Ma takes Manhattan

Jack Ma’s Alibaba makes its debut—at last—in a gigantic New York IPO
What do Midland Railway and IBM have in common? The answer is they were the largest companies by market capitalisation in the UK and the US when each country reached the apex of its economic dominance in 1914 and 1967 respectively.

Both firms were emblematic of their era. Midland Railway was the biggest coal hauler in the country that had ushered in the industrial revolution. IBM was the leading hardware manufacturer at the dawn of the computer age when American consumers were the envy of the world.

But the two examples also highlight how fleeting global hegemony can be.

Few now remember the railway firm, which lost its independence after the First World War thanks to the Railways Act. IBM may still be a colossus, but it no longer ranks in the top 20 global companies in market cap terms.

In fact, when the New York Stock Exchange opens later today, IBM is also likely to be eclipsed by Alibaba, the company now best symbolising China’s ascendancy on the world stage. The e-commerce giant priced its IPO in New York last night at $68 per share to the thunderous applause of global investors.

How gigantic is the deal?
Should the greenshoe be exercised, Alibaba’s flotation will raise $25 billion and rank as the world’s largest, beating Agricultural Bank of China’s $22.1 billion debut in 2010. When founder Jack Ma rings the opening bell, Alibaba’s market cap will be $177.5 billion, similar in size to Samsung Electronics. However, the stock price is expected to be much higher by closing on its first day, fuelled by newspaper hype and insistent demand from investors. Enthusiasm for the deal has been overwhelming, notwithstanding the fact that many investors have placed inflated orders to try to get some kind of al-
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location. The frustrated purchasing power of unallocated institutions, combined with the mass of retail investors who were unable to get into the IPO at all, could easily push the stock up into the stratosphere over the coming few days.

Should Alibaba trade up 10%, it will overtake IBM (market capitalisation of $191 billion) and Facebook ($193 billion) to become the world’s fourth largest tech stock behind Apple ($601 billion), Google ($396 billion) and Microsoft ($385 billion).

Should it trade up 20%, it will pass HSBC ($206 billion) and China’s largest bank, ICBC, on $209 billion.

At this point, it would also rank as China’s third largest company behind PetroChina and China Mobile.

How is it likely to perform?

What happens to Alibaba after the initial fanfare dies down depends on what investors believe about its prospects for growth. Shareholders are unlikely to reap the same upside as investors in rivals Tencent and Baidu, which both listed a decade ago when they were less than five years old. Tencent has risen 150-fold since its June 2004 IPO, for example.

Alibaba is now 15 years old, so can we expect similar growth? There are numerous jumbo IPOs of companies with relatively mature business models which have still done well for investors. The most famous is Visa, which listed in March 2008 and still ranks as the largest IPO on record by a US firm. It rose 28% on its first day of trading and has quintupled since then.

Yet for every Visa there is an NTT DoCoMo. When it listed in 1998, the Japanese mobile operator was also the world’s largest IPO, with investors riding a wave of enthusiasm for telecom and tech firms. NTT DoCoMo seemed to symbolise the beginning of the digital era and the stock made a promising start.

Within a year, it was one of the three largest companies in the world, with a market capitalisation of $366 billion. Today the Japanese firm’s shares trade at a fraction of their IPO price.

A century of upside?

Jack Ma has no such qualms about Alibaba’s future. In the company’s pre-roadshow filing, he wrote a letter to prospective investors explaining how the company is only at the beginning of a 102-year journey, that will span three separate centuries from its inception in 1999.

Alibaba is not a mature business, its management says. Rather, its digital ecosystem will disrupt and transform all that it touches to the benefit of its Chinese customers and, increasingly, its global ones too.

A few years ago, Alibaba identified three pillar industries. In many respects it has only made inroads into the first one – e-commerce.

Alibaba has an 80% share of the domestic e-commerce market through its two main websites Taobao (where consumers can buy from a host of online sellers, and where Alibaba generates revenues from ads) and Tmall (more of a platform for merchants, who pay fees for virtual storefronts).

Alibaba had 279 million active buyers at the end of June. However, during roadshow presentations, its management pointed out that online shopping still accounts for just 8% of Chinese consumption (and that consumption, in turn, is only 36% of GDP compared to 70% in the US, suggesting a lot of room for growth). American research firm IHS even predicts this month that consumer spending will lift the Chinese economy above the US by 2024.

The second pillar of Alibaba’s business strategy, finance, feeds from the first, but is at a much earlier stage of development. Alibaba’s payment system Alipay is not directly included in the IPO vehicle. But investors will be entitled to 37.5% of the profits of the group’s financial services holding company, SMFSC (Small and Micro Financial Services Company), which contains Alipay, alongside other financial assets such as Alibaba’s pioneering money market fund, Yu’E Bao (see WiC225).

As WiC has written extensively in the past, Alibaba is battling Tencent and latterly Baidu for control of Chinese consumers’ mobile wal-
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And outside China?
For many Chinese companies, their hallmark of success comes from going global. Alibaba has not really spent too much energy overseas yet, although it has made a number of smaller acquisitions. This is likely to change.

As Jack Ma put it in his recent investor letter: “In the past decade, we measured ourselves by how much we changed China. In the future, we will be judged by how much progress we bring to the world.”

Sohu Finance says one upshot of the IPO is the way it is shaping new perceptions of China’s internet firms. It notes that past listings tended to reinforce the view on Wall Street that China’s online giants were copycats of business models born in Silicon Valley. Thus Baidu was referred to as China’s Google, Renren as China’s Facebook and Sina Weibo as China’s Twitter.

“Of course, there are still many people calling Alibaba China’s Amazon,” writes Sohu Finance. “But this time there are a growing number of Wall Street investors realising that this title is not accurate.” In fact, many have given up trying to apply a simile to Ma’s creation.

In this respect, Sohu Finance thinks that Alibaba will herald a coming of age in China’s tech industry and raise awareness too in the West that Chinese firms are fostering unique and indigenous business models. With its sophisticated approach, Alibaba may also achieve a wider reputational milestone, reshaping the way China is seen in the world, and reducing the perception that its main advantages are cheaper labour and unfair subsidies.

On the other hand, a less welcome perception that some investors might glean is that buying China stocks continues to come loaded with corporate governance
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risk. In a list of five risks facing new shareholders, NetEase Finance says a key one is the absolute power Ma and his 29 partners have over decision-making and their control of the board. One day some of these investors might even rue the limited rights Alibaba’s VIE structure gives foreign investors too (for more on this see our related Talking Point in issue 237).

Oh yes, so why didn’t it list domestically?
Some wonder why Alibaba didn’t list in Shanghai – where enthusiasm for buying into the IPO would have been intense.

But Doug Young, who writes the Young China Biz blog, says that this was never a realistic option since Alibaba is incorporated outside China (a common practice among Chinese venture-backed tech firms).

“Such overseas incorporation has not only barred internet giants like Tencent and Baidu from listing in China, but has also locked out other major names like China Mobile and Lenovo, which are also technically incorporated outside China for historical reasons,” he notes.

Young continues: “Realising it was losing some of the nation’s best companies to overseas listings, China’s securities regulator began discussing plans more than five years ago for an international board in Shanghai where overseas-based firms could list and make their shares available to local investors. But that plan has been repeatedly been put on hold due to the anaemic performance of China’s domestic stock markets, which also resulted in a freeze on new IPOs last year and for most of the first half of 2014.”

WiC also suggests there’s another valid reason for electing to list in New York. It relates to Yahoo, which is selling down its Alibaba stake in the IPO. Had the deal been done locally in renminbi Yahoo would have had problems getting its cash out of China because of the country’s capital controls. That also helps to explain why Ma’s choices came down to Hong Kong or New York: he needed the IPO to be priced in a currency that is freely convertible.

Of course, that also means that the customer base which powers almost all of the company’s profits have had no chance to invest themselves.

Alibaba may be promising a pot of gold to its new shareholders, but there will be very few Chinese nationals among them. Only a small minority of China-domiciled investors have a US trading account and Chinese retail investors that can purchase American stocks have been deterred by the need to place an IPO order of at least $1 million for the stock.

As China.com writes, “They have lost one of the best investment opportunities in the capital markets, ‘selflessly and generously’ presenting it to American and Western investors.”

The Simpsons – now in Mandarin

“Woo hoo! Now we can reveal Springfield is actually in Guangdong.” That was how The Simpsons’ executive producer greeted news that the hit US show will air for the first time in China. The long-running hit starring the doughnut and beer obsessed Homer Simpson and his irreverent son Bart will be streamed online in China by Sohu Video, reports Variety. The latest season (there are 26 in total, in case you wondered) will be shown with subtitles in Mandarin, in a deal done with the show’s maker Fox. “The introduction of The Simpsons, a household name in the US, will further enrich our users’ choice of the best American content when they come to our platform. This deal once again demonstrated our commitment in bringing the best experience to our users and tirelessly efforts to enhance our competitive edge in the industry,” said Charles Zhang, Sohu’s boss. The timing of the deal will strike some as noteworthy, given Beijing has recently banned some US shows from airing on online video streaming platforms (see WiC235).
Xi Jinping has begun his first official visit to India. Xi kicked-off his three-day visit in the western state of Gujarat, where he attended a banquet hosted by Indian Prime Minister Narendra Modi (the reception coincided with Modi’s 64th birthday). Xi travelled to New Delhi on Thursday, and held talks with Modi on trade, infrastructure and border disputes between the two countries.

China’s anti-corruption campaign has gone global, as Beijing seeks to enlist the help of Western countries in pursuing officials who flee overseas. Beijing-based British, US, Canadian and Australian diplomats say they are all under pressure to assist with what Beijing calls “Fox Hunt 2014”, the Financial Times has reported. The authorities have reportedly asked to interview the wife, mistress and child of Cao Jianliao, the detained former vice-mayor of Guangzhou, even though all three have moved to New Zealand and at least one has become a New Zealand citizen.

To improve air quality, China will restrict the use of coal with ash content higher than 16% and sulphur content above 1% in the main population centres from January 1, 2015. The move, aimed at helping lift the smog that envelops so many cities, is likely to hurt Australian producers, who typically export coal with ash content above 20%. Australia exports around 50 million tonnes of thermal coal each year to China and the ban is expected to reduce exports by 40%, which could cost the industry $1.5 billion.

Dalian Wanda Commercial Properties, part of the conglomerate controlled by billionaire Wang Jianlin, filed a listing application with the Hong Kong Stock Exchange on Tuesday for an initial public offering that could raise up to $6 billion. At that size, the IPO could be the biggest offering in Hong Kong since Swiss metals trader Glencore International raised $10 billion in a Hong Kong-London listing in May 2011. According to the preliminary prospectus, the property firm made Rmb87 billion ($14 billion) of revenue last year, and Rmb25 billion of net profit.

China’s largest car rental company CAR Inc is set to raise $467 million in a Hong Kong flotation as retail investors flocked to the deal. Formerly known as China Auto Rental, the company is backed by private equity firm Warburg Pincus and Hertz, the US car rental outfit. Investors seem bullish on the prospects for China’s car rental market, which is forecast to surge to Rmb65 billion in sales by 2018, nearly double 2013 levels.

As part of its anti-monopoly efforts, the National Reform and Development Commission has questioned Toyota officials on pricing policies for spare parts in its Lexus division. BMW, Volkswagen’s Audi and Mercedes-Benz have already announced price cuts on auto spare parts in China in an effort to appease regulators, who have alleged anti-competitive behaviour. Lexus responded quickly by saying that the prices of about 15,000 parts will be reduced by an average 26% from next month.
Holiday spending
Fosun steps up its bid for Club Med, making a higher offer

Fosun’s chairman Guo Guangchang has never hidden his admiration for Warren Buffett. Copying the Berkshire Hathaway model, Guo has invested in stable financial assets, helping Fosun expand into China’s largest privately-run conglomerate. But while local media often dub him China’s equivalent to the Sage of Omaha, Guo demurs, telling CNBC last year that he sees himself more as “Buffett’s apprentice.”

If so, Guo appears to have forgotten a golden rule from his master. Buffett rarely gets into bidding wars, preferring friendly acquisitions. Last Friday, Fosun made an eleventh-hour counterbid for Club Med in an escalating battle for the French firm that began more than a year ago. Fosun has offered €22 for each Club Med share, valuing the holiday group at €839 million ($1.1 billion). The last-minute offer tops the €21-per-share proposal tabled in July by Italian investor Andrea Bonomi. Fosun and its partners initially offered €17 a share.

French private equity firm Ardian, Club Med’s management and U-Tour, a Chinese online travel agent, were part of Fosun’s original bidding consortium. However, under the latest buyout plan, Fosun’s participation will rise significantly, taking on more of Ardian’s stake in buying Club Med. The Chinese firm is now the single largest shareholder in the resort operator with an 18% stake.

But why is Guo so obsessed with taking over a lossmaking hotel brand, especially as it means a major deviation from his Buffett-esque philosophy in the process?

One reason is that – despite the takeover battle – Club Med’s valuation remains relatively cheap (the holiday chain was worth €2.1 billion in 2007). The Hong Kong Economic Journal notes that Club Med now operates 66 resorts globally, which equates to €12 million per resort before debt. “A luxury apartment in Hong Kong is easily pricier than that,” the newspaper suggests. Further, the newspaper believes that hotels and ‘travel experience’ fall into one of the rare industry categories that aren’t likely to be replaced by the internet (versus shopping malls, for example, which are competing with e-commerce).

“Club Med fits perfectly into Fosun’s acquisition strategy of combining China’s growth momentum (Chinese tourists) with global resources (a renowned resort operator),” the newspaper concludes.

Buying Club Med can add extra value to Fosun’s domestic businesses too. A five-star hotel with a strong global brand is an attractive calling card when dealing with local officials in China (see WiC196). They see luxury hotel construction as a boost to city GDP, bringing economic benefits like tourist spending and providing jobs. With the lure of new Club Med hotels, Fosun may be calculating that it can drive hard bargains with city mayors, getting cheaper land and other subsidies as welcome gifts.

Club Med management has similar ideas. Its China head Olivier Horps told the Hong Kong Economic Times this week that it expects China to overtake the US next year as Club Med’s second biggest market (by room nights). It already runs three resorts in the country but plans to add three more by 2016.

At a gathering in Macau last week Chinese Vice Premier Wang Yang told tourism ministers from APEC that the central government sees tourism as a “sunrise industry”. Wang promised that China will continue to promote it as a key economic driver, which means improving visa policies and more direct flights to Chinese destinations.

Guo’s plans could, of course, be foiled if his rival Bonomi comes back with a better offer.

The Italian must do so within a month of Fosun’s revised bid, which suggests he has until early October to make his decision.
In 2011, a 17-year-old student from China wanted an Apple device so much that he decided to sell one of his kidneys to raise money to buy one. He made enough to purchase an iPhone and an iPad. The somewhat sinister case was remembered again this month when Apple unveiled its new iPhone 6. With its larger screen, the phone is actually “bigger than a kidney”, wags joked. Would Apple-mania once again merit the exchange of bodily organs?

News of the smartphone, along with the supersized iPhone 6-Plus, has already crashed the servers of Apple’s online store. (Apple got a record 4 million global orders for the phone in the 24 hours after it became available, double the demand for the iPhone 5 the day it was launched.)

But Chinese Apple fans were further disappointed when they found that the devices, which went on sale in nine locations including Hong Kong, Japan, the US and the UK this week, won’t be immediately available in China.

Apple needed to obtain the network access licence from the authorities before selling the iPhones in China, says 21CN Business Herald. Somehow this application failed and the date of refiling for the licence has not been determined. As a result, the exact date that the new smartphones will go on sale in China remains uncertain, an industry insider told the newspaper.

Needless to say, the delay is frustrating for the country’s telco operators, which have been counting on the popular gadget to further spur sales for 4G services. Investors were similarly disappointed. All three China telco operators saw their shares drop on the Hong Kong Stock Exchange.

“Apple had promised China’s three major carriers [China Mobile, China Unicom, and China Telecom] the new phones would be launched in China at the same time as elsewhere. The carriers, have spent hundreds of millions of yuan on advertising,” says Xiang Ligang from CCTimes, a telecoms portal, adding that Apple’s reputation will “suffer among the carriers”.

Still, the delay shouldn’t dent enthusiasm for the new phones among Chinese consumers. In the past, Apple seems to have used delayed releases to build up buzz in China. And large-screen phones, or phablets, are already very popular, especially among players of mobile games. Nearly 40% of smartphones sold in China now have screens of five inches or larger, according to Canalys, a research firm.

“The iPhone 6-Plus will kill all the big-screen Android devices to become the new must-have for rich people,” Wang Guanxiong, a tech marketing expert declares.

Customers who can’t wait to get their hands on the new smartphone have turned to online stores promising to deliver them from Hong Kong, but at a premium price. This week Guangzhou Daily reported that a reseller in the Mongkok district of the city was selling the 128-gigabyte gold version of the larger iPhone 6-Plus for over $4,700, for instance, which is almost five times as much as the retail price.

Other unscrupulous merchants have been offering to help desperate customers find the new phone, even claiming that they have access to pink and yellow models “only available for purchase in Macau”.

The so-called “Macau version” costs Rmb1,000 ($160) more than the standard one, which starts at around Rmb4,400, and Guangzhou Daily says that 168 customers have already paid deposits.

“We can’t buy the iPhone 6 on the mainland now… but I can buy one from this shop, and it’s pink! I just hope it’s not fake,” one customer said.

The South China Morning Post has reported that the offer is, of course, fraudulent and there is no such thing as a special Macau version of the phone. Elsewhere, the entrepreneurialism is more legitimate. Rather than selling their vital organs, teenagers in Hong Kong have been making money by lining up outside Apple stores in the city. According to China News Service, grey market sellers have been paying the youngsters as much as $200 a day to queue up to buy phones (Apple is imposing a limit of two phones per customer).
In January 2013 the first episode of *The Americans* aired on television in the US. Created by former CIA agent Joe Weisberg, the drama features two KGB officers posing as an American couple in the Washington suburbs. Their mission is to protect Mother Russia and undermine American capitalism.

Back in 1982 — when the show’s action begins — the Cold War was very much a hot topic. When Weisberg first had the idea for the series studio bosses seem to have viewed it as more of a period piece. But by the time the second season ended in May this year, the subject matter seemed more timely. Vladimir Putin’s incursion into the Crimea (which he annexed in March) and the violence in eastern Ukraine have stirred memories of a more confrontational past among NATO members.

When the Cold War began, Moscow welcomed a new ally that Washington feared could alter the balance of power: Mao Zedong’s red China.

In a 1950 speech Richard Nixon warned congressmen that five years earlier the Soviet orbit had encompassed 180 million people. With Mao’s victory, the grouping had soared to 800 million.

In demographic terms, the future president said, the “odds are five to three against us”.

As concerns grow about an apparently expansionist Russia today, will history repeat itself as Moscow tries to forge a new axis with Beijing?

Signing up: Putin wants more gas deals with his “Chinese friends”

There is a danger of over-egging the historical comparisons. No formal treaties are involved on this occasion; whereas back in 1950 Stalin and Mao signed a military alliance pledging to defend the other.

Instead Putin’s priority is to push for closer economic ties with China, especially as he weighs the impact of Western sanctions and looks east for a counterweight to cushion the blow to the Russian economy.

A key part of this plan is to sell more Russian gas to China, shifting its reliance away from the European market (see WiC239). Earlier this month, the Russians broke ground on the Power of Siberia pipeline that is set to export 4 trillion cubic metres of gas to China over 30 years. At the ceremony Putin referred to “our key partner China” and a few days later he offered Chinese firms a stake in the Vankor oil and gas fields in Eastern Siberia.

As he told the media at the time: “We generally take a very careful approach to the approval of our foreign partners, but of course, for our Chinese friends there are no restrictions.”

There isn’t much need for decoding there: Putin could hardly be making his desire to work with Xi Jinping’s government more obvious.

Dmitri Trenin, director of the Carnegie Moscow Centre, reviewed the changing geopolitical world in the China Daily last week.

“The apparently long-term rupture of Russian relations with the West offers an opportunity to the Chinese leadership to enhance its already close relationship with the Kremlin,” he wrote, “and thus turn the global balance in its favour – not unlike former US president Richard Nixon and former secretary of state Henry Kissinger who reached out to Chairman Mao Zedong in 1972.

“The Russians, angry with Washington, are now more amenable to giving China wider access to their energy riches and their advanced military technology. The Western sanctions pushing Russia out of the...
international financial system are also making Moscow more ready and willing to back the Chinese yuan against the US dollar.”

The Russians look keen to point to any evidence of cooperation with the Chinese, mindful of the potential impact it might have on the calculations of politicians and business leaders in the US and Europe. Of course, it helps if the two sides can find common interests and one example this month is civil aviation, where both countries resent the dominance of Airbus and Boeing. Hence the Russian media reports about a new deal with Beijing to develop a long-range wide-body aircraft together. The plan, which was announced by the Russian deputy prime minister responsible for the defence ministry, is to upgrade a version of the Ilyushin II-96. But the new jet will be made with the help of China’s aspiring aerospace giant COMAC. The project, said to be starting out with commitments of $8 billion in investment, plans to make the new aircraft in China, with a potential release date in 2023.

Perhaps the deal suggests that the Chinese have given up on the idea of a fully homegrown jet, and will rely on more proven Russian aerospace technology instead. If so, the Chinese press haven’t discussed it. Probably they are at bit of a loss about what to make of this latest announcement. After all, COMAC unveiled its own plans to build the C919, a Chinese-designed competitor to Airbus and Boeing’s wide-body jets, in 2008. Last December we reported that the launch date for the new aircraft looked like being delayed (see WIC220) and that the first customer for the C919 – Chengdu Airlines – isn’t likely to get one before 2018.

Paradoxically, China’s media has been dedicating more serious discussion to some of the lower-tech opportunities thrown up by Russia’s cold-shouldering in Europe and North America. Moscow’s tit-for-tat decision to ban imports of American and EU agricultural products has Chinese farmers and food processing firms excited. Mudanjiang Daily says that China Baorong Corporation has already set up a new logistics centre on the Sino-Russian border to export more food to its northern neighbour. It adds that Dili Group has plans for something similar in a new cross-border trade zone that is also being established.

“Considerable volumes of contracts” were signed with Russian parties at a trade fair in Heilongjiang province in July for the export of frozen and preserved foods, with a focus on fruits and vegetables, the newspaper reports.

Heihe city in Heilongjiang has also said that work is underway on a 60,000-square metre fruit and vegetable logistics park to facilitate greater exports to Russia.

Despite signs that trade ties are growing stronger with the Russians, the Global Times called for as sense of caution in moving closer to Moscow. “For the booming development of Sino-Russian relations, we need to have a sober evaluation. China and Russia are friends on strategic cooperation and mutual support, but China and Russia are not allies like Japan and the US. Sino-Russian trade should be encouraged to grow more based on market factors than political factors. It must be noted that no matter how good Sino-Russian relations are, the bilateral trade relations have many uncertainties.”

The newspaper – often a thumper against the West in cases in which it feels that Chinese interests have been slighted – was unusually circumspect in its assessment of the current situation. One of its concerns is that selling fruit and vegetables to “help Russia” might be perceived wrongly in the West. Indeed it warns that any new efforts that China makes that seem to show it siding with the Russians carries the risk that “the US would deeply hate us and Russia would not necessarily appreciate us.”

Keri Russell: plays a Soviet spy in Cold War drama The Americans
China’s best-known historical novel The Romance of the Three Kingdoms begins with a statement that might resonate with voters in Scotland this week: “The truism of this world is that anything long divided will surely unite, and anything long united will surely divide.”

The same insight applies to corporate mergers and acquisitions. Companies combine and companies split. The case of AOL and Time Warner is one example. More recently BHP Billiton has also announced plans to divest parts of the company that it once rushed to acquire.

On the flipside it seems that those long divided may be united once more in China’s rail industry. Earlier this month Century Weekly reported that the State Council had “basically decided” to merge back together the two biggest railway equipment makers CSR Corp and CNR Corp. The magazine reported the deal is still in the preliminary stages and the two firms have yet to begin formal talks. But other domestic media quickly followed up and confirmed the plan.

CNR was established in 2000 and CSR followed two years later. They were both spun out of the powerful Ministry of Railways where they were a single entity. The intent behind splitting them was to introduce greater competition among state firms. The move followed the breaking up of other monopolies, for example in the telecoms sector (a move that eventually produced the rival firms China Mobile, China Unicom and China Telecom).

The reversal of the trend has surprised many investors, not least because CNR only went public in Hong Kong in May. But according to Century Weekly, policymakers think that the dual-trainmaker plan has backfired – not necessarily in China, but abroad. CNR and CSR have been competing for overseas business, often hobbling the other with their aggressive bidding tactics. A confrontation in 2011 over a deal in Turkey ended up with both firms losing the contract to a South Korean rival. “Similar situations have also occurred elsewhere, including in 2013 in Argentina, prompting the former Ministry of Railways to criticise the two openly,” Century Weekly noted.

The rivalry is threatening to derail China’s global ambitions to sell its bullet trains abroad. Chinese Premier Li Keqiang has been one of the biggest salesmen for made-in-China equipment and technologies, signing a slew of rail projects during his visits to Southeast Asia, Eastern Europe, Africa and Latin America. But before a new giant is created, the state firms in the train sector will need to sort out their differences. Another industry player isn’t likely to be pleased to hear about the potential consolidation, for instance. China Railway Corp (CRC), the operator of the national network (and itself spun out of the rail ministry last year), plans to spend Rmb150 billion ($24 billion) on trains and maintenance this year. It seems likely to lose one potential supplier. “Probably CRC won’t be too happy to see there is only one bidder for its massive contracts,” says CBN, adding that the rail operator places 75% of the orders CNR and CSR get.

CNR and CSR will also have different views on how consolidation should proceed. Century Weekly said both firms have submitted merger plans to Sasac, the state asset regulator.

“CSR wants CNR to delist from Shanghai and Hong Kong, then merge its assets into CSR,” the magazine reports. “CNR wants to set up a new parent company and keep the two firms subsidiaries.”

So expect uncertainty in the months ahead for the duopoly’s shareholders (the collective market value of the firms’ shares is about $22 billion). Most insiders seem to think that the merger will proceed. “If the State Council wants the railway merger to happen, it most certainly will,” Forbes agrees. But the magazine notes that the plan could also be interpreted as a case in which Li’s self-declared drive for greater market competition seems to be hitting the buffers.

“The railway merger seems counterproductive and could send the wrong signal on the direction of reform,” the magazine suggests.
Opening salvo

SOE reforms off to slow start as Citic faces landmark lawsuit

If you can get off to a good start it means you are half way to success, a Chinese proverb suggests. But if that’s the case, Beijing’s showcase effort for state-owned enterprises reform looks to have missed the starter’s whistle.

Last month Citic Pacific officially changed its name to Citic Ltd. The renaming brought a successful conclusion to the $37 billion backdoor listing of the Citic Group, China’s biggest state conglomerate (see WIC232).

The company began trading with its newly minted brand on September 1 in Hong Kong. Less than two weeks later, however, Hong Kong’s Securities and Futures Commission (SFC) announced it had launched legal proceedings against Citic and five of its former executives including Larry Yung, son of former Chinese Vice President Rong Yiren. The objective is to compensate shareholders who suffered heavy losses after a massive currency bet went sour in 2008. Citic and Yung could also face criminal prosecution.

The timing of the move may look odd, given the state behemoth’s decision to inject all its assets into a Hong Kong-listed vehicle constitutes a major commitment to the city’s capital markets. But the SFC was merely taking its last chance to strike. “Hong Kong has a six-year limit for civil actions,” David Webb, a corporate governance activist, told Bloomberg. “I think basically the SFC ran out of time.”

The case centres on a Citic Pacific regulatory announcement from September 12, 2008 in which shareholders were told that its directors were unaware of adverse material changes in the financial or trading position of the group since 2007. But the writ filed by the SFC, according to the South China Morning Post, alleges that a senior executive had already warned the board that the company’s currency hedge was “out of control”.

On October 20, 2008, Citic Pacific issued a profit warning and reported $1.6 billion in losses from currency trading.

The SFC says investors bought $245 million of Citic Pacific’s shares between the September circular and the October profit warning. The company’s value plunged 55% during those six weeks, and the SFC is now seeking to compensate about 4,500 investors for their losses.

Citic has said that it is taking legal advice. The potential compensation payment is manageable (the conglomerate reported last week it had $755 billion in total assets as of June). But the lawsuit’s outcome could have wider significance. The SFC says the case would “set a precedent for future payout demands linked to trading on misleading information”. That is especially important as class action suits are not allowed in Hong Kong. The territory allows multiparty proceedings but losing parties must pay all or part of their opponents’ legal fees. A few investors tried to take former boss Yung to the Small Claims Tribunal in this particular instance. But were forced to give up after Yung applied to transfer the case to a higher court, where legal costs are much higher.

Citic’s existing management will hope to close the chapter on the current episode quickly and move on. The SFC meanwhile knows a victory will be a landmark event in its fight to protect shareholders’ rights. Policymakers in Beijing may see that as a positive outcome too: encouraging better SOE corporate governance is a key objective of Citic’s ‘mixed ownership’ reforms, after all.

Speaking of a fresh start, Sinopec’s reform efforts got off to bumpy beginnings when it said on Sunday that 25 investors will acquire a 30% stake in its retail unit for $17.5 billion. The deal has been in the works for months (see WIC251) but investors seem unimpressed by the early details. That’s mostly because Sinopec’s new business partners are almost all Chinese firms and include several state-owned enterprises. That left investors wondering if Beijing is serious about introducing more private sector capital into the state giants. Sinopec’s stock fell nearly 10% this week.
You know Chinese leaders could be getting serious about a policy idea when they commission a ‘model drama’ to propagate it.

Xi Jinping’s “21st Century Maritime Silk Road” is clearly one such proposal.

On August 27 around 2,000 people turned up for the opening night of the splendidly titled Dream of the Silk Road on the Sea in Beijing.

The two-hour spectacle tells the fictional tale of a Chinese sailor who helps to establish ancient trade routes across the Indian Ocean.

The troupe’s tour schedule over the next few months suggests that the show – which resembles the ‘red’ ballets performed during the Cultural Revolution – will be used to woo overseas interest in Xi’s project. Xi first mentioned it a year ago at the ASEAN summit in Jakarta. Since then Xi and other top officials have returned to the phrase, talking about resurrecting old trading routes, and presenting them as new opportunities for countries like Myanmar to Pakistan to profit from their littoral status.

As more countries endorse the plan, its centrepiece appears to involve Chinese funding of projects such as ports and free trade zones in under-developed economies along the world’s shipping routes.

For countries like the Maldives, this is a huge boon. “The Maldives welcomes and supports the Silk Route proposal by China and is prepared to actively participate in relevant cooperation,” Maldivian President Abdulla Yameen said after meeting with Xi in his capital Male on Monday.

A multi-million dollar contract for a Chinese firm to upgrade Male’s international airport was also signed during the visit, while Xinhua reported that the Chinese might also finance the construction of a long-awaited bridge between Male and the neighbouring island of Hulhule.

Another major beneficiary of the Maritime Silk Road plan is Sri Lanka, which Xi also visited this week. Surprisingly his trip to Colombo was the first by any senior Chinese leader since the two countries established diplomatic ties in 1951. Colombo nevertheless regards the Chinese as a close ally after Beijing helped the current government win a 27-year war against the Tamil Tigers in 2009 – largely by providing military hardware, as well as diplomatic support at the UN Security Council.

During his day-long trip to the island, Xi inaugurated the final phase of a China-financed power plant and agreed to cooperate on a new port development, featuring an artificial island off Colombo.

Negotiations on a free trade agreement have also begun.

But the Maritime Silk Road has also ruffled some diplomatic feathers – specifically in Japan and India.

Japan, which has proposed its own “diamond of security” in the Western Pacific and Indian Ocean, also feels it is being isolated by the Silk Road plan. Hence, perhaps, the visit of Japanese Prime Minister Shinzo Abe to Sri Lanka just the week before Xi, as well as the trip from India’s newly-elected Prime Minister Narendra Modi to Japan a few days before that.

In the past India has accused China of trying to lay a “string of pearls” around the Indian Ocean – a phrase implying the build-up of strategic coastal assets throughout the region that could be militarised by the Chinese navy. Some Indians worry that by endorsing Xi’s Maritime Silk Road their country will be tacitly giving Beijing the nod to further extend the “string of pearls”.

“India has been invited to join the Chinese proposal in what is clearly a bid to unsettle it diplomatically,” India’s former Minister for Foreign Affairs Kanwal Sipal wrote in the Indian Defence Review back in February.

Ports in Kyaukpyu in Myanmar, Hambantota in Sri Lanka and Gwadar in Pakistan were the primary causes for Indian concern over maritime encirclement.

However, for now the Maritime Silk Road is a concept-in-progress. It is too early to judge whether it is a benign effort to harness Chinese prowess in helping other developing nations with major infrastructure projects, or whether the programme may have more covert goals.
Needs a boost

Supplement firms hope for China boom

Long before Shi Yuzhu made billions selling online games, he earned his first fortune flogging health supplements. The founder and chairman of gaming firm Giant Interactive, who is reportedly worth $3.5 billion, founded Goldpartner, still one of the leading supplement makers in China, back in 1994.

Shi said he used to travel the country pushing his multivitamins and other boosters under the Brain Platinum brand. In 2002, he sold part of his stake in the business for Rmb700 million ($114 million), which he later used to fund Giant Interactive.

Not everyone is as successful as Shi. The dietary supplement business is a surprisingly small market, worth about $13.4 billion in 2013, says Euromonitor. To put that in perspective, America’s market is reckoned to be worth $37 billion.

That’s a challenge that has become plain to American firm Nature’s Bounty, which has US revenues of about $2 billion. The company, which is owned by private equity giant Carlyle, has been operating in China since 2008. But according to Xia Junbo, the head of Nature’s Bounty China, its Chinese revenues are Rmb400 million annually (about $65 million). By comparison, Amway, the largest player, had sales of Rmb27.1 billion last year.

To drum up interest in Nature’s Bounty’s offering of vitamins, slimming aids, protein powders and wellness pills, it has invested heavily in advertising, hiring the actress Tang Wei – to promote its collagen-based natural beauty tablet – as well as South Korea’s Kim Soo-hyun from My Love Who Came From the Stars.

In an interview with Global Entrepreneur, Nature’s Bounty’s Xia says the biggest challenge with China’s supplement market is distribution. In markets like the US and Europe, there are plenty of outlets for people to buy dietary pills, including supermarkets, food and health product stores, or pharmacies. In China, the choice is more restricted, primarily to pharmacies. And worse, the pharmacy market is fragmented. Most large drug store chains are regional players and have limited reach nationally.

Relying on pharmacies may also give people the wrong impression: “Pharmacies are really not an ideal place to sell dietary supplements right now. The pharmacies are the places to buy medicines. And I think that’s one of the big education problems as to why Chinese people will typically see dietary supplements more like a medicine and as something that can cure and treat diseases. And that’s not what they are for,” says Jeff Crowther, executive director of the US-China Health Products Association.

As a result, supplement firms like Brain Platinum and Amway rely on direct sales forces to do most of the selling, accounting for about 60% of supplements sales in China. Xiao says this business model is more costly, which pushes up the price of the supplements. Perhaps that explains why supplements are viewed as luxury items by many Chinese consumers. In other markets, customers take supplements more regularly as a habit, he says. In China clients more usually buy them as gifts for friends and relatives.

Moreover, obtaining approvals from the State Food and Drug Administration is a time-consuming process for the supplement firms. “In China, it’s not that simple and it takes over two years to get the registrations and can cost up to $60,000. And all the testing has to be done on your product to get the registration. So that’s kept a lot of companies out of the market and kept domestic companies from investing in the sector because it is quite expensive,” Crowther complained to China Radio International.

Still, for supplement makers, there is bright spot in sales terms. Jing Daily has reported that sales of supplements for children have been expanding rapidly. As income rises, more Chinese are showing willingness to spend larger amounts on their children, and supplements sales are reaping a dividend.

“I think my investment is worthwhile if my child is able to achieve his academic goals while maintaining good health. I think many parents are of the same opinion,” one parent told China Radio International of their decision to buy such supplements.
That sinking feeling

After a six year hiatus, director John Woo unveils new big budget film

In 2008, director John Woo unveiled Red Cliff, a two-part epic about the Three Kingdoms Period (we reported on it in WiC’s first issue). It was widely rumoured that Woo split the film into two because he ran over budget (and needed a sequel to cover his costs) and because he couldn’t bear editing down the original footage. But no matter, it turned out to be a smart commercial decision. The two-part Red Cliff franchise went on to make Rmb600 million (almost $100 million) in China alone.

Almost six years — and 252 issues — later, WiC has another chance to write about Woo’s work. And once more he has decided to cut the production into two. The first instalment of period drama The Crossing will come out in December, with the second part due for release next May.

Like Red Cliff, Woo’s latest offering has run over budget, says Modern Life Daily, which is why he wants film fans to make two trips to the cinema.

Based on a true story, The Crossing follows the lives of three couples whose lives intersect aboard the Taiping, a steamer that sinks after a collision with a cargo ship in 1949. It features an A-list cast that includes Zhang Ziyi, Takeshi Kaneshiro (who played Zhuge Liang in Red Cliff) and South Korean actress Song Hye-kyo. It is believed to have cost more than Rmb400 million to make, a lofty sum by Chinese film industry standards. The studio built a replica of the doomed Taiping steamer and Woo used a pool about half the size of a soccer field to film the water scenes, an idea inspired by his visit to the set of Lee Ang’s The Life of Pi, which was filmed in a 6,750-tonne water tank in Taiwan.

“This is an epic love story spanning 50 years of modern Chinese history. [Three couples] survive war and disaster, they finally find happiness,” says Woo. “But this is not a happy or sad story. It is a romantic story of hope, and has a lot of action, drama and humour.”

The steamer from Shanghai sank on route to Taiwan, killing more than 1,500 passengers. It was ferry-
ing travellers from mainland China to Taiwan as they sought to escape the civil war between the Kuomintang and the Communist Party. “Because it was so chaotic in China at the time, my father was coming to Taiwan to see if it was possible to move here (Taiwan),” the son of one immigrant told the Taipei Times.

The ship, which left the port the night before the Lunar New Year, was sailing at night with its lights out due to a curfew. It collided with a cargo boat near the Zhoushan Archipelago, which is off the coast of Zhejiang province. It sank quickly. Designed to carry 580 people, about three times that number had boarded. Many of the passengers – often from affluent families – may also have loaded large quantities of silver and gold below deck, unbalancing the ship during the collision.

“I saw the other ship sinking quickly into the sea. I stood on a ladder on the side of our ship and dragged people up from the water – I managed to pull about 10 up. Then I saw that the water had come up to my knees and I realised our ship was sinking too. My mind was blank; I thought I might die,” Yip Lun-ming, a survivor of the tragedy, told the South China Morning Post in 2002.

As many as two million refugees like Yip moved to Taiwan in the same period, an island with a population of just 6 million before the migration from the mainland.

Kuomintang-affiliated historians have long compared the Taipings, which made multiple journeys to the island before its tragic end, to the Mayflower for its role in bringing immigrants to Taiwan. But others wonder if Woo had another vessel in mind. IndieWire, a film blog, calls the project “John Woo’s Titanic”, for instance, while Tencent Entertainment reckons much of the film could prove similar to the James Cameron classic.

But Woo denies the comparison. He says that while Titanic was mostly a love story, The Crossing goes beyond an onboard romance. His film is more akin to Gone With The Wind, he says, because it is a story about love during a turbulent period.

Expect a tear-jerker. Woo told the Beijing Daily that he had trouble controlling his own emotions during the editing of the movie. “These love stories are very touching. I am only just realising that I’m probably better at capturing female romantic sentiments than doing big action films,” says the director.

Jump for joy?

Hurdler’s new bride gets unflattering reception online

So crushing was the sense of disappointment when hurdler Liu Xiang dropped out of the Beijing Olympics in 2008 that Dayron Robles, a major rival, felt he should offer a few words of advice.

Liu should find a girlfriend, the Cuban hurdler suggested. “It’s time for him to do it. Life is not all about tracks and hurdles.”

Liu has just gone one better than Robles suggested, marrying the actress-and-model Ge Tian. Last week he posted a weibo photo of himself and Ge leaning against a set of hurdles. “The thing [i.e. the hurdle] and the girl I love most,” he wrote, with his father later confirming that the two had tied the knot.

News about the marriage soon spread online, with most of the attention centred on Liu’s bride. It was revealed that Ge had worked as a cover girl for fashion magazines and has also performed in television series since graduating from Central Academy of Drama in 2012. But most of the interest in Ge was about
her looks, with immediate speculation that she has undergone plastic surgery (allegedly in South Korea). After millions of ‘human flesh searches’ online, netizens were soon uncovering less flattering images of the bride when she was younger, prompting claims that she’d gone under the knife.

“She may look like Angelina Jolie but the difference is Jolie’s features are all natural and hers are fake!” one netizen said. “She doesn’t deserve Flying Man [Liu’s nickname], I just can’t accept it,” another wrote.

Ge’s mother refuted the surgery rumours. “All the charges about my daughter have no basis,” she told Sina. “Both my father and my husband’s father used to be servicemen, and now Ge Tian is also a service-woman working at the Air Force-League. It is impossible she went to South Korea to have plastic surgery as service people are not allowed to go abroad.”

Still, that didn’t seem to stop other speculation about Ge’s former lovers or gossip that the nuptials were brought forward because she is pregnant.

Some of Liu’s fans fear that marriage will distract him from his athletic career (the hurdler has been sidelined with an Achilles injury). Not so, said an official with the Sports Bureau, who told Sina Sports that Liu was back training a week before the marriage took place.

“If he wants to retire, why is he busy training himself?” the official asked. Liu’s father also denied that the athlete would soon retire, although his reasoning won’t have done much to calm the gossip about Ge’s condition.

“Why do people think getting married and giving birth to baby will affect his training?” Liu senior wondered. “Anyway, we can help him take care of the child.”

There were other sympathetic voices about the newlyweds too. “It’s so common for actresses to go under the knife. Is it so wrong to want to look pretty?” one weibo user asked. “As long as the couple is happily married, that’s most important.” Liu’s friend, Olympic gymnast Feng Zhe, also voiced his support: “Brother Xiang is married so we should give him our blessings. But instead netizens are so critical of his wife. I don’t think we are in any position to make these irresponsible judgements about someone else’s spouse.”

Liu, meanwhile, hopes that netizens will give the couple a break: “I think love beats everything else. Now I feel more of a man. I have to shoulder greater responsibilities to take care of my family. I hope everyone around me will be happy.”
And Finally

Pitch battle
Football clubs furious at soccer field seizures

When David Beckham visited China last year in his new role as ambassador for its national football league, he said that the Chinese must focus on promoting grass roots football instead of lavishing money on foreign talent (his own ambassadorial fee excepted, no doubt).

That meant more youth football academies and – above all – more football pitches to play on.

Beckham’s advice seems to have fallen on deaf ears in Shenzhen. Rather than building more pitches, the authorities there have just closed down a popular playing venue called Lotus Hill. According to the Shenzhen Evening News 300 amateur teams used the facility, which boasted six grass pitches. However, when teams called up to book the pitches late last month, they were told the venue was no longer available as it was to be redeveloped into a residential-cum-commercial complex.

News of the decision spread quickly online. Footballers turned up at Lotus Hill with banners protesting against its closure and local streets were even paved with funereal flowers.

Fans say that the city already lacked playing venues and that the loss of the Lotus Hill fields makes it even harder for teams to find places to play and practice.

The problem is that Lotus Hill sits on 50,000 square metres of prime real estate. Yangcheng Evening News estimates the land is worth as much as Rmb20 billion ($3.2 billion). By contrast, teams renting a pitch pay Rmb500 a session.

Xinhua points out that football pitches are under threat in most major Chinese cities. For historical reasons sports facilities are often in central locations and near good transport links. That makes the land they sit on very valuable and a huge temptation for the local governments that need revenues from land sales, as well as the boost in local economic activity from new construction projects.

But Xinhua also suggests that the Lotus Hill closure runs counter to new government policies. On September 2 Premier Li Keqiang chaired a State Council meeting on accelerating the development of China’s sports industries. So the Lotus Hill demolition looks embarrassingly timed, it says. The newspaper also believes that the central government might rezone areas like Lotus Hill as ‘sports industry land’ as a means to stop local governments from selling them to developers.

School sports fields are often at risk too because land near schools is often high-value (parents want to live nearby get priority status for their children as students). Around the same time that the Lotus Hill closure was causing a hoopla online, another much-viewed photo doing the rounds on the internet showed one school in Zhejiang that had relocated its 200-metre running track onto its roof.

Soon dubbed ‘the air playground’, the unusual arrangement soon generated comments from netizens. “Poor Chinese students,” said one. “Your playground has been robbed by developers.”

IMF boss speaks out on China’s role

“‘The under-representation of China and other emerging markets is just not right. Not right!’

IMF boss Christine Lagarde tells the Financial Times that she considers it an anachronism that China doesn’t have a bigger say on multilateral issues but that reform plans have failed to be ratified by the US Congress. She adds: “This is very frustrating. I spent a lot of time with members of Congress last year trying to to show them how ridiculous it is to stand in the way of change. I will keep pushing.”

Christine Lagarde

No more kick-offs at Lotus Hill
In Numbers

**Rmb500 billion**
The amount injected into the country’s banks this week. Sina, a portal, reported that the People’s Bank of China started channelling the cash to China’s five biggest banks for a three-month period. But the credit expansion is said to stop short of broad-based stimulus that risks increasing dangers from bad loans.

**1.10%**
The decrease in the average price of new homes in 70 cities in August compared with a month ago. It is the fourth straight month home prices have dropped in China. The rate of decline is also faster than the previous months. Home prices dropped 0.89% month-on-month in July and 0.47% in June.

**47%**
The proportion of Chinese worth $1.5 billion or more who have said they want to move overseas in the next five years, according to a recent survey of 2,000 high-net worth individuals.

**30**
The number of Rolls Royce cars that tycoon Stephen Hung has purchased to ferry guests to his Macau gaming complex. His Louis XIII hotel is due to open in 2016. A penthouse suite will cost about $130,000 per night.

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**Where is it?**

Some of the places referred to in this issue

- Beijing
- Shanghai
- Zhejiang
- Fuzhou
- Heilongjiang
- Guangzhou
- Hong Kong

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**Photo of the Week**

Electric atmosphere: battery-powered Formula E cars race during a Formula E Championship race in Beijing last weekend

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