Hong Kong

Economic environment holding up due to China exposure, although stock market tracking downwards in line with global markets. Deal activity closely connected to China which is expected to remain steady going forward

Current Environment

Hong Kong's economy continued to expand in the first quarter of 2008 with GDP growth of 7.1% despite the weakening US economy and increasingly challenging external environment. Economic growth was largely driven by net exports and domestic demand. Total exports of goods achieved growth of 8.3% in the first quarter of 2008, supported by steady demand from China, emerging economies and European Union markets. Exports of services increased by 10.8% in the first quarter of 2008 compared to the equivalent quarter in 2007 with the continued surge in financial services, offshore trade and inbound tourism. Domestic demand remained strong with private consumption expenditure rising by 7.9%, which is supported by rising wages and firm labour market conditions.

Labour market conditions continued to be firm in the first quarter of 2008. The seasonally adjusted unemployment rate remained stable at 3.4% and the overall unemployment rate fell further to a 10-year low of 1.9%.

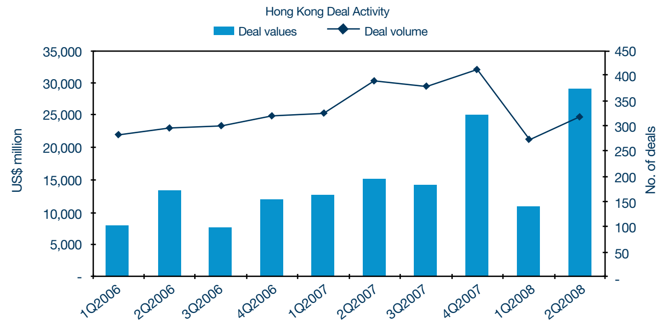
Overall consumer prices picked up faster with the inflation rate hitting 5.7% in May 2008 mainly due to surge in food and energy prices, as well as hikes in housing rent.

The Hong Kong stock market fell substantially from the 2007 record highs of 31,000 in October 2007 to 21,100 in March 2008 due to fears of a US-led recession resulting from the US sub-prime crisis and rising inflation worries.

The number of IPOs dropped significantly from 30 in the fourth quarter of 2007 to only 10 in the first quarter of 2008. The funds raised through IPOs also fell significantly from US$16.9 billion to US$4.2 billion in the respective quarters.

The Hong Kong property market in 2008 continues to ride the upward trend since 2007. Property prices and rents, in particular in the commercial office market, enjoyed record-breaking upswings with unprecedented levels of demand met by limited supply.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2008

The value of Hong Kong's deal activity in the first half of 2008 increased to US$30.9 billion compared with US$29.2 billion in the second half of 2008 but the number of announced deals decreased from 542 to 429. Some of the major deals in each industry sector included:

Telecoms sector

Telefonica Internacional SA, a subsidiary of the Spanish telecommunications and media company, which held a 5% stake in China Netcom Group, acquired an additional 2.22% interest for US$455 million in January 2008. Telefonica acquired these shares from four Chinese investment companies, allowing it to hold a 7.22% stake in China Netcom post-transaction.

PCCW, Hong Kong's dominant fixed line telecommunication operator recently announced a restructuring of its fixed line, mobile and media businesses, and invited bids for a 49% stake in a new company to be set up to hold those businesses, in what will be a multi-billion dollar deal if successful.

Real Estate sector

Hong Kong-listed real estate developer Franshion Properties China Limited announced its intention to acquire Wish Pine Limited, a Hong Kong real estate and hotel investment company, for US$1.6 billion in June 2008. The acquisition will help Franshion Properties tap into the luxury hotel sector and strengthen its position in the property space, management and hotel operations. The deal is expected to complete in or before December 2008.

Hong Kong-listed Champion Real Estate Investment Trust has agreed to acquire Renaissance City Development, the holding company of Langham Place shopping centre, from Great Eagle Holdings Limited, another Hong Kong-listed property developer for approximately US$1.6 billion. The acquisition was announced in February 2008.

Energy sector

Sino Union Petroleum & Chemical International Limited, the Hong Kong-listed company engaged in trading of petrochemical products, agreed in April 2008 to acquire a 36% stake in Madagascar Petroleum International Limited (“MPIL”), a Hong Kong-based oil and gas exploration company, from Smart Rich Energy Finance (Holding) Ltd for US$104 million. This acquisition will provide MPIL with access to additional financial resources which will allow it to further enhance its oil and gas operations.

Talisman Energy Inc, the listed Canada-based oil and gas development company, has acquired CNOOC Wiriagar Overseas Limited, the Hong Kong oil and gas exploration company, from China National Offshore Oil Corporation Ltd, for US$212.5 million in January 2008. This acquisition is in line with Talisman Energy’s strategy to grow and expand in the Asian oil and gas market.

Financial sector

China Merchants Bank Co Ltd (“CMB”), the Shanghai and Hong Kong dual listed commercial bank, announced the acquisition of Wing Lung Bank Ltd, a Hong Kong-listed bank for US$4.66 billion in June 2008. This acquisition offers CMB an opportunity to establish a sizeable customer base and distribution network in Hong Kong.

CITIC Group Holding, the China-based investment holdings group, proposed in June 2008 to privatise Citic International Financial Holdings, its Hong Kong-listed financial services subsidiary previously majority owned by Banco Bilbao Vizcaya Argentaria SA (“BBVA”), a listed Spanish bank. CITIC Group intends to issue new shares to BBVA, allowing it to participate in the share capital of CITIC’s banking subsidiary in the PRC.

Retail sector

Hong Kong-listed shoemaker, Belle International Holdings Limited, privatised Mirabell International Holdings Limited for US$181 million in May 2008. Mirabell was a Hong Kong-listed footwear retail company with a number of outlets in Hong Kong. Post transaction, Mirabell was delisted from the Hong Kong Stock Exchange.

Private Equity

Asia Packing Group Holdings Limited, the Hong Kong-based investment holding company formed by CVC Capital Partners Limited, acquired a 53.85% stake in Hung Hing Printing Group Ltd, the listed Hong Kong-based company engaged in the printing and manufacturing of paper and carton boxes, for US$112.2 million in April 2008.

CITIC Capital Holdings Limited, the Hong Kong-based investment management company and private equity firm, has acquired a 45% stake in Guan Sheng Yuan (Group) Company Limited, a Chinese food manufacturer, from Shanghai YiMin No.1 Foods (Group) Company limited for US$71 million in January 2008.

Outlook

Although the US economy and the global financial markets are likely to remain volatile, many observers expect domestic demand and private consumption in Hong Kong to remain strong, with firm labour market conditions and a resilient property market.

However, the surge in global food prices, the high prices of crude oil and other commodities, the weak US dollar (to which the HK dollar is pegged), the appreciation of the Chinese yuan and the continued strength of the local economy will continue to exert inflationary pressure on Hong Kong.

Despite its close links to China, which is a strong growth engine for the territory, Hong Kong is by no means isolated from events impacting the global economies. External shocks remain a concern for Hong Kong and, at press time, the Hong Kong stock market was tracking the steady decline seen in other leading world indicies.

Much of the territory’s deal activity is linked to targets in mainland China where many factors are at play and this will influence deal activity in Hong Kong for the second half of 2008. The global credit crunch has had less of an impact on banks providing capital in Hong Kong; deal sizes tend to be smaller (which makes them easier to finance); and the private equity industry – with a very strong presence in Hong Kong – remains committed to the region. One-off big transactions, such as the mooted PCCW deal described above, tend to make value trends hard to forecast but the number of M&A transactions might best be expected to track that of the first half of the year, with some growth moving into 2009 if the global economies start to improve.