

Industry Review & Analysis

Z-Ben Advisors' projected "floor" in equity prices and fund raising was premature. These are dark days indeed and fund managers may be under intense pressure if, this time, investors do decided to liquidate.

Finding a floor? Not yet

Wrong, wrong wrong. Z-Ben Advisors suggested in our April report that a floor had been reached and share prices were set to finally re-emerge from their half year funk. Not only was this incorrect, with sentiment once again turning negative, but these conditions ended up leaving fund managers scrambling to raise whatever assets they could find. Then there was the issue of a possible spike in redemptions rearing its ugly head again. Whether or not investors have finally thrown in the towel remains to be seen. The probability that fund managers will close Q2 unscathed, however, is in rapid decline.

To a great extent the stock market, and by extension fund raising, was adversely impacted by the devastating earthquake which struck the Sichuan province interior. A calamity of epic proportions and adding to the growing list of unexpected events taking place this year. Z-Ben

month of May there were 13 individual products reporting results. This time, however, total assets raised was half that of the previous month - Rmb11.1bn - with and even more rapid deterioration in the average product size; Rmb0.85bn.

Similarly, there was scant interest for either of the latest two mutual funds developed under the Qualified Domestic Institutional Investor (QDII) program. First up was Fortune SGAM and which announced assets raised totaling Rmb463m. That was then followed later in the month by Yinhua and which ended with assets of Rmb418m.

For sure these results would have been seen as a disappointment to both the fund managers and their appointed foreign advisors. Z-Ben Advisors actually views the results as positive. Yes, it would have been fantastic to pull in Rmb30bn like those firms first to market late last year.

Industry Assets Under Management (RMB Billions)

	Current ¹	Share	1Q08	Share	4Q07	Share	3Q07	Share
Industry AUM under pressure. Redemptions may finally be rising								
Total Industry Assets	2,325.2	100.0%	2,612.7	100.0%	3,272.2	100.0%	3,111.0	100.0%
Quarterly Δ	-11.0%		-20.2%		5.2%		72.9%	
Total Domestic	1,341.0	57.7%	1,553.1	59.4%	1,951.3	59.6%	1,840.1	59.1%
Total Joint Venture	611.3	26.3%	678.2	26.0%	838.5	25.6%	834.4	26.8%
Total Foreign Invested	372.8	16.0%	381.4	14.6%	482.4	14.7%	436.6	14.0%

SOURCE: Z-BEN ADVISORS

Footnote 1: Estimate of AUM as of May 30, 2008

Advisors has been arguing for some time now that value - and specifically alpha - can be found. It is the fog of uncertainty, to a great extent and in Z-Ben Advisors' opinion, which is holding buyers back.

Only when reviewing the hard cold numbers, though, do we get a real sense of actual investor demand and appetite for risk. We need look no farther than the speed in which end demand for newly issued mutual funds has deteriorated over the past month both in absolute and relative terms.

In April, there were a total of eight products which completed the fund raising process with a grand total of Rmb22.2bn in assets raised for an average product launch of Rmb2.8bn. For the

That's just not going to happen again any time soon. Instead, the focus needs to be on successfully deploying the platform so that when conditions do change - and they will - those with a QDII mutual fund at the ready can benefit. In the meantime expect downward pressure to remain.

We aren't holding our breath for any kind of material rebound in the near future (be that demand for onshore or offshore funds). The best case scenario would have a larger degree of uncertainty removed from the market in the next month or two so as to set the stage for a relatively stronger second half.

Fund managers will first need to get through the final month of the quarter and counter the risk of rising redemptions. Z-Ben Advisors was

Fund raising is now firmly against the wall:

APR Avg = Rmb2.80bn

MAY Avg = Rmb0.85bn

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At least fund managers turned in solid profits in 2007

rather confident that investors would hold firm in Q1 and our assessment proved to be correct. This time around, unfortunately, we aren't so certain. It is all but assured that the industry will finish the period with net outflows. All that we are left to ponder is by what degree.

It isn't all doom and gloom (although it certainly appears that way). Fund managers can at least reflect on their collective achievements from last year and, thanks to record setting profits of Rmb15.2bn, ample cash reserves to weather the current storm.

Later in the report Z-Ben Advisors includes a detailed assessment of the industry's revenue

and income for 2007. Again, the results were quite impressive although widely expected. Still, upon closer examination we find that more than a few fund managers turned a profit only with the support of non-core revenue.

What can be agreed to today is increasing downward pressure on both profits and net margins. Firms of all shapes and sizes are seeing a marked rise in their cost structures while several vital sources of non-core revenue will be missing this year. In turn, success in 2008 should be more a reflection of how well all firms adapt to these changing conditions.

Analytical Quick Hits

New QFII Quota

The State Administration of Foreign Exchange (SAFE) has been issuing quota over the past several months, but doing so with little fanfare (and no longer publicly disclosing which firms are provided quota). Still, six firms, including Pictet, Norges Bank and Columbia University have received a quota totaling US\$650n.

Moving Through the QFII Queue

Of those to recently receive QFII quota was AMP Capital Investors with an additional USD100m provided to the Australian asset manager. This is the first quota to be issued to an already participating institution. It would then look as though the queue is set to (finally) re-open.

Fund Managers' Hong Kong Expansion

The CSRC announced that it will permit mainland fund management companies to set up either branches and representative offices in Hong Kong. Meant to promote cooperation in the area of asset management the expectation is for those managers currently approved to operate a QDII fund to receive the first approval.

NCSSF Looking for External Investment Managers

NCSSF released a notice on its official website that it intends to select a group of external investment managers to provide global investment services. The mandate types are all active equity products. The call for RFIs even includes a new equity category of Chinese SWFs: Active China Overseas Equity. The process will be rather quick with all interested parties submitting an RFP by no later than June 18th.

NCSSF Investing into Private Equity

In addition to the second round of international mandates, the NCSSF also disclosed that the State Council has approved the Fund to allocate assets into private equity. The upper limit of investment was set at 20% of total assets. Management decided on a targeted allocation of half that level for the time being. It's was further reported that Rmb2.0bn has been committed to both CDH Investments and Hony Capital respectively.

Analytical Quick Hits

Bank of Shanghai Goes After Hua'an

Bank of Shanghai will likely acquire a 20% stake in Hua'an Fund Management. The stake is currently held by Shanghai Feidian Investment Development. Now both parties are waiting for approval of the CSRC. It will be the first such move by a Chinese city commercial bank and could be followed by others including Bank of Beijing.

Fund Raising at Multi-Year Low

Ten new funds in this year raised less than Rmb1.0bn each, even though some extended the subscription period by several weeks. The worst subscription result was from a China Nature equity fund, which only raised RMB248m. The average new product size also dropped to just Rmb0.85bn in May versus Rmb2.2bn in April.

QDII Demand Declined as well

Similarly to the comments above, end demand for the two most recently announced QDII mutual funds came in on the low side. Fortune SGAM disclosed that its product finished with Rmb462m with Yinhua at month's end announcing fund raising totaling Rmb418m. Investors' cold response was mainly due to volatility in both local and global markets.

Rothschild Wins the Zhonghai Stake

Rothschild Banque won at auction the right to acquire a 15.385% stake in Zhonghai Fund Management with a bid of RMB150m. The stake was sold by Yunnan Tobacco Xingyun Investment Co. The price was RMB7.49 per share, and far below that recorded during the Rongtong auction earlier in the year and the auction of shares in Yinhua and Bosera at the end of last year.

Tianhong Deal Receives Approval

Separately, it was also disclosed that the CSRC formally approved Zhangze Electric Power to liquidate in full its 26% stake in Tianhong. Acquiring the position was Wuhai Junzheng Nengyuan Huagong and which paid Rmb31.2m or Rmb1.20 per share and a near term low. Valuation are expected to remain under pressure on the threat of asset outflows and rising cost structures.

Segregated Accounts' Rapid Growth

While new fund issues landed in hot water, segregated accounts were growing rapidly. Since the first contract signed in March, many fund companies have received large volumes of new SA business. Among the biggest winners were such companies as E-Fund, Southern, and Bank of Communications Schroders. It's conservatively estimated that capital managed within segregated accounts is currently more than RMB5bln.

New Rules for Securities Firms

The CSRC issued the Detailed Rules on Segregated Account Business of Securities Firms (Provisional) and the Detailed Rules on Pooled Asset Management of Securities Firms (Provisional), which will be effective from July 1, 2008. According to the new rules, securities firms are allowed to have segregated account service for their clients including individual investors.

INDUSTRY AUM & MARKET SHARE

MAY 30, 2008: ESTIMATES

DOMESTIC FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
Baoying	15.7	0.68%	37
Bosera	145.2	6.24%	2
Changxin	23.5	1.01%	31
China AMC	214.2	9.21%	1
China Nature	5.5	0.24%	51
China Post & Capital	45.9	1.97%	20
China Universal	51.9	2.23%	16
CITIC	11.3	0.49%	40
Dacheng	88.3	3.80%	7
E-Fund	126.4	5.43%	5
First Trust	17.6	0.76%	35
Galaxy	14.9	0.64%	38
Golden Eagle	2.3	0.10%	56
Great Wall	45.6	1.96%	21
Guangfa	100.4	4.32%	6
Guotai	38.6	1.66%	23
Hua'an	81.1	3.49%	8
Huafu	5.9	0.25%	49
Huashang	8.6	0.37%	45
Lion	46.2	1.99%	18
New Century	1.4	0.06%	59
Orient	8.6	0.37%	46
Soochow	9.4	0.40%	42
Southern	132.8	5.71%	4
Tianhong	4.8	0.21%	53
Wanjia	9.7	0.42%	41
Yimin	9.2	0.40%	43
Yinhua	55.0	2.36%	15
Zhonghai	21.2	0.91%	33
TOTAL	1,341.0	57.67%	

SOURCE: Company Data, Z-BEN ADVISORS

JV FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
ABC-CA ³	-	-	N/A
ABN Amro TEDA	22.1	0.95%	32
AIG-Huatai	20.7	0.89%	34
AXA-SPD Bank	1.7	0.07%	58
Bank of Communications Schroders	46.0	1.98%	19
BOC ¹	24.7	1.06%	30
CCB Principal	28.7	1.23%	29
China International ¹	73.6	3.16%	9
China Merchants ¹	39.0	1.68%	22
CITIC-Prudential	7.1	0.30%	48
Everbright Pramerica	38.1	1.64%	24
First State Cinda	8.8	0.38%	44
Fortis Haitong	34.8	1.50%	25
Fortune SGAM	59.4	2.55%	11
Franklin Templeton Sealand	17.3	0.75%	36
GTJA Allianz	7.5	0.32%	47
HSBC Jintrust	5.8	0.25%	50
ICBC Credit Suisse	50.4	2.17%	17
INVESCO Great Wall	64.2	2.76%	10
KBC-Goldstate	3.7	0.16%	54
Morgan Stanley Huaxin	2.3	0.10%	57
Lombarda China	3.5	0.15%	55
Lord Abbett China	5.4	0.23%	52
SYWG BNP Paribas	14.1	0.61%	39
UBS SDIC	32.4	1.39%	27
TOTAL	611.3	26.29%	

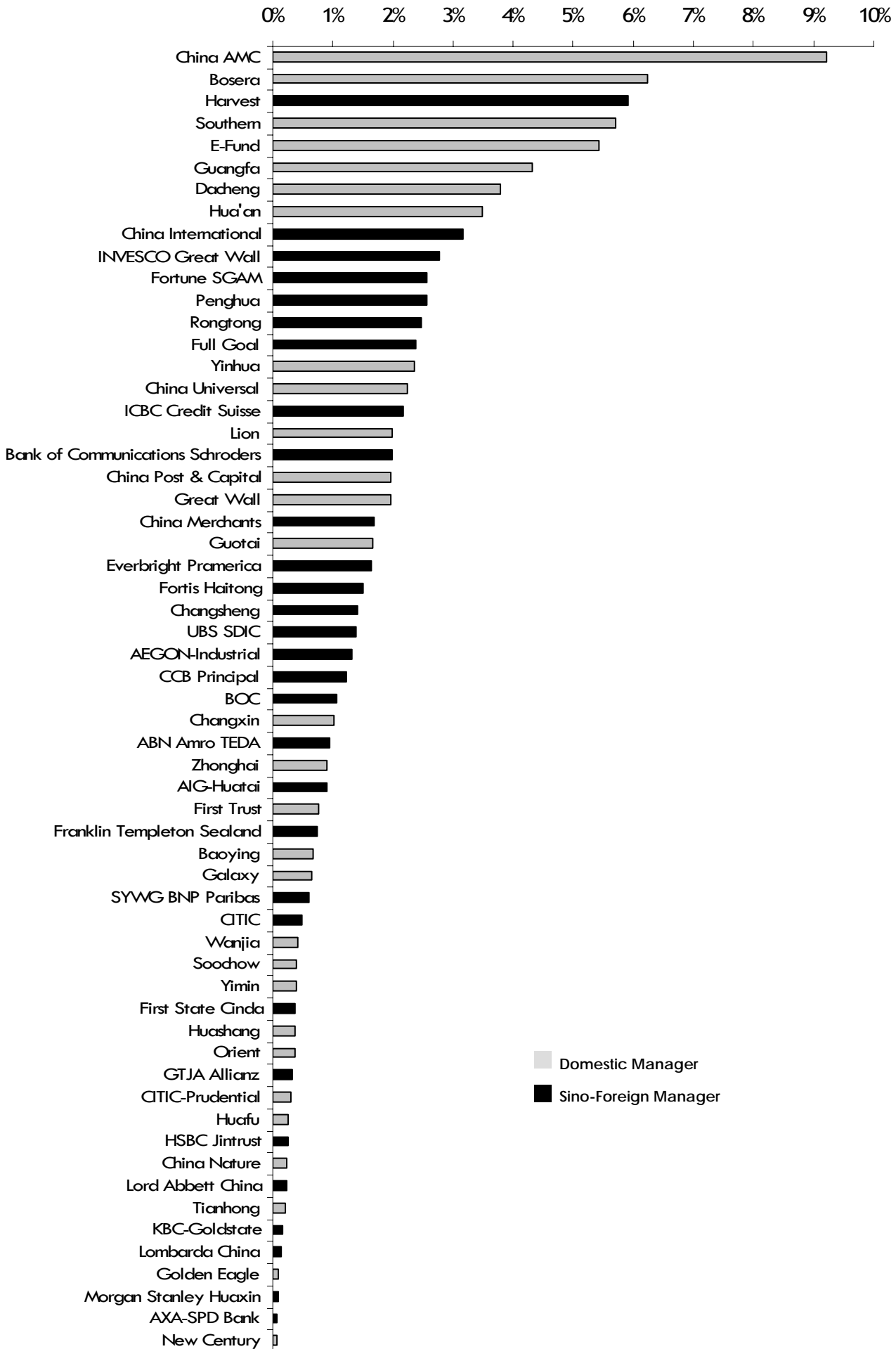
FOREIGN INVESTED MANAGERS ²

	AUM		
	RMB Bill	Share	RANK
AEGON-Industrial	30.3	1.30%	28
Changsheng	32.6	1.40%	26
Full Goal	55.5	2.39%	14
Harvest	137.6	5.92%	3
Penghua	59.3	2.55%	12
Rongtong	57.4	2.47%	13
TOTAL	372.8	16.03%	

¹ - ING INVESTMENT MANAGEMENT OWNS A 33.3% EQUITY INTEREST IN CHINA MERCHANTS; JP MORGAN FLEMING ASSET MANAGEMENT OWNS A 49% EQUITY INTEREST IN CHINA INTERNATIONAL; MERRILL LYNCH OWNS A 16.5% EQUITY INTEREST IN BOC INTERNATIONAL.30

² - BANK OF MONTREAL BOUGHT AN EQUITY INTEREST IN FULL GOAL THAT CURRENTLY STANDS AT 27.775%; DEUTSCHE ASSET MANAGEMENT PURCHASED 30% EQUITY INTEREST IN HARVEST. DBS ASSET MANAGEMENT ACQUIRED A 33% STAKE IN CHANGSHENG WITH NIKKO ASSET MANAGEMENT BUYING A 40% POSITION IN RONGTONG. EURIZON FINANCIAL GROUP OWNS A 49% STAKE IN PENGHUA. AEGON OWNS A 49% STAKE IN THE MANAGER.

³ - MANAGERS HAVING AN OPERATIONAL LICENSE BUT HAVE NOT YET ISSUED A MAIDEN PRODUCT.



SOURCE: Z-BEN ADVISORS