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INTERNATIONAL AFFAIRS

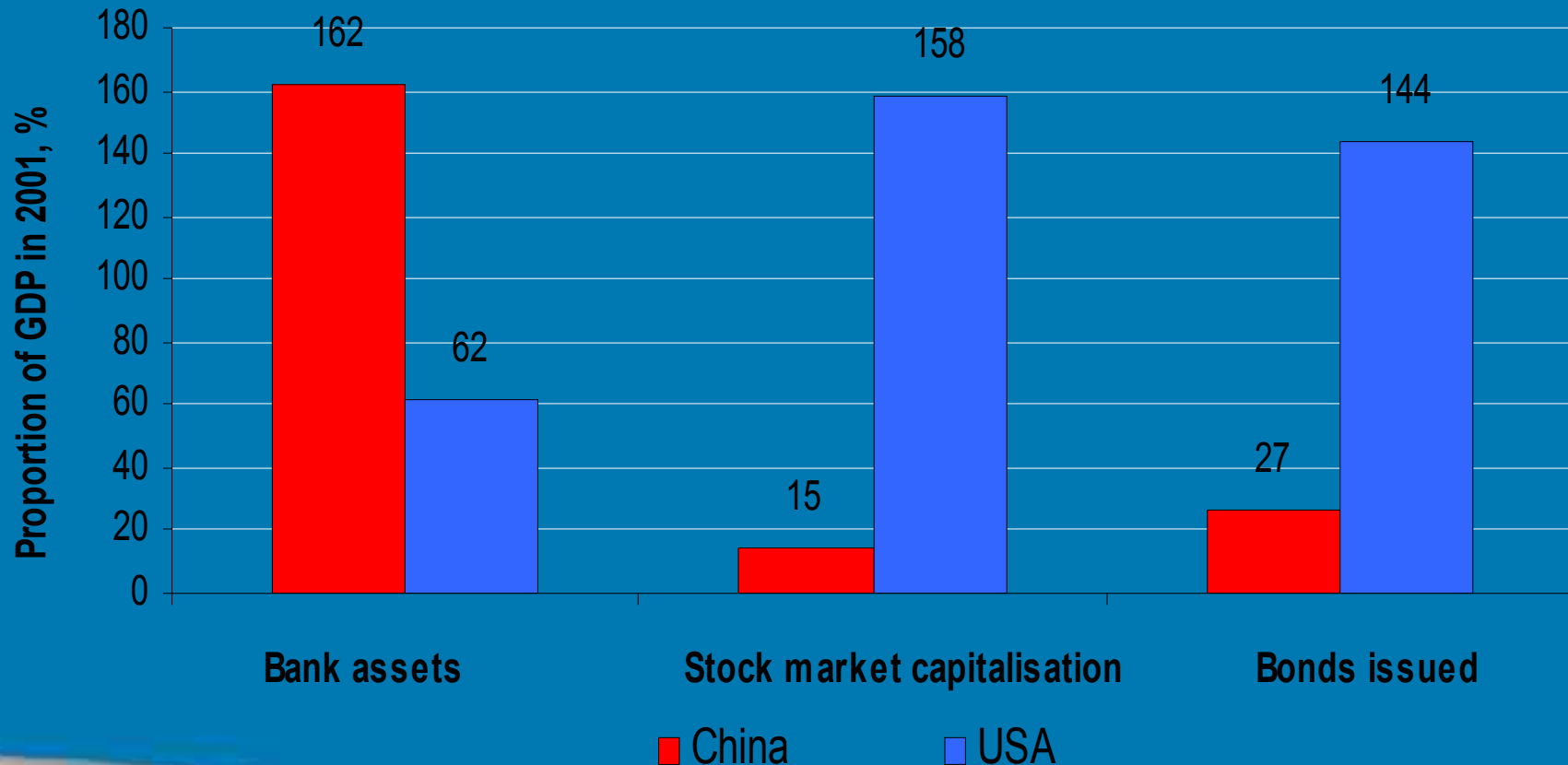
**To privatise is glorious!**

**Stock market development and privatisation in the  
People's Republic of China**

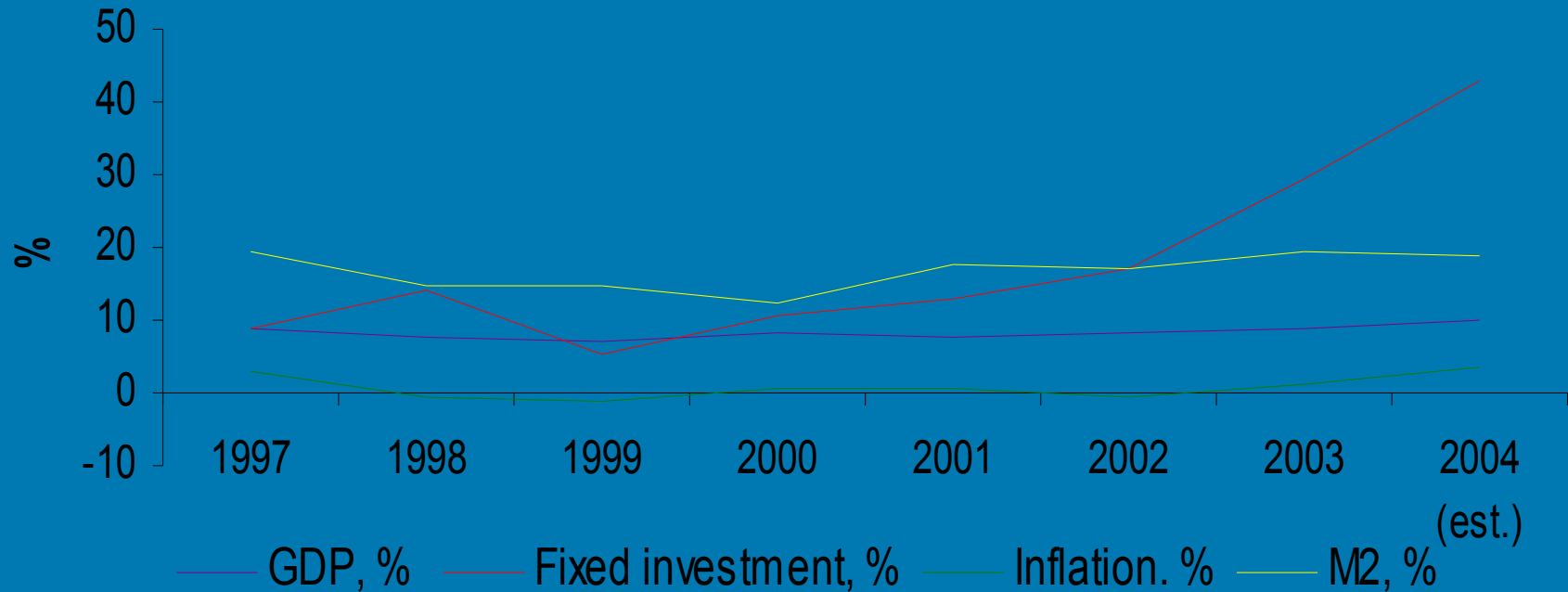
Stephen Green

Head of Asia Programme, Chatham House

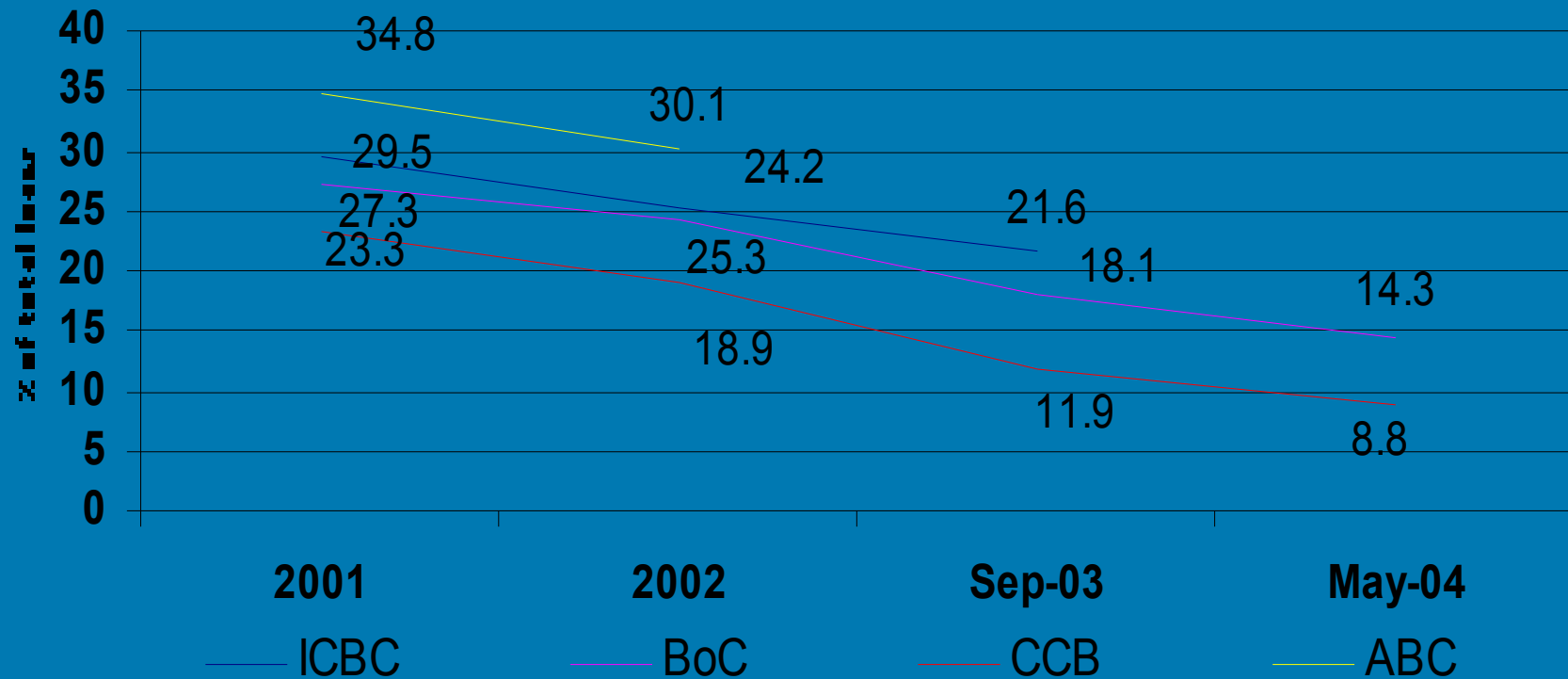
## China's financial sector is bank heavy



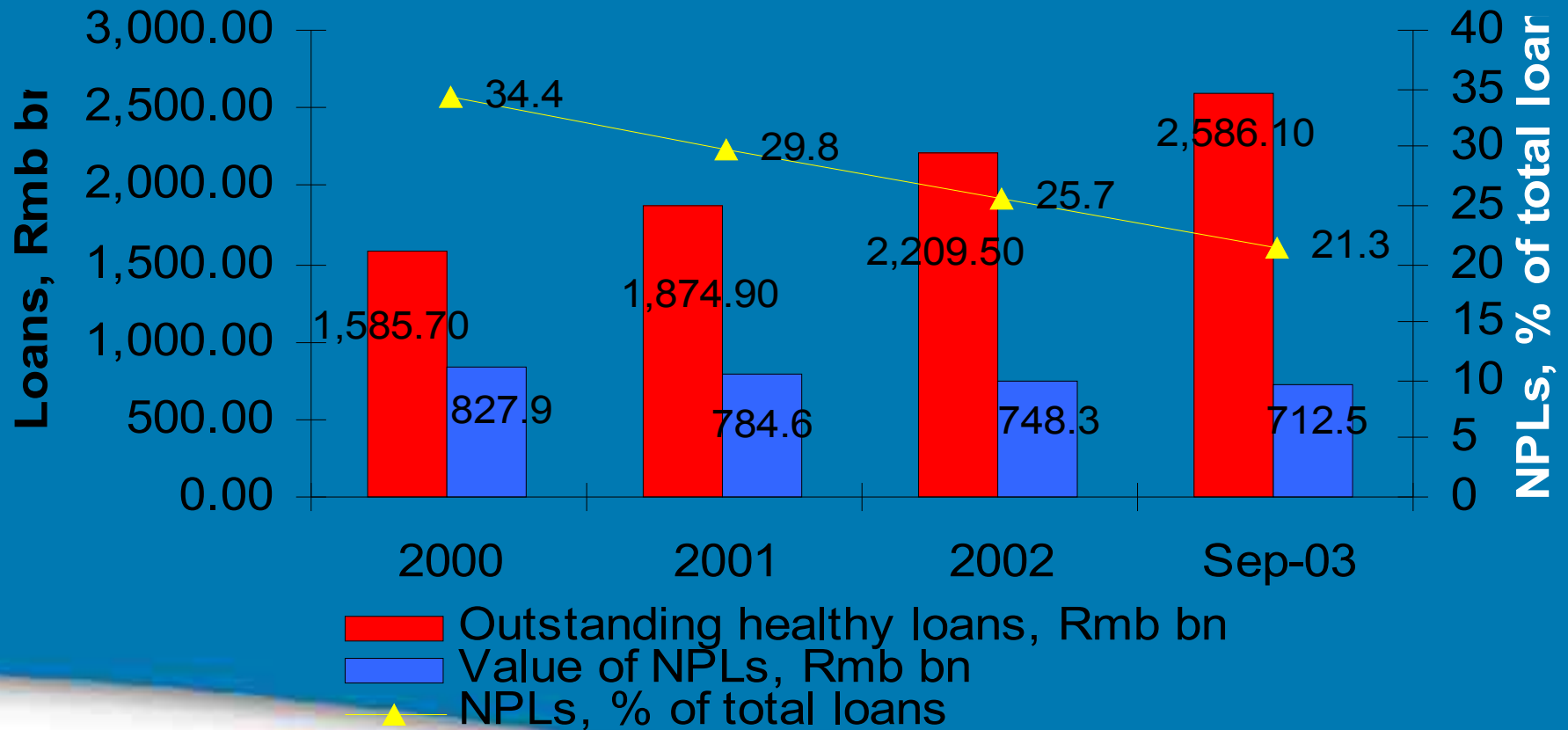
# The macroeconomic environment is creating tougher operating conditions for the banks



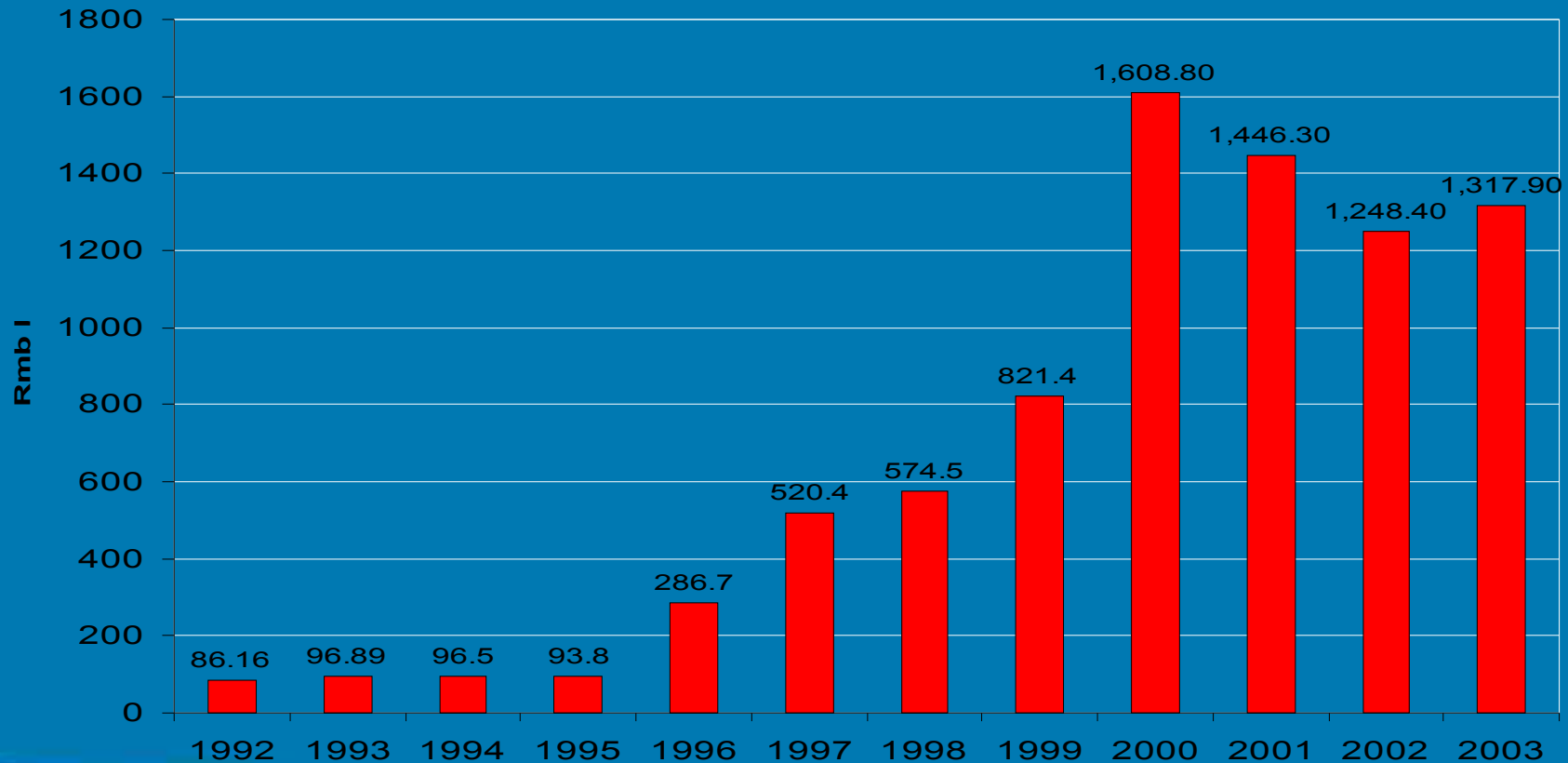
# Non-performing loan ratios are falling



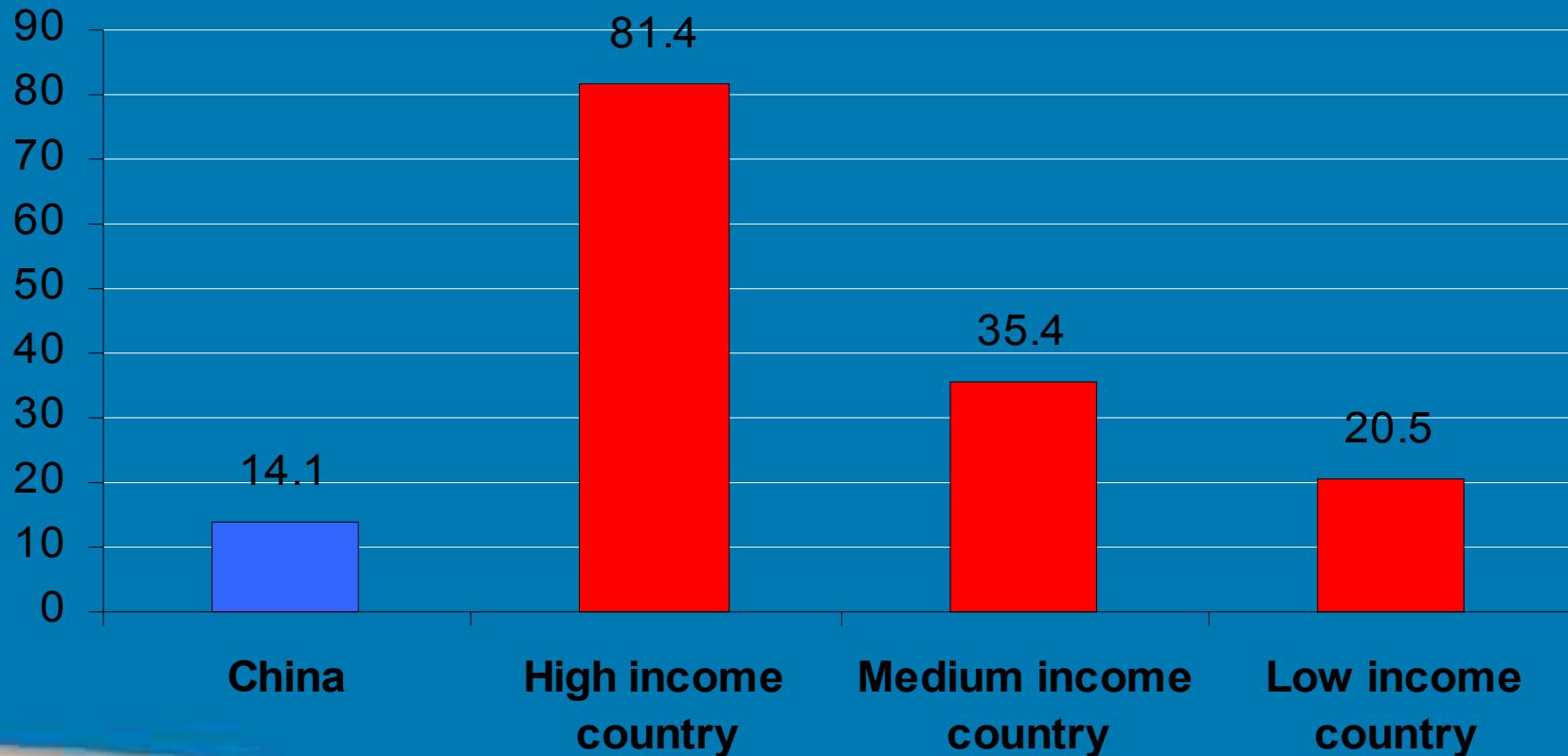
## But mostly because of expanding loans



# The stock market has been going through some tough times



# It is still small, in absolute and relative size



## **So there is a role for the capital market**

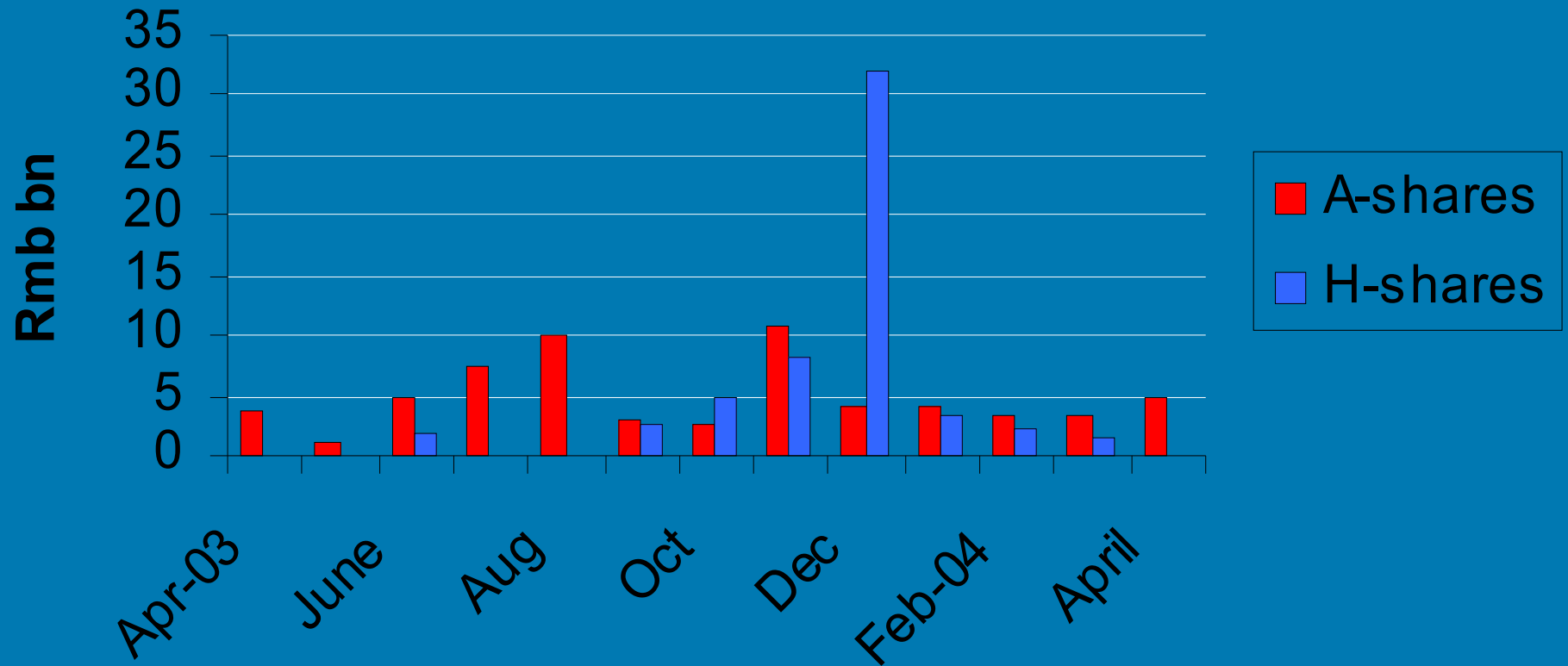
As bank lending slows, and the banks come under pressure to cope with additional NPLs, attention will turn to the capital market.

Key issues for 2004-05 include:

- What types of firms are being sent to list? How are they restructured and who chooses them?
- The privatisation of listed firms through reverse take-overs: new firms?
- Foreign buy-outs of non-tradable equity: How problematic?
- Selling off state shares: Could it happen? How would it affect prices?
- The privatisation story: is the central government a keen privatiser? What are local governments selling? How will sales take place?



# A-share and H-share issuance, April 2003-April 2004

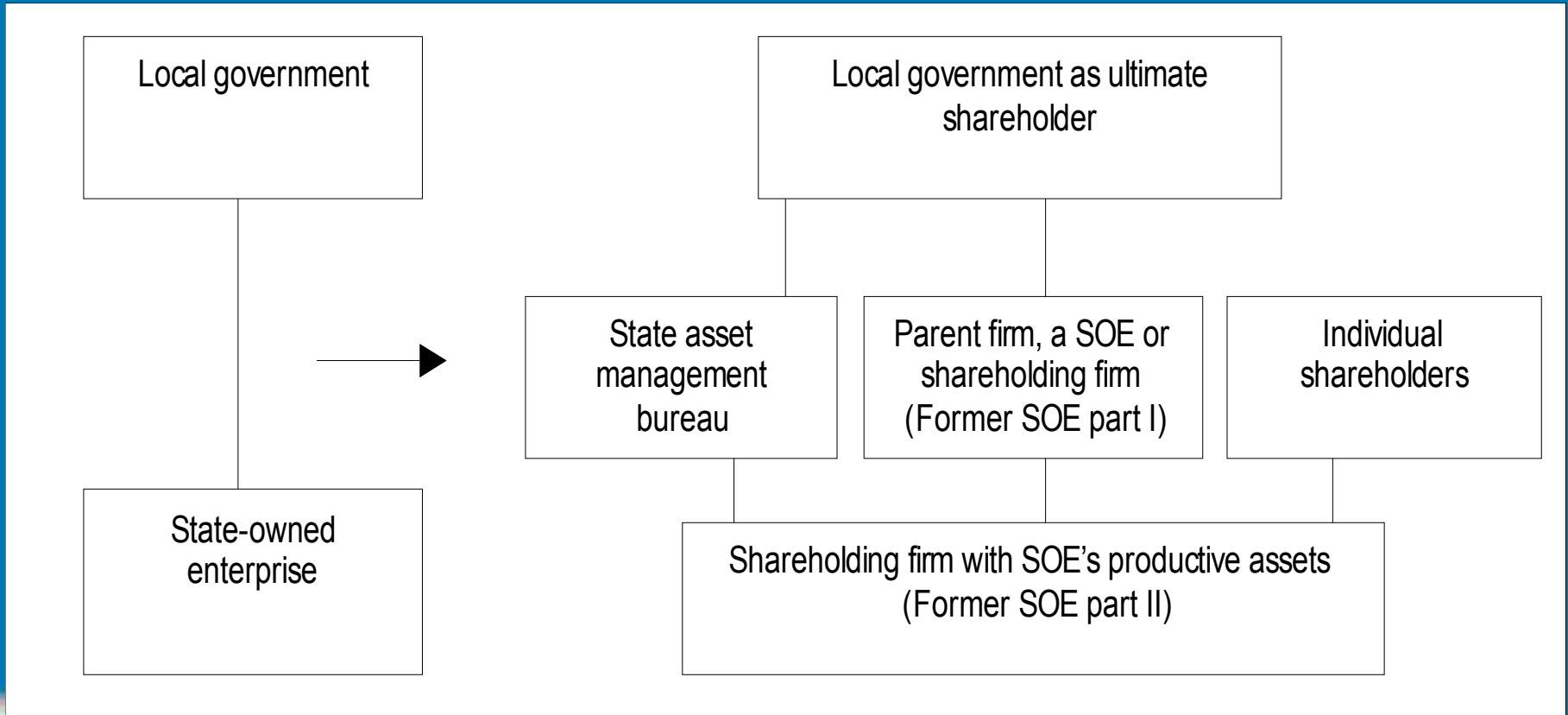


# Planned Overseas Chinese IPOs, as of May 2004

	<i>Proposed IPO size, \$</i>
China Construction Bank	5-10 billion
Ping An Insurance	2 billion
China Shipping Container Lines	2 billion
China Netcom	1.5-3 billion
Shenhua Group	1.5 billion
Minsheng Bank	1 billion
Dongfeng Motor Corp	1 billion
Sinotrans Group	500-600 million
Air China	500 million
China Power	500 million
Shenzhen Energy	500 million
Tangshan Guofeng Steel Co Ltd	500 million
Grandtour Tyres	400 million
Shanda Interactive Entertainment	259.8 million
Tencent Technology	250 million
Mengniu Dairy	200 million
Chint Group Corp	128 million
CSMC Technologies Corp	100 million
Mtone Wireless Corp	55 million



# How an SOE restructures and lists



# The approval process for listing is improving, but is still problematic

- In December 2003, the CSRC's listing approval process was reformed: 25-person committee made up of a broader range of people. Names of the seven person panels that decide on issuance applications to be made public and their decisions will also be open to public scrutiny. However:
- Enterprises that have passed the basic issuance requirements, including the need to have a 10% return on assets for three consecutive years, are all submitted to the CSRC's committee. Those firms that the committee chooses join the line for firms waiting to make an IPO.
- Profit criterion is backward looking
- Once the basic criterion has been met, the better firms have to wait.
- Administrative influence affects the ordering of the queue.

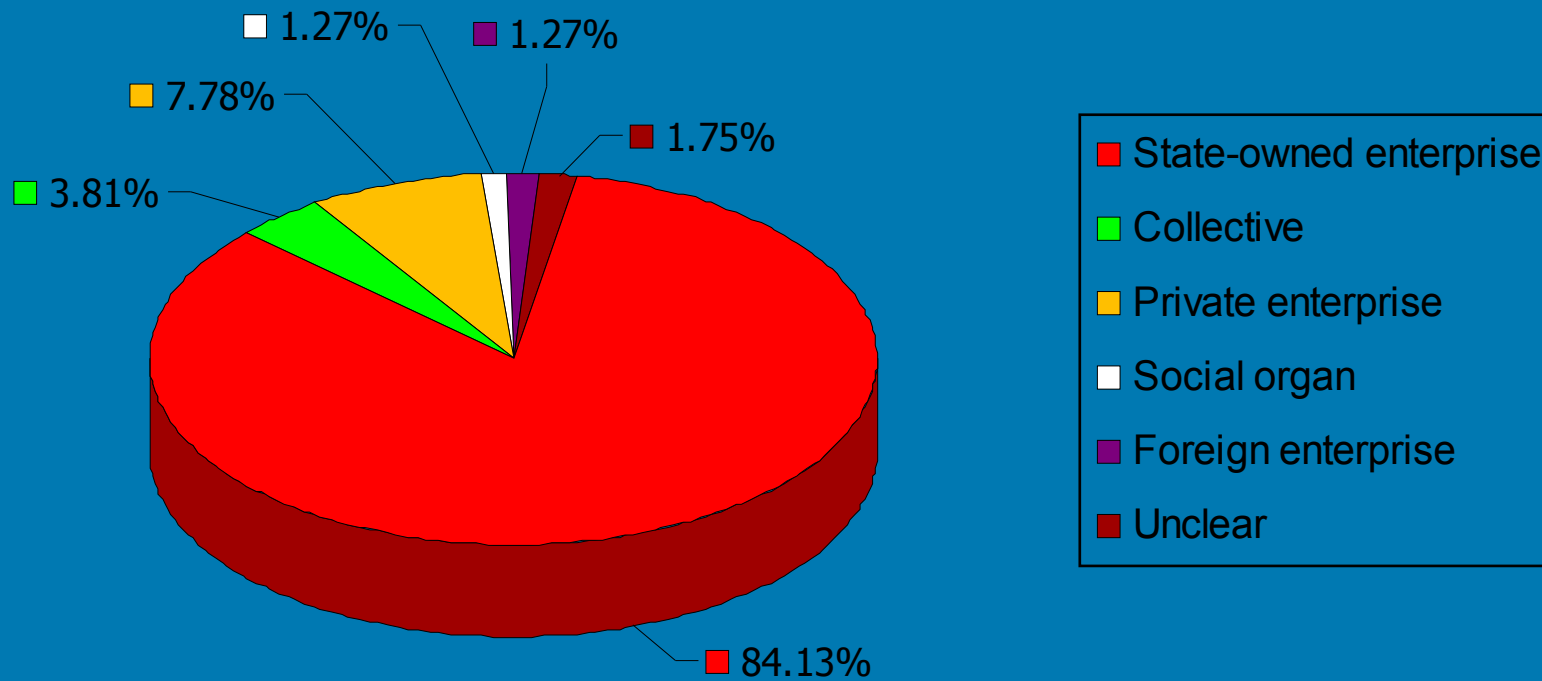


# Changes in control at listed companies, 1993 - 3Q 2003

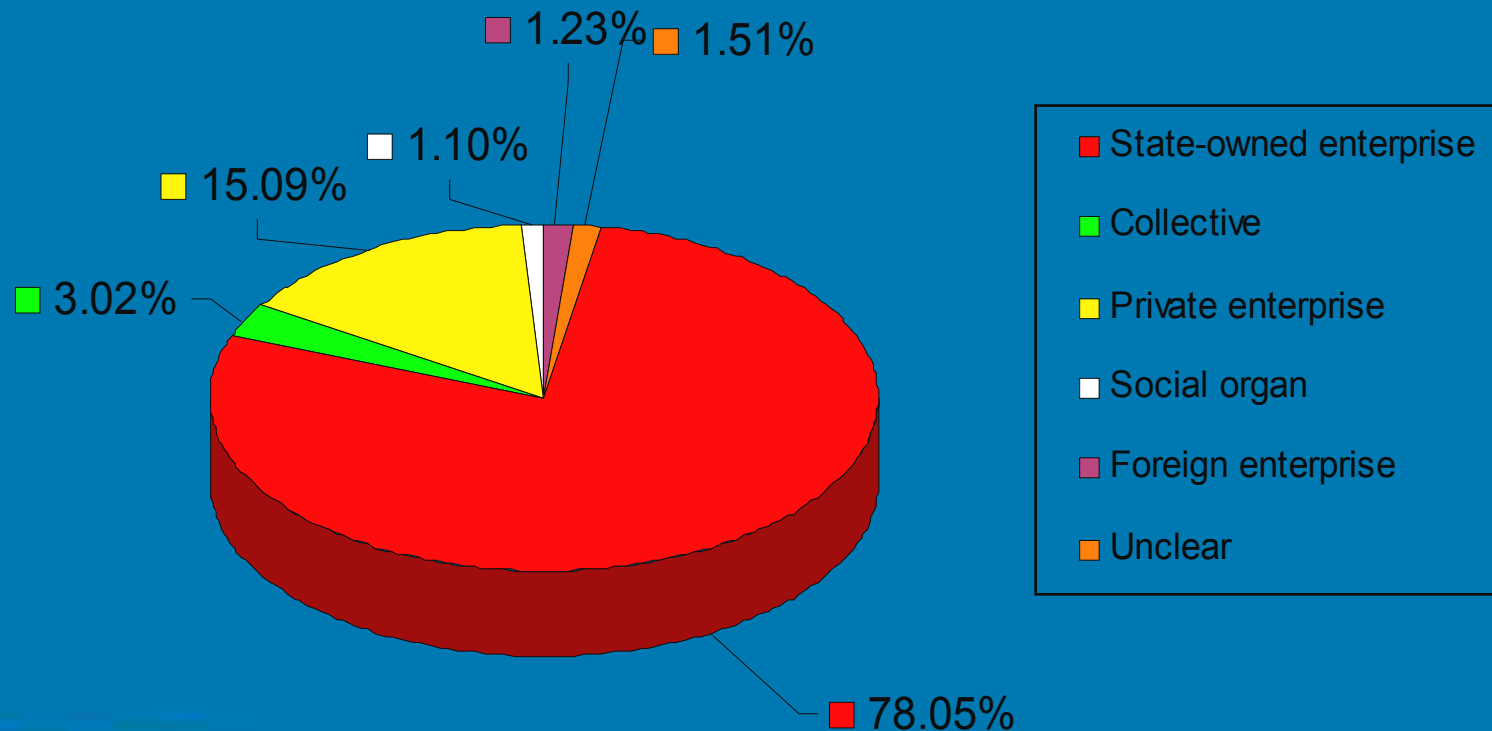
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 Q3
Number of changes in controlling shareholders at listed firms	1	2	1	9	33	71	67	110	130	180*	100
Number of listed companies at year end	183	291	323	530	745	851	949	1,088	1,160	1,224	1,287
Proportion of listed companies undergoing change in control, %	0.5	0.7	0.3	1.7	4.4	8.3	7.1	10.1	11.2	14.7	-



# Control of listed companies at the Shanghai Stock Exchange, 2001



# Control of listed companies at the Shanghai Stock Exchange, 2002



# Shanghai Yongjiu/Shanghai Forever: A re-invented company

- Famous state bike firm which listed and then fell into hard times after 1995.
- Shanghai Zhonglu Group 143.6m state shares in Yongjiu from Shanghai Light Industry Group for Rmb34.1m (\$4.1m) in September 2002, a 54.1% stake.
- Purchase was primarily motivated by Zhonglu's interest in the Yongjiu brand name, an intangible asset whose value was not included in the official valuation.
- Buyer assumed responsibility for all the firm's bank debts and employees.
- Zhonglu downsized Yongjiu's staff (with considerable difficulty), re-trained a core group of workers, introduced new bike models, began manufacturing for Raleigh, and started producing gas-powered mopeds.
- Firm is profitable and has paid off almost all of its old debts.



# Foreign investors and legal person and state shares

- A CSRC notice in 2001 over-turned a ban in 1995 on foreign purchases of non-tradable shares. A number of deals have since taken place:
- **Newbridge and Shenzhen Development Bank.** Newbridge, a private equity firm based in San Francisco, agreed to buy 20% of SDB from the Shenzhen government, a controlling stake for an estimated \$150m in May 2004. The deal collapsed in 2001 and was spectacularly revived in 2003.
- **China Resources and Sichuan Jinhua.** China Resources Light Industries and Textiles, a Hong Kong firm, bought control of Sichuan Jinhua, a textile firm listed in Shenzhen, from its main shareholder, Suining Xingye, in July 2003. Rmb163.5m (\$19.7m) was paid for 66.1m LP shares, 51% of the listed company's total share capital.
- **Jiatong Tyre and ST Hualin.** On July 13<sup>th</sup> 2003, Jiatong Tire Group (Grandtour Tires) from Singapore acquired 151.1m LP shares, a



## Foreign investors and legal person and state shares (2)

- **Samsung and SEG.** South Korea's Samsung Group hopes to gain a majority stake in SEG Samsung, a Shenzhen-listed firm, as a result of two LP share deals. As of early 2004, the deal was stuck waiting for approval.
- **Kodak and Lucky Film.** On October 29<sup>th</sup> 2003, Kodak and China Lucky Film Group signed a deal in which Kodak paid \$45m, extensive technological assistance and shares for a 20% legal person share stake in Lucky Film, the group's listed subsidiary.
- **Scottish & Newcastle and Chongqing Brewery.** In December 2003, Scottish & Newcastle agreed to acquire 50m state shares in Chongqing Brewery from its parent Chongqing Beer Group for Rmb10.5 a share, a premium to the listed firm's shares' NAV in September 2003 of Rmb2.50.
- **Anheuser-Busch and Harbin Brewery.** After an intense competition with SABMiller (which bought a 29% legal person share stake in HB in 2002), AB bought both SABM's shares and those still held by Harbin city government for a stake of 70%. The price, HK\$5bn, valued the



# Foreign investors and legal person and state shares (3)

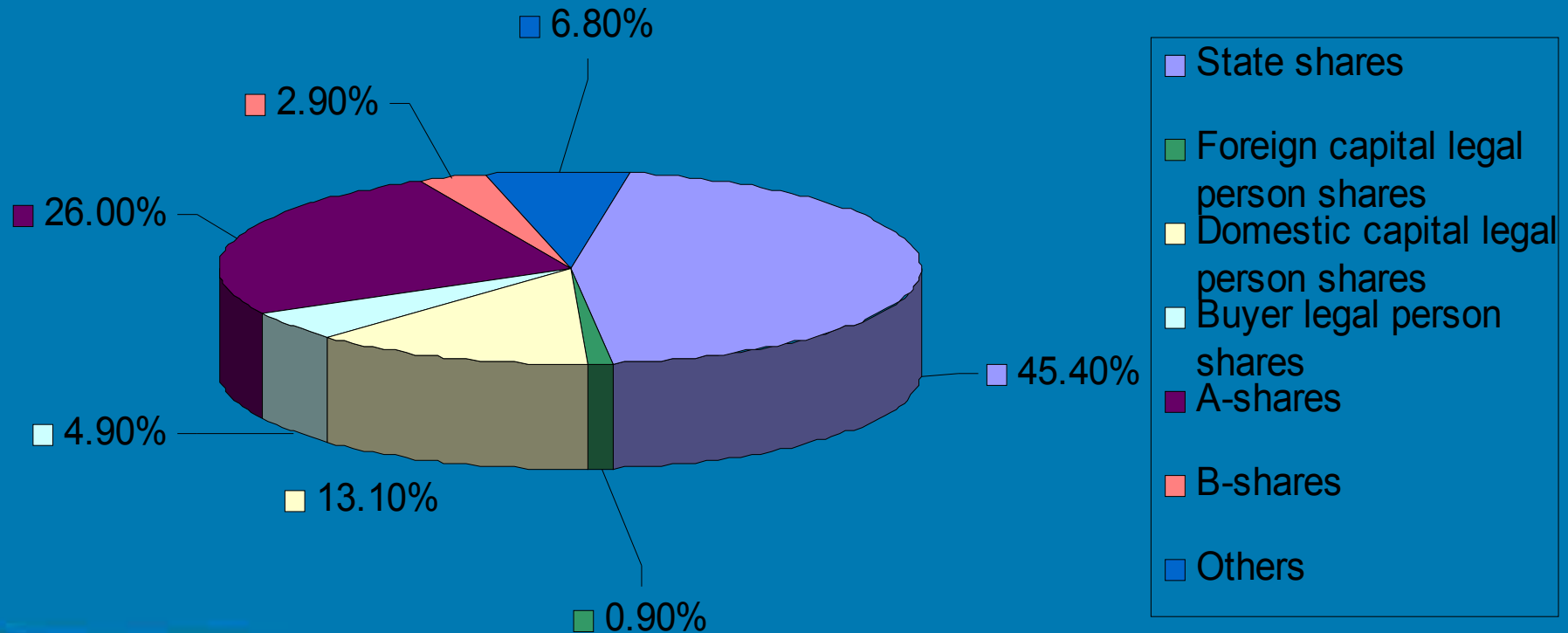
Problems faced by foreign investors in buying these shares:

- How to price the deals is controversial since there are worries that such deals could result in losses of state assets. There has been some public discontent at some sales.
- Sellers can want to restrict the ability of new owners/buyers to re-negotiate contracts with suppliers/customers.
- New buyer needs to take on old bank debts and responsibility for workers, something foreign firms are much less willing to do than some domestic investors.
- Regulation is still fairly unclear over issues such as whether or not permission will be given: the process is subject to corruption.



# The state share issue

Proportion of total equity capital, 2002, %



# **Selling off the state shares: a pretty good idea which does not have to send prices down**

- The State Council's 'Nine Article on the Development of China's Capital Market', released in February 2004 signalled the commitment of the senior leadership to tackle the state-share issue.
- As of April 2004, senior CSRC officials were reported to be backing a sell-off scheme in which each listed company and its advisor proposed their own method and timetable. Both tradable and non-tradable shareholders would then vote on the sale scheme separately, a double-majority meaning a formal application can then be lodged with CSRC and SASAC.



## **Selling off the state shares: a pretty good idea which does not have to send prices down (2)**

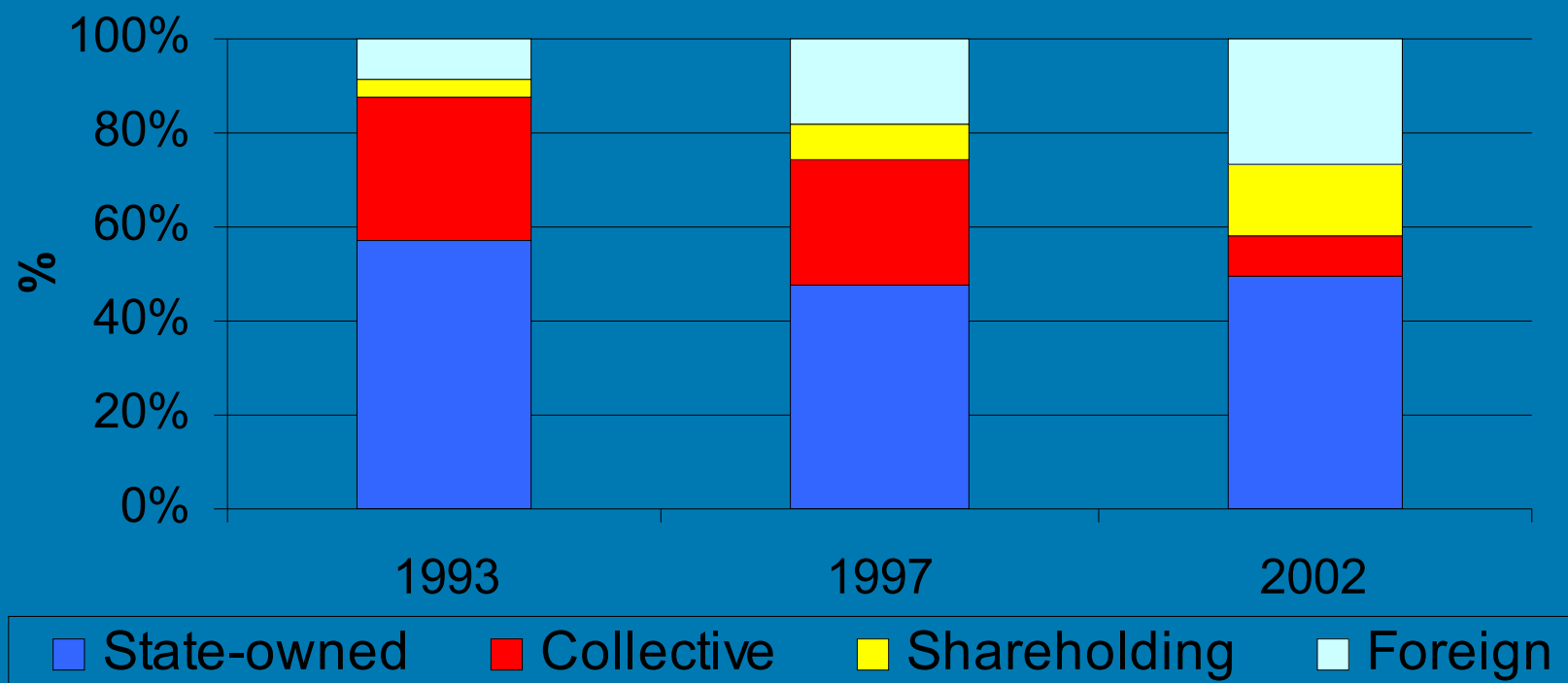
There are several reasons why a state share sell off does not have to hit

prices:

- Deals will be organised on a one-by-one basis by the firms themselves, their shareholders, as well as by local officials. This self-selection will bolster shareholder confidence.
- The CSRC will allow profitable firms to go forward first, aiming to encourage investor confidence.
- Allowing the market to set the price with the NAV used as a floor.
- The CSRC understands the importance of timing the liquidation and conversion – a few companies will be authorised at a time.



# Privatising China: Industrial value-added by ownership types, 1993-2002



# The State-owned Assets Supervision and Administration Commission (SASAC)

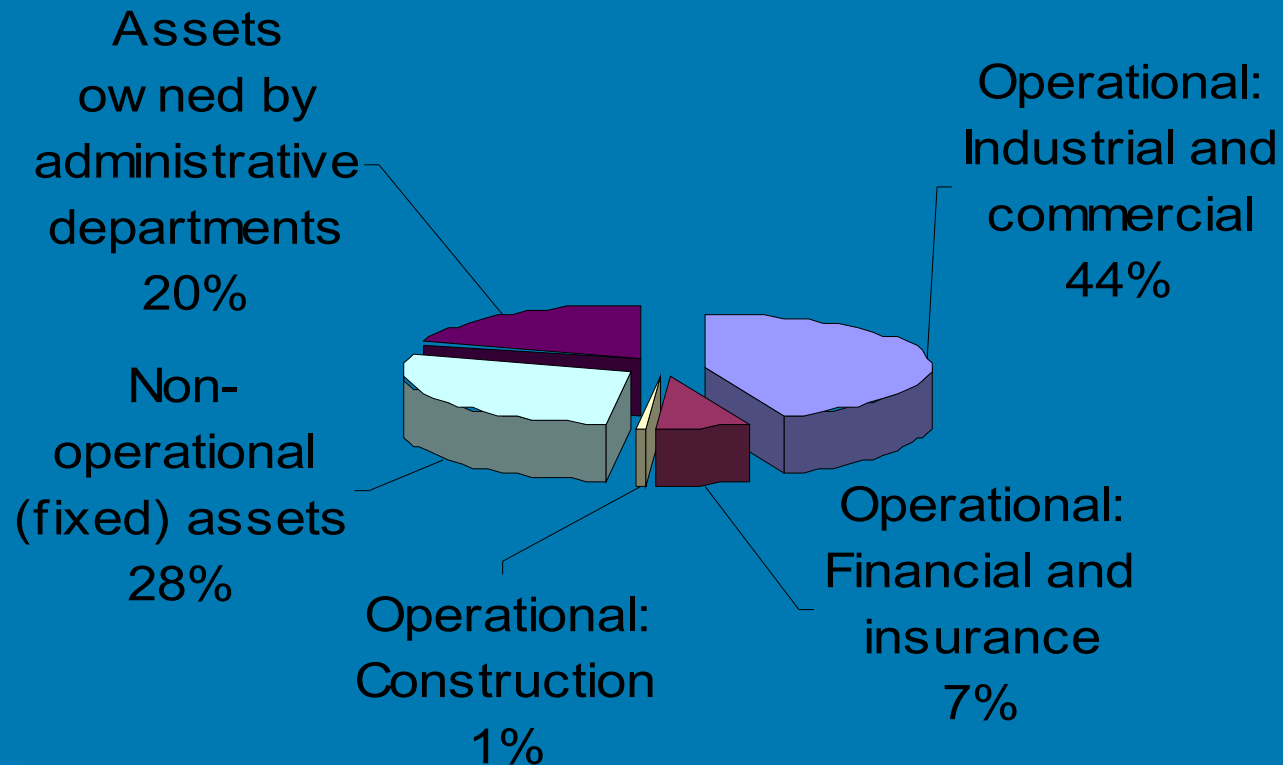
In March 2003, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) was established.

- Given charge of 191 large enterprise groups (initially 196) and has been mandated to improve their performance.
- Of the biggest 500 Chinese companies in 2003, 368 (74%) were state-owned or state controlled.
- At year end of 2002, the Chinese state was officially in control of Rmb14.8trn (\$1.3trn) worth of assets.
- The 196 enterprise groups owned by SASAC owned some Rmb6.9trn (\$833bn) worth of assets, 58% of the state's enterprises' (operational and fixed) assets.



# The PRC state's assets, year end 2002

## Total value: Rmb14.8trn (\$1.8trn)



## Will the SASAC block or facilitate privatisation?

Official mandate: to increase the value of the assets under its control.

However, there are also signs that it wants to forward with some sales.

- Discussions about entire groups transforming into shareholding companies and listing.
- Little opposition to some subsidiaries listing shares.
- Official policy is also to close those SOEs which are 'no longer competitive', although how and which government organ makes this decision is unclear.
- Li Rongrong is also on record as wanting the market decide the price of state assets.
- Rigorous debate across government departments and within the senior leadership over the extent to which privatisation is possible.



## Privatising China: Shenzhen's 2002-03 revolutionary sale

<i>Firm for sale</i>	<i>Proportion of firm approved for sale, %</i>	<i>Deal details</i>
Shenzhen Energy Group	25	Huaneng Power International (Hong Kong) beat 16 competitors to win the deal for Rmb2.39bn (\$290m) on January 28 <sup>th</sup> 2003
Shenzhen Water Group	45	Veolia Water acquired the stake in Shenzhen Water.
Shenzhen Gas Group	24, later increased to 40	Hong Kong & China Gas purchased 30% and New Hope Group acquired 10% for a total of Rmb905m (\$109m).
Shenzhen Public Transportation Group	45	Kowloon Motor Bus Holdings reached an agreement in principle to buy a 35% stake for Rmb498m (\$60m) on September 29 <sup>th</sup> 2003
Shenzhen Food Group	70	Ng Fung Hong paid some Rmb380m (\$46m) on September 30 <sup>th</sup> 2003



# Privatising China: Property Rights Transaction Centres: a new platform for privatisation?

- October 2003: the third plenum meeting of the 16<sup>th</sup> Communist Party Congress called for the 'regulated development of [China's] property rights market'. In early 2004, the SASAC made clear what that meant by ruling that all sale of state assets must now be hosted by a PTRC.
- Entire firms, large chunks of equity in a firm, or major assets are 'listed' until they are purchased, or until the offer period ends and they are withdrawn. Generally only host the sale of local assets.
- Time elapses to allow competing bids to be made. If several bids are made, then the centre may organise a formal auction between the parties.
- Some are managed by local Economic and Trade Commission  
• Others are managed by restructured local SASAC offices



## **Property Rights Transaction Centres: a new platform for privatisation (2)**

- Reasons to be excited about the emergence of the PRTCs.
- Stock exchanges, despite the establishment of the new Shenzhen board, are limited in the number of companies they can bring to the public. Only 83 companies made A-shares initial offerings 2003.
- The PRTCs should also improve the quality of the privatisation that is already going on. Open and competitive auctions are one of the best ways to sell state assets, much better than the one-to-one direct deals that are so common currently. Foreign members appear to enjoy national treatment.
- The PRTCs could well also increase the numbers of assets coming to market. By collating information about buyers and sellers, they reduce some of the market's frictions.

