the majority of total FDIs. In practice, it is difficult to distinguish between Greenfield FDIs and Cross-border M&As, and in the long-term, the difference in impact of the two on economic development will become even more indistinguishable.

About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 152 countries and have 145,000 people working in memberfirms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

In 1992, KPMG became the first international accounting network to be granted a joint venture license in Mainland China. It is also the first accounting firm in Mainland China to convert from a joint venture to a special general partnership, as of August 1, 2012. The firm's Hong Kong operations have additionally been established for over 60 years. This early commitment to the China market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in the firm's appointment by some of China's most prestigious companies.

Today, KPMG China has around 9,000 professionals working in 13 offices; Beijing, Shanghai, Shenyang, Nanjing, Hangzhou, Fuzhou, Xiamen, Qingdao, Guangzhou, Shenzhen, Chengdu, Hong Kong SAR and Macau SAR. With a single management structure across all these offices, KPMG China can deploy experienced professionals efficiently and rapidly, wherever our client is located.

About KPMG's Global China Practice (GCP)

KPMG's Global China Practice (GCP) was established in September 2010, to assist Chinese businesses that plan to go global, and multinational companies that aim to enter or expand into the China market. The GCP team in Beijing comprises senior management and staff members responsible for business development, market services, and research and insights on foreign investment issues.

There are currently around fifty China Practices in key investment locations around the world, from Canada to Cambodia and from Poland to Peru. These China Practices comprise locally based Chinese-speakers and other professionals with strong cross-border China investment experience. They are familiar with Chinese and local culture and business practices, allowing them to effectively communicate between member firms' Chinese clients and local businesses and government agencies.

The China Practices also assist investors with China entry and expansion plans, and on both inbound and outbound China investments provide assistance on matters across the investment life cycle, including market entry strategy, location studies, investment holding structuring, tax planning and compliance, supply chain management, M&A advisory and post-deal integration.

Contact us

Yali Peng
Head of Research
Email: yali.peng@kpmg.com
Tel.: +86 10 8508 5828

Robert Ritacca
Research Manager
KPMG Global China Practice
Email: robert.ritacca@kpmg.com
Tel.: +86 10 8508 5109

kpmg.com/cn

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2012 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such gate or bind any member firm. All rights reserved.