

Economy

China: China's economy recorded growth of 10.7% in 2006, the quickest annual pace since 1995, and exceeded economists' forecast. In 2007, China's economy is expected to maintain fast growth. Investment and manufacturing activities continue to rise, however, the risk of inflation remains and the People's Bank of China will remain vigilant for signs of overheating. The 2.8% increase in the consumer-price index in December was much faster than analysts' forecasts of 1.9%, though some argue that the biggest contributor was the rise in grain price that is driven by the global commodity market.

Hong Kong: The overall GDP growth was 6.8% last year, with a better-than-expected fourth quarter growth of 7%. This was due to benefits from strong domestic consumption and a booming stock market. A fiscal surplus of HK\$55.1B (\$7.1B) allows the government to fund a series of tax cuts aimed at low and middle income earners. In its annual budget, the government expects GDP to expand by 4.5-5.5% in 2007. The government also forecasts that the consumer price index will rise by 1.5% in 2007, compared with a 2% rise last year.

Taiwan: The economy grew 4.02% in the fourth quarter from a year earlier. The lower pace of expansion in 4Q was a result of slumping exports. However, strong domestic demand offset some weakness and the government expects private consumption and private-sector investment to continue growing at a healthy clip.

South Korea: According to the Bank of Korea, the GDP growth rate was 5.0% in 2006, coming off a slower-than-expected 0.8% in the fourth quarter. GDP is predicted to grow to 4.4% in 2007 and was undermined in 4Q'06 by a fall in exports and a government crackdown on home loans. The Bank of Korea predicted that Korea's per capita GNP would be \$20,000, up from \$7,355 in 1998, as the value of won has risen fast against dollar.

India: India's economy is expected to post a growth rate of 9.2% for the fiscal year ending March 2007, over the same period last year. The growth rate is in line with the average growth of 8-9% for the past three years. Sustained momentum is expected through 2007 due to an impressive 10.8% year-on-year growth in industrial output. The inflation rate climbed to 6.6% due to supply side constraints. In view of a 30% surge in the loan growth, the Reserve Bank of India (The central bank in India) has raised the cash reserve ratio by 100 basis points to 6% in the past three months. The central bank also raised its key lending rate last week to 7.5%, a four-year high, following four increases in 2006 to cool inflation and rapid credit growth spurred by demand for houses, cars and consumer goods. The call money rate has declined from 8.35% to 6.59% at the end of February 2007. India's union budget for 2007-08, presented on February 28th, had a focus on education and healthcare reforms. The funds for these two items have been raised by 34% and 22% respectively, whereas defense spending has grown by only 7.8%

Japan: The economy continued expansion in 4Q 2006, capping off eight consecutive quarters of positive growth with a 4.8% expansion in GDP. The growth was higher than market expectation mainly because of a rebound in consumer spending which had been weak in the previous quarter due to poor weather and high gasoline prices during the summer months. On February 21, the Bank of Japan raised its target overnight rate by 25bp to 0.50%. Its rate action was the first time since last July when it raised the interest rate and ended their "zero interest rate policy." The central bank expects that the economy will continue moderate expansion in 2007. Nevertheless, because of the uncertainty in the global economy and the national election of the upper House this July, the Bank's next action is not expected until after the election.



Markets

China: On February 27th, the Shanghai Stock Exchange Composite Index unexpectedly dropped 8.84%, the largest one-day decline in 10 years. The stock market turmoil then spread from Wall Street to Europe and other bourses in Asia. Prior to the correction, China's stock market posted record highs by the end of 2006. The Shanghai Composite Hushen 300 Index was up 122% in 2006, the highest growth of any stock market in the world and the combined market capitalization of Shanghai and the Shenzhen Exchange totaled \$815 billion at year end, nearly half China's GDP in 2006. Shares traded on mainland Chinese exchanges cost twice as much relative to earnings as they did 18 months ago while listing companies raised a record-high of \$27.56 billion.

Hong Kong: The Hong Kong market also embraced a bull run as total market capitalization hit an all-time high of \$1638.9 billion. The Hang Seng Index reached a record closing high around 20,820 just prior to the Shanghai induced sell-off on Feb 27th, albeit much smaller at 1.8%, followed by 3.8% the following day. The Hong Kong dollar reached new highs towards the close of 2006, breaching HK\$7.81/US\$.

South Korea: The KOSPI was 1,417.34 as of February 27th, dropping from 1,454.60 in one the day due to fears ignited by the Shanghai market sell-off. The KOSPI has traded sideways since due mainly to slower anticipated growth in the U.S. economy and fluctuations in foreign exchange rates and. The won-dollar exchange rate remains in the 920 to 960 range, indicating the Korean Won remains strong against the U.S. Dollar. Additionally, talks between North Korea and the U.S. are fuelling optimism that nuclear talks might lead to a new era of peace.

India: The boom in the Indian stock markets took the BSE sensx beyond the 14,500 mark in February 2007. However, the combined effect of an 8.8% slide in Shanghai markets and a disappointing union budget from the corporate perspective, led to a 2,000 point

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IPO/M&A

India: Tata Steel won a dramatic takeover battle last week to buy Anglo-Dutch steel maker Corus for \$12.2 billion while India's largest aluminum producer, Hindalco announced an acquisition of Novelis, for US\$3.4B. The price includes Novelis' debt of \$2.4B. In other news, Boeing signed a MoU with Larsen & Toubro Ltd while Northrop Grumman signed one with Dynamatic Technologies, indicating future partnerships and joint ventures in India among these aerospace competitors. British Telecom's Vodafone, has agreed to acquire a 67% controlling interest in Hutch Essar from Hutchison Telecom International for \$11.1B. Hutch Essar is the fourth largest telecom operator in India with 23M customers and 16.4% market share. Japanese car maker Suzuki Motor will invest \$1.66B in its Indian venture for capacity expansion and Deutsche Bourse AG signed an agreement to buy 5% of Bombay Stock Exchange for \$854M. Earlier, Goldman Sachs and NYSE bought a 5% stake each in the National Stock Exchange of India.

Japan: On February 15, a U.S. activist fund, Steel Partners, proposed to increase its stake in Sapporo Holdings, Japan's third-largest beer brewer, from 17.5% to 66.6% at an offer of ¥825 per share; a 4.3% premium. In January, the fund urged Sapporo's management to abandon the poison pill provisions adopted last year which offers shareholders less than 20% of voting rights and a chance to buy additional shares for ¥1 each. There has been speculation that Asahi Breweries, Japan's largest brewer, will make an offer to seek a tie-up. Steel Partners has launched four hostile takeover bids for Japanese companies since it opened a Tokyo office in 2002. Sapporo's sales and operating profit declined 4.1% and 16.4% respectively and with a 139 P/E ratio, much higher than the industry average. Part of the high valuation was due to Sapporo's large real estate operations. In response, a survey showed that 196 Japanese companies have introduced anti-takeover defense schemes. This is about 5% of all Japanese firms listed on stock exchanges.

China: As mentioned in our prior issue, China heads the list of big IPOs in 2006 with three of the largest, including a \$20B IPO for ICBC in Oct, \$11B for Bank of China Ltd in May, and \$2.3B for China Communications Construction Co Ltd (CCCC) in Dec. Stock trading for CCCC commenced on the HK Exchange on Dec. 15, 2006 with a total of 3.5B H-shares offered at HK\$4.60/share. Not to be outdone, other Chinese companies whose shares are listed in foreign markets began issuing shares on the booming A-share market in Shanghai. Datang International Power Generation Co, the third-largest Chinese electricity producer listed in Hong Kong, raised as much as 3.34B yuan (US\$427M) in a Shanghai IPO to raise funds for plants. VC/PE backed companies are providing decent exit returns for venture investors by listing in overseas markets such as the NASDAQ. Home Inns & Hotels Management is in the midst of a building boom, leasing properties and adding franchises in rapidly growing cities across China, netted \$72.8M in an Oct IPO.

Hot Topic

While red tape, foreign ownership restrictions, and other barriers have made foreign investments in India difficult, foreign private equity investments have exploded in the past few years. Foreign private equity investments in India doubled to \$2.26 billion in 2005 and more than tripled in 2006 to \$7.46 billion. Two of the largest investment deals in 2006 were KKR's acquisition of Indian software business Flextronics International Ltd. in September for about \$900 million and Providence Equity Partners taking a 16% stake in Idea Cellular, an Indian wireless company, for about \$400 million. Aside from U.S. private equity, other foreign private capital is making its way into India. Singapore's government owned Temasek Holdings acquired an almost 10% stake in Tata Teleservices for about \$300 million, and represents the first time the \$22 billion Tata Group as brought in a private equity investor.

Forecasts show that private equity investments in India could reach as much as \$10 billion in 2007. In fact, Warburg Pincus sold most

of its 18% stake in Bharti Airtel in 2005, locking in a return on their initial investment of six times, signaling to the market that highly profitable exits are attainable in India. Hong Kong's Baring Private Equity followed in 2006, selling its initial investment of Mphasis, a Bangalore back office services company, at 14 times.

Not only are exit multiples attracting further private capital, but so too are the broadening array of investment options. At first, foreign private equity chased India's boom in IT and outsourcing expertise. Now there is investment opportunity in everything from financials to pharmaceuticals. Other opportunities amid rising corporate profits of 20-30% for publicly listed companies will attract potential private-investment in public-equity (PIPE) transactions as seen in other markets. Whatever direction private equity growth takes in India, the near future is rosy for Indian companies seeking foreign private equity.

Questions? Contact Harold "Tray" Spilker: hspilker@umd.edu

Upcoming Event - April 6th, 2007, 9:00-12:30pm

Smith China Business Forum:
Private Equity and Investment in China

Information and registration:
www.rhsmith.umd.edu/chinabusinessforum

Markets

M2

India (cont.): drop in a two week period that brought the BSE sensx down to 12,150, a drop of nearly 14%. The continuing slide of the Indian stock market has shaken investor confidence and has raised doubts about the solidity of the current market situation. Infrastructure has been one of the major obstacles for India in surpassing China's economic rate of growth. Infrastructure Development Finance Company Limited, Citigroup Inc., India Infrastructure Finance Company Limited, and Blackstone Group Holdings L.P., announced the launch of "The India Infrastructure Financing Initiative", a collaborative effort to deploy approximately US \$5 billion in capital for infrastructure projects in India. The plan is to deploy about US\$2 billion in equity capital and US\$3 billion in long term debt financing with maturities exceeding ten years.

Japan: After news of strong GDP growth in 4Q and the central bank's action, Japan's stock market picked up momentum with the Nikkei 225 Index topping 18,000 in February for the first time since May 2000. The broader index, TOPIX, also reached 1,800 points for the first time in 15 years. However, the global stock decline on February 27th did not miss the Japanese markets, precipitating a 1,000 point fall in the Nikkei 225 Index in one week. The Japanese yen, on the other hand, declined against the dollar from ¥119 to ¥121 after the interest rate raise. Nevertheless, the yen rebounded strongly to ¥116/\$ after the market decline as a result of the oft mentioned unwinding of the carry trade.