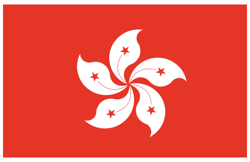

North Asia

Hong Kong

Economic recovery will continue in the first half of 2010 driven by the increases in private consumption from an improved job market, an increase from inbound tourism and new major infrastructure projects

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Current Environment

While still in decline, Hong Kong's economy showed some improvement in the second half of 2009 reflecting the effects of the government stimulus programmes (including temporary tax cuts and loan guarantees for enterprises) and benefiting from the rapid recovery in the Chinese economy. Real GDP recorded a third quarter decline of 2.4% in 2009 as compared to a 7.8% and 3.6% decline in the first and second quarters of 2009 respectively.

Private consumption expenditure, having declined for four consecutive quarters, bottomed out in the third quarter of 2009 on a year-on-year basis and showed a 0.2% increase. For businesses, capital spending increased by 3.4% in the third quarter of 2009 after three consecutive quarters of decline.

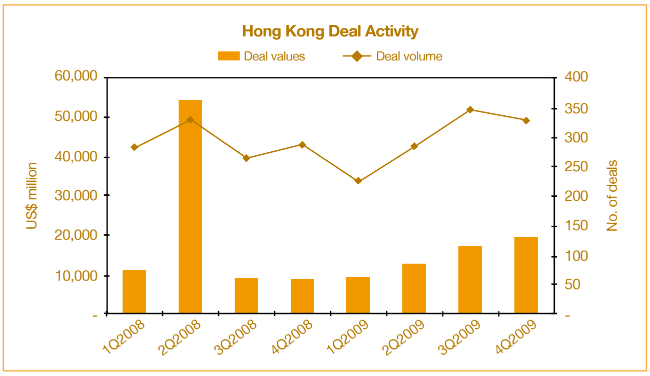
Hong Kong total trade exports, after three consecutive quarters of decline, recorded year-on-year growth of 1.3% in November 2009. Yet, the momentum of recovery is uncertain and is highly dependent on global demand as advanced economies are still struggling to recover from the aftermath of the global financial crisis.

The unemployment rate in the third quarter of 2009 was 5.3%, a slight improvement from 5.4% in the second quarter of 2009 and the first reduction since the onset of the global financial crisis.

Attracted by relatively low valuations for quality assets and the low interest rate environment, high levels of capital inflow were recorded in the second half of 2009. This lifted the Hong Kong equity markets and pushed the Hang Seng Index up 19% between June 2009 and December 2009. Further, both the average daily turnover and the market capitalisation in November 2009 increased by 24% and 7% respectively, compared to June 2009. The number of IPOs jumped to 40 in the second half of 2009 from 18 in the first half. Funds raised in the equity markets increased over ten-fold from HK$17 billion in the first half of 2009 to HK$185 billion in the second half.

The Hong Kong property market also benefited from the inflow of liquidity and the low interest rate environment with residential property prices increasing by over 30% in 2009. Average monthly sales transactions more than doubled from 5,488 in the first quarter of 2009 to approximately 11,800 in each of the second and third quarters of 2009. In October 2009, the Hong Kong Monetary Authority adopted new measures by advising banks to lower the loan-to-value ratio for luxury apartments to curb speculation and ease any concerns of a property bubble developing.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2009.

Deal activity in terms of value decreased from US$82 billion in 2008 to US$57 billion in 2009. However, there continues to be increased activity in the Hong Kong deal environment with total deal value for the second half of 2009 increasing to US$36 billion, a 40% increase over the US$21 billion of deals announced in the first half of 2009.

In the second half of 2009, 673 deals were announced, compared with 508 deals in the first half of 2009 and 551 deals in the second half of 2008.

Some of the major transactions in the second half of 2009 include:

Financial Services

China's Haitong Securities (Haitong) has agreed to buy Hong Kong's Taifook Securities (Taifook) for US$232 million. According to the agreement, Haitong will acquire a 52.9% controlling stake in Taifook. The acquisition offers an opportunity for Haitong to establish a sizeable customer base and distribution network in Hong Kong, which is important to its international expansion strategy.

China Insurance International Holdings Company Limited (CIIH) has signed a definitive agreement to acquire Ming An (Holdings) Company Limited, a Hong Kong-based property and casualty insurance company from China Insurance HK (Holdings) Company Limited (CIHK). The deal consideration was US$233 million.

China CITIC Bank Corporate Limited has signed a share purchase agreement to acquire a 70.3% stake in CITIC International Financial Holdings Limited, an investment company involved in banking and asset management based in Hong Kong from Gloryshare Investment Limited, a Hong Kong-based investment holding company and a wholly owned subsidiary of CITIC Group. CITIC bank had financed the transaction with a deal size of US$1.75 billion through its internal cash reserves.

Consumer and Retail

Esprit Holdings Limited, the listed Hong Kong-based company engaged in wholesale and retail distribution and the licensing of fashion and lifestyle products, has agreed to acquire the remaining 51% stake in its joint venture CRE Esprit Inc, the China-based joint venture company engaged in retail sales and wholesale distribution of Esprit and Red Earth branded apparel and accessories, from China Resources Enterprise Limited (CRE), the listed Hong Kong-based conglomerate. The deal was announced in December 2009 for a cash consideration of US$500 million. The acquisition will enable Esprit to unify its interests in China and further facilitate its expansion in China.

Real Estate

China Overseas Land & Investment Ltd., a Hong Kong-listed property developer, announced in September 2009, that it will acquire the property business of Shell Electric Manufacturing (Holdings) Company Ltd., a Hong Kong-listed electrical appliances manufacturer. The value of the general offer is approximately US$440 million. The deal is expected to be completed subject to the satisfactory result of due diligence and the Hong Kong Stock Exchange listing committee's approval.

Telecommunications

In September 2009, China Unicom Ltd., the Hong Kong -listed arm of Unicom Group, and Telefonica, a Spanish telecommunication operator listed on the Spanish Stock Exchange, signed a mutual investment agreement of US$1 billion to foster a strategic alliance between the two telecommunications companies. The alliance will enable Telefonica and China Unicom to strengthen their business relationship in the telecommunications sector and enhance services to their clients. It will also create synergies and provide better growth prospects to strengthen their core business. The agreement is effective for a period of three years but may be terminated in the event that Telefonica's holding in China Unicom falls below 5%, or China Unicom holds less than a 0.5% stake in Telefonica.

Recently, Hutchison Whampoa Limited announced its plan to privatise its international telecommunications arm, Hutchison Telecommunications International Limited (HTIL).

Energy and Mining

China Investment Corporation (CIC) has signed a framework agreement to acquire a 20.1% share in GCL-Poly Energy Holdings, a Hong Kong-based green energy supplier in November 2009. CIC also entered into a joint venture agreement with GCL-Poly Energy Holdings to establish a joint venture company which will operate in a photovoltaic electricity generating businesses.

Pharmaceutical

China Pharma Limited, a Hong Kong-based company incorporated by Morgan Stanley Private Equity Asia III Holdings for acquisitions in the pharmaceutical sector, announced in August 2009 that it was to acquire Sihuan Pharmaceutical Holdings Group Ltd (Sihuan). Sihuan is a listed China-based investment holding company engaged in manufacturing cardiocerebral vascular drug and research and development. The total deal size is approximately US$246 million and the offer made by China Pharma has been declared unconditional as of October 2009. China Pharma will make a compulsory acquisition of Sihuan after the privatisation offer closes by the end of October 2009. China Pharma will delist and privatise Sihuan post-acquisition.

Private Equity

China Investment Corporation (CIC), the China-based investment company and sovereign wealth fund owned by the Chinese Government, has agreed to acquire a 40% stake in CITIC Capital Holdings Limited, the Hong Kong-based company engaged in private equity investment, real estate funds, structured finance and alternative investments, for an undisclosed consideration. The deal was announced in July 2009. CITIC Capital has approximately US$2 billion of funds under management from international investors.

Outlook

The Hong Kong economy will continue its recovery in the first half of 2010 driven by the increases in private consumption from an improved job market, an increase from inbound tourism and the launch of new major infrastructure projects, such as the extensions of the MTR, the development of West Kowloon Cultural District and the new Guangzhou-Shenzhen-Hong Kong railway.

With continued low interest rates and the pegged currency, liquidity will continue to be available in the market in 2010. However, any reversal of “hot money” flows may have an immediate effect on the Hong Kong economy and investor sentiment.

While both corporate and private equity buyers have remained cautious in 2009, we expect Hong Kong’s M&A activity in 2010, both in terms of volume and deal value, to match or exceed 2009 levels fuelled by growing investor confidence, improved rates of economic growth and due to valuation gaps between buyers and sellers reducing. Increased private equity deals and the financial services, real estate and consumer related sectors will likely be key drivers of the M&A market.

Inevitably, Hong Kong’s economy in 2010 will continue to leverage on its close ties with China and benefit from the latter’s robust economic growth. It will also be dependent on the advanced global economies of the US and Europe recovering and continued government stimulus programmes. The recent announcement of Dubai World’s financial difficulties is an indication that the recovery from the global financial crisis is still only tentative and the possibility of Hong Kong suffering another setback from a potential downturn in the global economies can not be eliminated. ■