Z-BEN ADVISORS

China Investment Management: Market Update

June 2009

Verbatim

Opportunities are plentiful and quickly being seized

It has been a remarkable month. We've seen astonishing fundraising, the kick-start of a dormant QDII program, impressive 2008 profitability numbers from the overwhelming majority of FMCs and, in our view, significant change in the opportunity set for foreign fund managers hoping to do (or do more) business in China. Where to start? Let's take it from the top.

Plan for a very, very busy summer:

- **QDII reopens**
- **CIC funds mandates**
- **JV firms up for sale**

Equity market returns continue to spark investor appetite and fundraising results have, on average, exceeded end-08's most optimistic expectations. Significant work is being done by domestic and Sino-foreign FMCs both to fill product range gaps and create better platforms for future growth, a move wholeheartedly encouraged by CSRC, which has kept the new product window wide open. Icing was put on this cake with the release of 2008's revenue and profitability numbers for the industry (a subject we explore in greater detail in this issue), which showed exceptional resiliency in a difficult year. That success underscores, as few other data could, the strength and phenomenal profitability of fund management, as a business, in China. As a result, Z-Ben Advisors' research finds that both interest and effort from foreign asset managers hoping to do more business in China has intensified. In fact, we expect this to be one of the busiest summers we have ever seen in the asset management industry on record.

Industry Assets Under Management (RMB Billions)

	Current	Growth	1Q09	Growth	4Q08	Growth	3Q08	Growth
Total Industry Assets	2,088.0	4.0%	2,007.0	3.5%	1,938.9	5.2%	1,843.3	-11.7%
Total Domestic	1,146.7	2.4%	1,119.4	5.9%	1,057.5	0.4%	1,052.9	-11.5%
Total Joint Venture	941.2	6.0%	887.6	0.7%	881.4	11.5%	790.4	-11.8%

SOURCE: Z-BEN ADVISORS, Current as of May 31, 2009

Driving this activity just as strongly as retail demand are the regulators – especially where QDII products or any other form of Sino-foreign collaboration is in view. Put bluntly, SAFE has all but reversed its nearly year-long policy of limiting investment fund outflows from China. QDII fund quota approvals spent ten long months withering in the queue. Now, we expect to see at least three raise funds beginning this summer, with a long list of other opportunities ready to roll out behind them. QDII segregated accounts, another longstanding item on FMCs' wishlists, are now being sold in size. And SAFE isn't the only place where investing in global markets has become a high priority: China Investment Corporation (CIC) is also, finally, ramping up and in a big way.

We had hoped, in this report, to be able to describe to you how CIC's new appetite for global investment was being translated into mandate funding. We anticipated providing our readers with an analysis of CIC's new investing pattern, suggesting which areas were likely next in line for attention and funding. We strongly suspect that we will be providing exactly that analysis in days, not weeks, but no public announcements have yet been made. For now, stand by for the arrival of further evidence that closer Sino-foreign investing ties are growing in bounds.

For those readers already pursuing business with Chinese institutions, whether as fund advisors, investment consultants or mandate recipients, our advice is simple: make sure your A-team is manning every phone and chasing every contact. It's going to be a very busy few months and the action

For more information, please contact:

Derek Wang
Director, Research
derek.wang@z-ben.com

Ms. Peggy Xu
Associate, Sales
peggy.xu@z-ben.com

Z-BEN ADVISORS, LTD

Tongsheng Tower, 5/F
458 Fushan Road
Pudong New Area
Shanghai, China 200122

Email:info@z-ben.com

Phone: 86-21 6876-1650
86-21 6876-1651
Fax: 86-21 6876-1652

has already begun.

For those who are contemplating a closer link – the purchase or establishment of a Sino-foreign funds management JV – the timing couldn't, in our view, be better. A substantial number of existing Sino-foreign JVs are, as a consequence of M&A activity abroad, currently non-compliant with regulatory ownership restrictions. A record number of stakes in such JVs, we believe, will come on the market in the remainder of 2009. Given the bullish domestic market and expansion plans most JVs are putting into place, prices for these stakes are unlikely to be depressed by the increase in supply. However, stakes in companies with market shares from less than 1% to more than 5% will be available for foreign asset managers who have the will (and the means) to navigate negotiations that will be, in our estimation, more tortuous than the normal run of events. Domestic regulators, foreign government stakeholders, frustrated majority owners and time-pressed minority sellers will all want – and get – a louder-than-usual voice at the table. We foresee a long summer of dealmaking.

Several Sino-foreign stakes are coming up for sale

Over the past five issues of our Monthly Update, we've been stressing the extent to which the domestic mood is shifting. For foreign asset managers who don't have a foothold in China, we know that's made for frustrating reading: the door has been remained closed while those few firms with domestic ownership stakes made all the running. The game just changed. It's open season for Chinese assets and the foreign firms able to move the fastest will see the lion's share of the rewards. Better still, some of the best prizes available – stakes in experienced, successful JV FMCs – are now also up for grabs.

It is quickly becoming a changed game

Monthly Research Highlights

Profits Aplenty: Fund Managers Show Their Foul-Weather Mettle Page 10

2008 proved the resilience of China's fund management industry: despite equity markets dropping like stones, huge institutional investor moves into fixed income products and substantial drops in non-mutual fund fee income, average profit margins remained high at 34.3%. Other than the smallest and newest FMCs, who faced difficult challenges, almost every fund manager enjoyed a profitable, if occasionally bleak, year. Expect calmer waters in 2009 but, as we make clear in our analysis, don't look for significant profitability growth.

G-Share Reforms: No Threat, Only Success Page 13

Once again, the naysayers have been proven wrong. After nearly four years, China's experiment to address the massive state share overhang has been a success. The supposed flood of new supply never arrived and China's equities market is now well above last year's bottom. Investors have even dismissed the projected Rmb8tr worth of fresh supply which will be working its way into the market in the next 18 months. But this is all in the past. The focus today needs to be on M&A opportunities as the reforms have unlocked considerable value now looking to be tapped.

Innovative Closed-end Funds: At Their Best in their Beginning Page 16

In May, the Changsheng Tongqing Detached Trading Fund raised nearly Rmb15bn in a single day. Not bad considering the average for all fund launches previously in the year is Rmb2.2bn. The product, a dual-class innovative closed-end product, offered investors a combination of stable guaranteed shares and high risk leveraged shares. In this report, Z-Ben Advisors reviews the fund compared to its closest relative to better understand the innovations at work. At the same time, we detail the reasons for the success and explain the impact on the industry's competitive landscape.

Meet Hopu: A New PE Powerhouse is Born Page 19

Hopu Investment Management arrived with a splash this year, snapping up politically-sensitive stakes in a pair of domestic banks with, apparently, the blessing of regulators. The PE managers' leadership is made up of some of the most experienced and best-connected operators on the Mainland and early moves suggest not only an ambitious agenda but strong (and continuing) capital commitments from deep-pocketed investors (think Quantum, with little solace for Hopu's competition). We analyze the structure of the fund, the background of the managers and the way forward for what is potentially one of the most important new PE houses in China.

Casing the Joint: Market Entry Opportunities in Focus Page 22

Ambition to crack the China market is once again in strong supply. However, market entry strategies now being dusted off after a year on the shelf may be badly out of date. Market conditions have undergone a dramatic shift, as have regulators' key concerns. In this article we lay out the options for firms now thinking of taking a strategic stake in a Chinese FMC: what is and is not worth wanting, how to assess the value of a potential partner and how to maximize the value of the new investment. With record numbers of JV stakes likely to be sold this year, a definitive buyers' guide.

QDII Update: Shifting out of Neutral Page 25

Reading the tea leaves, however arbitrary it may seems, is a necessary exercise in China if one is to avoid being blind-sided by a rapidly changing environment, especially in the case of regulatory attitudes. We followed through on just such an exercise and find it to be very likely that regulator - SAFE in particular - is set to resume QDII quota issuance. And, much like the first wave, one or two firms may be going to market fist, in effect, testing the waters. Any expansion of the program, naturally, will be determine by the success, or lack thereof, of these few firms.

Trust Companies: An Interesting Niche (Emphasis on Niche) Page 28

The entire trust industry has been undergoing a fundamental restructuring for the past two years. Yet, trust companies are still quite a distance away from transforming into a truly competitive wealth management platform. We examine here the reasons behind this and show how the future may not be as bleak for trust companies that can take advantage of the broad reach of their various business lines. If creative, then trust products can stoke end-investor demand. It is this possibility which is driving continued M&A activity, both among domestic and foreign institutions.

Joint Venture Review: Building on a Solid Foundation Page 31

More often than not, we find small and mid-tier Sino-foreign managers facing disproportionate challenges. While many of these firms often fail to take corrective actions in a timely manner, we observe three JV firms - AIG-Huatai, GTJA-Allianz and UBS-SDIC - getting more than a few things right: hiring the right people, improving performance, and remedying their lack of product diversity. As such, we believe each to be in a stronger competitive position. All that remains is whether they can continue to excel on all fronts.

New Product Review & Analysis: Ramping up for Summer Page 38

Three trends were notable from our review of new product offerings in May. First, both fundraising and new product approval slowed a bit last month. Second, product innovation and diversification were received positively by investors, with Changsheng Tongde Detached Trading Fund raising Rmb15bn within one day. Third, the new product pipeline will probably see a further slowdown from the second half of June, although it is now stuffed with 13 new products. We suspect that this is a sign that CSRC is managing the new product pipeline for some soon-to-surface projects.

Monthly Performance Review: Market Gains as Funds Underperform Page 54

May ended with another 5% gain in the A-share market, which has posted a TYD return of 52%. Valuations no longer look as attractive but liquidity remains ample, making it difficult for retail investors to believe in a near-term correction. Mutual fund managers have taken a more cautious stance, though. As equity-centric products underperformed the market by 20% during the month, we believe there was a near-universal cut-down of equity exposure. It should be noted that some top performers remain heavily invested and the debate about where the market goes is far from over.

Analytical Quick Hits

China Pacific to Invest in Changjiang Pension. China Pacific Insurance Group announced that China Pacific Life Insurance, a wholly-owned unit of the Group, plans to increase its stake in Changjiang Pension Insurance from 12.27% to 51.75%. China Pacific will buy 114 million shares from Shanghai International Group, the current largest shareholder of Changjiang Pension, and buy 219 million shares through a private placement. The deal will cost about Rmb498m and is expected to expand China Pacific's pension business. Currently, Changjiang Pension manages Rmb22.5bn in enterprise annuities with qualifications to be trustee, account manager, and investment manager.

The Second Classified Fund Finished Fundraising. Changsheng Tongqing Fund, the second classified fund since UBS SDIC Ruifu Classified Fund, completed fundraising in May, pulling in Rmb15bn within one day. This was the biggest fundraising since the end of 2007. Institutional investment amounted to 61% of total AUM. It was listed on May 26th. Class A, the preferred class, enjoyed a premium, while Class B, the leveraged class, has been trading at a discount.

Large Share Split of Hua'an Shanghai 180 ETF. Hua'an conducted a 1:10 share split of its Shanghai 180 ETF to boost liquidity. The split brought its NAV from Rmb6.19 down to Rmb0.63. This fund used to be the least-traded ETF in the market. Trading volume on the secondary market rose sharply after the split. This might make other ETF managers take the same action if the split's effect proves sustained.

One More Custodian Bank. Guangdong Development Bank obtained fund custodian qualification. It is the fifteenth bank qualified as a fund custodian bank. This market is currently dominated by Industrial and Commercial Bank of China (ICBC) and China Construction Bank (CCB).

CIC Restructured Investment Department and Started Investing. CIC has announced a restructuring of its investment department. The original three components, equity, fixed-income and alternative asset investment, will be rearranged into four sectors: relative return investment, strategy investment, private equity investment and special project investment. Late last month, CIC also announced plans to make a USD1.2bn investment in the common stock of Morgan Stanley, returning its holding in the investment bank from 7.68% to 9.86%.

Central Huijin to Take over Jianyin Investment Securities. Central Huijin will take over a 100% stake in Jianyin Investment Securities from Jianyin Investment. Currently, Huijin has a 100% interest in Galaxy Securities and Shenyin&Wanguo Securities and a minority share in Guotai Jun'an Securities. After the shareholder transfer, Jianyin Investment will have controlling stakes in CICC and Hongyuan Securities and a minority stake in UBS Securities in China. The deal marked Jianyin Investment's move to comply with CSRC's "1+1" shareholding rule: only a majority stake and a minority stake in two securities firms is permitted.

New QDII Product Possibilities. It was reported that E-fund's first QDII product has gained approval from CSRC and is now waiting for quota approval from State Administration of Foreign Exchange (SAFE). Full Goal has also submitted its QDII product for regulatory review. There have not been any announcements from the managers. If the report proves true, the next two months may be a possible window for the managers to start offering new QDII funds to the public. A number of other managers have also expressed their interest in QDII products.

New Rule for Segregated Accounts to be Effective on June 1st. A new rule that allows up to 200 investors in one segregated account will become effective on June 1st and it is expected the fund managers will officially start this operation in the middle of June. The rule lowered minimum investment requirements from the original Rmb50m to Rmb1m per client, which can expand the client base for managers tremendously. This may greatly change the competitive landscape for this service.

CSRC to Introduce ETF Feeder Fund. CSRC released a new regulation recently that will allow fund managers to launch ETF Feeder fund, which will place no less than 90% of the portfolio in ETFs that follow the same index. The minimum purchase requirement is Rmb1,000 and arrangement makes it possible for retail investors to procure ETFs on the primary market. So far, E-fund, Hua'an and AIG-Huatai have announced their ETF feeder fund plans and all of them have ETFs.

Analytical Quick Hits

A PM Dismissed Because of Front-Running Scandal. Mr. Zhang Ye, manager of Rongtong CN-INFO 100 Index Fund and Shenzhen 100 Index Fund was alleged to be involved in a front-running scandal last month. CSRC concluded the investigation and declared that the fund house had no part in the scandal.

New Shareholder of Lombarda China. CSRC approved Lombarda China to change its foreign shareholder from Banca Lombarda e Piemontese to UBI Banca, without making any change to its shareholding structure. Banca Lombarda e Piemontese merged with Banche Popolari Unite in 2007 to form UBI Banca, which now holds 49% of Lombarda China.

Fortis Haitong Cooperates with Polaris Securities. Fortis Haitong Fund Management has announced plans to cooperate with Polaris Securities in mutual funds and privately offered funds. Fortis Haitong will be the investment consultant for Polaris Securities' Greater China Equity Fund. This is the first time that a domestic fund house will work with a Taiwanese securities company.

ICBC Credit Suisse Start QDII Segregated Accounts. After signing a QDII segregated accounts contract in April, ICBC Credit Suisse obtained quota approval from SAFE. No details of the deal have been disclosed. This will be second QDII segregated account in the industry, following that of Bank of Communications Schroder signed in April.

Dacheng Setting Up Hong Kong Subsidiary. Dacheng FMC has gained approval from CSRC to set up a subsidiary in Hong Kong and becomes the fifth manager to do so. The subsidiary will mainly focus on three businesses: QFII investment consulting, PE product development, and developing international cooperation. Dacheng has a QDII license but no QDII products at the moment.

Banks Allowed to Acquire Insurance Firms. CBRC recently approved Bank of Communications and Bank of Beijing to acquire stakes in insurance companies. Bank of Communications will hold 51% of shares in China Life-CMG Assurance and Bank of Beijing a 50% interest in ING Capital Life Insurance. The deals are still subject to State Council final approval.

INDUSTRY AUM & MARKET SHARE

MAY 31, 2009: ESTIMATES

DOMESTIC FUND MANAGERS

	AUM RMB Bill	Share	RANK
Baoying	11.09	0.53%	42
Bosera	125.00	5.99%	2
Changxin	21.18	1.01%	32
China AMC (Including CITIC FMC)	204.35	9.79%	1
China Nature	5.32	0.25%	53
China Post & Capital	37.80	1.81%	22
China Universal	44.85	2.15%	18
Dacheng	75.18	3.60%	8
E-Fund	103.21	4.94%	5
First Trust	13.26	0.64%	37
Galaxy	12.51	0.60%	38
Golden Eagle	2.61	0.13%	57
Great Wall	35.00	1.68%	24
Guangfa	80.87	3.87%	6
Guotai	37.49	1.80%	23
Hua'an	75.86	3.63%	7
Huafu	5.36	0.26%	52
Huashang	7.45	0.36%	47
Lion	43.05	2.06%	19
New Century	1.42	0.07%	59
Orient	8.67	0.42%	44
Soochow	8.24	0.39%	46
Southern	108.65	5.20%	4
Tianhong	3.74	0.18%	55
Wanjia	13.63	0.65%	36
Yimin	7.22	0.35%	48
Yinhua	53.71	2.57%	11
TOTAL	**1,146.7**	**54.9%**	

SOURCE: Company Data, Z-BEN ADVISORS

SINO-FOREIGN FUND MANAGERS

	AUM RMB Bill	Share	RANK
ABC-CA	11.31	0.54%	41
ABN Amro TEDA	22.69	1.09%	31
AEGON-Industrial	34.16	1.64%	25
AIG-Huatai	20.51	0.98%	33
AXA SPDB	1.39	0.07%	60
Bank of Communications Schroders	53.86	2.58%	10
BOC [1]	24.61	1.18%	29
CCB Principal	30.58	1.47%	28
Changsheng [2]	41.89	2.01%	20
China International [1]	57.79	2.77%	9
China Merchants [1]	33.16	1.59%	26
CITIC-Prudential	12.38	0.59%	39
Everbright Pramerica	31.96	1.53%	27
First State Cinda [1]	8.50	0.41%	45
Fortis Haitong	38.06	1.82%	21
Fortune SGAM	47.98	2.30%	16
Franklin Templeton Sealand	15.05	0.72%	35
Full Goal [2]	46.23	2.21%	17
GTJA Allianz	9.73	0.47%	43
Harvest [2]	115.66	5.54%	3
HSBC Jintrust	6.26	0.30%	50
ICBC Credit Suisse	51.06	2.45%	13
INVESCO Great Wall	49.26	2.36%	15
KBC-Goldstate	5.15	0.25%	54
Lombarda China	6.96	0.33%	49
Lord Abbett China	5.41	0.26%	51
Minsheng Royal	2.69	0.13%	56
Morgan Stanley Huaxin	2.15	0.10%	58
Penghua [2]	51.61	2.47%	12
Rongtong [2]	50.62	2.43%	14
SYWG BNP Paribas	11.66	0.56%	40
UBS SDIC	23.71	1.14%	30
Zhonghai [2]	17.18	0.82%	34
TOTAL	**941.2**	**45.1%**	

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; BLACK ROCK OWNS A 16.5% EQUITY INTEREST IN BOC; COLONIAL FIRST STATE GROUP OWNS 46% IN FIRST STATE CINDA.

2 - BANK OF MONTREAL BOUGHT AN EQUITY INTEREST IN FULL GOAL THAT CURRENTLY STANDS AT 27.775%; DEUTSCHE ASSET MANAGEMENT PURCHASED 30.0% 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. LA COMPAGNIE FINANCIERE EDMOND DE ROTHSCHILD BANQUE OWNS A 15.385% OF ZHONGHAI.

EXTRA: Old Mutual/BNP Paribas: Straight from Pre-Nup to Divorce

Old Mutual's break fee payment a significant event

One of the more surprising events of the last week was the decision by Old Mutual to walk away from its planned purchase of BNP Paribas' 49% stake in ABN Amro Teda, paying an eye-watering EUR45m break fee to escape the deal. For those keeping score, that's equivalent to paying 4.4% of AUM to walk away - a price that would be considered generous to buy most non-Chinese fund managers. Our proprietary database of every stake sale price achieved in China provides the table below, showing just how much Old Mutual originally agreed to pay in context.

Old Mutual's move was apparently a consequence of a head office decision to scale back expansion efforts and focus more closely on keeping the balance sheet healthy. By now, that change in priorities is no doubt widely shared among the more than 10 rumored bidders for ABN Amro TEDA when the stake was first put on the market in summer 2008. How well BNP Paribas will be able to resurrect interest among the original shoppers remains an open question.

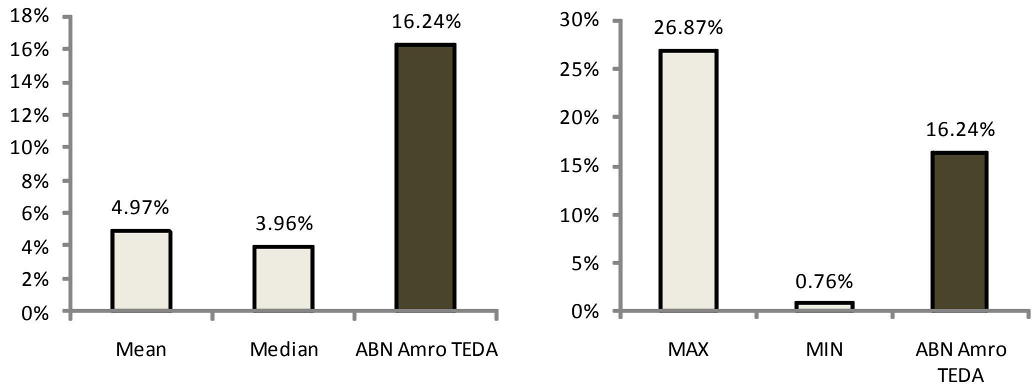
For BNP Paribas, the clock is ticking. It currently owns stakes in three Sino-foreign JVs: BNP Paribas SYWG, Fortis Haitong ABN Amro TEDA. By law, that's two stakes too many. CSRC, as we discuss in detail in this report, is attempting to extinguish all non-compliant ownership stakes as quickly as possible, however caused. While the agency has, so far, been relatively tolerant of non-compliance caused by factors such global M&A to stave off bankruptcy, its patience isn't infinite. Soon, if not already, BNP Paribas should expect to see its three JVs denied opportunities to launch funds, to make senior personnel changes, or to open up new lines of business.

Consolidation, in our view, is not an option of BNP Paribas: the majority partners in each of its JV operations have no interest in being relegated to minority status. Indeed, none of them can be expected to support any course of action other than a straight stake sale. Moreover, the regulator will not likely look kindly on any other course: better to bring fresh, healthy blood into the industry than allow BNP Paribas to leverage non-compliance into a more dominant market position. Two stakes must go, in Z-Ben Advisors' view, preferably both by the end of 2009.

Balance of supply and demand less obvious than at first glance

Supply and demand have changed a lot since the first attempted sale last year. By our estimate, at least 12 Chinese FMCs are currently non-compliant for a long list of reasons and the majority of Sino-foreign JVs could best resolve their regulatory problems with a stake sale. At the same time, the number of potential bidders with healthy balance sheets and with will to expand has declined. That combination suggests that supply and demand have become imbalanced in favor of the bid. Of course, it's not that simple: Chinese equity markets have shot up in 2009 and demand for fund products is running extremely high. That alone should force a revisitation of prices. Moreover, we strongly suspect that the number of new market entrants will be held artificially low by CSRC in the next few years, another factor favoring the ask. We expect to see price idiosyncrasies: high premia for stakes in strong firms, bargain prices for weak ones. And we expect to see many deal, with BNP Paribas at the heart of at least two.

Historic Valuation Comparables (% of AUM)



SOURCE: Z-BEN ADVISORS

Z-BEN ADVISORS

China Investment Management: Market Update

Corporate subscribers receive 10 reports annually (monthly excluding January and July) with five copies of each sent to any two international locations of the clients' choosing.

To join, please complete the form and return it by fax to (86-21) 6876-1652

Name: ______________________________

Company: ______________________________

Address: ______________________________

____

Phone: ______________________________

Email: ______________________________

PRICE .... Rmb 60,000.00
(per annual subscription)

Ms. Peggy Xu
Marketing Associate
Tel: (86-21) 6876-1119
peggy.xu@z-ben.com

Z-BEN ADVISORS
Tongsheng Tower, 5/F
458 Fushan Road
Pudong New Area
Shanghai, China 200122

Tel: (86-21) 6876-1650
(86-21) 6876-1651

Fax: (86-21) 6876-1652

Email: info@z-ben.com