China’s richest man?

Investors seem to be betting big on the solar ambitions of Hanergy boss Li Hejun
In the 2009 novel The Curse of Forbes, the protagonist describes the likely fate of those who find themselves on the magazine’s list of Chinese billionaires. “If you get onto it, you’ll be dead meat in no time,” is the warning. In 2012 three Chinese academics came up with similar conclusions in their research paper The Price of Being a Billionaire in China, which found that members of the Hurun rich list – a competitor to the rankings from Forbes – saw the market values of their firms dip significantly within three years of being mentioned.

Becoming a billionaire can also generate unwanted attention from the authorities, which is why so many business bosses prefer to steer clear of the publicity (and why the rankings are known colloquially as “pig-killing lists” – see WiC16). Nevertheless the wealth tables have become a staple topic for the media, stirring controversy and debate. This month Hurun compiled its latest ranking. But interestingly, the newly-crowned richest man doesn’t seem too concerned by the new spotlight on his success. And rather than dodging the publicity, he even seems to be chasing it.

Who is China’s richest man? Because competing compilers produce different rankings, the title has already changed hands three times this year.

Just like heavyweight boxing, it’s hard to crown an undisputed champion. In late January Forbes reported that the tycoon behind property giant Dalian Wanda, Wang Jianlin, had surpassed Jack Ma as China’s richest man (following a 9% dive in Alibaba’s stock after a disappointing results announcement).

However, Bloomberg reinstated Ma just a few days later. It reasoned that Alipay, a payment system controlled by Ma, is considering a private placement (and a full listing in 2016) that could significantly boost his worth.

Last week a new name was tossed into the ring. Hurun’s latest rich list suggests that Li Hejun, the chairman of energy conglomerate Hanergy Holding, is now China’s richest man.
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person with an estimated net worth of $26 billion. According to Hurun’s calculations, Wanda’s Wang ranked second with assets of $25 billion and Ma is third with $24.5 billion.

Hanergy began life as a hydro-power firm in 1994, when Li invested in a project on a river in Guangdong where he had swum in his youth.

Later it branched out into wind farms before making another switch into solar, opening a series of plants producing thin-film solar panels.

Helped by favourable financing from China Development Bank and friendly relations with local governments, Hanergy was soon billing itself as the largest private enterprise in China’s clean energy sector (see WiC154 for our first profile of the company). By 2013, Li had taken control of 10 hydro-electric dams, 18 solar plants and two wind power sites (see WiC214).

A case of ‘get rich quick’?
Li’s wealth has skyrocketed over the last year – Hurun’s list for 2013 estimated that he was worth about $2 billion that year and ranked him 83rd nationwide. Since then his fortune has surged more than tenfold. The main driver is Hanergy’s 75% stake in its Hong Kong-listed unit Hanergy Thin Film Power (HTF), which runs the bulk of Li’s solar business. Li chairs Hanergy – the parent firm – which is unlisted and controls the group’s other alternative energy operations. But the financial action has been at its most frenzied at HTF in Hong Kong. In 2014 its share price surged 255% and the unit’s market value has climbed 63% further so far this year.

As of Thursday, HTF’s market capitalisation stood at HK$190 billion ($24 billion). Assuming that Li owns a majority stake in Hanergy, his effective holding in HTF is now worth at least $17 billion.

Let there be light: workers producing Hanergy’s solar panels

After two years of breakneck earnings growth, HTF’s net profit jumped from HK$719 million in 2011 to HK$2 billion in 2013. But investors seem to be expecting even better results: HTF is currently trading on a hefty 77 times price-to-earnings ratio.

Such a performance is pretty much unmatched in the industry. As the South China Morning Post noted this week, HTF’s value exceeds the combined market caps of 11 of its main rivals. These include heavyweights with strong backing themselves, such as GCL Poly (see WiC141).

Equally impressive is that HTF’s rally has run counter to the performance of rivals like Shunfeng (which bought Suntech’s huge solar panel business), which have seen their share prices head south in conjunction with the falling oil price.

Does Li’s stellar rise convince?
Not exactly, which is why his new title as the country’s richest man has been a little controversial.

Plenty of analysts are warning that Hanergy’s story is too good to be true. Mainland media have been questioning HTF’s reliance on its parent firm to buy its products for at least two years. And after HTF’s spectacular spurt in market value, it has begun to solicit interest from international media too.

“A little-known Hong Kong-listed firm is now the world’s largest solar-power company by market value. A tight relationship with its parent company suggests its time in the sun may not last,” the Wall Street Journal warned in its Heard on the Street column on January 6. How could HTF enjoy profit margins as high as 54%, the Journal wondered, referencing margins of less than 9% at American photovoltaic manufacturer First Solar?

These profits must be “mostly on paper”, it concluded, adding that HTF’s parent (and biggest customer) is perennially late in paying for its orders.

A remarkable thing about HTF is its apparent immunity from less-than-positive media coverage – indeed, the Wall Street Journal article did little to dampen its market value. Then on January 28, following another spike in HTF’s share price, the Financial Times weighed in on
the solar group, running a full-page investigative report. Again it warned of the “unconventional practices behind HTF’s soaring fortune” and highlighted that nearly all of HTF’s HK$14.8 billion in revenues since 2010 have come from sales of equipment to its parent, Hanergy.

According to HTF’s 2013 annual report, only 35% of these contracts had been settled, with the balance held as receivables.

Citing a study from another investment analyst, the FT raised questions about the production data too. Where were all these panels ending up, for instance? If Hanergy is producing at close to full capacity, its panel output would be enough to saturate a small European country.

Yet “nary a Hanergy panel has been seen in the wild,” the analyst noted wryly.

**Li addresses doubters**

After the FT’s feature, HTF put out a statement via the Hong Kong stock exchange. It didn’t deny that the company has yet to reduce its reliance on its parent firm as a customer. However, it reiterated that any connected transactions with Hanergy have been properly disclosed and comply with Hong Kong listing rules. Most of the contract revenue from these dealings, HTF stressed, has been “due and paid”.

“The company has recently expanded its downstream photovoltaic power generation business and would continue to expand our customer base and diversify our source of revenue,” it said.

HTF share price performance was unruffled by the speculation. Since the beginning of February its stock has gained another 25%.

Li has been accused of providing inaccurate business data in the past. In 2012 the National Audit Office said that one of his solar factories falsified its capacity so as to obtain a government subsidy. Hanergy returned the money in the same year.

But Li has stepped up the charm offensive himself this year, taking on media interviews to commemorate his top new position on Hurun’s rich list.

“Being the richest man means nothing to me… I can’t bring my money with me when I go into a coffin,” he told the Global Times.

“The highest goal in my life is to help others and contribute more to the country… My secret formula for getting rich is to dream big.”

Appearing on CNBC, he also hit back at his critics. Speaking in English and occasionally explaining himself in Chinese, Li dismissed the allegations directed at HTF. “There are a lot of people who don’t understand Hanergy or thin-film solar,” he explained. “The biggest advantage of thin-film solar is the mobility. I could, for instance, use it on my car.”

HTF secured its thin-film technology from foreign acquisitions in Germany and the US. However, Hanergy hasn’t disclosed the technology’s cost per watt, which is a major indicator of solar energy companies’ performance. Critics have also claimed that – even if HTF can raise the conversion efficiency of solar cell technology – the costs to make the panels will still be high.

In the meantime, Li is joining the growing list of tycoons with an interest in making electric cars. Smartphone maker Xiaomi and internet video firm LeTV are both said to be interested in manufacturing them (see WiC268) and now Hanergy has entered the fray, declaring its ambition to launch a “totally solar-powered car” that will go into commercial production in October.

In April last year Hanergy said it would partner with Tesla to build an electric vehicle charging network, completing solar carports in Beijing and Shanghai using the company’s MiaSole panels.

Now it says that it will be working with five vehicle designers – all yet to be identified – in developing up to five new models. The aim is to produce cars capable of travelling 100 kilometres on four hours of charge time in the sun, it said. Power will come from six square metres of thin-film cells plastered over the vehicles’ bodies.

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**POCKET ROCKET.** China famously invented the firework. And now it says it has invented the first ‘green’ firecracker too. The reusable, non-electric, non-chemical banger is the brain child of Wang Xinxing, an oil executive from Henan who was worried about the effects of traditional firecrackers on China’s notoriously bad air. His model works by releasing air rapidly to make the all-important bang. It can also be filled with perfume or coloured mist, Xinhua said.

The Chinese traditionally let off firecrackers during the Lunar New Year to ward away the Nian, a mythical monster who feeds on children and represents bad luck. Fired off en masse they prompt PM2.5, PM10, sulphur dioxide and nitrogen dioxide readings to rise dramatically. So Chinese cities have been banning them in greater numbers, only allowing their sale for a brief period over New Year. In places like that, Wang’s invention could go down as a sparkling innovation.
Solar powered cars are part of Li’s dramatic vision for mobile energy, in which people harness the sun’s energy more easily with flexible, lightweight panels across applications like cars, mobile phones and wearable devices. Freed from the limitations of more cumbersome traditional panels, which are usually located in industrial settings, Hanergy hopes to cash in on demand from a massive new universe of customers.

Investors who buy into that dream are backing HTF’s shares, it seems.

**Is anyone short-selling?**

Given HTF’s stock surge since 2014, short-sellers will be staring at staggering losses. In a response to the Financial Times, HTF’s chief executive Frank Dai brushed off concerns that hedge funds were shorting its shares. But according to Chinese newspaper reports, the recent rally in HTF’s share price has been partly driven by short-sellers desperate to square off their positions.

China Securities Journal, a financial daily run by Xinhua, is one of the proponents of this theory. Citing unidentified sources, it said that an American firm headed by a prominent ex-Wall Street banker has been shorting HTF since the beginning of 2013. It has accumulated a huge short position of about 1.2 billion shares which it is now trying to unwind. “The squaring up of this position is igniting a chain reaction, forcing other short-sellers to snap up HTF shares, which in turn could trigger further share price increases,” the newspaper thought.

The National Business Daily followed up with a more detailed report, suggesting that the firm in question is facing losses of $2 billion. “It is similar to the short squeezing episode that occurred with Volkswagen,” the newspaper claimed, referring to the tumultuous trading in VW shares in 2008, when hedge funds were badly burned after Porsche revealed that it had cornered the market in the shares of the German carmaker.

**And back to those rich lists...**

Even if he is riding high today, Li isn’t likely to top the Hurun poll for long, the Global Times has noted. Tenure at the top is tenuous in China, with the newspaper highlighting that Li is the 12th person to head Hurun’s rich list in the past 16 years. In comparison, Bill Gates and Warren Buffett have been the mainstays of American wealth leagues over the same period. The same is true of Hong Kong, where the same property tycoons have topped the rankings for decades.

“Depending on how you read the rich lists, one can say the richest Chinese tycoons could fall from grace at any time. On the other hand these changes over the years also suggest that, unlike in developed economies like the US, many people do at least still have the chance to make it to the top,” Sina Finance concluded.

**Buzzing Barack**

It sounds like a Hollywood script: an unmanned aircraft of Chinese origin evades secret service defences and lands on the White House lawn (it even recalls the plot of the the movie *Olympus Has Fallen*, in which a North Korean group were able to take over the presidential home).

But in this case it was more truth than fiction after a Chinese-made DJI Phantom drone was flown into the White House grounds in the middle of the night.

According to the New York Times, the drone struck a tree and then crashed onto the America’s best-known lawn. Turns out it was being flown by an off-duty government employee (who has not been named) and it was too small to be detected by the secret service’s radar.

Back in China its manufacturer DJI (for more on which, see WiC266) told the Global Times that it took no responsibility for the incident, blaming the owner, who it said was drunk. The company also pointed out that the owner had failed to install a firmware upgrade that it had sent to its customers intended to stop the drone from flying in “sensitive airspace”.

Meanwhile many netizens were viewing the incident in Washington as priceless publicity for DJI, which is now the world’s largest supplier of civilian drones.
China’s trade figures sank 10.8% in January versus last year, dropping to Rmb2.1 trillion ($336.5 billion). Exports fell 3.3% to Rmb1.23 trillion, while imports plunged 19.9%. The slide in imports is the sharpest since May 2009, when Chinese factories cut back their inventories in response to the global financial crisis. However, lower commodity prices may also explain the drop in China’s import bill. Some Chinese economists also pointed out that trade figures for the month of January can be distorted depending on when the Lunar New Year falls.

American chipmaker Qualcomm said it would pay $975 million for violating China’s anti-monopoly law. As part of the deal, Qualcomm will lower the royalty rates on patents used in China’s mobile phone market which could help local manufacturers like Xiaomi and Huawei. The fine will knock 58 cents a share off Qualcomm’s earnings for the year. Xinhua noted that the Qualcomm settlement exceeded the total amount of anti-monopoly fines given out in the whole of 2014.

A state visit by President Xi Jinping to the US will take place in September, said Xinhua. The announcement was made after Xi and President Obama spoke by telephone on Wednesday morning. In a statement, the White House said the two discussed a wide range of issues, including climate change, Iran’s nuclear programme and China’s currency policy. The timing of the visit is significant because it comes three months before the UN climate summit meeting in Paris.

Liu Han, the former chairman of Sichuan-based miner Hanlong Group, was executed this week. The mining tycoon had ties to Zhou Yongkang, the powerful former security chief, and had a fortune of $650 million, according to estimates by the Hurun report. Chinese prosecutors argued that Liu covered up murders committed by his brother, Liu Wei, who allegedly ran gambling rings in their hometown of Guanghan in Sichuan. Liu Wei and three others were also executed.

Alibaba has invested $590 million in Meizu, a domestic smartphone maker. It is the first time Alibaba has invested directly in a smartphone company, but is in line with the group’s strategy to challenge rival Tencent in the mobile internet sector. The move suggests that Alibaba is anxious to push YunOS, its mobile operating system. YunOS has been locked in a dispute with Google since 2012. The US group claimed that YunOS was a version of its Android operating system that was incompatible with its broader mobile ecosystem. But Alibaba claims YunOS is not a version of Android.

Dalian Wanda announced that it will pay $1.2 billion for sports marketing company Infront Sports and Media. The acquisition of the company, based in Switzerland, will “drive the development of the Chinese sports industry and its interests around the globe,” Wang Jianlin, chairman and founder of Wanda, said in a statement. Infront has the sales rights to broadcast packages of FIFA tournaments from 2015 to 2022, which will include two soccer World Cups.
China and the World

Off the rails
China’s overseas projects in political hot water

Is China doing its due diligence before investing overseas? That’s the question local academics and newspapers asked this month after at least three Chinese projects in Sri Lanka, Greece and Mexico got into hot water.

The situations in Colombo and Athens — both involving ports — may yet be resolved, with the projects continuing as planned.

But the dispute in Mexico, involving a cancelled high-speed rail project, now has China Railway Construction Corp (CRCC) suing that country’s government for the money it spent bidding for the $3.7 billion contract.

News that CRCC had taken the unusual step of seeking compensation came on Tuesday with the Mexican government confirming it had received a list of the costs the Chinese company had incurred. The actual amount has not been disclosed but a statement by Mexico’s transport ministry says the figure includes hotel bills for CRCC employees, their salaries and money involved in financing the offer.

The CRCC-led consortium first ran into trouble with the contract in November. Two days after the Chinese had won the bid, President Enrique Pena Nieto withdrew the offer amid allegations of corruption.

CRCC was untainted in the scandal, which centred on Pena Nieto’s relationship with one of the Mexican members of the Chinese-led consortium, and the company was encouraged to bid again when the tender was reopened. That was meant to happen in January but instead the Mexican government “suspended” the project indefinitely citing a lack of funds.

The 220km rail line — should it ever be built — will run from Mexico City to the industrial hub of Queretaro, north of the capital. Had CRCC been allowed to build the rail link, it would have been the largest single overseas construction deal won by a Chinese firm.

China sees its high-speed rail technology as one of its most exportable industries and it is working hard to find global clients. A report by the Ministry of Commerce last week showed that Chinese railway companies had tripled their overseas contracts last year, netting a total of $24.7 billion in deals.

It also said China had exported nearly Rmb27 billion ($4.3 billion) of railway equipment in 2014, an increase of 23% over the previous year.

A senior executive with the trainmaker CNR Corp told state media that China was currently negotiating with 28 countries about constructing high-speed rail lines. These include Russia, Laos and Thailand. The same executive told China Daily: “The US will be the next strategic focus for us.”

But given the recent setbacks, many are asking if Chinese firms are in too much of a rush to show they can win overseas contracts.

“The Mexican situation reminds Chinese companies that if they want to invest abroad, they should learn the policies and regulations of other countries to have a clear, general view of their political environment,” wrote the Shanghai-based online newspaper The Paper.

Beijing Business Today added that doing business in democracies such as Greece or Sri Lanka was not the same as working in one-party China.

“China often invests in projects that require long periods and in countries that may go through an election. That demands greater diplomacy from our country. Not only should we maintain good relations with the governing party, but also with the opposition party.”

That’s a point reiterated by an academic paper hosted on the Ministry of Land and Resources website: “China focuses too much on economic risks and not enough on the political risks when doing assessments,” it said. “We overestimate the power of the top-level and overlook the power of civil level including opposition parties, non-governmental organisations and media.”

As news emerged late last month that another Chinese project in Mexico — a massive trade mall in Cancun — had been scrapped for environmental violations, the criticisms ring true.

And with China Telecom reportedly readdying a bid to build a broadband network in Mexico, they are lessons that may well be worth heeding.
Fung King Key couldn’t even speak English when the diminutive Hong Kong financier visited New York in 1980. But that communications drawback didn’t stop Manhattan’s borough president from hyping his arrival in the city. Not only did he declare it "Fung King Key Day", he told his fellow New Yorkers that Fung’s financial conglomerate Sun Hung Kai (or SHK) was “the Merrill Lynch of Hong Kong”.

The comparison was carefully chosen, since Merrill Lynch was courting Fung frantically at the time. Two years later it spent $82 million – then its largest overseas investment – to gain a 25% stake in SHK’s brokerage operation and 15% in its banking unit.

An expansionary Merrill wanted access to Fung’s wealthy Chinese contacts. In exchange, Fung got a 4% holding in the US firm, plus convertible notes equating to a further 10% stake. It made him the largest single shareholder in Merrill.

Unfortunately for Fung he didn’t enjoy that for status for long. That’s because when Hong Kong’s stock market crashed (Sino-British talks over the territory’s future made investors jittery) he was forced to offload his Merrill stake to keep SHK afloat.

Fung died in 1985 and control of SHK has changed hands several times since. In the latest twist, the Hong Kong brokerage has become part of a Chinese giant.

China’s Everbright Securities said this month that it has agreed to buy a 70% stake in SHK Financial, SHK’s brokerage and wealth management service unit, for HK$4.1 billion ($529 million).

“It marks the end of an era and the beginning of a new one,” a Sina blogger wrote, noting how it is reflective of closer connections being forged between mainland China’s and Hong Kong’s stock markets. For instance, the Shanghai-Hong Kong Stock Connect, a trading programme allowing foreign investors to buy Shanghai-listed shares and vice versa, was implemented late last year. A similar trading scheme between the Hong Kong and Shenzhen bourses is planned too.

Everbright is one of a number of Chinese brokerages making forays into Hong Kong. Haitong Securities took over Chow Tai Fook’s brokerage unit in 2009 and renamed it Haitong International. Likewise, in a deal that was completed in 2013, Citic Securities acquired Hong Kong-based broker CLSA.

The Chinese brokers are choosing Hong Kong for their first acquisitions overseas, buying the local houses for their client lists and know-how.

After the recent run-up in the domestic stockmarkets, they also have more cash to do deals. Profits at Everbright rose 10-fold last year to a little over Rmb2 billion ($320.1 million), with its shares more than tripling in value in the last two months of 2014.

In fact, there were more than 10 bidders for SHK Financial, according to Hong Kong media reports, and Everbright paid a rich premium for its new asset. According to Securities Times, the deal valued the Hong Kong firm at 1.8 times its net book value and nearly 30 times recent earnings. For comparison, Haitong International is only trading at 11 times its 2013 net profit.

According to Singtao Daily, other Chinese firms are in buyout talks with other Hong Kong brokers. "It is because of the convergence between Hong Kong and China’s financial markets,” the newspaper suggests.

But if asking prices get any higher it may make more sense for the Chinese brokers to build their own teams in the city.

In the meantime, cross-border ties continue to deepen. Hong Kong’s chief executive CY Leung told an industry conference this week that the afore-mentioned Shenzhen-Hong Kong scheme is expected to launch in the second half of this year. This will trigger more capital flows, Securities Times notes, thanks to the proximity of the two cities, as well as the attraction of investing in promising private sector firms listed in Shenzhen.
Old, and cold

Can Chinese planners revive the Northeast?

To celebrate the fifth anniversary of the People’s Republic, a special stamp was issued in 1954. It featured the Fuxin coalmine in Liaoning province. A five-yuan banknote issued in 1960 also carried the image of the same coalmine. These collectors’ items now serve as a reminder of the glory days of China’s northeast: a region that provided the industrial base for Mao’s first five-year plan. Back then Fuxin was also home to Asia’s biggest open-cast mine.

In recent times Fuxin has become better known as the “sinking city”. Five decades of intensive excavation have undermined its foundations (see WiC9). It is a manifestation of the challenges faced by the provinces of Heilongjiang, Jilin and Liaoning. The three – home to 110 million people – sit huddled together in the ranks of China’s worst performing provinces (they are in the bottom five measured by GDP growth in 2014).

Heilongjiang recorded a growth rate of 5.2% in the first nine months of 2014, almost 25% less than the national average and far below its own 8.5% target. This is not the first time it has struggled. At the turn of the century, former premier Zhu Rongji’s state-owned enterprise reforms had a devastating impact on the former Manchurian heartland. A revitalisation plan was launched in 2003 and for much of the past decade it seemed to be working. All three provinces had double-digit growth rates through to 2012. And then their economies stalled again.

Observers are now wondering whether the slowdown is a temporary blip, or the sign of more serious structural pressures. In Liaoning, it is the latter, according to Liang Qidong, a vice president at the Chinese Academy of Social Sciences.

Liang tells the Economic Observer that there are still 1,751 branches and units of the major SOEs in Liaoning. “The big SOEs are just not reforming themselves and Liaoning dare not meddle with them,” he says. “The centrally-planned economy is still alive and kicking here.” And SOEs still make up 50% of local GDP (albeit down from 66% at the beginning of the century). Liang argues that the northeast has relied on a familiar three-pronged economic model, which now runs contra to the government’s national ambitions. Firstly it continues to depend on polluting heavy industries. Secondly, growth has been propelled by investment, no matter how uneconomic the potential returns, and thirdly, there has been huge capital expenditure on industries already suffering from a supply glut.

These issues are of particular interest to Premier Li Keqiang, who was Liaoning’s Party boss from 2004 to 2007. He has been spearheading a new drive to prevent the three provinces from turning into the Chinese equivalent of America’s rust belt. This involves building better transportation infrastructure and affordable housing alongside the development of new industries such as robotics. But the National Business Daily reports that the plan has not been yielding much success to date.

One major initiative is supposed to be the creation of a super city by linking Shenyang and Fushun (see WiC173). The original idea was to let the two cities continue to expand until eventually they touched each other (they are 45km apart). But the absence of an overarching plan means their development has been uncoordinated. Meanwhile The Economist magazine visited Shenfu, a dormitory town midway between the two cities, which has experienced a property boom and bust. “Guys used to walk through the door and buy two or three homes at a go,” says a saleswoman at Deshang International Garden, a large housing complex. In fact, its occupancy rate is now about 50% which makes it one of the most successful developments in town, she told the UK magazine.

China would also like the three provinces to form the backbone of a new North Asian trade zone. But weakness in the Russian economy does not bode well for this prospect in the near term. So is some regional stimulus on the way? The Economic Observer says there is a case for it: “The Northeast has had to quietly endure the environmental costs of China’s resource-based economy. It’s a debt which the whole country needs to pay back by helping these three provinces.”

Fushun: ring for help?

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Fushun: ring for help?
The war on VPNs

China proves it can ‘nail Jello’ to the Great Firewall

At the turn of the millennium US President Bill Clinton famously compared China’s efforts to restrict access to the worldwide web to being like “trying to nail Jello to the wall”.

Fifteen years on it seems the internet wasn’t as slippery as he thought, and that China has developed some pretty good nails too. For much of January this was plain once more when Beijing began a crackdown on virtual private networks or VPNs. As regular readers of WiC will know, these tunnelling and encryption services are widely used by expats and businesses in China to circumvent local restrictions blocking the use of an increasing list of foreign websites. Without a VPN it is impossible to access Google, Facebook, Bloomberg, The New York Times and Twitter, among others.

The crackdown meant that many Chinese students with overseas university applications pending were unable to check on their status and foreigners were left frustrated as they were unable to pick up documents stored on overseas cloud services. The move had followed an earlier clampdown on Gmail access (see WiC265).

Still, it wasn’t a total shock. VPNs are illegal in China (the exception being their use in inter-company networks that are registered with the Chinese government).

The authorities have not directly confirmed that they are squeezing VPNs but on January 27 in response to a question on the issue, Wen Ku, an official with the Ministry of Industry and Information Technology, said: “The rapid development of the internet is forcing the ministry to use new ways to maintain cyber security and steady operations.”

VPN providers such as Astrill, StrongVPN and Golden Frog all confirmed they were having problems and asked their customers to bear with them. “Our fight with the Chinese censors is not over,” said Astrill in a message. “We know how important unfettered internet access is to you.”

Experts said the crackdown was caused by an upgrade in China’s detection software, part of the Great Firewall, which is now able to identify data travelling on a VPN without having to locate its IP address.

It also seems the authorities are happy to cast a pretty wide net and block any content that looks like it might be illegal. “Now it seems they are doing it automatically,” the Wall Street Journal quoted Liviu, a VPN provider in Romania, as saying.

Last year there was a steady stream of official statements that hinted at a tightening of China’s digital reality. At a seminar last November Ren Xianliang, deputy director of the Cyberspace Administration told officials and internet entrepreneurs that China needed to “enhance the rule of law on the internet to create a clean cyber space”. And later that month China used the first World Internet Conference – an event it created – to lobby for “internet sovereignty” – a concept it also thought up.

Indeed, that is what many observers believe this recent VPN outage to be about – China’s increasing belief that it should have the internationally recognised right to limit what sections of the internet its citizens see.

“The internet has posed new challenges to national sovereignty, security and development interests, which requires the international community to meet urgently and seriously and pursue common governance and win-win outcomes,” Chinese President Xi Jinping said in a congratulatory message sent to the World Internet Conference last year.

Judging by its citizens’ reactions, it’s not a popular move. “This is just a new version of the isolation the Ming and Qing Dynasties chose and look how that ended,” wrote one. Another student preparing for postgraduate studies in the US asked: “This a backwards step for a country. I wouldn’t mind if Baidu returned similar results [to Google], but it is completely useless.”

Even the uber-patriotic Global Times warned against further restrictions. “We cannot always ban young people from seeing things but we can train them to keep calm whatever they see,” it noted, adding, “We hope that the motivation of China to block access to foreign websites and web pages will gradually reduce, rather than increase.”

The ‘Big Dog’ was wrong

Photo Source: Reuters
Jerry Sanders, founder of America’s Advanced Micro Devices (AMD) once called computer chips the “crude oil of industry” and the foundries, which mass-produce them the “smelters of the information age”.

His comments about the power and value of the semiconductor industry resonate very strongly in China, which now finds itself in the unhappy position of spending more on importing computer chips than it does on oil.

But if the past decade was dominated by oil and gas acquisitions, then the coming one looks set to governed by more M&A in the semiconductor industry.

China is determined to move up the value chain and create a domestic ecosystem that can compete head on with global industry leaders such as Qualcomm, Intel, ARM Holdings and TSMC. Since Edward Snowden’s revelations about US phone tapping, it has also wanted to tighten control for security reasons.

As cnstock.com wrote last week, “China is accelerating the localisation process. Chips form the cornerstone of national information security, which means the government will become a very large source of end demand for domestically produced products.”

The government has said all this before. But few doubt the strength of its commitment this time round, particularly as its ambitions are being coordinated by the State Council through a national development programme under vice premier Ma Kai focused on IC (i.e. integrated circuits, another name for a chip).

And the country is already well on the way to meeting its near-term targets, which include increasing China’s market share of the packaging and testing sector to 30% and promoting stronger collaboration between domestic fabless and foundry firms (which design chips and manufacture them).

A recent string of M&A deals may soon culminate in the largest takeover to date – an offer for AMD itself. China’s International Online last month reported that a Chinese consortium including BLX IC (a leading microprocessor designer), SMIC (the country’s largest domestic foundry) and one of China’s new IC venture capital funds would make a bid for AMD.

Should an offer emerge it is likely to be in the region of $3.5 billion based on AMD’s enterprise value (a $2.35 billion market capitalisation and $1.2 billion in net debt). The stock price responded strongly to the rumours, rising 35% between January 20 and February 5, before tailing off slightly.

In recent days, speculation about a buyout offer has been replaced by suggestions the Chinese are preparing to make a series of strategic investments in AMD’s key technologies and product lines. Analysts believe this makes more sense given an outright takeover might prompt American national security concerns and run up against contractual issues with Intel from whom AMD licences chip technology.

Local newspapers now say the investment vehicle will be Loongson Technology, a joint venture between BLX and the Chinese Academy of Sciences. Having failed to develop its own world-beating microprocessing chip over the past decade, Loongson appears to be taking the tried and tested path of trying to

Is China buying its way into the global semiconductor industry?
buy the intellectual property from overseas instead.

The same strategy holds true in the chip packaging and testing sector where a Chinese consortium has entered into an exclusivity agreement with Singapore’s Temasek to take over STATS ChipPAC. The consortium has put forward a cash bid of $780 million for the world’s fourth largest packaging and testing company, valuing it at $1.5 billion including net debt.

Consortium members include Jiangsu Changjiang (JCET), the world’s sixth largest IC testing and packaging company, SMIC and the state-back IC Industry Investment Fund. (The fund was set up in September last year. Its founders include leading state firms such as China Mobile and the China Development Bank.) During an earnings call earlier this week, SMIC told investors it was putting up $100 million for a 19% stake because it wants to localise its supply chain and support government policy.

Together a merged STATS ChipPAC and JCET would still be the world’s fourth largest packaging and testing company, but in terms of sales, inch far closer to the current numbers two and three (Taiwan’s Siliconware and America’s Amkor).

The merger will also expand China’s market share, which had already risen from 15% to 25% between 2010 and 2013. Were the deal to go through it would add a further 6%, taking China over its 30% target. Analysts say neither company currently generates free cashflow, so the merged entity will need heavy government support to fund the capex needed to increase its market share further.

And this is likely to be forthcoming thanks to the firepower of the IC Industry Investment Fund, which is believed to have raised about Rmb100 billion ($16 billion) by the end of last year. A further Rmb40 billion fundraising round is expected during the first quarter.

McKinsey has estimated China will spend up to Rmb1 trillion over the next decade to break its dependence on foreign chip suppliers and create the national champions it has long desired. The new IC fund is likely to be at the forefront.

One of the first beneficiaries will be SMIC, which has attempted (not entirely successfully) to break the Taiwanese duopoly held by TSMC and UMC over the past 15 years. The domestic foundry is receiving $300 million in a new bid to push it further up the technology curve.

Since last summer its efforts to develop 28nm wafer technology have been aided by smartphone chip manufacturer Qualcomm, which hoped its collaboration would spare it from having to pay punitive damages from an ongoing antitrust probe. This has not proved to be the case, with the company fined $975 million earlier this week and more importantly, told to reduce the royalty payments it receives from Chinese manufacturers (WiC will examine Qualcomm’s problems more deeply in next week’s issue).

Other Chinese firms may also benefit from a series of regional IC funds, which are being set up. The city of Beijing has raised Rmb30 billion so far and Shanghai has also pulled in Rmb10 billion. Similar funds are being set up in Wuhan and Hefei.

Hua Capital is managing one of Beijing’s sub funds and last August submitted a $1.7 billion non-binding bid for Nasdaq-listed OmniVision, which makes image sensors for smartphone cameras. Its bidding partner is Shanghai Pudong Science and Technology, which also made a bid for China’s third largest mobile chip designer RDA Microelectronics, but found itself up against Tsinghua Unigroup – highlighting the potential pitfalls of different pools of money competing against each other. Tsinghua Unigroup has rapidly emerged as a dominant player in the fabless semiconductor sector after successfully bidding $910 million for RDA, as well as spending $1.78 billion for Chinese chip designer Spreadtrum.

Together they have the potential to become a formidable competitor to Qualcomm and Taiwan’s MediaTek, potentially lowering their rivals’ margins when Spreadtrum launches its 4G chip products later this year. CEO Leo Li recently told cnstock.com how the established players have been trying to maintain their stranglehold. MediaTek, he said, threatened to terminate its agreements with electronics manufacturer TCL after discovering it had been talking to Spreadtrum.

Intel, however, has taken a different tack. Keen to diversify from PCs to mobile phones and tablets, it has decided to cooperate with China’s efforts to move up the value chain and make a number of investments, including the purchase of a 20% stake in Tsinghua Unigroup for $1.5 billion.

Spreadtrum and Intel are now using Intel’s architecture to develop a system-on-chip, which integrates all of a computer’s components onto a single chip. These super chips will likely be manufactured at Intel’s new foundry in Dalian, offering SMIC strong competition from a domestically-located rival for the first time.

iSuppli analyst Gu Wenjun tells cnstock.com that China’s time has come. “Over the past 30 years the semiconductor industry has suffered a number of cyclical downturns, which have enabled Asian countries from Japan to South Korea and Taiwan to benefit,” he concludes. “Now it’s China’s turn to seize the moment and grab the opportunities in front of it.”
At a loss

Renault’s Chinese dealers are in a furious mood

Going to a Lincoln dealership in China is an experience,” the brand’s president Kumar Galhotra tells Detroit News. “People bring their whole families.”

The US luxury car manufacturer is a late arrival to China. But Galhotra has high hopes that he can break the stranglehold of the big three German marques (BMW, Audi and Mercedes), which control 80% of the luxury sector. Having opened its first three sales outlets in late 2014, Lincoln hopes to have 60 dealerships in place by the end of 2016.

To keep clients entertained the dealerships will typically provide LED television screens, elaborate tea selections and comfy sofas from which customers can view their cars being fitted out. But Lincoln will not be footing the bill for this. The dealers themselves will. And according to National Business Daily many are already losing money since car sales are no longer on a double-digit growth tear. The China Automobile Dealers Association (CADA) believes only 30% of dealers made money in 2014, compared to 90% five years ago.

The figures are correct, says Li Qi, a dealer with Renault, which has a joint-venture with Dongfeng Motor, China’s second largest car maker.

He tells National Business Daily that 2014 was his worst year ever and blames the French firm’s “blood and iron” policy – setting unrealistic sales targets which the dealers simply cannot meet. He says that after selling 200 Renault cars in the first half of the year, the company upped his target to 300 for the second half.

Unable to shift them, he started discounting cars by up to Rmb30,000 ($4,802) each. Given that his gross profit was only Rmb10,000, this meant he was operating at a loss. But he did so in order to collect the typical 5% to 6% performance-related bonus or rebate per car, which is only triggered if dealers meet their targets.

Other dealers, if they didn’t resort to price-cutting, ended up with record inventories of unsold cars. One of Dongfeng Renault’s biggest dealers told the National Business Daily that at the end of 2014 his inventory equated to five months of normal sales, tying up Rmb100 million of capital. This led some dealerships to refuse to take any more cars. Some in eastern China quit being Dongfeng Renault dealers altogether.

Renault’s local sales head, Chen Wei, argues that at least half of the dealerships are profitable, though he admits feeling pressure to report high sales figures to his global bosses so they’ll increase their investment in China.

Rising inventory levels explain the dichotomy between slowing national car sales (growing an estimated 9.9% in 2014) and the high sales volumes reported by the brands themselves. BMW, for example, recorded 17% sales growth from January to November and Audi 16% over the same period.

But the dealers are fighting back. Helped by CADA, they have been pushing the car manufacturers to increase rebates.

And so far they have been very successful, with BMW agreeing to provide Rmb5.1 billion in subsidies, payable this February. Analysts believe this will cut BMW’s China EBITDA by 25% (a material move given that China is estimated to account for up to 45% of its global net profit).

Other car makers have also fallen into line including Renault. Earlier this month, the group agreed to “improve dealers’ profitability through additional and faster rebates,” as well as moderate its sales targets so the “majority can keep up”.

Meanwhile, pollution controls present another roadblock for car makers. In December, Shenzhen said it would only issue 100,000 new licence plates in 2015. By contrast, car sales in the city in 2014 topped the 500,000 mark. Half of these licence plates will be issued at auction (meaning they are likely to go to wealthier bidders). This is to the advantage of luxury vehicle brands. While overall car sales are forecast to rise by 8% in 2015, the luxury sector is still expected to register double-digit growth at around the 12% level. This could be a problem for Dongfeng Renault which is battling it out in the mid-market segment. And not with great success: the Sino-French JV holds just 0.2% of the Chinese passenger car market.
The love life of Wang Feng is almost as colourful as that of Jennifer Lopez. The 43 year-old rock star – who stars as a mentor on the hit show The Voice of China – has been married and divorced twice (he has a daughter from each of the relationships). Before he announced his second divorce, he was photographed by paparazzi getting quite intimate with actress Zhang Ziyi at a concert. This started the rumour that he was having an affair with the 36 year-old Chinese superstar.

In November 2013 Wang and Zhang decided to make their relationship public.

During a concert in Shanghai, Wang addressed her from the stage, declaring: “I imagine that when we get old one day, we could hold each other and walk forward on the road. My love, you have had a hard time! I never imagined that a simple love can add so much burden to you. I will make you the happiest woman in the world.”

Now Wang appears ready to return to the altar for the third time. At Zhang’s birthday party last weekend, he surprised both her and her friends by using a white drone to fly in an engagement ring (see photo). He then got down on one knee to propose.

“We have experienced happiness and heartbreaks. I hope you, Ziyi, will always be happy. Even when we are both old, I will still take care of you,” he told the assembled party.

If Zhang wasn’t moved by his words – or Wang’s drone strategy – she must have been impressed with the ring. NetEase, a portal, reported that Wang proposed with a 9.15 carat diamond ring from the London jeweller Moussieff. Wang also gave his bride-to-be a ruby and diamond bracelet as a birthday gift.

On Monday, the actress posted a picture of fireworks from the party and details of the proposal on her personal weibo account, adding a public message to Wang: “Thanks for completing my life. All the hardship is past. From now we are together till we’re old.”

Zhang’s love life has also been...
regular tabloid fodder. She was once linked to CCTV show host Sa Beining and was engaged to Israeli billionaire Vivi Nevo in 2008 (they parted ways in 2010).

But the romantic glow around the couple was soon marred by speculation that the diamond ring may have been part of an endorsement for Moussaieff. That’s because when Sina, a portal, first published the news of the engagement, it was filed as a press release. Eagle-eyed netizens soon identified the firm that sent out the item as none other than the UK jewellery brand. Moussaieff was mentioned in virtually every article about the couple’s engagement.

“The Voice of China should pay our Mentor Wang more. Don’t let the jewellery company grab the headlines,” one netizen mocked. Meanwhile, the maker of the drone involved in the proposal DJI told the South China Morning Post that it has gained a lot of publicity from the event. DJI (see WiC266) said it was probably the first time a drone had been used in a marriage proposal in China. After news of the engagement went viral, the company’s store on e-commerce website Tmall added a description to the Phantom 2 Vision+ model as “Same style that Wang Feng used.”

So far, there has been little discussion as to whether that was a sponsored item too...

**Voice over**

**HK singer fails China contest**

Last year, Hong Kong singer Deng Ziqi (who goes by the name G.E.M) became the biggest breakout star on the second season of Hunan Satellite TV’s reality competition *I’m A Singer*. The show, based on an adaptation of a South Korean reality series, features seven contestants – all professional singers now lacking the limelight – who fight for another chance at celebrity on national television. Every two weeks a live audience of 500 people casts a vote and the contestant with the least support is eliminated. Deng, with a petite frame but a gigantic voice, finished second.

Another Hong Kong singer Leo Ku, however, didn’t enjoy the same fortune as Deng. Ku, one of the contestants on the third season of *I’m A Singer*, which premiered late last year, exited in the sixth round. His elimination quickly became a topic of contention in Hong Kong, with many arguing that mainland audiences did not appreciate his more subtle performance.

Hong Kong’s Apple Daily, for instance, believes the reason Ku was eliminated so early in the competition was because his performance – a rendition of Faye Wong’s *Fleeting of Time* – was relatively subdued versus those of the mainland Chinese performers on the show. It also argued that compared with Hong Kong, Chinese audiences prefer over-the-top and lung-busting performances. That explains why in the first round of the competition, Singaporean singer Kit Chan, who also delivered a pitch-perfect but otherwise low-key performance, was quickly eliminated.

In response to Ku’s elimination, Chan told Hong Kong Daily News: “I told Leo before, singers like us are not suitable for that kind of competition environment.”

Similarly, one columnist at Sky Post said the reason why Ku was voted off has nothing to do with his singing ability: “He was eliminated not because his singing is not on par. His problem is that he never tried to cater to the taste of mainland audiences by singing songs that have ridiculously high notes and choosing songs that are in Cantonese (as opposed to Mandarin).”

In some ways, the Ku debate in Hong Kong was about more than just a singing contest. In the context of the ongoing tension between the territory’s residents and their mainland Chinese compatriots, it was yet another manifestation of Hongkongers expressing their sense of being different, and their belief they possess more sophisticated tastes.

**What to expect from the Goat**

**Previewing the Lunar New Year**

We are entering the most confusing year of the Chinese zodiac. The Chinese ‘Year of the Yang’ means both the Year of the Goat and the Year of the Sheep. Obviously these are distinctly different looking animals, making it the one year of the twelve animal cycle where the images used in the celebrations (sometimes of a thrusting goat, others of a cuddly sheep) are likely to puzzle anyone who is not Chinese.

A television programme in Hong Kong has even tried to figure out whether the zodiac sign was origi-
nally intended to mean goat or sheep. The experts were unable to come to a definitive conclusion though it was pointed out that a Tang Dynasty statue of the ‘yang’ zodiac symbol looked more like a sheep. However, there is also a subjective element to the imagery chosen, reckoned the experts. The goat, they say, has more of a negative connotation and will be used by those with a pessimistic outlook on the twelve month ahead. A sheep is viewed as more lovable.

In case you were wondering, the Oxford English Dictionary defines a goat as “a hardy domesticated ruminant mammal that has backward-curving horns and, in the male, a beard. It is kept for its milk and meat, and noted for its lively behaviour”. A sheep is “a domesticated ruminant mammal with a thick woolly coat and, typically only in the male, curving horns. It is kept in flocks for its wool or meat.

The Lunar New Year starts on February 19, and here at WiC we are going to term it the Goat, as – in keeping with the negative connotation – there is much to suggest that the world faces an uphill struggle in the year ahead.

Chinese Premier Li Keqiang and billionaire Bill Gates are both born in the Year of the Goat (these include 1955, 1967, 1979 or any twelve years before or after). Goats are believed to be calm, dependable and intelligent. They also enjoy being part of a group, but prefer the sidelines rather than the centre. They tend to be quiet and reserved because they spend much time absorbed in their thoughts.

Historically, many those who are born in the Year of the Goat are believed to be doomed. In fact, one common folk saying has it that out of 10 children who are born in the Year of the Goat, nine have bad luck.

Though the Chinese government has tried in recent years to debunk the myth – declaring it to be untrue – it seems to have done little to change the perception: “I don’t really care what zodiac sign my baby is, but it better not be a goat,” one prospective mother told CNN.

So what does the year hold for those goats? It seems they will face more pressure than ever this year. Feng shui master Li Juming says they should take more holidays to relieve their stress. Career-wise, they will encounter plenty of obstacles but as long as they persevere they will be rewarded in the end, says Shin Min Daily News. The newspaper also advises those born in the Year of the Goat to donate generously to charities to reverse their fortune (Gates should have nothing to worry about there).

But when it comes to the zodiac sign with the worst fortune in the year ahead, some feng shui masters believe it is those who are born in the Year of the Ox (1961, 1973, 1985). This is a group that includes US President Obama and if you believe the predictions he will likely experience a bleak year. An Ox should compensate by visiting temples and going to bed early to avoid getting sick.

On a more positive note, another Hong Kong feng shui master Li Chengze says those who are born in the Year of the Tiger (1962, 1974, 1986) are going to enjoy a rocking year. If they are still single they should consider tying the knot in the coming months. But for those who are married should be careful, however. Because they are so popular this year, they need to pay extra attention to avoid extra-marital entanglements.

Similarly, those who are born in the Year of the Rabbit (1963, 1975, 1987) should look forward to a rewarding year ahead. Chinese fortune tellers say rabbits can afford to make dramatic changes to their lives in what promises to be a fortunate period. They will make huge financial gains in the second half of the year apparently.

Meanwhile, in good news for investors, Beijing Business Today believes that this year will be a positive one for the stock market. In previous Years of the Goat, Hong Kong’s Hang Seng Index has posted gains. The newspaper also reckons China’s A-share market should continue to outperform in the coming Lunar year.

But not every sector will shine. This year is a “wood goat”, which means that metal and fire will flourish so investors should pay attention to metal- and fire-related stocks, like jewellery, electronics, and oil and gas. On the other hand, shares in the financial, technology, retail, telecommunications and internet sectors will be volatile.

Real estate, which is also related to wood, is said to be positioned to do well this year. That’s heaven-sent news for many struggling Chinese developers. Some brokers also think the property market could stabilise and begin to rise again. One positive: the central bank’s decision to cut the reserve ratio requirement last week may bode well for the housing market.

“Even though the central bank’s move to cut the reserve ratio is not directly aimed at propping up the property market, it will add more cash to the system, which is good news for the property sector,” says Sohu, a portal.
And Finally

A
other

Cell phoning
What life is like inside China's rowdiest prison

Another week, and another prison story hits the local press. Regular readers will recall that a fortnight ago we reported on how jailed officials were reducing their sentences by filing patents. In some cases they weren’t actually doing much in the way of invention. The Beijing Youth Daily found that outside agencies could take care of the whole process – so long as the family of the crooked bureaucrats paid an appropriate fee.

For Beijing Youth Daily this smacked of systemic abuse. By contrast the latest revelation against the penal establishment centres on gross failings at a single prison in Heilongjiang. But as CCTV informed its viewers, Nehe Prison is no stranger to controversy. Its “chaotic management” has seen six prisoners commit suicide between 2008 and 2014; and in a past scandal it emerged that its guards made extra cash by selling wine to inmates (at a 500% mark-up).

Bizarrely the prison’s bosses also got into the press in 2006 when it was revealed they’d bought 200 computers and made prisoners play World of Warcraft. This wasn’t a rehabilitation strategy, mind you. The prison pocketed the profits made by the better players from selling online the virtual weapons they had earned.

But past tales of management misdemeanours pale in comparison to the latest scandal involving Wang Dong, an inmate jailed for kidnapping. With the cooperation of some guards he’d smuggled a smartphone into the prison and began to make friends with at least seven women on WeChat. All of the ladies lived near the jail and were seduced by Wang’s charm, as well as a fraudulent scheme he got them to invest in. He was clearly a bit of a smooth-talker as he got at least one woman to transfer Rmb80,000 ($12,800) of her savings to his account.

But as newspaper New Cultural View notes, the most serious case involved a married woman who actually visited Wang in prison. That relationship got more intimate – especially after Wang bribed a prison officer to let her come to his cell, where they had sex. But in her case it was not a willing liaison. Wang was blackmailing her (in some of their early video chats she’d rather incautiously posed nude for him and he threatened to put the images online).

Eventually her husband, a police officer, found out what was going on, and reported Wang to the authorities.

The upshot: a team of troubleshooters was sent to the jail and late last month it sacked a number of prison officers from their posts. (New Cultural View also said that senior figures at the rowdy prison were told to compensate the defrauded women with a payment of Rmb300,000.)

Aside from confiscating his smartphone, what further punishments await Wang are as yet unknown.

Levered to the hilt?

“Before the [post-2007] crisis there was one area where debt was very low and stable, and that was China. When there was a crisis in the West, China could lever up. Now that is not the case”

— Luiggi Buttiglione of hedge fund Brevan Howard on China’s debt levels, which have quadrupled since 2007 to the equivalent of 282% of GDP. This figure emerged from a recent McKinsey study, and means the Chinese debt to GDP ratio now exceeds that of the US. But McKinsey adds that if financial sector debts are removed, the Chinese ratio remains lower than America’s.
China’s consumer price growth year-on-year in January, the lowest reading since November 2009. Apart from falling energy prices and benign food inflation, core inflation also eased to a multi-year low, suggesting weak domestic demand.

200,000
The number of TV sets Panasonic sells every year in China. However, the Japanese firm says it will stop making televisions in China, where it is faced with severe price competition and slowing market growth. Its Chinese television business has recorded losses for six straight years.

$230 million
The amount Sunshine Insurance has agreed to pay for the still-unopened Baccarat Hotel in New York. According to industry observers, Sunshine is paying the highest price ever for a New York hotel on a per room basis with the hotel’s 110 rooms going for more than $2 million each.

48%
Percentage increase in Baidu’s fourth-quarter revenue as the China-based search engine benefited from stronger marketing revenue and added more customers. In the latest period, revenue reached Rmb14.1 billion ($2.3 billion).