OWW Investment Quarterly 3Q09

RMB funds the way to go?

Historically, foreign private equity funds gained exposure into China by investing in offshore entities typically incorporated in British Virgin Islands, Cayman Islands, etc. which in turn invested in WOFEs ie. "wholly owned foreign enterprises" domiciled in China. These investments which were made in USD could easily be monetized as the offshore entities listed in foreign exchanges such as NASDAQ, Hong Kong Stock Exchange, London Stock Exchange etc. However, since 2006, China stopped approving conversion of local companies into WOFEs. As the number of WOFEs depleted, the other option was to invest in onshore Chinese companies. With the gradual appreciation of the RMB, the sterling performance of the Shanghai Stock Exchange and the gradual improvement of legal and investors rights, foreign investors started to embrace RMB funds.

Presently foreign investors can invest in onshore Chinese companies through the following vehicles:

Comparison of Investment Funds For Onshore Chinese Investments

	Offshore	Parallel		J.V. RMB	Local RMB
		Offshore	J.V. RMB		
Investors: Foreign Local	✓ X	✓ X	✓ ✓	✓ ✓	X ✓
Investment: Offshore through WOFE Onshore	✓ ✓	✓ X	X ✓	X ✓	X ✓
Approval for onshore investment	3 - 4 mths	X	RMB remittance	RMB remittance	No approval required
Drawdown	Per Investment	Per Investment	Lump sum	Lump sum	Per Investment
Conflict of Interest	None	Equalisation Agreement		None	State Backed
Can invest in Restricted Industries e.g. media, education, resources	X	X	X	X	✓ Can also invest in listed shares and property
Exits	No limitation	No limitation	Onshore IPO/ trade sale	Onshore IPO/ trade sale	Onshore IPO/trade sale

Offshore funds, which can invest in WOFEs, can also invest in onshore Chinese companies subject to approval from Ministry of Commerce (MOFCOM) and State Administration of Foreign Exchange (SAFE) on a case by case basis. This approval can stretch to 3-4 months making them uncompetitive.

J.V. RMB funds invested by foreign investors have been the vogue of the day. As MOFCOM and SAFE approvals have been obtained upfront, J.V. RMB funds can compete with Local RMB funds in terms of speed. However, foreign investors are concerned that the RMB may have to be converted upfront while awaiting investments to be sourced and also whether there may be capital controls when converting their gains back to foreign currencies. This would have an impact of their IRR.

Parallel funds which run 2 funds - one foreign which is similar to offshore funds and one local J.V. RMB Fund - can enjoy the best of both worlds. While the 2 parallel funds will have an equalization agreement to average the returns of the 2 funds for all investors, there may be complications if the 2 funds have different investors and if the returns differ by a huge margin.

Local RMB funds which foreign investors are prohibited, claim maximum flexibility and advantage. They are also allowed to invest in listed shares, property and restricted industries such as media, resources and education. Currently, most of these funds are state backed giving rise to possible conflict of interest as IRR may not be their primary objective. Presently, J.V. RMB funds and Local RMB funds can only exit their investments through local IPOs or trade sales. This means that the exits may be at risk if the local capital markets falter.

Foreign investors wishing to continue to have exposure to China will eventually have to embrace J.V. RMB funds. On the positive note, legislation is evolving to permit investments through partnerships, companies and trusts although the timing of their implementation is uncertain. While there remains the risk of conflict of interest, capital controls, capital gains tax, withholding taxes, these risks can be compensated by higher IPO PEs and possibly exchange gains.

Pulse on semiconductor

In stark contrast to the dismal performance at the end of 2008, major semiconductor companies have since rebounded sharply in Q2 2009 and are now reporting improved demand outlook, recovery in book to bill ratio and more optimistic revenues and profit guidance for Q3 2009.

Likewise for OWW portfolio of semiconductor companies, China based SMIC experienced 82.5% revenue growth in Q2 over Q1 and revenue guidance for Q3 is expected to show double digit growth over Q2. ePAK Holdings Ltd, a Shenzhen based semiconductor packaging manufacturing company also saw its monthly revenue improve by more than 50% since Q1.

Based on a poll by Semiconductor Industry Intelligence LLC, the industry is expected to enter into sustained recovery in 2010 with growth prospects in 2011.

World Semiconductor Market Forecasts - Annual Change

Source	Date	2009	2010	2011
WSTS	June	-21.6%	7.3%	8.9%
SIA	June	-21.3%	6.5%	6.5%
Gartner Dataquest	June	-22.4%	10.6%	10.8%
iSuppli	July	-23.0%	13.1%	n/a
Future Horizons	July	-13.7%	19.0%	28.0%

Source: Semiconductor Intelligence, LLC

Chinese IT companies still hiring

Capitalising on the demand for IT infrastructure, Chinese IT companies are continuing to flourish. According to data from Zhaopin, a local recruitment company, Chinese IT companies are still actively hiring and have not reduced recruitment budgets.

IT Outsourcing job postings on zhaopin.com:

Company	# of jobs posted	Company	# of jobs posted
Vanceinfo	599	Symbio Group	70
Neusoft	443	Cognizant	58
iSoftStone	351	Augmentum	56
Beyondsoft	243	Longtop	42
HiSoft	208	Dextrys	36
Satyam	186	Freeborders	31
Acheivo	150	Bleum	25
Objectiva	101	Genpact	21
Accenture	84	Dalian Hi-Think	20

OWW IT portfolio companies in China have experienced a strong revenue pickup in Q2 and Q3 2009 with order book continuing to be strong. This has been accompanied by a heightened demand for skilled professionals and on a continuing basis, need to focus on retention efforts for their experienced staff.

The economic crisis, which has destructed many industries and thrown many out of jobs, has not significantly alleviated the skilled labor shortage affecting the IT industry in China as a whole.

About OWW

OWW Capital Partners Pte Ltd ("OWW") (www.oww.com.sg), formerly known as OCBC, Wearnes & Walden Management (Singapore) Pte Ltd, was established by OCBC Bank, WBL Corporation and Walden International in 1991. In October 2006, the management team of OWW acquired WBL Corporation's interests and the company assumed its current name.

OWW focuses on expansion stage companies in the enterprise and consumer services sectors within the South East Asia and North Asia regions.

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