

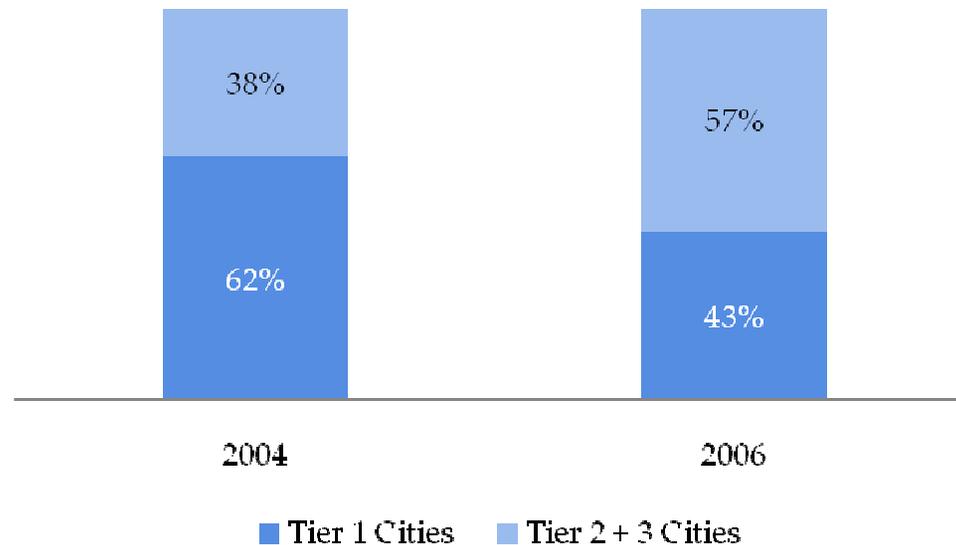
# *China's Financial Industry*



# Introduction

The traditional stronghold of wealth in China has been concentrated in the first tier cities and on the east coast which historically were the first to benefit from China's economic policies. With recent new policies and government drives, economic growth has been spurred in the second/third cities and beyond. With the increase in wealth and business in these areas comes a new breed of services and institutions to support this growth.

## Direct Foreign Investment into Real Estate in China



# Executive Summary

As the Chinese Financial System grows in terms of complexity and services offered, coupled with the increase in urbanization and SMEs, improvement in infrastructure and the rise of the affluent Chinese consumer leads to a multitude of investment potential in several areas.

## 1) Increase of Small Medium Enterprises

The growth of SMEs has been encouraged by the government and with this, new services and financial institutions have sprung up to fuel their need for loans, as well as a surge in lending from non traditional sources. Industries supporting the SME growth trend will be of great interest to investors.

## 2) Increasing Complexity of Financial Products

As financial markets move to a greater level of complexity with a wider range of financial vehicles and asset classes being made available, the infrastructure to support this has also grown in tandem. There is demand for products able to provide information on finance matters from both corporate and personal investors.

## 3) Payments

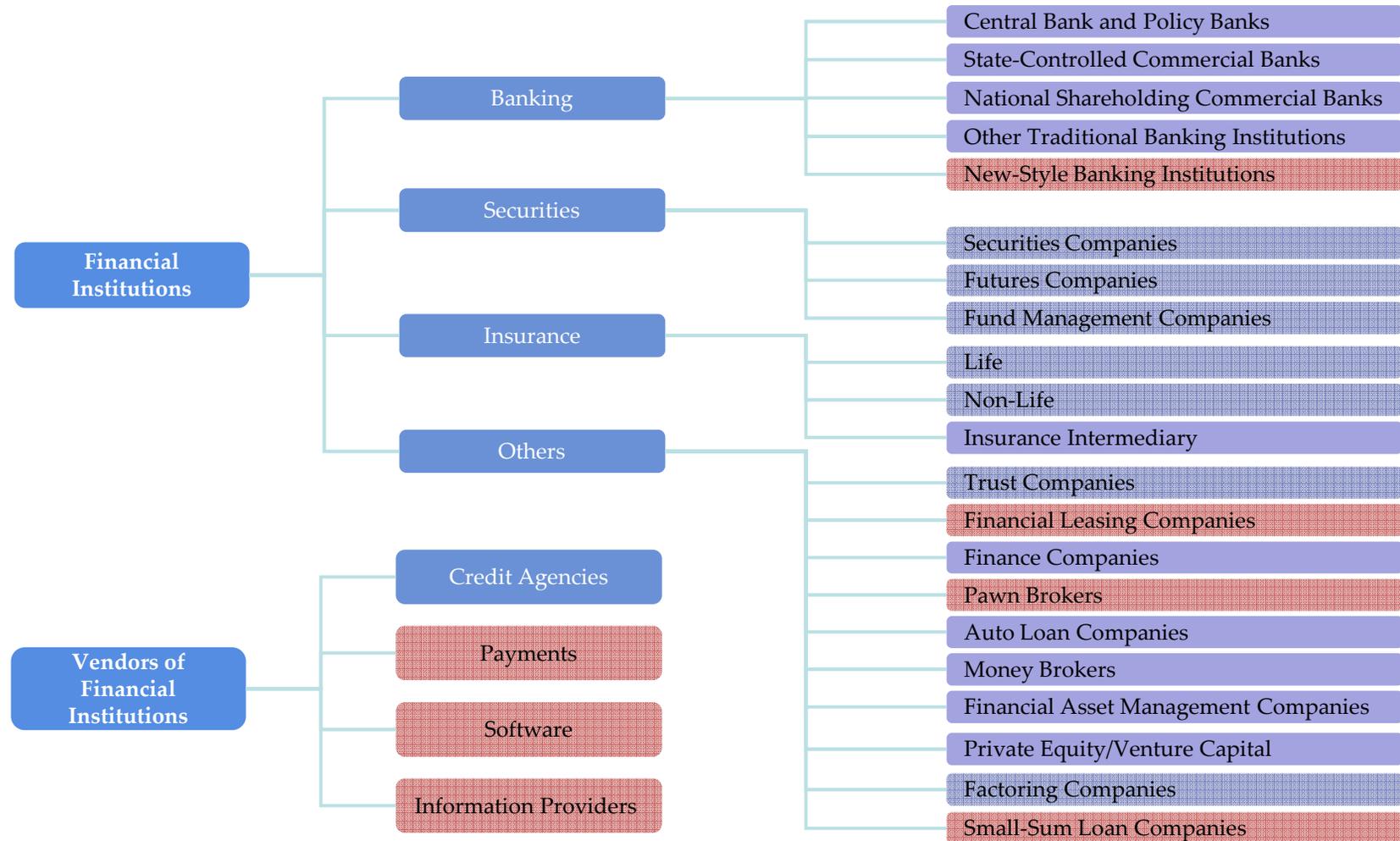
As migration from rural to urban areas continues and as the Chinese consumer indulges in more varied kinds of purchasing, they will require more innovative and convenient methods of paying for their goods as opposed to the traditional cash in full payments. Electronic payments and related industries will continue to be of interest.

## 4) Mainland Investment in Taiwan

Following the trend in other previously restricted industries, Taiwan's financial institutions should soon be open to mainland investment, and PE firms investing in Taiwanese companies stand to gain by purchasing now and selling to Chinese corporations in the future.

# Structure of China's Financial System

China has a maturing financial system, covering many sub-sectors with a wide and ever increasing variety of services and products. Areas of interest that we have looked at in detail are highlighted in red.



# Financial System Reform

Since 1978, China has been gradually reforming its financial system. From this, opportunities such as rural finance and SME lending have arisen. In addition, healthy and stable financial markets and regulatory systems have contributed to providing a better development environment for sectors such as credit agencies.

## Developing SMEs

- SMEs play a significant role in the Chinese economy but they find financing difficult, which has been a focus of both academic research and government meetings. The Chinese government has taken measures to solve the financing problem faced by SMEs
- The Chinese government actively promotes the development of SMEs. This brings investment opportunities in areas including SME lending and credit agencies

## Rural Finance

- Financial system in the Chinese rural area is weak. Rural finance has always been the focus of financial reform
- Investment opportunities lie in rural financial institutions

## Opening-Up of Chinese Financial Industry

- Over the past 20 years, China's financial institutions in the special economic zones, coastal open cities and inland central cities have approved a range of wholly foreign-owned and Chinese-foreign joint venture financial institutions
- Foreign financial companies have also stepped into China's vast rural area to benefit from the increasing demand for financial services

## China's Ambition to Expand its GDP

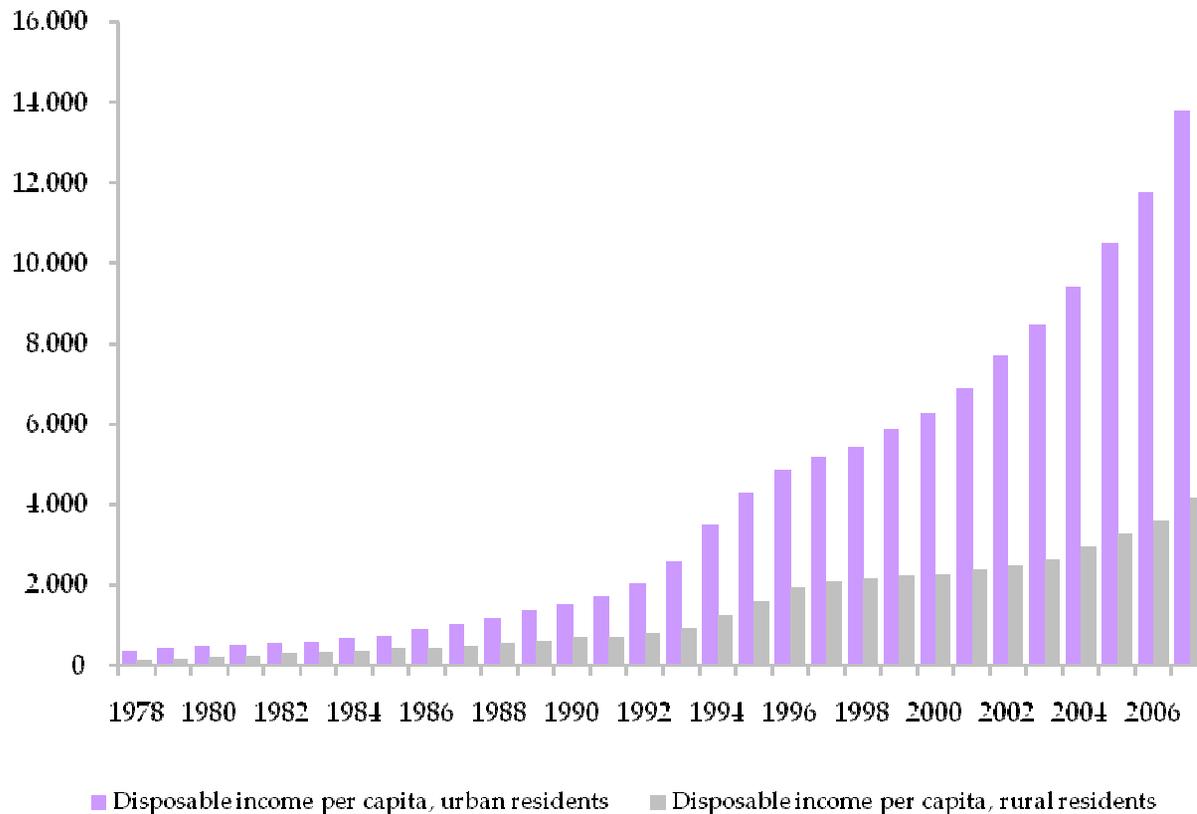
- On December 3, 2008, Chinese Premier Wen Jiabao hosted the executive meeting of the State Council to research how to make use of financial tools to promote the economic development. 9 policy measures were mentioned. The most significant measures to be implemented are
  - Maintain a moderate loose monetary policy and expand liquidity steadily
  - Encourage local governments to support credit guarantee companies through capital injection and risk compensation, set up SME loan guarantee funds and guarantee companies, increase SMEs loans, business tax breaks for qualified SMEs and loan credit guarantee companies, build up credit guarantee system in rural areas and actively expand housing, auto and rural consumer credit markets
  - Develop the safeguarding and financing functions of insurance, improve insurance services such as rural citizens insurance, housing and auto insurance, health insurance, and endowment insurance, guide the insurance companies to invest in transportation, telecommunications, energy, and rural infrastructure construction programs by issuing bonds
  - Financing channel innovation: M&A loans, real estate investment trusts (REITs), PE, etc.

# Rise of the Affluent Consumer

As Chinese consumers become more affluent, their demand for more varied and complex financial services increases accordingly. Many wish to start a new business or pursue diversified investment portfolios, which brings investment opportunities to areas such as SME lending, rural finance, insurance, bonds and credit agencies.

## 1978-2007 Disposable Income per Capita

Unit: RMB



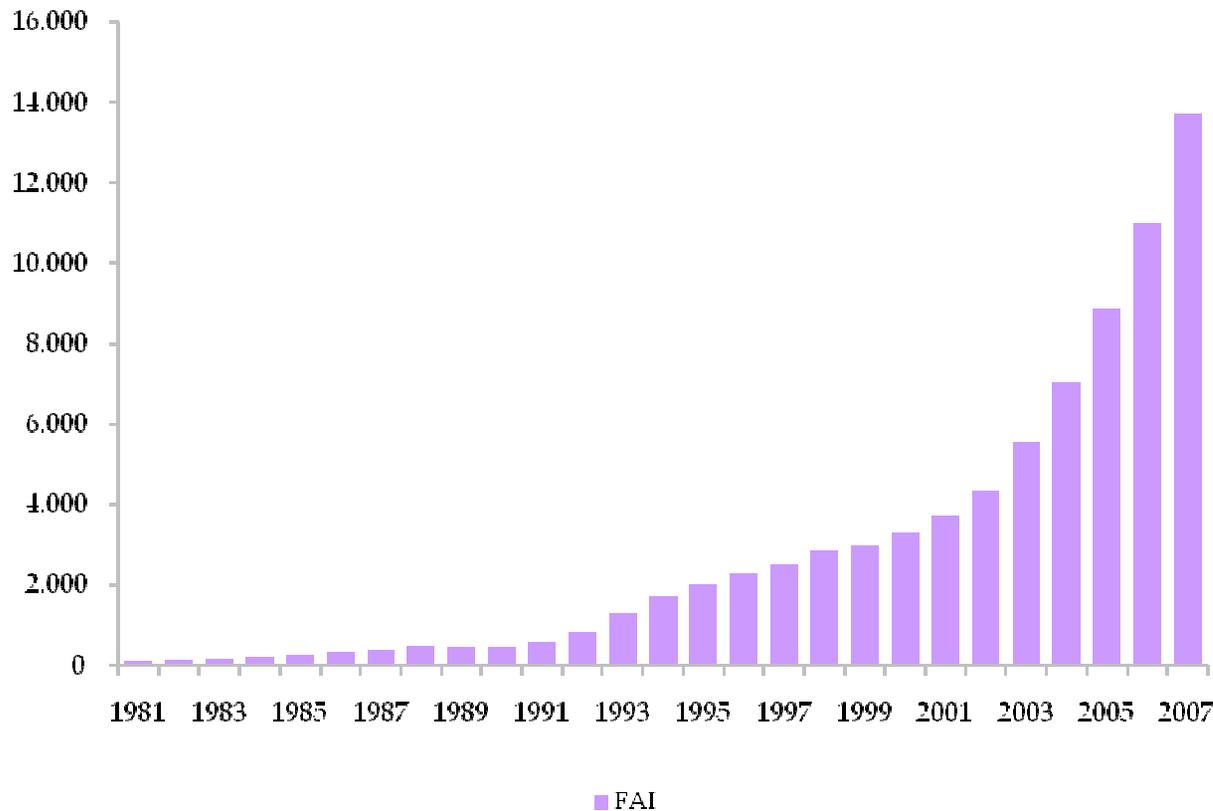
- Disposable income per capita has grown rapidly in the past 30 years (1978-2007 CAGR: 12.4% for urban residents and 8.5% for rural residents)
- The strong spending power demonstrated by Chinese consumers both domestically and abroad has caught the attention of market watchers during the past decade. They are more liberal than those of their savings-minded parents. The new consumers are trendy, hold white-collar jobs, own an apartment and a car and travel abroad extensively
- China's total consumer expenditure by 2008 was RMB10.4 billion (US\$1.52 billion). As the Chinese consumer grows more affluent with the emphasis of the Chinese Government on promoting quality of life and increasing per capita income, the urge for image and up market goods will continue to be an increasing trend

# Rapidly Developing Infrastructure and Urbanization

Infrastructure construction has had strong emphasis placed on it by the Chinese economy. This has been coupled and supported by mass urbanization and a rise in investment opportunities including SME lending, insurance, money transfer and credit agencies.

## 1981-2007 China Fixed Assets Investment

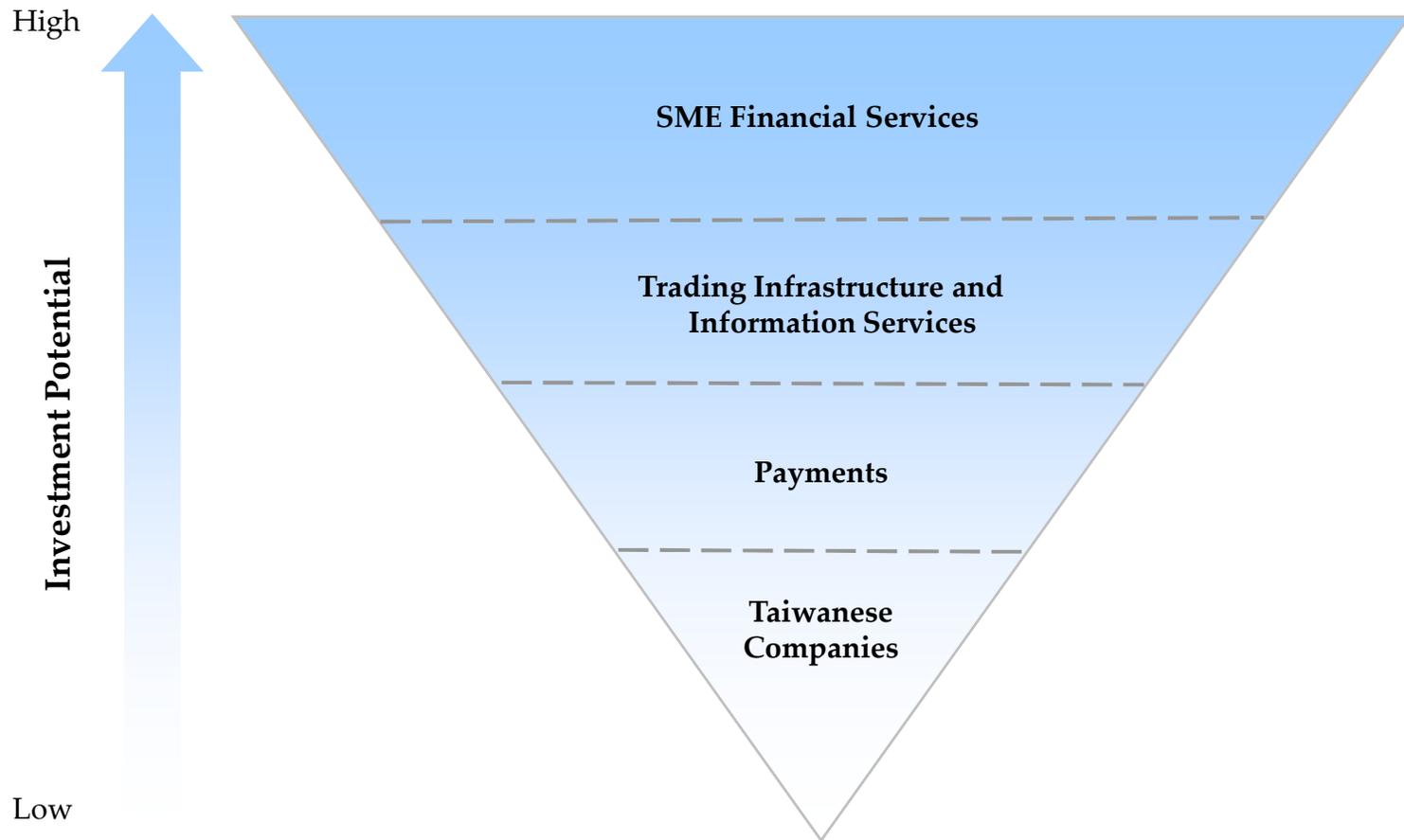
Unit: RMB, Billion



- China fixed assets investment (FAI) grew from RMB96 billion in 1981 to RMB13,724 billion in 2007, with CAGR of 57.6%
- Unlike developed economies, China has the opportunity to spur GDP growth via infrastructure investment. More than 70% of China's RMB4 trillion stimulus package will be used for infrastructure construction
- An annual average of 12 million people per year will migrate from China's rural to urban areas bringing opportunities for further services to be provided for these new arrivals to the cities

# Summary of Potential Opportunities

The development and rapid advancement of China's financial systems has led to opportunity in every sector, but at this time we believe the clearest opportunities to lie in the following areas.



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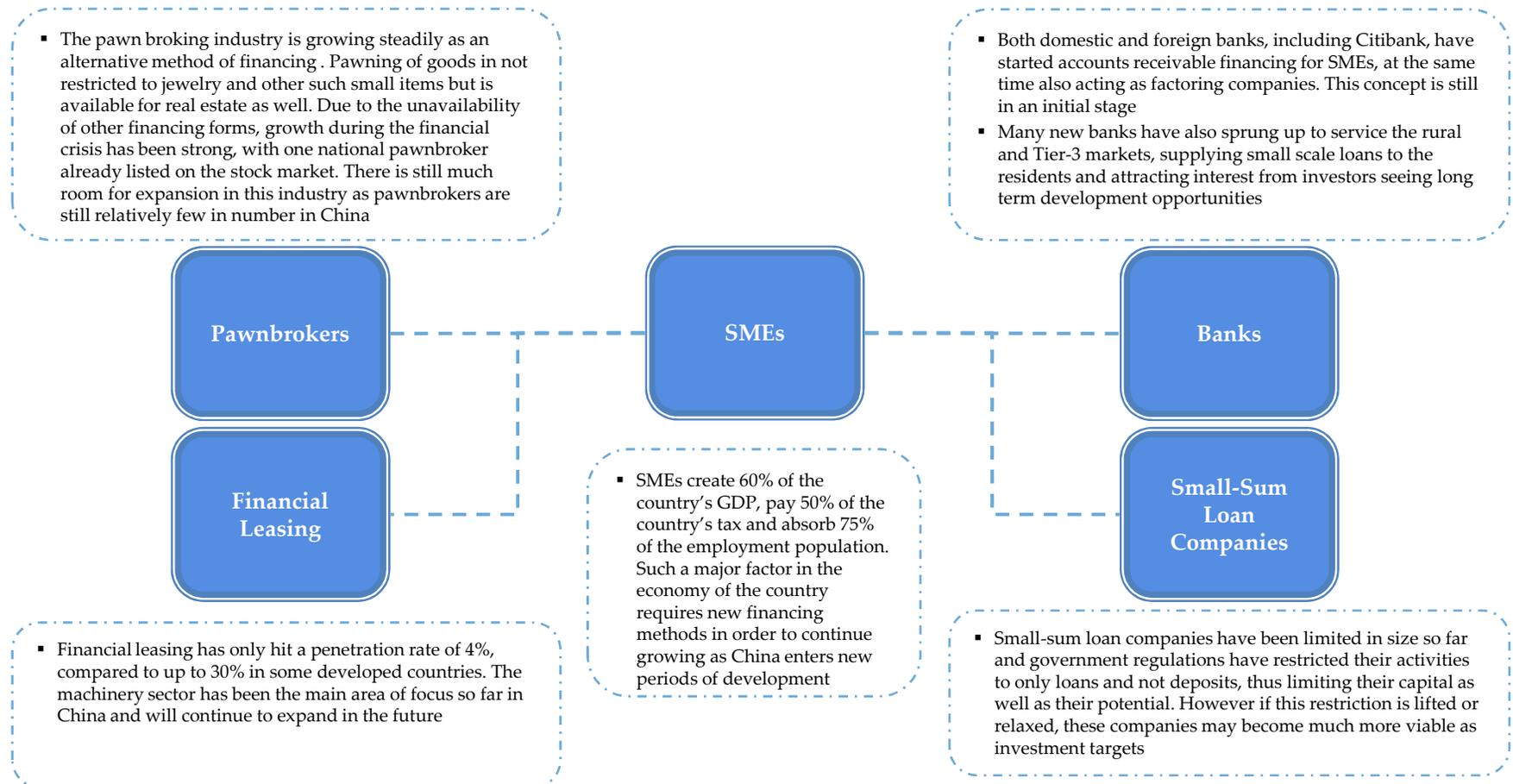
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# Overview

Due to the high risks associated with SMEs, only a small-sum amount of banking loans go towards their development. However, banks have introduced accounts receivable financing for SMEs which is still an emerging industry. At the same time, other loaning providers have been encouraged by the government to develop, providing an alternative source of funding to growing enterprises.



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# The Push for Development of SMEs

SMEs find bank loans hard to get and have to resort to the informal lending market. Demand for loans is high among private businesses. The government has been taking measures to solve the financing problem faced by SMEs. There appears to be investment opportunity in banking institutions which engage in SME lending.

## SMEs Drive a Major Part of Chinese Economy

- In 2008, China had more than 50 million SMEs and individually-owned businesses which account for 99.3% of all the enterprises
- SMEs created 60% of the country's GDP, paid 50% of the country's tax and absorbed 75% of the employment population

## Significant Demand for External Financing

- In 2008, only 5% of bank loans went to SMEs forcing most SMEs to resort to the informal lending market
- People's Bank of China (PBoC) estimates that private financing in China is about USD140 billion, up to 50% of external financing of SMEs

## Other Lending Institutions Needed

- Informal lending markets are estimated to be US\$100 billion and include loan sharks, pawnshops and underground banks
- Informal financing is usually the usurious loan market, which is largely considered illegal by the government
- Because of the high risk of usury loans, suicides of entrepreneurs have been hitting the headlines in recent years in China

## Government Policy Highlight

- China Banking Regulatory Commission (CBRC) issued *Proposals on Adjusting and Relaxing the Market Entry Policies for the Banking Institutions in Rural Areas to Support the Building of New Countryside* (December 2006)
- CBRC issued *Temporary Regulations on Village Bank Management and Guidelines on Approving the Establishment of Village Banks* (January 2007)
- PBoC and CBRC issued *Guiding Opinions on Pilot Operation of Small-Sum Loan Companies\** (May 2008)
- *Money Lenders Ordinance* was included in the legislative program of the State Council on Chinese Lianghui of this year\*\* (March 2009)
- China Premier Wen Jiabao presided over a State Council executive meeting to research into the development of SMEs (August 2009)

## Potential Investment Targets

- While Tier-1 and Tier-2 banks are more willing to make loans to large SOEs, Tier-3 and new-style banking institutions have devoted themselves to SME lending
- Tier-3 and new-style banking institutions (mainly village banks, small-sum loan companies, and consumer finance companies) are potential investment targets. Many deals have occurred frequently among these institutions in recent years

Note: \*Qualified small-sum loan companies may be allowed to become deposit-taking village banks. \*\*Chinese Lianghui – 中国两会, the second session of the 11th National People's Congress & the second session of the 11th Chinese People's Political Consultative Conference.

Source: CBRC; PBoC; Hexun; IFeng Finance; Xinhua; McKinsey;

# Rural Finance Development

New-style lending institutions have been opening in the last two years. The loan market in the rural area is big and growing, pushed by the government's plan of building new socialist rural villages. Therefore, there is significant opportunity in banking institutions engaging in rural finance activities.

## Vast Rural Area with Great Business Opportunities

- In 2008, 55% of Chinese were rural people (700 million people)
- Robust economic growth in the rural area has attracted both domestic and international financial institutions
  - In 2009, HSBC opened 5 village banks and Standard Chartered opened 1 village bank in China. Citibank has opened 3 rural loan companies
  - Both domestic and international investors show interest in possessing ownership in rural financial institutions

## Government Has Placed a Heavy Emphasis on Rural Area Development

- As of the end of 2008, total loans outstanding in the new-style financial institutions\* reached USD410 million, of which farmer individual loans and rural small business loans accounted for 96.8%
- A new plan implemented by 7 ministries will expand the rural lending market for cars and motorcycles going to the countryside. The government is going to spend USD735.3 million to drive consumption of 1.5 million vehicles
- On July 28, 2009, CBRC issued Work Plan for New-Style Rural Financial Institutions for 2009-2011, planning to set up 1,294 new-style rural financial institutions in China (1027 village banks, 106 rural loan companies, and 161 rural mutual cooperatives)

## New Types of Financial Institutions are Opening Up

- Existing financial institutions: rural credit unions, rural cooperative banks, rural commercial banks, rural mutual cooperatives, rural loan companies and village banks (the latter 3 have been recently allowed)
- As of the end of 2008, 107 of these new-style financial institutions had been opened (10 rural mutual cooperatives, 6 rural loan companies and 91 village banks)

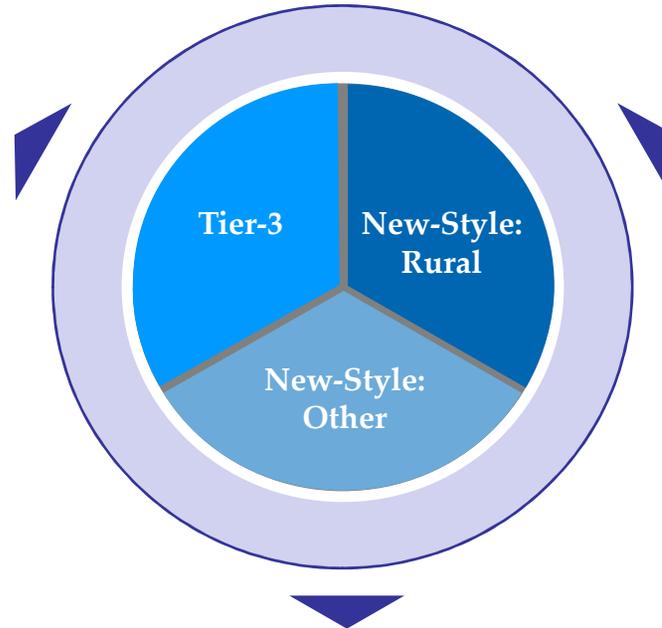
## Potential Investment Targets

- Rural banking institutions which form the bulk of rural finance
- Rural credit unions, rural cooperative banks, rural commercial banks and village banks

# Company Examples

## Examples of Tier-3 and new-style banking institutions

- Jiangsu Province Rural Credit Union
- Xiaoshan Rural Credit Union
- Changshu Rural Commercial Bank
- Weifang City Commercial Bank



- Sichuan Yilong Huimin Village Bank
- Shandong Shouguang Village Bank

- Wenzhou Yongjia Ruifeng Small-Sum Loan Co. Ltd.
- Shanghai Pudong Jinpu Small-Sum Loan Co., Ltd.
- Chongqing Yuzhong Hanhua Small-Sum Loan Co., Ltd.

# Recent Deals in Tier-3 Banking Institutions

Listed are some recent deals with approx USD30 million value in Tier-3 banking institutions.

	Target	Buyer	Stake	Deal Value (USD Millions)
Apr 2009	Jiangsu Dongwu Rural Commercial Bank	Suzhou International Development (Group) Co., Ltd.	10%	33.66
Mar 2008	19 Credit Unions in Ningxia	Yellow River Rural Commercial Bank	NA	23.42
Jan 2009	Bank of Ningxia	Zhejiang Hailiang Group Co., Ltd.	6.8%	25.75
Jan 2008	Jilin Bank	Jilin Yatai (Group) Co., Ltd	5.26%	25.13
Dec 2007	Huishang Bank	China National Cereals, Oils and Foodstuffs Corp.	1.26%	23.98
Nov 2007	Taizhou City Commercial Bank	China Merchants Bank	10%	36.47
Aug 2007	Qingdao City Commercial Bank	N M Rothschild & Sons Ltd. (UK)	5%	34.74
Dec 2006	Jiangsu Bank	Jiangsu Huaxicun Co., Ltd.	3.11%	38.13
Aug 2006	Hangzhou City Commercial Bank	Asian Development Bank	4.99%	27.15
Jul 2006	United Rural Cooperative Bank of Hangzhou	Rabobank Nederland	10%	22.18
Dec 2005	Tianjin City Commercial Bank	Baotou Huazi Industry Co., Ltd.	5.17%	29.72
Nov 2005	Hangzhou City Commercial Bank	Hangzhou Steam Turbine Co., Ltd.	7.97%	29.69

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# Pawn Broking Market Overview

In order to satisfy the funds required by the development of SMEs, the pawn broking industry has been encouraged by the government to develop.

## Revived and Deregulated Development (1987-1992)

- In 1987, the emergence of Chengdu's Huamao Pawn Corporation was the sign of the revival of China's pawn industry
- In order to stimulate the development of the pawn industry, the problems of multi-management, lack of regulation policies and the opening of new branches must be faced
- During this period, pawn companies increased to more than 3,000, with a growth of approximately 500 per year

## Restructure and Reorganization (1993-1999)

- In 1992, Sunny Loan Top, China's only listed pawn shop, went public on the SSE
- In 1993, PBoC released 'Notice to Increasing the Management in Pawn Industry', giving clear indications that the pawn industry will be regulated by the PBoC, and begun the restructure and reorganization of the pawn industry
- In 1995, the Ministry of Public Security issued 《典当业治安管理办法》 to protect the operating environment for the pawn industry
- In 1996, the PBoC issued 'Temporary Measures on Administration of Pawn Industry' to enhance regulation
- During this restructuring period, the number of pawn companies reduced to 1,350 with total assets of over RMB8 billion

## Fast Development (2000-Now)

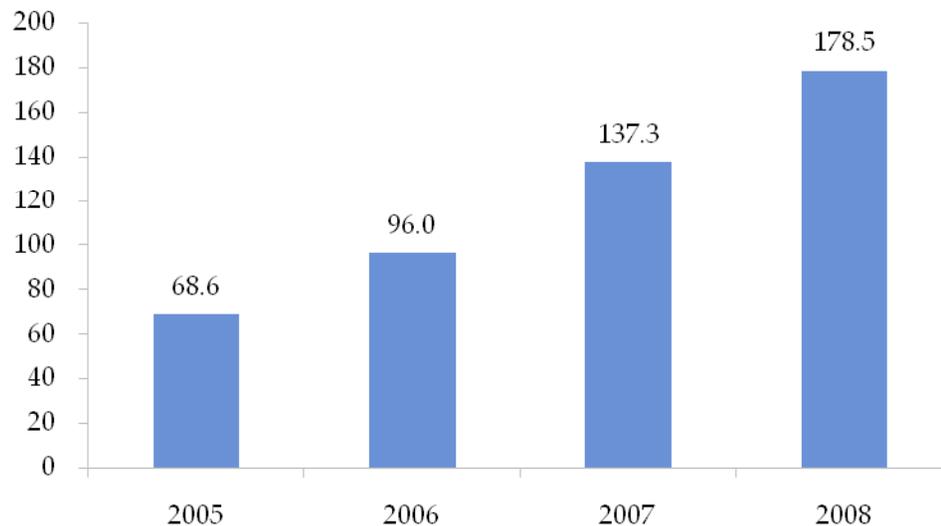
- In 2000, in order to meet the requirements of financial reform, the Chinese government placed the pawn industry as a non-financial industry which will be regulated by the State Economic and Trade Commission
- In 2001, the State Economic and Trade Commission reorganized the pawn industry again, reducing the number of pawn companies to 890
- In August 2001, the State Economic and Trade Commission launched 'Measures on the Administration of Pawn Industry', encouraging and stimulating the development of the pawn industry using a scalable business model
- By the end of 2004, the number of pawn companies increased to 1,374 with total assets of approximately RMB 10 billion
- In 2005, the Ministry of Commerce and Ministry of Public Security became the regulatory institutions for this area and released modified 'Measures on Administration of Pawn Industry'
- By the end of 2007, the number of pawn shops increased to 2,342 with total assets of RMB86.2 billion
- In 2008, the pawn industry experienced fast development, as affected by the financial crisis, SMEs were facing the problem of fund raising and resorting to alternative methods

# Market Statistics

Along with the development of SMEs in China, the pawn broking industry has experienced fast growth in the past years, and the value of pawning has increased to RMB178.5 billion in 2008.

## Pawn Market Size

Unit: RMB, Billion



- In the first half of 2007, the pawn industry provided 38,000 transactions for SMEs, up 18% YOY, with the value of pawning reaching RMB22.2 billion, and provided 99,000 transactions for the residents, up 8% YOY, with the value standing at RMB19.9 billion
- In 2008, facing a shortage of liquidity in the market while banks were reluctant to lend, many SMEs turned to loans from pawn shops

# Investment Opportunities

Although the government has strict regulations on the establishment of pawn companies, there are still some investment opportunities in China's pawn broking industry.

## Lack of Professional Personnel

- Pawn business covers a wide range of areas, such as real estate, jewelry, stocks and other high liquidity assets , and needs multi-industry knowledge professionals
- There is only one government institute in Dalian and two private institutes in Hubei and Beijing that conduct pawn investigation and research. They are currently lacking analysts, stalling the development and progress of academic research

## Growth of the SME Market

- Although SMEs account for 90% of the total number of companies in China and provide 75% of the employment opportunities in town, they only take approximately 30% of total loans issued by banks
- In order to support to the development of SMEs, both central and local governments have engaged in efforts to help them solve the problems of raising funds
- The development of the pawn market in China gives SMEs additional financing channels to mitigate their financing problems

## Potential Market for Expansion

- Although by the end of 2007, the number of pawn shops increased to 2,342 with total assets of RMB 86.2 billion, compared with other developed countries, the Chinese pawn industry is still in its initial development stage
- Sunny Loan Top Co. Ltd (SHA:600830) went public in 2000 with a current market value of 3.7 Billion RMB. It is currently China's only listed pawn broker.
- The ratio's of people to pawn shops is still lacking by a large margin in comparison to developed nations. The US has 1,700 people/pawn shop, Japan has 3,000 people/pawn shop, and Singapore has 5,000 people/Pawn shop. However, China only has 0.6 million people/pawn shop by the end of 2007
- Along with economic development, the number of pawn shops should grow accordingly and will experience another fast growth stage

# Recent Deals

Listed are some recent deals involving pawn broking shops and buyers.

	Target	Buyer	Stake	Deal Value (RMB Millions)
2007	Shanxi Yulong Pawn Corporation	Tanrich Securities Co., Ltd.	55%	30
	Shaoxing Tianye Pawn Corporation		57%	15
	Zhejiang Jinbao Pawn Corporation		55%	20

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# Financial Leasing Market Overview

Compared to European and American markets, China's financial leasing market is still immature.

## Development of China's Financial Leasing Market

- In Feb. 1981, financial leasing was introduced into China. China Oriental Leasing Co., Ltd., China's first foreign-invested (China-Japan) financial leasing company, was established. China Leasing Co., Ltd., China's first domestic financial leasing company, was established in July 1981
- After China's entry into the WTO in 2001, financial leasing was heavily restructured
- At the end of 2004, Ministry of Commerce and State Administration of Taxation started experimental operation of domestic financial leasing companies
- In 2007, CBRC issued Administrative Measures for Financial Leasing Companies
- In December 2008, financial leasing companies (those who are regulated by CBRC) were permitted to issue financial bonds

## Market Structure

- Three types of leasing companies are qualified to provide financial leasing services in China
  - Financial leasing companies regulated by CBRC (12): As of the end of May 2009, their assets surpassed RMB94.8 billion, of which leasing assets is RMB85.5 billion. The assets mainly go to twelve areas including machinery equipment, airplanes, and ships
  - Foreign-invested financial leasing companies regulated by the Ministry of Commerce (approx 100)
  - Experimental domestic financial leasing companies regulated by the Ministry of Commerce (37)

## Market Size

- As of the end of 2008, cumulative registered capital of the 150 financial leasing companies was at RMB500 billion, with a total transaction value at RMB140 billion
- In China, the machinery industry had the highest financial leasing penetration rate\* , which was 8.3% with a total transaction value at RMB24 billion in 2008. Machinery companies such as Shaanxi Automobile Group Co., Ltd, Yuchai Group and Longgong (Shanghai) Machinery Co., Ltd had all engaged in financing leasing business
- The accumulative market value of China aviation leasing market has reached USD200 billion, the average annual newly added contract value was USD8.6 billion, especially in 2005, the contract value was totaled at USD16 billion. By the end of 2007, China had a total of 1,131 planes, 70% of them were acquired in the form of leasing, of which, 30% were financial leasing

# Investment Opportunities

China's financial leasing industry, especially the construction machinery financial leasing market, has huge growth potential. Investment opportunities come from significant importance of infrastructure construction to the Chinese economy and China's determination to develop its domestic SMEs.

## Low Penetration Rate Implies Development Potential

- Financial leasing penetration rates in European and American markets are about 15% and reach up to 30% in some countries. But in China, this rate is only 4%
- Low penetration rate indicates huge growth potential in Chinese financial leasing industry

## China's Commitment to Expand GDP and Develop SMEs are the Main Investment Themes

- Fixed assets investment (FAI) is an important tool for China to push economic growth; equipment investment accounts for about 40% of FAI
- Financial leasing has a unique advantage in promoting the development of SMEs

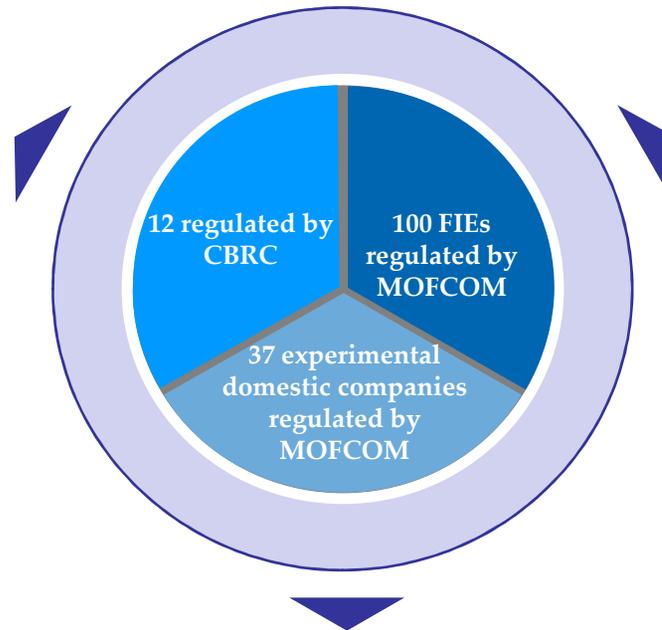
## China's Construction Machinery Financial Leasing Market will be a Bright Spot

- Chinese government has adopted the policy to positively expand upon the demands of the domestic market, which brings opportunities to the rapid development of the construction machinery financial leasing industry.
- The penetration rate of Chinese construction machinery financial leasing market is only about 8%
- The penetration rate of Chinese domestic construction machinery financial leasing is estimated to increase year by year. It is estimated that in 2010, it will be 12% and in 2015, it will reach 25% and market size will reach USD20 billion
- Financial leasing benefits both construction machinery enterprises and SMEs
  - For those construction machinery enterprises with large scale and sufficient cash flows, setting up their own financial leasing companies is very significant. Especially in the background of the financial crisis, bank mortgage amounts can not satisfy the sales demands of quite a few construction machinery enterprises. As a new sales model, to some degree, the financial leasing makes up for this demand
  - For SMEs, financial leasing is a very important financing channel

# Company Examples

## Examples of financial leasing companies operating in China

- ICBC Leasing Co., Ltd. (wholly owned by Industrial and Commercial Bank of China)
- Huarong Financial Leasing Co., Ltd. (99.9% owned by SOE - China Huarong Asset Management Corporation)
- CCB Financial Leasing Co., Ltd. (JV of China Construction Bank and Bank of America)



- International Far Eastern Leasing Co., Ltd. (Sino-foreign JV)
- Golden Bridge United Financial Leasing Co., Ltd. (wholly owned by foreign investors)

- Wanxiang Leasing Co., Ltd.
- Changjiang Leasing Co., Ltd.
- Huayuan Leasing Co., Ltd.
- Chongqing Yin Hai Leasing Co., Ltd.

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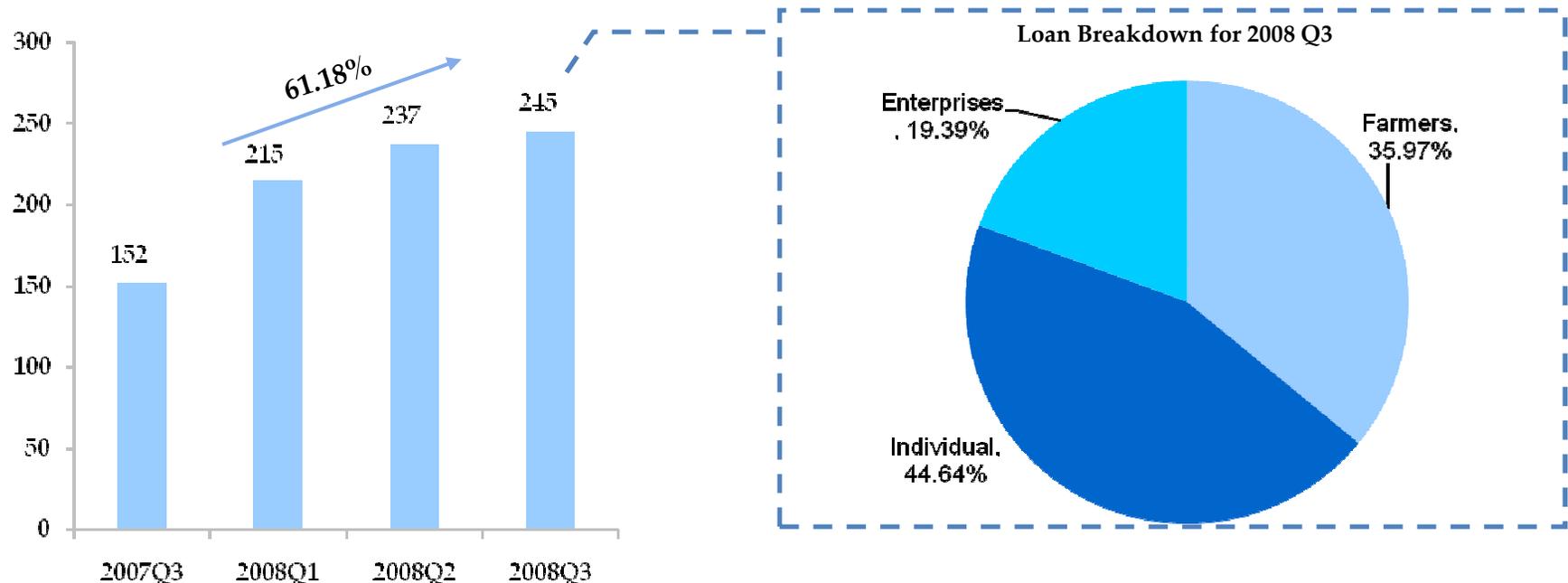
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# Small-Sum Loan Providers

In China, SMEs make up more than 90% of the total enterprises in the country. For a long time, due to the difficulty of direct financing, SMEs main debt financing method has been to rely on indirect financing. Small-sum loan companies are a new government-backed financing method which mainly provides funds to support SMEs and agriculture including farming activities.

## Loans Issued by Small-Sum Loan Companies

Unit: RMB, Billion



- In 2005, the first two small-sum loan companies, namely Jinyuantai and Rishenglong, were founded in Shanxi Province, promoted by the People's Bank of China. So far there are seven small-sum loan companies established in China. The overall operating performances of the 7 small-sum loan companies have been healthy and they provided RMB390 million in total loans in 2007 and RMB763 million until September 2008
- According to data released by CBRC, the number of small-sum loan companies has reached 583 in China, with an additional 573 small-sum more in preparations to open soon

# Investment Opportunities

Although small-sum loan financing in China has developed and made great progress over a period of more than 10 years, it is still on its initial stages with incomplete regulation and barriers to entry

## Large Potential Market

- In China, SMEs take up more than 90% of total enterprises in the country, created 60% of the country's GDP, pay 50% of the country's tax, and absorb 75% of the employment population. The potential for expansion is huge
- Currently only 5% of bank loans go to SMEs because of their uncertain industry future and financial performance which make SMEs resort to the informal lending market. The PBoC estimates that private financing in China is about USD140 billion, and up to 50% of the external financing of SMEs

## Government Regulation Risks

- 'Only loan and no deposit' policies cause narrow sources of raising funds for these microcredit companies. Reducing the liquidity of their capital and increasing their operational risks, limiting the overall development of these small-sum loan companies
- Although there have been several regulations published by the PBoC and the CBRC, there is still a lack of complete laws to regulate and guide the small-sum loan companies in their business activities. The high threshold of being a financial institution still limits the development of small-sum loan companies

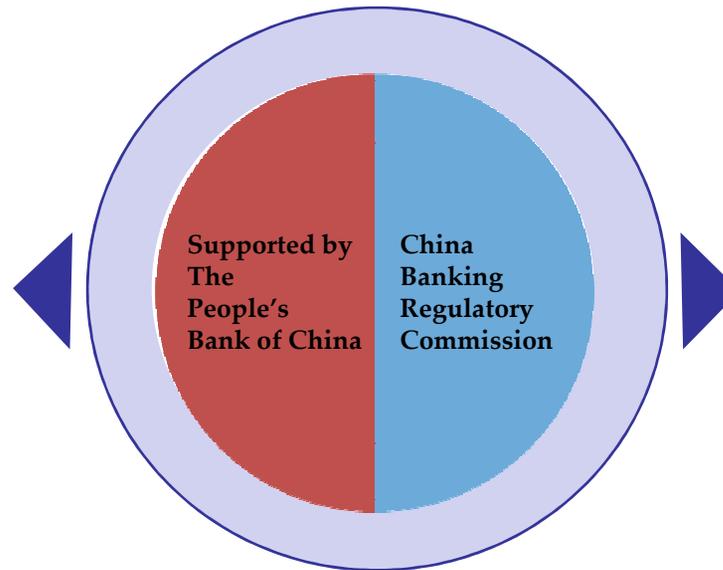
## The Difficulties Microcredit Companies Met

- Lack of funding sources. Only able to raise funds from owner's equity, donations and capital from no more than two different banks
- Lack of talent. It is difficult to attract talent because of the monotonous business of the work. The management of companies can not be improved using international standards and practices and the financial risks can not be not effectively controlled

# Company Examples

Examples of companies operating as small-sum loan companies in China

- Shanxi Jinyuantai Small-Sum Loan Company
- Shanxi Rishenglong Small-Sum Loan Company
- Sichuan Quanli Small-Sum Loan Company
- Guizhou Jiangkuohuadi Small-Sum Loan Company
- Shanxi Xinchang Small-Sum Loan Company
- Shanxi Dayanghuixin Small-Sum Loan Company
- Inner Mongolian Rongfeng Small-Sum Loan Company



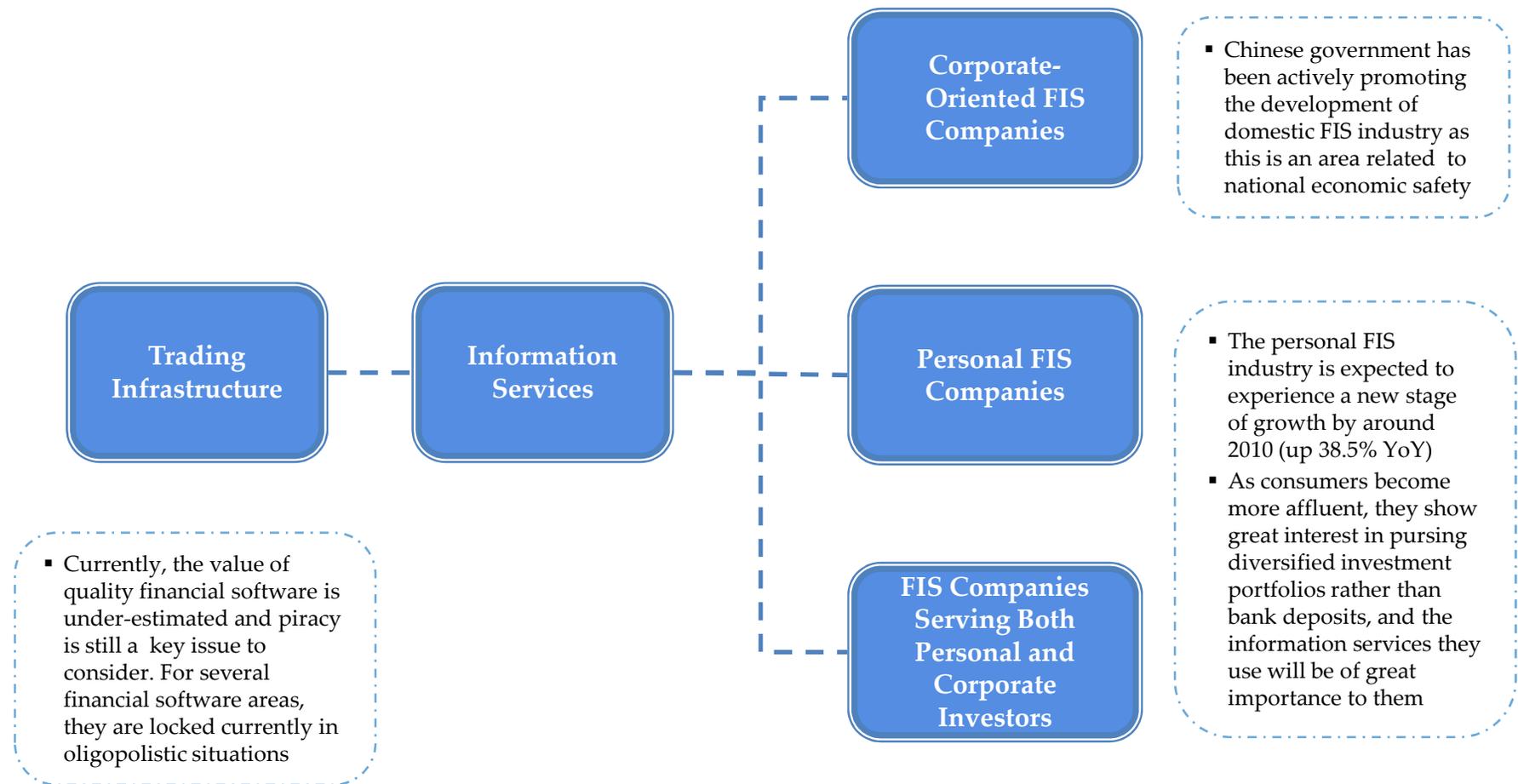
- Small-sum loan companies were founded by several listed companies in Wenzhou in Zhejiang Province:  
Ruianhuafeng Small-Sum Loan Co., Ltd.  
Yongjiaruifeng Small-Sum Loan Co., Ltd.  
Cangnanlianxin Small-Sum Loan Co., Ltd.

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# Overview

Investment opportunities with regards to trading infrastructure and information services are related to China's economic growth and the performance and interest level of securities and financial derivatives markets. As China moves into an information age, people will expect a more professional level of information services regarding financial topics. This area, however, is heavily regulated. Foreign-owned providers are strictly limited to the services they can provide in order to prevent them from acting as news centers.



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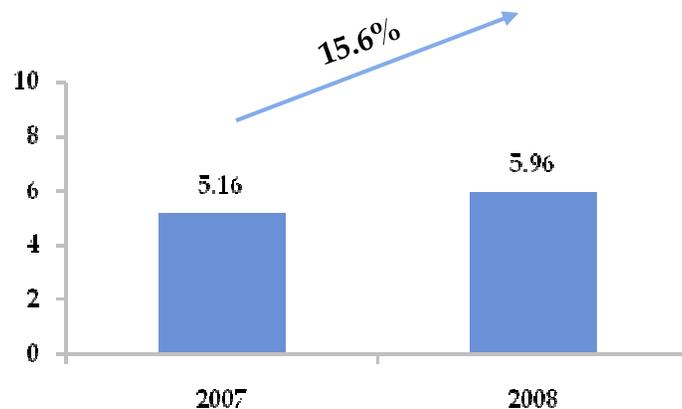
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# Financial Software Industry Overview

As the scope and complexity of the financial industry grows, there is great demand for more professional software and management tools and products from banks, securities and insurance firms.

## Bank Software Investment

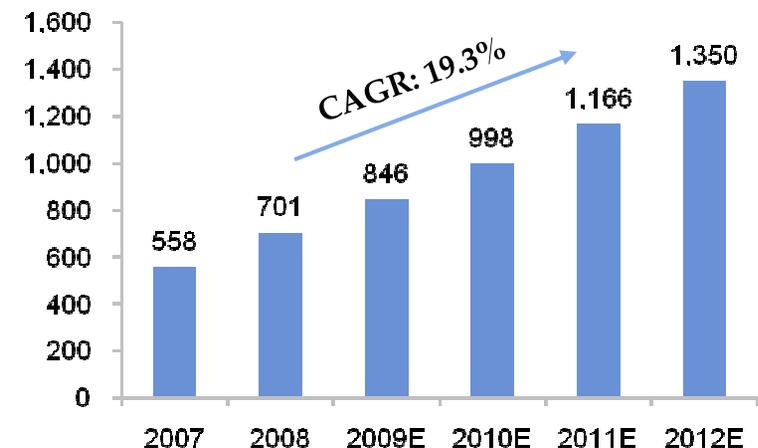
Unit: RMB, Billion



- Merchant banks have increased their investment in order to accommodate the needs of the development of modern merchant banks, such as e-banking services

## Insurance Software Investment

Unit: RMB, Billion



- Insurance software investment took up less than 20% of insurance information technology investment
- Insurance software is still in the preliminary stages of growth

## Securities software investment:

In the short-term, the demands of software may decline periodically because of the unclear securities market prospect.

In the future, investment will focus on transactions management software. These factors will stimulate the growth of the software investment in securities firms:

- New financial derivatives
- Continuing upgrading to meet the needs of transactions
- Firms payment capability

# Investment Opportunities

Keeping pace with the overall development of the financial industry, investment into software will continue to increase. However, at the moment the software industry for financial related products is in an oligopolistic situation.

## Significant Demand from Financial Institutions

- The rapid growth of the macro-economy is of great benefit to the development of the financial industry. Financial firms will increase in number and size and their requirements towards financial software will be more professional
- Customers' awareness of financing will increase because of the growth of their income, thus financial institutions have more incentives to improve their equipment and systems

## Profit Margins will be Increased

- Currently, the value of financial software is under-estimated. The price of local financial software is only 10% of the foreign software

## Risks from Government Policies and Capital Market

- Government policies will continue to affect the financial industry and software investment
- The performance of financial industry has influence on financial software investment. If the financial institutions' transactions are not profitable, poor performance may make them unwilling to invest in and improve on their financial software

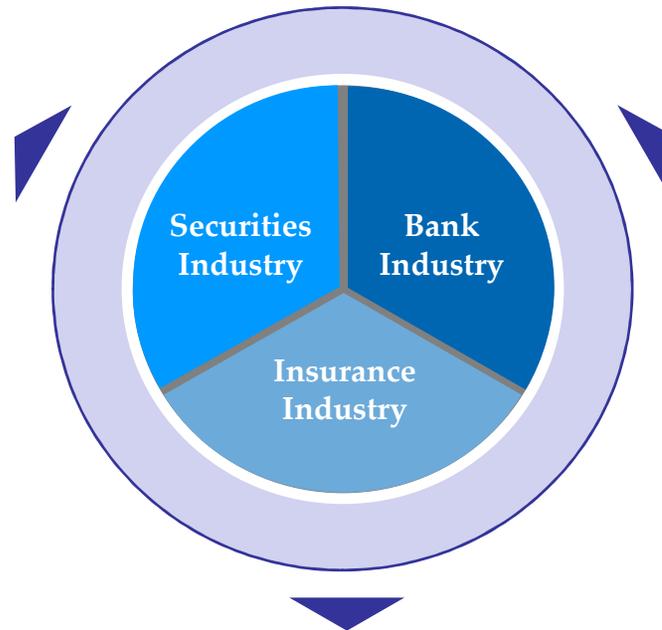
## Oligopolistic Situation

- Hundsun Technologies Inc. currently dominates the financial software industry, holding an almost absolute monopolizing position on fund and asset management software systems. In 2009, it acquired Shanghai Leadmind Technologies Co., Ltd. in order to expand into the bank businesses

# Type of Companies

Examples of companies operating in this industry. Hundsun Technologies Inc. dominates the vast majority of market share in both securities and banking areas

- Hundsun Technologies Inc.
- Shenzhen Kingdom
- Singlee Group
- SunGard China
- Fujian Apex Software Co., Ltd



- Hundsum Technologies Inc.
- Shenzhen Kingdom
- Singlee Group
- Hangzhou Sunhoo Co., Ltd

- Wanxiang Leasing Co., Ltd.
- Changjiang Leasing Co., Ltd.
- Huayuan Leasing Co., Ltd.
- Chongqing Yin Hai Leasing Co., Ltd.

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3. **Trading Infrastructure and Information Services**
  - **Information Services Market**
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# Financial Information Services Market Overview

Depending on customers serviced, China's financial information services (FIS) companies can be categorized into three types: individuals-oriented FIS companies, institutions-oriented FIS companies and FIS companies serving both individual and institutional investors.

## Individuals-Oriented FIS Market

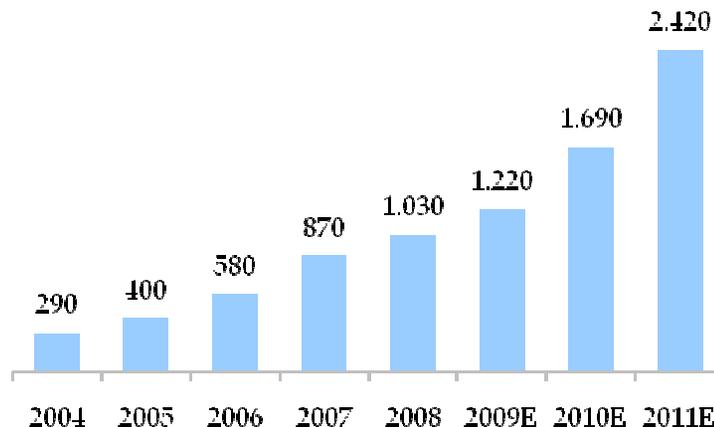
- The individuals-oriented FIS companies usually run websites providing FIS to customers via the internet
- Development history
  - Introduction (1996-2004): Financial vertical portals\* were successively set up. Business model was not clear. Revenue was mainly from advertisement
  - Growth (2004-2012): The competition has become fiercer in this market. Multiple conglomerates would come into being to dominate the market and to claim more than 80% of all the customers and revenue
  - Maturity (2012-): Market structure will form and entry barrier will be high. Business model will be mature

## Institutions-Oriented FIS Market

- The institutions-oriented FIS companies provide financial database services and terminals to customers
- The market size is approx RMB5 billion (USD0.74 billion), compared to Bloomberg's 2007 revenue of USD5.4 billion

## China's Individuals-Oriented FIS Market Size

Unit: RMB, Million



- The boom in China's stock market in 2006 and 2007 greatly boosted the individuals-oriented FIS market, with the revenue of RMB580 million (up 45% YoY) and RMB870 million (up 50% YoY) respectively
- In 2008, the downturn of the stock market made a significant impact on the FIS market and the YoY growth rate was only 18.4%, resulting in revenue of RMB1.03 billion
- Revenue of individuals-oriented FIS companies comes from internet advertisement, analytical software (developed for individual investors), consulting fee (research reports selling), mobile value-added services, and online transactions

Note: \*A vertical portal (sometimes called vortal) is a website that provides a gateway or portal to information related to a particular industry  
Source: Market Avenue; iResearch; Wenhui-xinmin United Press Group

# Investment Opportunities

Investment opportunities come from China's robust economic growth and stock market, rise of affluent consumers and government support. Those FIS companies with clear business models and relatively large market share are potential investment targets.

## Investment Themes for Individuals-oriented FIS Market

- In the long term, China's economy is expected to grow steadily and rapidly. Therefore, after the stock market bottoms out, China's individuals-oriented FIS industry is expected to embrace a new stage of growth by around 2010 (up 38.5% YoY)
- As Chinese consumers become more affluent, they show great interest in pursuing diversified investment portfolios such as stocks, mutual funds, gold, real estate, luxury goods, etc., rather than bank deposits. Access to more information to allow them to make these decisions is a vital tool to success
- In China, rapid income growth means that nearly 60% of the population will be considered middle class (with incomes between USD6,000 and USD30,000 in PPP terms) by 2015, up from 37% today. Middle class are considered to be the main visitors of the FIS websites

## Institutions-oriented FIS Market

- As FIS is an area related to national economic safety, the Chinese government has been actively promoting the development of domestic FIS industry. They aim to build up one or two leading FIS companies with international competitiveness
- After China's entry into WTO, China has been lowering entry barriers for foreign FIS suppliers. Provisions on Administration of Financial Information Services in China by Foreign Institutions\* was issued in April 2009. The foreign-invested FIS enterprises established in China shall conduct business activities according to their registered business scope strictly and shall not engage in any news collection and news agency business

## Potential Investment Targets

- For both individuals-oriented and institutions-oriented market, potential investment targets are those with clear profit models and relatively large market share

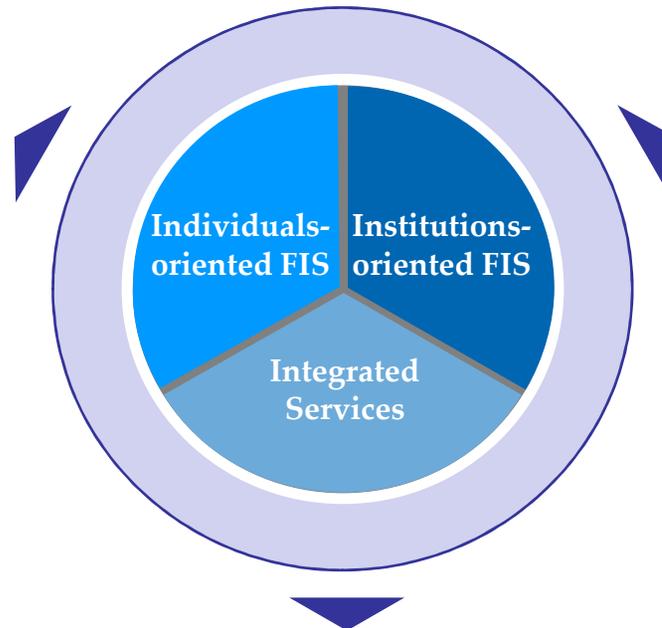
Note: \*FIS company in this Provisions means a supplier providing information and data that may affect the financial markets for clients engaging in financial analysis, financial transactions, financial decision, and other financial activities

Source: Goldman Sachs; Information Office of the State Council; Ministry of Commerce; Market Avenue

# Company Examples

Examples of companies operating in this industry

- Hexun.com (2008 revenue: over RMB100 million)
- Eastmoney.com
- Cnfol.com
- 788111.com (Dayingjia)
- Compass (analytical software only)
- Cnsec.com (Zhengquantong)
- Gw.com.cn (Dazhahui)



- Xinhua 08
- Wind Information Co., Ltd.\*
- Shanghai Juyuan Data Services
- All China Marketing Research Co. Ltd. (ACMR)
- Huiyuan Baoyin Information & Technology Co., Ltd.
- TX Investment Consulting Co., Ltd.
- China Economic Information Network
- Financial China Information & Technology Co., Ltd.

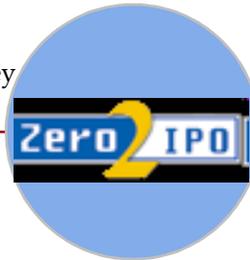
- China Finance Online (NASDAQ: JRJC; Revenue was USD56.24 million in 2008, up 117% YoY)
  - Jrj.com (individuals-oriented)
  - Stockstar.com (individuals-oriented; acquired at price of USD8 million in August 2006)
  - Shenzhen Genius Information Technology Co. Ltd. (institutions-oriented; acquired at price of USD1 million in July 2006)
  - Daily Growth Securities Ltd. (a Hong Kong Brokerage firm)

# Case Study (1/2)

Zero2IPO is a leading integrated service provider in China's PE/VC industry

## Company Overview

- **Headquarters:** Beijing
- **Founded:** 1999
- **Offices:** Shanghai, Shenzhen, Hong Kong and Silicon Valley



## Business Overview

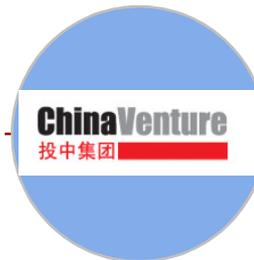
- **Investment Banking Services:** Investment Banking Division (IBD) represents high-potential, high-growth China enterprises seeking PE/VC funding. Through its extensive investors network worldwide, IBD channels over USD200 million to startups each year. These companies are distributed across a broad spectrum of industries, including biotechnology, health care services, telecommunications, media, education, internet and e-commerce
- **Financial Information Services (FIS)**
  - FIS releases annual, quarterly, and customized research reports covering China's PE/VC, M&A, and IPOs. Also known as the Zero2IPO Research Center, FIS is viewed as the most trustworthy information source in the industry. FIS reports are used by investors, LPs, investment banks, auditing firms, law firms and entrepreneurs worldwide. Each year, FIS publishes the China venture capital ranking results which are widely accepted and quoted among these professionals
  - Zero2IPO Database: Profiles and contacts of active VC/PE funds, fund commitments, portfolio company investments, M&A and IPO data and latest investment trends
- **Media & Network Services (MNS):** MNS strives to provide a networking platform for entrepreneurs and investors. Since 2000, MNS has organized more than 20 China Venture Capital & Private Equity Forums and over 70 Z-Club activities. Each year, over 5,000 participants attend these conferences and club events held in Beijing, Shanghai, Tokyo, London, and Silicon Valley. Together, the China Venture Capital & Private Equity Forums and Z-Club events constitute the largest networking platform for investors and entrepreneurs in China
- **Zero2IPO Capital:** Formed in 2006, Zero2IPO Capital is a venture capital arm of the Group targeted at high-potential, high-growth China enterprises. Leveraging Zero2IPO's vast network in China, Zero2IPO Capital does not compete with other venture funds, but rather pursue a two-prong investment strategy, i.e. to co-invest with active venture capital firms in growth and late stage companies and to lead or co-lead in early stage startups in China

# Case Study (2/2)

ChinaVenture is a Chinese research and consulting institute that provides third party research services, including standardized research results & industrial reports and customized research practices.

## Company Overview

- **Headquarters:** Beijing
- **Founded:** 2005
- **Offices:** Shanghai



## Business Overview

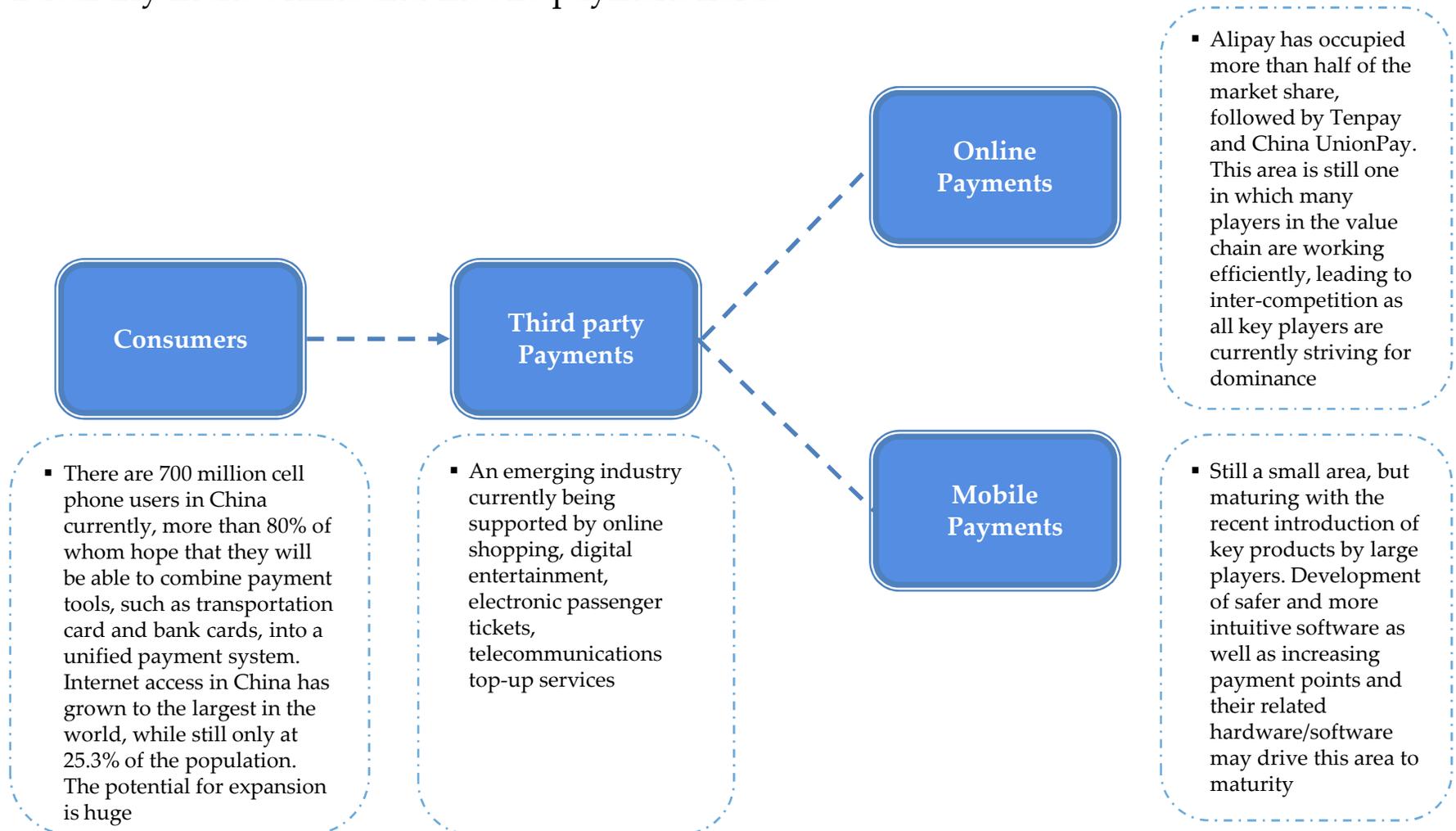
- **Research Reports**
  - Investment Market Research: China PE/VC research reports, China PE/VC fund market research reports, China IPO market research reports, and China M&A market research reports
  - Investment Value Research: Industry investment status reports and industry investment value reports
- **Consulting:** Industry and enterprise selection research, enterprise due diligence, investment fund due diligence, investment fund strategy, business plan optimization, and investor and investment firm selection research
- **Products:** CVSource (an online database system). As of May, 2009, the data range & size of the database are listed as follows: More than 750 VC/PE investment institutions (including data about their investment teams, their assets/funds under management, their ROIs); more than 13,000 best enterprises in different sectors (including data about their management teams, financial statuses, rankings in their respective industry); more than 2,800 VC/PE-related investment events (including data about VC/PE institutions, funds, investees, personages); more than 3,500 public listings/IPOs and M&As (full sets of public listing/IPO records of domestic enterprise); more than 700 VC/PE funds (including data about fundraisings, investment strategies, ROIs, etc.); more than 500 LP's (including data about their investment teams, their invested funds)
- **Events Services:** China investment conference, industrial investment forum, city investment fair, and congregation
- **Financial Advisory:** PE financing, M&A consulting, IPO advisory, core leadership, and notable transactions
- **CVClub:** CV annual conference, industry congregation, CVSource, research report, promotion, E-journal, and other benefits

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# Overview

In terms of debt/credit card and remittance, there appear to be no direct plays into competing with already established systems and networks. International payments are a particularly difficult area to navigate due to regulatory issues arising from the flow of currency in and out of China. However there may be opportunities to invest in ancillary systems involved in payments, particularly in the online and mobile payment fields.

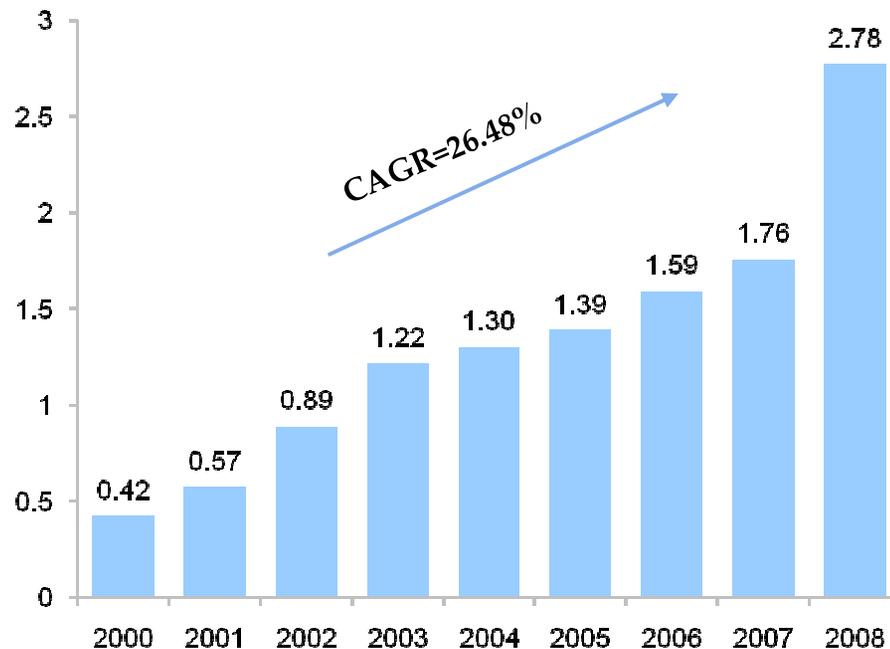


# Remittance Market Overview

China's recipients of migrant remittances have increased tremendously in recent years, making it the 2nd largest market among the developing countries. In 2008, Money Transfer through banks in China reached a total number of RMB 57.5 trillion, among which issued cross-banks business reached RMB75 billion.

## Recipients of Overseas Migrant Remittances Growth in China, 2000-2008<sup>1</sup>

Unit: RMB, Billion



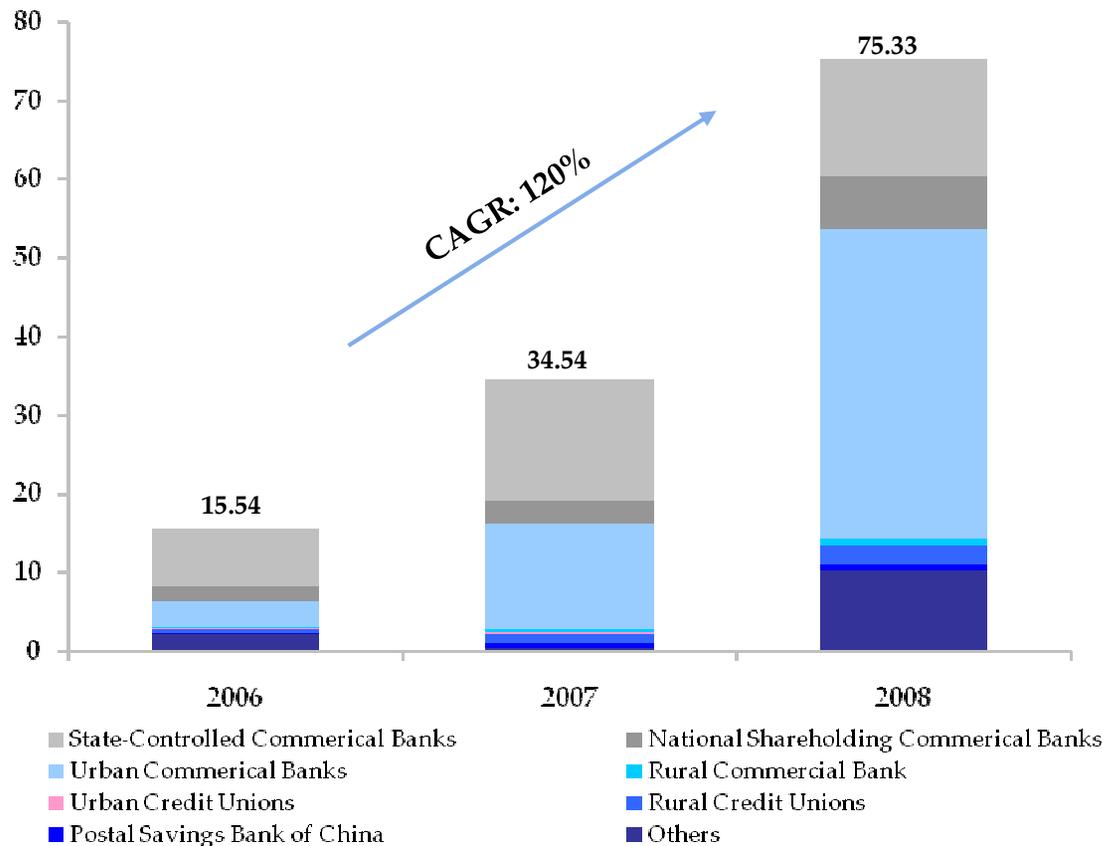
- Originally, overseas migrant remittances were mainly contributed by Chinese working outside of China to support their families
- The growing of remittances is due to the increase of Chinese migrants as well as their awareness of financing
- There was a sharp growth in remittance in 2008, possibly because China managed to remain financially stable and became a relatively safe place to keep money in comparison to other countries
- Apart from Chinese banks and the post office, Money Transfer Organizations are also involved in the market, among which Western Union (WU) has the biggest market share with its China revenue and transactions growing at 37% and 25% for the year 2007, and 13% and 11% for year 2008 respectively. The slow down of W.U.'s growth indicated the impact of the financial crisis on methods of remittances due to W.U.'s high fees

# Nation Wide Cross-Bank Money Transfer Market

The compound annual growth rate of cross-bank money transfer from 2006 to 2008 has been 120%. Sending through urban commercial banks has seen the highest growth in terms of the methods used.

## Cross-Bank Money Transfers (Issued) in China<sup>2</sup> Breakdown, 2006-2008

Unit: RMB, Billion



- The money transfer business has been growing rapidly from 2004 since ChinaPay started connecting banks to enable a much more convenient system of cross-bank transfers
- Transfer fees vary across banks and other methods. Although ATM and online banking tools usage is growing, the main method utilized was still over the counter at Urban Commercial Banks, due to less fees being charged

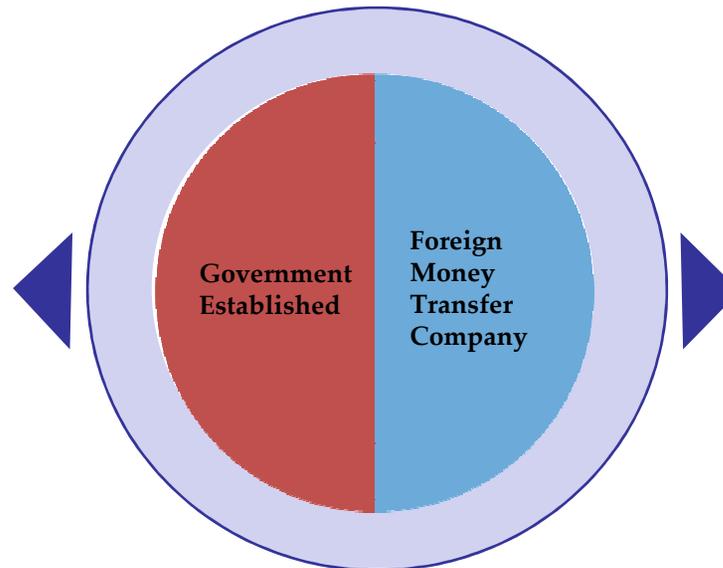
# Type of Companies

Except for China's banks and post office system, there also exist external money transfer organizations. They usually work with China's banks and post offices to conduct their operations, amongst which Western Union and Money Gram are the two main organizations involved in this business.

## China's Banks

- Bank of China
- The 'Big Four'
  - Agricultural Bank of China
  - China Construction Bank
  - Bank of Communications
  - Industrial and Commercial Bank of China
- Commercial banks

## Post Office



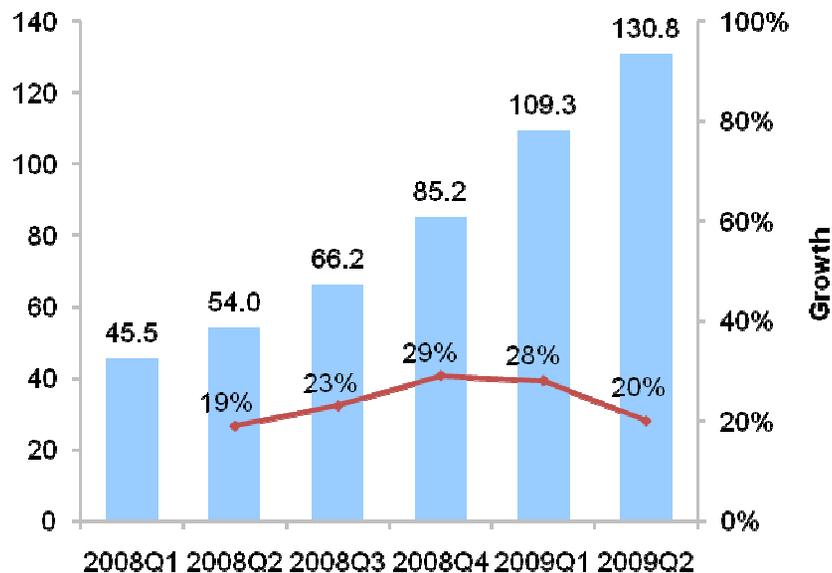
- Western Union (Entered China: 1994; partner: China Post, Agriculture Bank of China, China Everbright Bank)
- Money Gram (Entered China: 1994 inward remittance; 2001 outward remittance. Partner: Industrial and Commercial Bank of China, Bank of Communications, China Citic Bank, Industrial Bank)
- Xoom.com (online MTO. Entered China: 2009; partner: China Post)
- 1-pay/Neteller (online MTO. Enter time: 2005)

# Third Party Payments

Third party payment providers in China have been growing rapidly, making it an attractive market to enter. Among the wide number of third party payment organizations, particularly for network payment, Alipay has occupied more than half of the market share, followed by Tenpay and China UnionPay.

## Transaction Size of Third Party Payments in China, 2008Q1-2009Q2

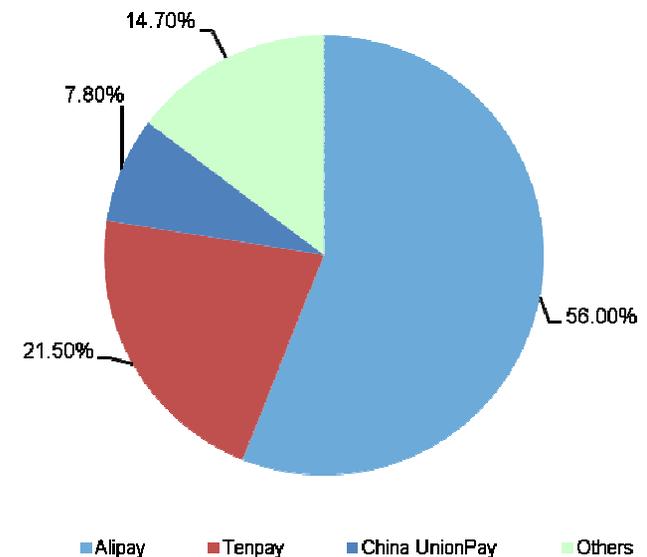
Unit: RMB, Billion



- Digital entertainment, electronic passenger tickets, telecommunications top-up are the main business supporting the development of the third party payments industry. Ticketing was the key driver for third party payments in 2008, airplane tickets has occupied more than 30% of third party payments' transactions

## Market Share of Third Party Network Payments, 2009Q1

Total: RMB103.96 Billion

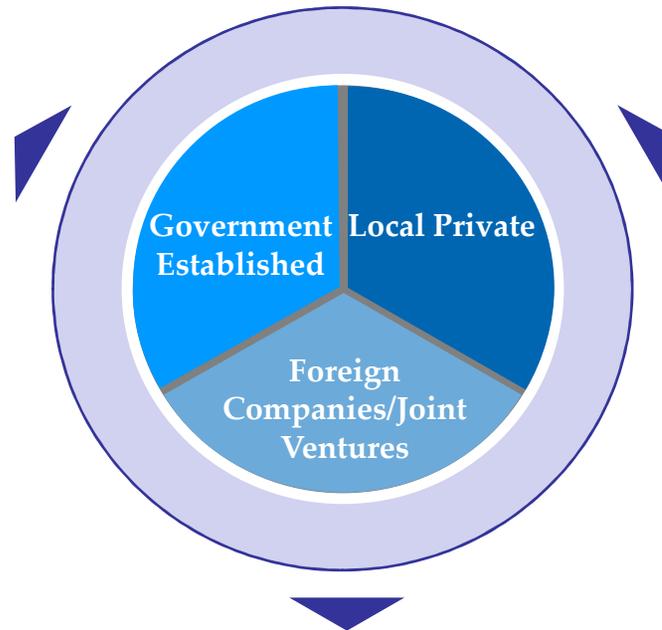


- Alipay and Tenpay have occupied the majority of market share, due to their user friendly platform and account payment model. Their clients are culled from existing clients from QQ and Ali.com and have expanded to other platforms

# Company Examples

There are many players emerging the local private market. Their order from top to bottom represents their current market share in the industry.

- China UnionPay



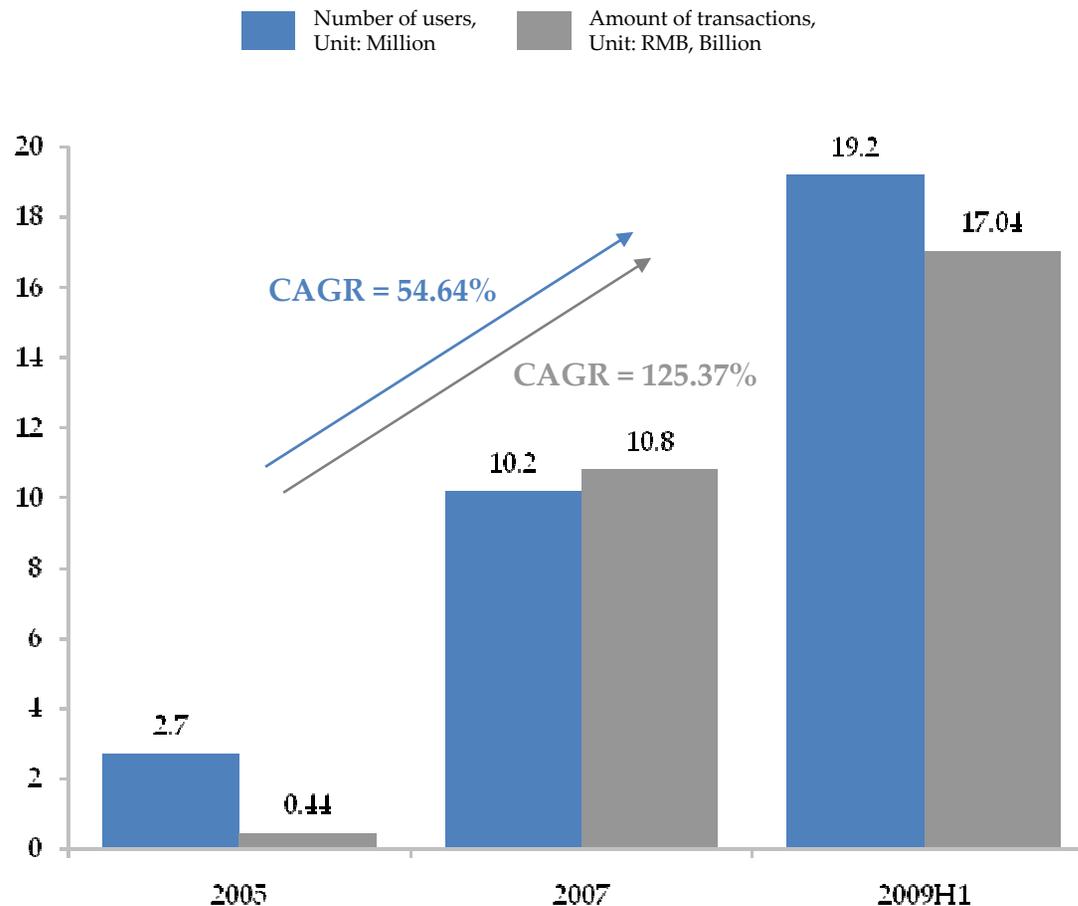
- Alipay
- Tenpay
- IPS
- YeePay
- Chinabank Payment
- PayEase
- Cncard

- PayPal
- Money bookers

# Mobile Payment Overview

Mobile payment is a new and upcoming payment method in China, existing since 2002. There are five major categories of mobile payment services available in China: mobile billing, mobile top-up, mobile ticketing, mobile banking and other services.

## Growth of Mobile Payment Users and Transactions



- **2002-2004:** A period of lukewarm development due to various reasons including technology security problems, immature industry chain and lack of usage and awareness amongst users
- **2004-2007:** A regional expansionary period when several business models became more mature and customer usage increased. However, market size was still limited
- **2007-2009:** Also an expansionary period; as usage increased, industry chains became gradually matured and business lines and service offerings developed
- **Post-2009:** This period should represent a turning point as business lines mature and number of users increases

# Investment Opportunities

Mobile payment has developed over 7 years, but it is still an emerging industry which has definite opportunities with corresponding risks.

## Large Potential Market

- Mobile phone users have reached 700 million by July 2009
- More than 80% of consumers hope they can combine payment tools, such as transportation card and bank card, into mobile payment

## The Central Government's Strategy

- 3G strategy promotes an opportunity for mobile payment as government plans to invest RMB400 billion in 3G network in the near future

## The Cooperation of the Industrial Chain is Strengthening

- Operators, banks, merchants, third party payments and manufactures are exploring the market, and cooperation between banks and network operators is becoming more evident

## Lack of Standardized Technology

- There are currently three main technology standards: NFC, SIMpass (based on 13.56MHz) and RFIDSim (based on 2.4GHz). All of them have distinct advantages and limitations, and a lack of standardization will affect the healthy development of the mobile payment industry
- Technology problems give rise to customer issues regarding transaction safety and security

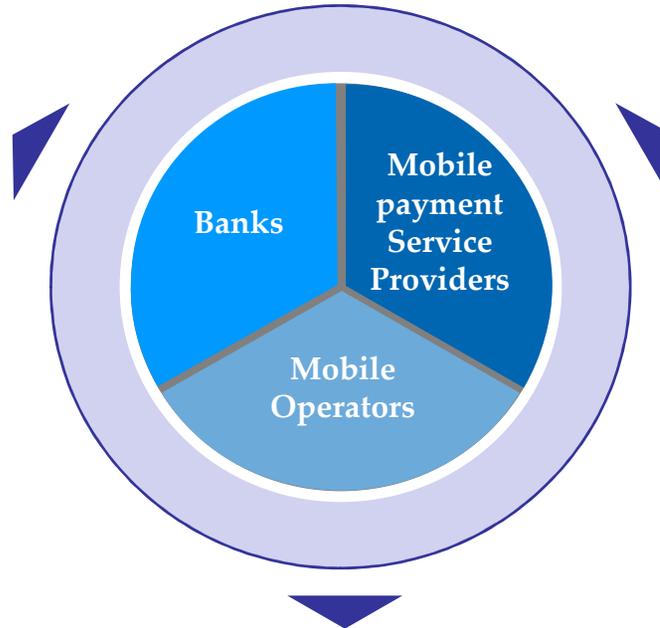
## Lack of Standardized Regulation Policies

- No national policy or law has been published to regulate and coordinate different organizations and to keep the market in order
- 24 local governments have a strategic and cooperative agreement with different individual operators. Until now, no directive has been made from the central government in Beijing

# Company Examples

Examples of companies operating in this industry.

- Bank of China
- The 'Big Four'
  - Agricultural Bank of China
  - China Construction Bank
  - Bank of Communications
  - Industrial and Commercial Bank of China
- Commercial banks (such as)
  - China Minsheng Banking Corp.
  - China Merchants Bank



- Union Mobile Pay (holds the largest market share)
- SmartPay Jieyin
- Guangzhou Huanxin
- Unicom Huajian
- China M-World
- IPS
- YeePay

- China Mobile
- China Unicom
- China Telecom

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# Investment in Taiwan's Financial Industry

Lured by the fact that the Taiwan Strait is slowly becoming a two-way street for investments, global PE funds have found a window of opportunity to invest in Taiwan's financial sector, making acquisitions with the hope of turning a profit when the market opens to Chinese corporations in the years to come.

## Two-Way Street for Investments is Emerging

- Taiwan and mainland China concluded the third-round negotiations on economic cooperation at the end of April 2009. The two sides signed an agreement allowing financial institutions to invest and do business in each others' markets, and issued a joint statement on allowing Chinese companies to invest in Taiwan, which paves the way for establishing full-fledged capital links across the strait
- On June 30, 2009, the Ministry of Economic Affairs of Taiwan announced the first group of items open to investment from mainland China, including 64 items in the manufacturing industry, 117 in the service industry, and 11 in public construction, for a total of 192 items. The Ministry began accepting mainland Chinese investment applications that same day
- The opening of financial services to mainland Chinese investment will be handled in accordance with the results of cross-strait financial MOU negotiations. With warming ties between Taiwan and China and Taiwan's easing of restrictions to allow Chinese investments in sectors, such as transportation and tourism, Chinese ownership of financial institutions is merely a matter of time

## Incentives for Investing in Taiwan's Financial Industry

- Taiwan's financial companies are aiming to open business on the mainland after they get licenses from Chinese authorities. The market of mainland China is thought to be an important driver for Taiwanese financial institutions
- PE firms can make considerable profits if they pick one or two Taiwanese financial firms, stick to it for a couple of years and then sell it off to a Chinese company when the time is ripe. Chinese companies will want a stake in everything in Taiwan both for business and political reasons

## Previous Transactions

- Over the past two years, some private equity firms have spent hundreds of millions of dollars to buy controlling stakes in Taiwanese banks in order to gain a board seat in the hope of improving management expertise. TPG Capital TPG.UL has already invested in Taishin, Taiwan's No. 3 financial firm, and analysts said they would be looking at good opportunities to sell their stakes in coming years
- PE firms can make considerable profits if they pick one or two Taiwanese financial firms, stick to it for a couple of years and then sell it off to a Chinese company when the time is ripe. Chinese companies will want a stake in everything in Taiwan both for business and political reasons

## Potential Investment Targets and Chinese Investors

- Government-owned financial companies can't be targets for PE investments. Chinatrust, Fubon, and SinoPac are possible targets
- Already potential Chinese investors have been sighted: Industrial and Commercial Bank of China, China Merchants Bank, and Shanghai Pudong Development Bank



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