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毕马威全球中国业务
KPMG Global China Practice

China Quarterly Report

Third Quarter 2014

Contents

- Macroeconomic Analysis 02
- Outward Direct Investment (ODI) Analysis 05
- Foreign Direct Investment (FDI) Analysis 08

The Chinese government's Fourth Plenum meeting concluded on 23 October. KPMG will be separately commenting on the Plenum and implications for inbound and outbound investment.

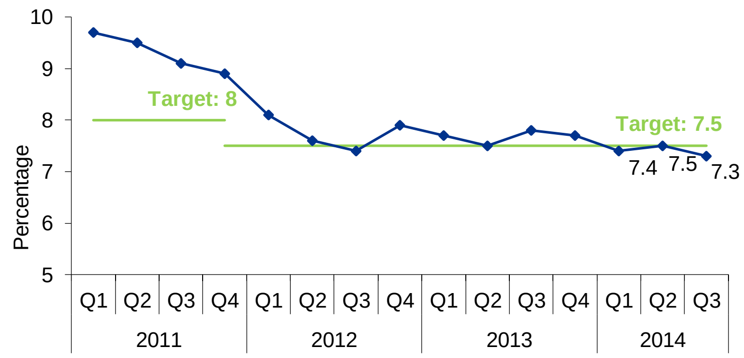
- China's GDP grew by 7.3 percent for the third quarter of 2014 and 7.4 percent for the first three quarters, close to the government's target of 7.5 percent.
- Accumulated Fixed Asset Investment growth continued to fall, to 16.1 percent for September, while the Purchasing Managers Index (PMI) was 51.1: still positive, but down from a 27-month high of 51.7 in July.
- ODI in the non-financial sector increased by 21.6 percent year-on-year through the first three quarters of the year, with the highest growth seen in the EU, Japan and Russia.
- FDI declined by 1.4 percent year-on-year through the first three quarters of the year. While the service sector still saw solid FDI growth, manufacturing sector FDI experienced a double-digit decline.

Macroeconomic Analysis

Third quarter growth reflects a slowdown

China’s GDP grew 7.3 percent in the third quarter of 2014, 0.2 percentage point less than the second quarter, but still broadly in line with the government’s annual target of 7.5 percent. The decline was mainly caused by slower manufacturing growth and a cooling real estate market.

GDP quarterly growth rate, year-on-year

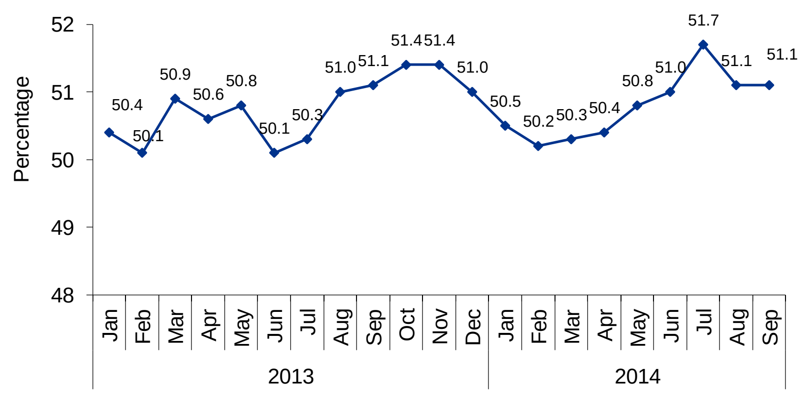


Source: National Bureau of Statistics (NBS)

Industrial value-added growth fell to 8.0 percent in September, 1.2 percentage points lower than June. The automotive sector saw slower growth, and demand for manufactured goods such as iron and steel was affected by continued weakness in fixed asset investment growth.

China’s official Purchasing Managers Index (PMI) is still positive, but at 51.1 in September, down from a 27-month high of 51.7 in July. The decline of fixed asset investment growth can be mainly attributed to a luke-warm real estate market and a reduction of directly infrastructure investment made by the government in the second quarter.

Monthly Purchasing Managers Index (PMI)



Source: National Bureau of Statistics (NBS)

Stimulus policies with a tight focus

The government continued to implement a variety of narrowly targeted stimulus measures in the third quarter, mainly focused on the real estate sector, small and medium enterprises (SMEs) and the service sector. These are not large scale stimulus measures designed to significantly boost the overall economy; rather they are focused on key sectors with the aim of preventing the economy from a "hard landing".

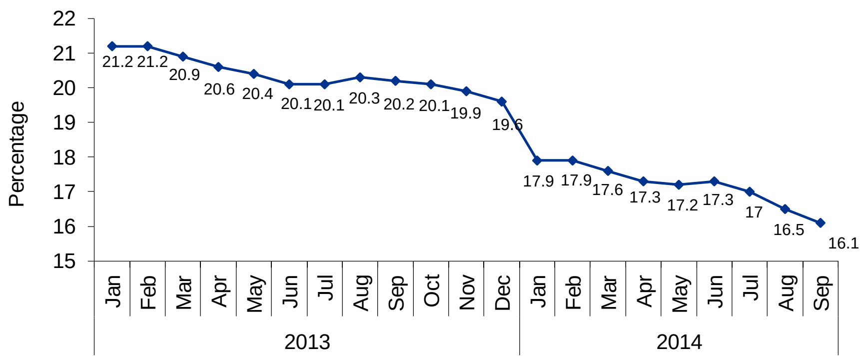
- On 30 September, China's central bank eased mortgage loan policies, including reducing the minimum down payment, discounting mortgage rates[1] and scrapping a ban on mortgages for people buying a third home. In addition, most local governments have loosened restrictions on property purchases[2].
- On 23 July, the State Council released ten measures to cut financing costs for companies, especially SMEs, including cutting bank finance charges, promoting the private sector to set up financial institutions, and expanding direct financing channels.
- From July to September, the State Council released a series of 'guiding opinions' aimed at upgrading manufacturing technology and accelerating the growth of the service sector. These opinions covered alternative energy vehicles (on 21 July), producer services (on 6 August), insurance (on 13 August), tourism (on 21 August) and shipping (on 3 September).
- On 23 September, the Ministry of Finance (MOF) issued a notice to promote Public Private Partnerships (PPP) to encourage more social capital investment in infrastructure.

1. Provided they have paid off the mortgage on their first property, prospective borrowers applying for a loan to buy a second home can enjoy the same treatment as first-time home buyers: a lower minimum down payment of 30 percent, and a 30 percent discount on mortgage rates.
2. All local governments, except for Beijing, Shanghai, Guangzhou, Shenzhen and Sanya, have loosened restrictions on the number of properties an individual can purchase, and on purchases of property by non-local residents.

Consumer demand appears to be weakening; the retail sales growth fell to 11.6 percent in September, 0.8 percentage point lower than that in June. The Consumer Price Index (CPI) was 1.6 percent in September, and this is the lowest CPI figure since February 2010, another indication that consumer demand remains subdued. The Producer Price Index (PPI) fell to -1.8 percent in September, also indicating sluggish demand of manufactured products.

Exports appear to be a bright spot, with an increase of 15.3 percent in September, 8.1 percentage points higher than that in June, mainly due to a recovery in overseas demand, especially from the U.S. market.

Accumulated Fixed Asset Investment monthly growth rate, year-on-year

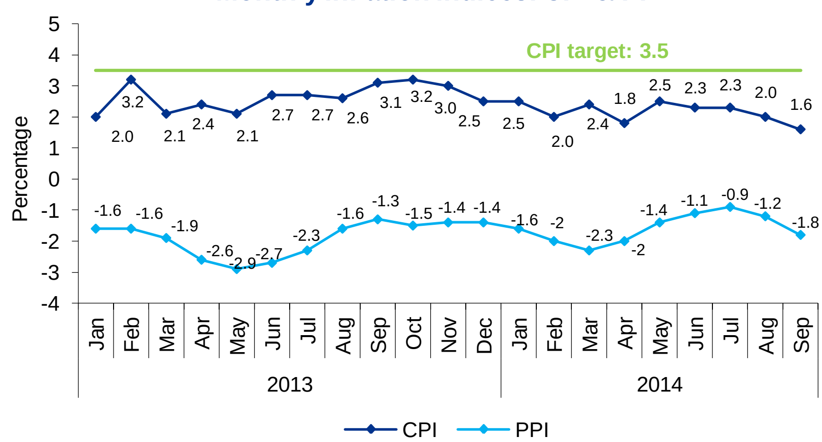


Source: National Bureau of Statistics (NBS)

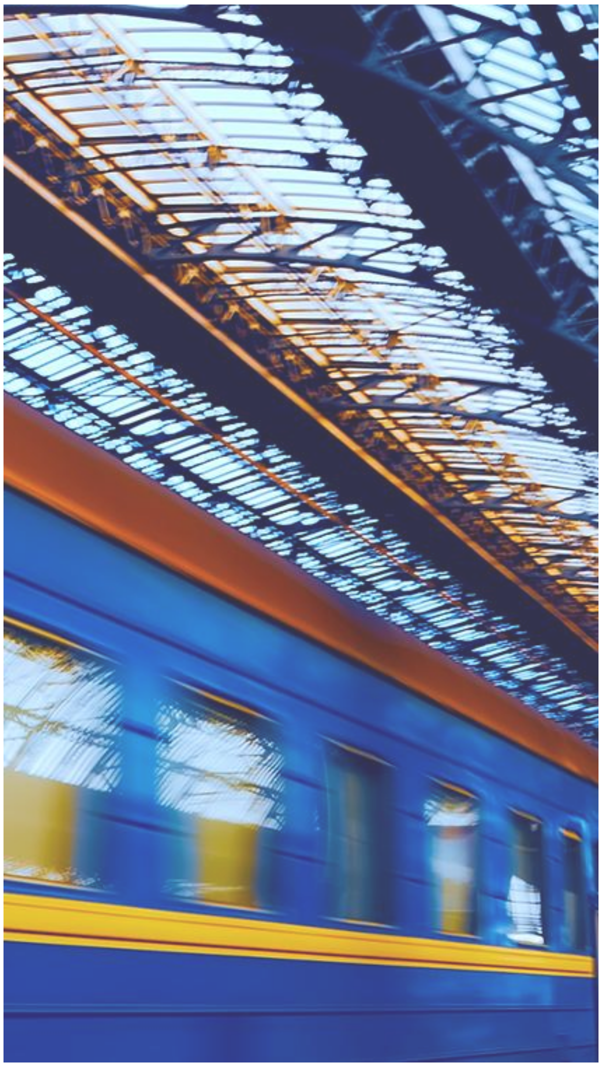
The Chinese government has been encouraging the growth of the service sector through the tax and other support policies, and the service sector continues to increase its importance as a driver of the economy. The service sector accounted for 46.7 percent of China's economic output in the first nine months, up 1.2 percentage points compared with the same period last year, and ahead of the manufacturing sector by 2.5 percentage points.

China's private sector has continued to expand, with investment from the private sector growing 18.3 percent in the first nine months, 2.2 percentage points higher than the overall fixed asset investment growth rate. Compared to the same period in 2013, the private sector increased its proportion of total fixed asset investment by 1.1 percentage point, to 64.7 percent.

Monthly inflation indices: CPI & PPI



Source: National Bureau of Statistics (NBS)



Andrew Weir
Global Chair, Real Estate and Construction, KPMG

"The Chinese government views stepped-up infrastructure investment as a way to offset the negative effect caused by the cooling real estate sector. We expect to see strong growth in China's infrastructure investment in the near-term, as the government introduces new support policies and more social capital funding for infrastructure – with a focus on projects to improve people's living standard, such as shantytown renovation."

More stimulus policies on the way

During the State Council executive meeting on 8 October, Premier Li indicated that the economic growth was still within the "proper range" [3] and that new drivers of economic growth were performing well:

- Infrastructure investment: the government has continued to promote infrastructure investment since the second quarter. As the real estate sector remains in a cyclical period of decline, the government is likely to release more support measures related to infrastructure investment.
- Growth of the service sector: weak domestic demand and the reduction of overcapacity will continue to weigh on manufacturing activity. Development of the service sector is seen as the government's main option for rebalancing the economy. Premier Li anticipated that the proportion of service sector in China's GDP will continue to grow.
- Regional industry development: the government has been promoting industrial development in less-developed central and western parts of the country, and issued a set of tailor-made lists of industries eligible for preferential policies, such as tax breaks and loan support. This is expected to boost economic growth in these specific regions.

According to Premier Li, the government is adhering to its GDP target of approximately 7.5 percent in 2014, and the National Bureau of Statistics' (NBS) data indicated that the government's target of creating 10 million new jobs in cities and towns in 2014 had already been met by the end of September.

We expect to see continued small-scale, targeted stimulus measures to maintain growth at around the current level and to promote economic reforms; it is unlikely that massive stimulus measures will be rolled out in the near term unless the economy departs significantly from its present trajectory.

3. Li delivers boost for the economy, China Daily (中国日报), 9 October 2014, http://www.chinadaily.com.cn/china/2014-10/09/content_18708538.htm

Outward Direct Investment Analysis

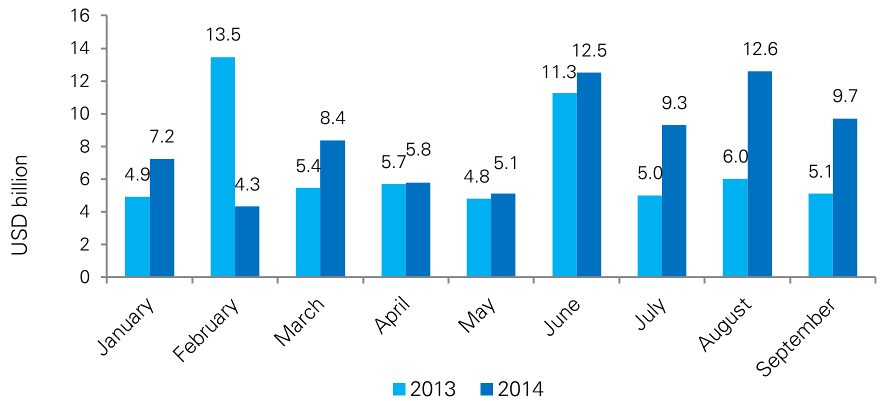
Outward Direct Investment (ODI) Summary	Q1-Q3 '2013	Q1-Q3 '2014	% Change
Non-financial ODI (US$ billion)	61.6	74.9	21.6%
Overseas contracting project revenue (US$ billion)	86.0	92.3	7.3%

Source: Ministry of Commerce accessed 20 October 2014, KPMG analysis

ODI Overview

- Non-financial ODI for the first three quarters of 2014 increased by 21.6 percent year-on-year, to US$74.9 billion. Chinese ODI into the European Union, Japan, and Russia grew the fastest, with year-on-year growth of 218 percent, 150 percent, 70 percent, respectively.
- Revenue from China's overseas contracting projects rose by 7.3 percent year-on-year. Asia and Africa remained the primary sources of Chinese companies' revenue; however rapid growth was seen in Europe and Latin America.

Chinese ODI in non-financial sectors



Source: Ministry of Commerce accessed 20 October 2014, KPMG Analysis

High level visits strengthen China's outbound investment and trade links

- In July, Chinese President Xi Jinping visited Brazil, Argentina, Venezuela and Cuba, and inked a number of loan agreements, plus trade and investment deals in agriculture, oil, mining, nuclear power, and satellite communications, as well as construction projects for rail, port and housing.
- In September, President Xi visited Tajikistan and witnessed the signing of a number of cooperative agreements covering agriculture, energy and infrastructure.
- The President then travelled to the Maldives, Sri Lanka and India; those visits each saw billions of dollars worth of investment agreements on infrastructure projects.

Chinese outward M&As	Q1-Q3 '2013	Q1-Q3 '2014	% Change
Deal value (US$ billion)	55.7	48.7	- 12.6%
Number of deals	316	266	- 15.8%

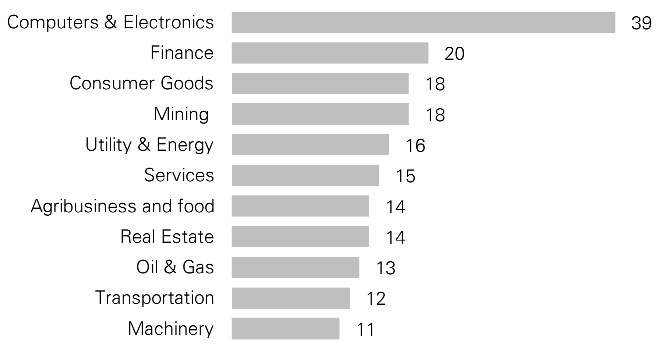
Source: Dealogic accessed 30 September 2014, KPMG analysis

M&A Summary

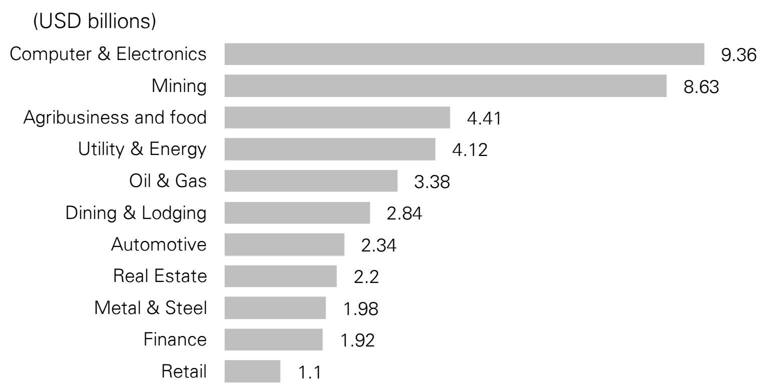
Chinese companies are keen to acquire technologies, brands, market share and management skills in developed countries; the outbound statistics bear this out, with the US, Australia, Germany, Singapore, UK and Canada the top destinations for outbound deals in the first nine months of 2014. This growth trend towards the developed countries is likely to continue.

In terms of investment sectors, Chinese companies continued to secure sources of supply to meet Chinese domestic demand, through deals in the mining, energy, agriculture and food sectors; investors have also sought to bolster their competitive position by acquiring advanced technologies in the high-tech, automotive, metal and consumer goods sectors. An additional factor behind some major deals in 2014 has been the pursuit of diversification strategies in sectors such as real estate, hospitality and utilities. In particular, given that the domestic real estate sector is expected to remain depressed, it is very likely that we will see continued Chinese investment in the overseas real estate market.

Top sectors by number of deals in Q1-Q3'2014



Top sectors by deal value in Q1-Q3'2014



Source: Dealogic accessed 30 September 2014, KPMG analysis

Top ten outward M&A deals by deal value in Q3'2014

No	Date	Acquirer	Target	Target country (region)	Deal value (US$ mn)	Shares acquired (%)	Target sector
1	2014.7	State Grid Corp of China	CDP RETI	Italy	2,814	35	Utility & Energy
2	2014.8	Hua Capital Management	OmniVision Technologies Inc	US	1,682	100	Computers & Electronics
3	2014.7	Hony Capital Investment	PizzaExpress Ltd	UK	1,540	100	Dining & Lodging
4	2014.9	Fosun International-led consortium	Club Mediterranee SA	France	1,080	81	Dining & Lodging
5	2014.9	Fosun International	Espirito Santo Saude SGPS SA (ESS)	Portugal	580	100	Healthcare
6	2014.8	The People's Bank of China	Assicurazioni Generali SpA	Italy	570	2	Insurance
7	2014.8	Fosun International	Ironshore Inc	US	464	20	Insurance
8	2014.8	Fosun International	Roc Oil Co Ltd	Australia	442	100	Oil & Gas
9	2014.8	StarChase Group	WBL Corp Ltd (Automotive division)	Singapore	364	100	Auto/Truck
10	2014.8	China Rongsheng Heavy Industries	Central Point Worldwide Inc	Kyrgyzstan	282	60	Oil & Gas

Source: Dealogic accessed 30 September 2014, KPMG analysis

Michael Jiang
Partner, Head of Corporate Finance, Transactions & Restructuring, KPMG China

"With good investment opportunities being presented in overseas markets and the favorable policies recently issued by the Chinese government, we expect Chinese outbound investment to continue to rise. This will encompass a larger spectrum of sectors beyond natural resources, as more Chinese companies seek to improve their global competitiveness through acquiring core technologies, expanding into international markets and investing into assets with low risk and stable return."

Chinese companies investing in European privatization projects

European countries such as Italy, Portugal, and Greece are currently selling down state-owned assets to repay debts accumulated in the run-up to the European debt crisis. This deleveraging situation has presented opportunities for Chinese companies to purchase European assets at a relatively low cost. We have seen a number of such transactions in recent months, including:

- State Grid Corp of China invested approximately €2 billion in July for a 35 percent stake in Italian state-owned energy grid holding company CDP Reti.
- Fosun International bought a 3.9 percent stake in the electricity and natural gas transmission company REN in June, from the Portuguese government for €56.8 million, through its Portuguese subsidiary.

ODI policy developments and trends

MOFCOM eases outbound investment approval rules

In September, the Ministry of Commerce (MOFCOM) revised its "Overseas Investment Rules" (the "Rules"). According to the revised Rules, only outbound investments into sensitive countries or regions[4], as well as in sensitive industries[5] will require approval; all other outbound investments will only be required to be registered with MOFCOM or its local counterpart at provincial level, and the expected registration processing time is within three working days.

There is also a reduction in the time - to 20 working days - for MOFCOM to review investment approval applications from Central enterprises[6], and to 30 working days for MOFCOM and its local counterpart at provincial level to review approval applications from local enterprises[7].

The Rules further simplify the administrative process for outbound investment: this is seen as another major policy change after the National Development and Reform Commission (NDRC) eased restrictions on outbound investment in April 2014, enabling Chinese companies to move faster on their outbound investments and become more competitive when competing with other foreign bidders.

SAFE relaxes controls on offshore investment and financing activities

In July, the State Administration of Foreign Exchange (SAFE) released a new Circular ("Circular 37"). The effect of this Circular is to liberalize the flow of cross-border capital for domestic residents' offshore investments and financing activities. In particular, Chinese investors will no longer be required to repatriate offshore profits, dividends and proceeds arising from disposal of an interest in a special-purpose vehicle (SPV) within 180 days, which allows for greater flexibility in capital allocation, including being able to redirect funds into other investments and operations overseas.

4. "Sensitive countries or regions" refers to countries or regions with which China has not established diplomatic relations or which are subject to sanctions by the United Nations.
5. "Sensitive industries" include industries or projects that: (i) involve products or technologies whose export is prohibited or restricted by China; or (ii) where multiple countries (regions) have an interest – e.g., a cross-border water resource development project.
6. Central enterprises comprise 113 state-owned enterprises (SOEs) funded and managed by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) and their subsidiaries, state-owned financial enterprises owned by the Ministry of Finance and/or Central Huijin Investment Ltd., China Investment Corporation, the Social Security Fund, and SOEs 100 percent controlled or managed by Ministries of the State Council or organizations of public ownership.
7. Local enterprises are all other enterprises which fall outside of the scope stated in footnote 6, i.e., non-Central SOEs and privately-owned enterprises (POEs).

Foreign Direct Investment Analysis

Foreign Direct Investment Summary

	Q1-Q3 '2013	Q1-Q3 '2014	% Change
Foreign Direct Investment (US$ billion)	88.6	87.4	-1.4%

Source: Ministry of Commerce accessed16 October 2014, KPMG analysis

- Total FDI into China decreased by 1.4 percent year-on-year in the first three quarters of 2014.
- China's manufacturing sector FDI continued to decline at a double digit pace in the third quarter, while service sector FDI increased in the first 3 quarters.
- Central China saw FDI growth of 9.5 percent in the first three quarters, outperforming East and West China, where FDI declined noticeably.

Stephen Mercer
Partner in charge,
Multinational Clients,
KPMG China

"Multinationals continue to play a key role in the development of the Chinese economy. Given China's ambitious and visionary program of policy reforms announced in recent years, in many ways the country's need for insights, technology and know-how from outside its boundaries has deepened across numerous sectors, creating good opportunities for multinationals."

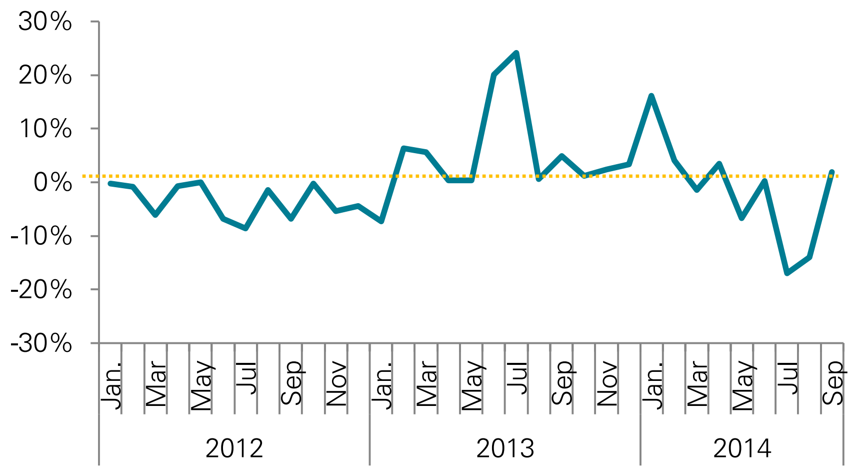
Lower levels of FDI reflect a changing Chinese economy

In the third quarter, China's FDI fell 9.7 percent to US$24.03 billion. For the first nine months of 2014, China attracted US$87.4 billion of FDI, down 1.4 percent from 2013 levels and underscoring challenges facing the Chinese economy. As China continues its economic restructuring, indicators ranging from imports to industrial output and investment are all pointing to relatively sluggish economic activity.

There is no one factor responsible for the slump in FDI in Q3, but rather a combination of global economic conditions, Chinese government policies to promote industrial restructuring, and continued tailing-off of lower value manufacturing investments. These factors are likely to continue to depress FDI in the short and medium term.

Alongside the recent FDI statistics, multinational corporations (MNCs) already operating in China are facing new challenges. As KPMG China found in its September 2014 report **"MNCs in China – Making the Right Moves"**, many MNCs are still confident in the opportunities in the market, and are adapting their strategies to succeed in an environment characterized by slower growth and increased complexity.

Monthly FDI growth, 2012 to Q3'2014



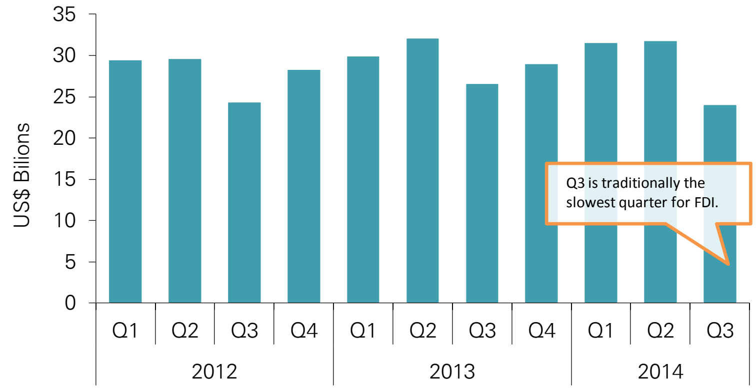
Source: Ministry of Commerce accessed16 Oct. 2014, KPMG analysis

Service sector FDI is still growing

In the first nine months of 2014, China's service sector attracted US$48.6 billion in FDI, up 8.7 percent from a year ago. This performance is in marked contrast to the manufacturing sector, where FDI over the same period dropped 16.5 percent to US$29.6 billion. While to some extent this slowdown may reflect global demand and corporate investment sentiment, it is likely that these numbers also reflect the effect of Chinese industrial rebalancing, making overseas investors more reluctant to increase their manufacturing footprint in China.

In contrast, the rapid growth in service sector FDI is a trend expected to continue in line with the government's Third Plenum "Decision" in late 2013. The "Decision" and subsequent policy announcements have facilitated investment in a broad range of service industries in China, and encouraged new foreign investment into a number of sectors including finance, education, culture and healthcare .

FDI value by quarter, 2012 to Q3'2013



Source: Ministry of Commerce accessed16 September 2014, KPMG analysis

FDI is rebalancing geographically

Central China saw a 9.5 percent FDI growth in the first three quarters of 2014, outperforming East and West China, where FDI levels dropped from 2013 levels noticeably. Central China is clearly becoming a more popular investment destination in China, although the eastern coastal provinces still receive a much larger share of FDI in absolute value. Companies are relocating or expanding operations in Central China due to relatively lower labor and land costs and competitive infrastructure.

Inbound M&A Summary

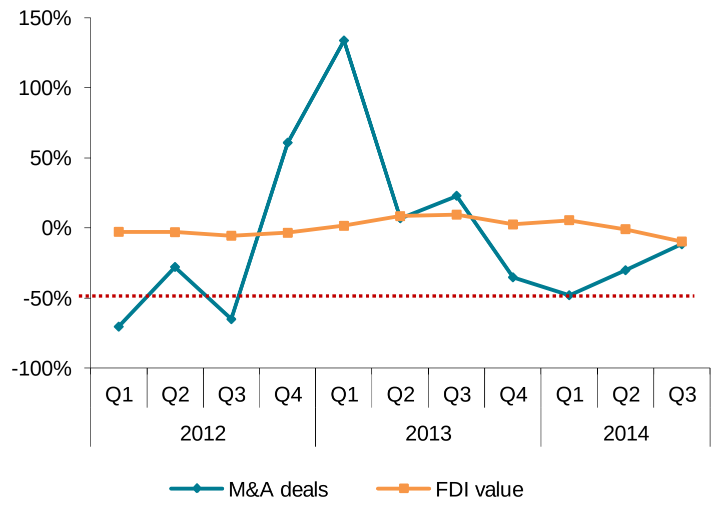
	Q1-Q3 '2013	Q1-Q3 '2014	% Change
Deal value (US$ billions)	27.3	19	-30.5%
Number of deals	442	328	-25.8%

Source: Dealogic accessed 30 September 2014, KPMG analysis

Inbound M&A

There were a total of 328 'announced' or 'completed' inbound M&A deals in the first three quarters of 2014, versus 442 through the same period of 2013, representing a 25.8 percent decrease in year-on-year deal activity. Total deal value was also down: deal value was US$19 billion during the first three quarters, down 30.5 percent year-on-year. In the third quarter alone, the number of deals decreased 23.1 percentage year-on-year to 120, with the total deal value down 11.7 percent year-on-year to US$8.23 billion.

Changes in M&A deals and FDI value, 2012 to Q3'2014



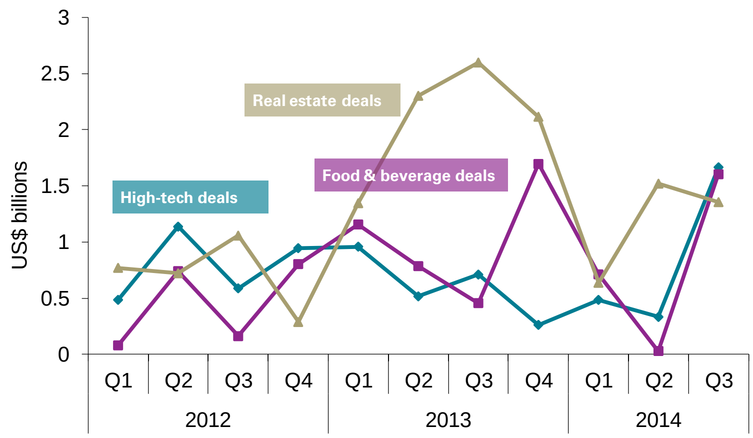
Source: Dealogic accessed 30 September 2014, KPMG analysis

Analysis by industry

In the third quarter, high-tech, food and beverage and real estate were the top three FDI sectors.

In the high-tech industry, inbound M&A activities were relatively slow in the first half of 2014, compared with the same period of 2013 and 2012. The surge in the third quarter was mainly due to Intel's US$1.5 billion acquisition of 20% shares in Spreadtrum Communications Inc and RDA Microelectronics Inc, controlled by Tsinghua Unigroup[8]. Over the past few years, food and beverage has been a key destination for inbound M&A. This trend is expected to continue: demand for safe and high-quality food is on the rise, creating investment opportunities for foreign food companies with more advanced technologies and higher standards of food security. In the real estate industry, inbound M&A activities showed a declining trend in the last five quarters, which is in line with the ongoing slowdown experienced in the Chinese real estate market.

Inbound M&A deal value by industry, 2012 to Q3'2014



Source: Dealogic accessed 30 September 2014, KPMG analysis

Top ten inbound M&A deals by deal value in Q3'2014

No.	Date	Target	Acquirer	Acquirer Country	Target Sector	Shares acquired (%)	Deal Value (US$ mn)
1	2014.9	Spreadtrum Communications Inc; RDA Microelectronics Inc	Intel Corp	United States	Computers & Electronics	20	1,500
2	2014.8	Yonghui Superstores Co Ltd	Dairy Farm International Holdings Ltd	Hong Kong	Retails	20	925
3	2014.7	CP Pokphand Co Ltd	Itochu Corp	Japan	Food & Beverage	25	854
4	2014.9	Beingmate Baby & Child Food Co Ltd	Fonterra Cooperative Group Ltd	New Zealand	Food & Beverage	20	598
5	2014.9	Yantai Joy City Co Ltd; Shenyang Joy City Real Estate Development Co Ltd; COFCO Commercial Property Investment Co Ltd	COFCO Land Holdings Ltd	Hong Kong	Real Estate	33	530
6	2014.8	CMST Development Co Ltd	Global Logistic Properties Ltd	Singapore	Transportation & Logistics	15	323
7	2014.9	Hospitals (Grade-two general hospital)	China HealthCare Holdings Ltd	Hong Kong	Healthcare	100	307
8	2014.9	ABC Life Insurance Co Ltd	CTBC Financial Holding Co Ltd	Taiwan	Insurance	20	277
9	2014.8	Liaoning Cheng Da Co Ltd	Fubon Financial Holding Co Ltd	Taiwan	Textile	4	160
10	2014.7	China Sciences Hengda Graphite Co Ltd	Lamboo Resources Ltd	Australia	Mining	100	150

Source: Dealogic accessed 30 September 2014, KPMG analysis

8. http://technews.tmcnet.com/news/2014/09/27/8039211.htm

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About KPMG's Global China Practice (GCP)

毕马威全球中国业务
KPMG Global China Practice

KPMG's Global China Practice (GCP) was established in September 2010 to assist Chinese businesses that plan to go global, and multinational companies that aim to enter or expand into the China market. The GCP team in Beijing comprises senior management and staff members responsible for business development, market services, and research and insights on foreign investment issues.

There are currently around 60 China Practices in key investment locations around the world, from Canada to Cambodia and from Poland to Peru. These China Practices comprise locally based Chinese-speakers and other professionals with strong cross-border China investment experience. They are familiar with Chinese and local culture and business practices, allowing them to effectively communicate between member firms' Chinese clients and local businesses and government agencies.

The China Practices also assist investors with China entry and expansion plans, and on both inbound and outbound China investments provide assistance on matters across the investment life cycle, including market entry strategy, location studies, investment holding structuring, tax planning and compliance, supply chain management, M&A advisory and post-deal integration.

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