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## This Week in China

### China's Healthcare Reforms to Strengthen Country's Consumer Economy

China's continued overhaul of the nation's healthcare system took another step forward last week with health officials announcing plans to purchase and distribute hundreds of vital medicines at lower costs and to provide low-income patients with government subsidies directly at hospital admission, alleviating the need to apply for receipt reimbursement after receiving care.

The current pharmaceutical system, spurred in large part by faulty incentives, has allowed hospital pharmacies to mark up prices on drugs so dramatically that they have become unaffordable to many citizens. A Financial Times report cites that China's share of pharmaceutical expenditure relative to total health expenditure was nearly 45 percent in 2003, compared with the Organization of Economic Cooperation and Development's average of about 15 percent.

To remedy this anomaly, "the essential drugs used in government clinics will be purchased centrally

through government controlled institutions, to be picked by provincial governments," the health ministry said in published guidelines. Other clinics would also have to buy these medicines through similar mechanisms.

The government subsidies will be put in place by 2011 and stipulate that hospitals pay for part of the patients' medical bills and get reimbursed by government assistance programs or government-sponsored health insurance programs later.

The measures are part of the RMB 850 billion (\$124 billion) revamping of the country's ailing health system, established to ensure that at least 90 percent of China's more than 1.3 billion citizens have basic health insurance by 2011.

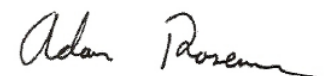
"This commitment to improve equitable access to essential health care for all in China is quite important," says Sarah Barber, a China-based World Health Organization expert on health policy.

China's healthcare reform is based in part on the government's efforts to boost disposable income for citizens and shift towards citizens placing

less of their money in savings and more into the local economy.

"The government has to provide social welfare so people feel secure enough to spend," said Huang Jing, a visiting professor at the National University of Singapore's Lee Kuan Yew School of Public Policy said in an interview with Bloomberg earlier this year. "Chinese leaders finally realized that social-welfare systems, like the health-care system, are not just for people's health, they're for the health of China's economy."

China's healthcare reforms will serve to decrease the national savings rate and in turn the country's dependence on exports to drive the economy by further increasing consumer spending. With already negligible consumer debt levels, this will help set the stage for the Chinese consumer to become the global economic engine that the American consumer has been for so many years.



**Adam Roseman,**  
**Founder & CEO**

ARC China

# This Week in China (cont'd)

## China's Economic Growth May Accelerate This Quarter

China's economic growth may accelerate to 8.5% this quarter on stimulus spending and a "moderately loose" monetary policy, a government research agency forecast.

The nation's recovery will continue to gain traction, the State Information Center, an affiliate of the National Development and Reform Commission, said in the China Securities Journal.

A RMB 4 trillion (\$585 billion) stimulus package, record growth in credit and improving demand for exports may help the world's third-biggest eco-

## China Growth Shifts To Inland Provinces

The words "Inner Mongolia" may not immediately suggest sizzling economic activity. Yet in the second quarter it was the fastest growing province in China. The country's economic growth during most of the past 30 years has been led by its long eastern seaboard. Coastal provinces such as Guangdong, Jiangsu and Shanghai benefited from foreign investment and prospered from large export industries. But eight of the ten fastest growing provinces in

nomically to grow faster than the government's 8% target this year. Investors' concern that lending will slump in the second half has contributed to the Shanghai Composite Index falling 16% from this year's peak on Aug. 4.

"Improvements in external conditions are picking up speed while domestic investment and liquidity remain strong," said Ken Peng, an economist with Citigroup Inc. in Beijing.

China's economy grew 7.9% in the second quarter, rebounding from 6.1% in the first, which was the weakest pace in almost a decade. Citigroup raised this week its estimate for growth this year to 8.7% and

China, based on second quarter growth, now lie inland.

Higher growth in inland regions is nothing new. China's central and northern areas quietly overtook its coastal regions in late 2007. This partly reflects a natural catch-up effect among poorer provinces, which are able to sustain far higher investment growth. The growth gap between central provinces and those in the east widened further in the third quarter of last year as coastal cities were hit by a property slowdown.

Since then the global downturn has arguably hit

Goldman Sachs forecasts a 9.4% expansion.

The government needs to stick to its moderately loose monetary policy in the second half because of "slight deflation," the center said.

Urban fixed-asset investment will increase 32% this quarter from a year earlier, industrial output may climb 10.8% and retail sales will rise by 14.6%. Imports may tumble 12.7% and exports decline 20%, the report said.

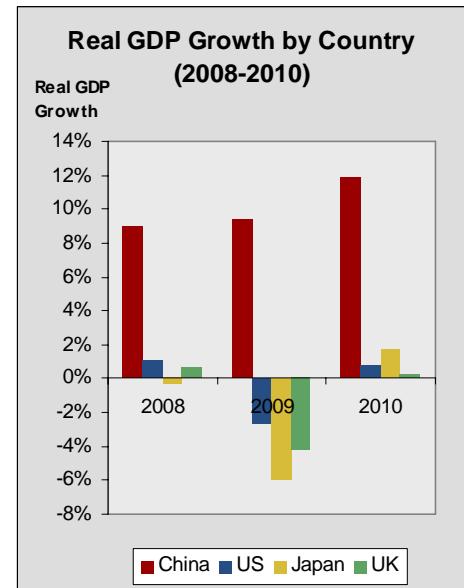
Consumer prices will fall 1.3% this quarter from a year earlier, while producer prices may decline 7.9%, the agency said.

Source: Bloomberg

export-dependent coastal provinces harder than inland ones. In eastern provinces exports are equal to 41% of GDP; in the rest of the country they make up just 6%.

Government expenditure in coastal areas has historically grown at a similar pace to that elsewhere, but the infrastructure-heavy stimulus has been skewed towards needier inland provinces. State-directed improvements in transport infrastructure, especially in railway networks, should further encourage more companies to make the journey westward.

Source: Economist



Source: Goldman Sachs; Euromonitor

Eight of the ten fastest growing provinces in China, based on second quarter growth, now lie inland.



Sources: CEIC; Economist Intelligence Unit

# Metals and Mining

## China's Appetite for Nickel Drives a Symbiotic Alliance

Chinese nickel companies are quietly collecting stakes in junior nickel miners, in a move that guarantees future supplies for China and could help the small companies meet output targets.

With its huge construction projects and export market, China is the world's biggest consumer of stainless steel, of which nickel is an important ingredient. But with the country's consumption of nickel ore outstripping its own mines' output - China needs to import about 23% of its consumption needs - the country has traditionally imported large amounts of the refined metal.

Therefore, eager to ensure its future supply, China is buying stakes in resource-rich junior nickel miners, many of them based in Canada. And as a further guarantee of supply, it is parlaying some of its holdings into takeovers.

"China isn't self-sufficient in nickel," said Vanessa Davidson, an analyst at consultancy CRU. "If it wants to be self-sufficient, it needs to negotiate new contracts for raw material because it doesn't have that much in the ground."

That is where the stakes in small miners come in. Many small miners have been struggling since finance dried up and credit

tightened last year. But Chinese nickel companies are offering the small miners an alternative, in the form of stake acquisitions and offtake agreements, where Chinese companies agree to buy part of the miners' output at a fixed price.

In short, the junior miners have the material and China has the smelters and the financial firepower. The junior miners are able to reduce debt, restart closed projects and resume mine development while China secures nickel supplies for its expanding smelters.

"My sense is that the Chinese prefer to be an investor with significant stakes that secures stuff for the future," said BMO Capital Markets analyst David Cotterell.

Mr. Cotterell said Western-owned companies tend to be good at producing, and the Chinese companies appear to be happy to let them run the mine and then get the output results.

Taking stakes in several small miners spreads out risk -- at least one of the projects is likely to be fruitful, Mr. Cotterell said. And the lower profile of the junior miners compared with that of big companies such as Rio Tinto Ltd. minimizes the risk of political problems, analysts say.

In May, Jilin Jien Nickel Industry Co. completed a \$30 million deal to buy a stake in Canadian nickel

miner Liberty Mines Inc. It is now the company's largest shareholder, with 51% of common shares. Liberty restarted mining operations this month as a result of the funding.

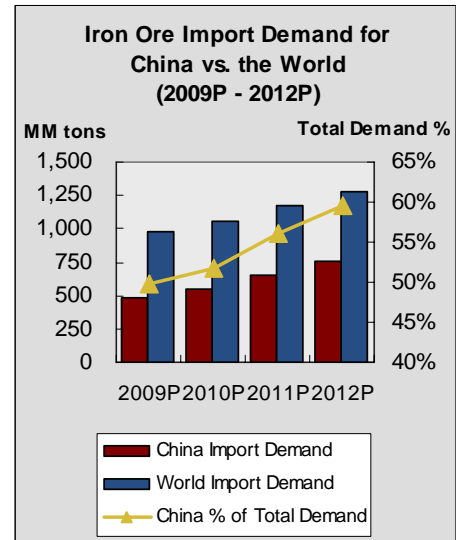
"With bleak nickel conditions it's a good opportunity for Chinese companies to be involved in overseas nickel operations," a Jilin Jien spokesman said. "We are the second-largest nickel producer in China and we need more nickel" from overseas. The Jilin spokesman said the company likes small-to-medium mining operations producing ore with a nickel content of at least 1%.

Liberty Chief Executive Gary Nash said the company normally sends half of its output to Jilin and the rest to Xstrata PLC, with price determining whether it is more feasible to ship to Xstrata's smelter in Ontario, Canada, or farther afield to China.

Jilin also has investments in Canada's Victory Nickel Inc. and Goldbrook Ventures Inc.

Victory Chief Executive Rene Galipeau said that with its smelters and refining technology, Jilin is a good destination for Victory's nickel concentrate output. "They're a strong shareholder, a plus for financing, and a potential customer," he said.

Source: Wall Street Journal

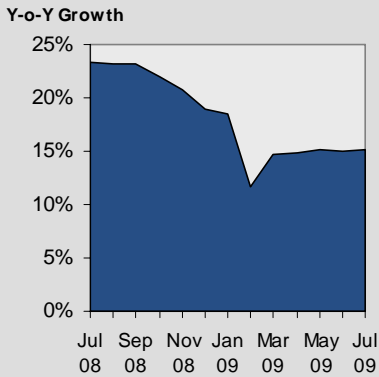


Source: Morgan Stanley

*"China isn't self-sufficient in nickel," said Vanessa Davidson, an analyst at consultancy CRU. "If it wants to be self-sufficient, it needs to negotiate new contracts for raw material because it doesn't have that much in the ground."*

## Consumer / Retail

**China Retail Sales Growth Rate (Jul 2008 - Jul 2009)**



Source: Zero2IPO

*It is estimated that the Chinese shampoo market is worth RMB 25 billion (\$3.7 billion), with a gross profit rate of between 50% and 70%.*

### China's Taobao On A Tear: Now 1.4% Of China's Retail Sales

With no shortage of products to sell, Chinese merchants appear to be flocking to Taobao, the Chinese consumer-based online retail marketplace owned by Alibaba, China's answer to eBay. According to information released by the company, gross sales volume increased 97% during the first half of the year to \$11.8 billion.

Citing information from the

### Isetan Mitsukoshi To Open Five New Stores In Mainland China

Japanese department store retailer Isetan Mitsukoshi Holdings has decided to expand its network in mainland China by adding five new large-scale stores before 2014.

With this expansion, the

### L'Oreal Eyes China's Mass Shampoo Market

L'Oreal Group, one of the world's largest cosmetics companies, has announced plans to enter China's mass shampoo market.

According to Paolo Gasparrini, President of L'Oreal China, this move will enhance the company's presence in the mass shampoo market. The company will distribute its L'Oreal brand shampoo products through various channels, including supermarkets and hypermarkets and expand

Chinese Bureau of Statistics, the company said its sales now represent 1.4% of China's retail sales, both online and offline. As a point of reference, eBay's US sales volume accounts for less than 1% of total US retail sales.

The weaker Chinese economy caused spending per-order to drop on the site, but the growing popularity of the service in China made up the difference. Overall orders

company will have ten outlets on the mainland. At the same time, it plans to set up a holding company within 2009 to manage its business in mainland China and this establishes the Chinese market as the major market for its overseas business.

It is reported that each of into third and fourth-tier cities in China.

Gasparrini said, L'Oreal has learnt a lot from its acquisition of Mini Nurse in China, especially about the sales channels of the Chinese mass cosmetics market. Mini Nurse is L'Oreal's first brand to target the mass market in China.

Lan Zhenzhen, the Vice President of L'Oreal China, revealed to local media that over half of L'Oreal's annual sales in China are contributed by mass cosmetics brands, including L'Oreal Paris, May-

grew 184% during the first half 2009, with household goods topping the list of products sold.

Chinese merchants, both professional and independent are embracing the Taobao model, which enables anyone to create a store to sell whatever goods they wish. The site claims 120 million registered users and 300 million product listings.

Source: Business Insider

Isetan Mitsukoshi Holdings' new stores in China will have an area of over 30,000 square meters and these stores will sell the same range of high-end products as is sold in its department stores in Japan: targeting wealthy Chinese consumers.

Source: China Retail News

belline, and Garnier; and the rest are from luxury brands such as Lancome. The situation is similar to that in the international market.

It is estimated that the Chinese shampoo market is worth RMB 25 billion (\$3.7 billion), with a gross profit rate of between 50% and 70%.

At present, Procter & Gamble occupies about 50% of the Chinese mass shampoo market with five brands while the rest of the market is shared by Unilever, C-Bons, Bawang, and Lafang.

Source: China Retail News

# Recent Transactions

## Sinopec Spends \$7.5 Billion on China's Largest Overseas Takeover

Sinopec announced it has bought Geneva-based Addax Petroleum Corp through its wholly-owned Sinopec International Petroleum Exploration and Production Corporation (SIPC). SIPC's bid for Addax is C\$52.8 (\$46) per share, totaling more than C\$8.32 billion (\$7.56 billion), the largest overseas takeover tran-

saction by a Chinese oil company. Sinopec will also take over all convertible bonds and equity options held by Addax.

Addax, listed in London and Toronto, is one of the largest independent oil producers in West Africa and the Middle East. Total earnings are \$3.76 billion in 2008 with net profit reaching \$784 million. With its oil and gas assets concentrating in Nigeria, Gabon and Iraq, Addax has 25 oil and gas blocks. Its remain-

ing recoverable proved and probable reserves are 537 million barrels and the average crude oil output is 143,000 barrels per day. The annual oil output is expected to be increased from 7 million tons to 10 million tons.

This acquisition is an important step for Sinopec to accelerate international growth and optimize its offshore oil and gas asset portfolio.

Source: China Daily

## China Valves Acquires Yangzhou Rock

China Valves Technology, Inc. (OTCBB: CVVZ) announced that it has acquired 100% equity ownership of Yangzhou Rock Valve Lock Technology Co., Ltd. for \$7.3 million in cash.

Yangzhou Rock designs, manufactures and distributes interlock valves, valve lock devices, magnetic lock valves, and mechan-

ical interlock machines that are widely used in the petrochemical, chemical, natural gas, thermal power station and metallurgy Industries. Its designed annual capacity is 15,000 units. The acquisition will also include all patents applied by Yangzhou Rock before July 31, 2009, including a patent for a 90 degree rotating valve lock device, a patent for a key management control de-

vice and a patent for a type of mechanical valve interlock. China Valves expects to utilize Yangzhou Rock's distribution channels and customer base as well.

China Valves expects the acquisition to add \$2.9 million in revenue and \$1.0 million in net income for 2009 and \$8.6 million in revenue and \$3.0 million in net income for 2010.

Source: Zero2IPO

## Air China Raises Cathay Pacific stake

Air China paid HK\$6.3 billion (\$812.8 million) to buy a 12.5% stake in Cathay from Citic Pacific Ltd., raising its stake to nearly 30% from 17.5%. The added share-holding in Cathay is a step forward for Air China's global ambition and China's strategic aim of upgrading its fast-growing aviation industry, given Cathay's dominant position in Hong

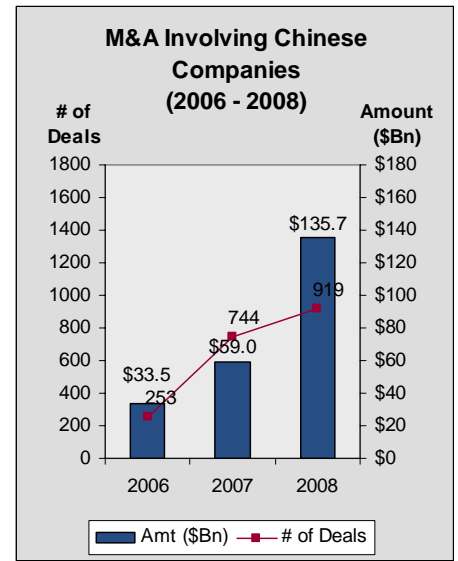
Kong, one of the world's busiest international transport hubs.

In 2006, Air China took a 17.5% stake in Cathay as part of a complex HK\$12.29 billion airline transaction that resulted in Cathay taking full control of Dragonair. Since then, Cathay, Dragonair and Air China have cooperated closely on flights between Hong Kong and China, marketing seats on each other's flights through

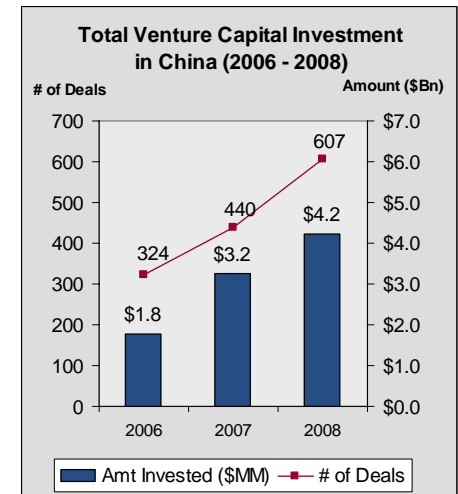
code-sharing and shared costs and revenues by operating single sales offices in certain cities.

Air China's increased stake in Cathay comes after a bid last year to develop a hub in Shanghai was thwarted by a merger between China Eastern Airlines Corp. and Shanghai Airlines Co., both of which have their hubs there.

Source: Wall Street Journal



Source: Capital IQ



Source: Zero2IPO