

MAY 2010

At What Price?

Methodologies for valuing Chinese fund managers

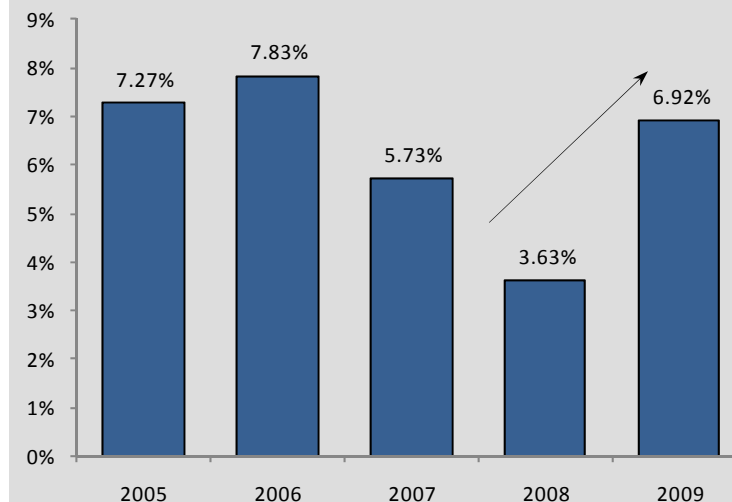
Over the past decade, the Chinese fund management industry has gone from zero to AUM totaling Rmb2.4tr (appx. US\$356bn). Phenomenal growth. Not surprisingly, this growth has attracted the attention of numerous foreign institutions seeking to gain access to the market. But isn't the price to enter at this stage now prohibitively expensive? That all depends. **In absolute terms, the price to enter the Chinese fund management industry is trending higher. An investment, when measured as a multiple of trailing earnings or by discounting attributable dividends, may actually be quite attractive.** The final decision will hinge on a number of highly subjective variables, but for those having a real interest it would be advised to keep in mind the following highlights.

- Demand among foreign institutions to enter the marketplace will continue to be robust. It will, however, be competitive as the supply of acquisition targets is now expected to decline;
- Based upon recently concluded deals, foreign parties will need to allocate - at a minimum and for a minority position - up to US\$150million as payment or between 7% and 8% of AUM;
- Valuations, on a relative basis, may be quite attractive: as low as 16x trailing earnings. The real attractiveness will depend on an acquiring party's growth projections for industry assets;
- Fund managers pay dividends to owners of upwards to 60%-70% of annual net profits. This information can and should be used to value firms through the application of a dividend discount model.

Notwithstanding the above comments, any and all acquisition strategies will be complex. And that's where this report comes in. **Z-Ben Advisors' latest report demystifies the process of buying into the Chinese funds industry. But the report's real value comes from providing directional guidance in valuing and pricing the underlying equity of a Chinese fund manager.** Using hard data taken from nearly three dozen comparable transactions, the report acts as a vital road map for any firm looking to buy into the industry. It also seeks to reconcile the pricing differentials between the local methodology for valuing a firm and those techniques more commonly applied in other markets.

VALUATIONS ARE TRENDING HIGHER

Average valuations as a percentage of AUM (2005-2009)



SOURCE: Z-BEN ADVISORS

REPORT HIGHLIGHTS

- An assessment of the four primary drivers of transaction activity over the past decade and Z-Ben Advisors' near term expectation for future deal flow.
- More than a dozen detailed individual case studies highlighting critical aspects of past transactions.
- Identification and evaluation of the primary approaches used by buyers to acquire FMC equity.
- Detailed analysis (plus examples) on the usage of both trailing PE and dividend discount valuation models.
- A complete and detailed appendix which includes detailed price and valuation metrics on 50+ deals.

Z-BEN ADVISORS Ltd. (Hong Kong)

Two Exchange Square, 39/F
8 Connaught Place
Central, Hong Kong SAR

Research Affiliate

Z-BEN ADVISORS Ltd. (Shanghai, China)

上海咨奔商务咨询有限公司

Tongsheng Tower, 5/F
458 Fushan Road
Pudong New Area, Shanghai 200122
People's Republic of China

Disclaimer

The contents of China Executive Series 2010: At what price? (Product hereafter) are for informational purposes only. The data contained herein is based entirely upon the available information provided in public reports by the locally operating fund managers. The contained information has been verified to the best of Z-Ben Advisors and its research affiliates ability, but neither can accept responsibility for loss arising from the decisions based upon the product. The Product does not constitute investment advice or solicitation or counsel for investment in any fund or product mentioned thereof. The Product does not constitute or form part of, and should not be construed as, any offer for sale or subscription of and fund or product included herein. Z-Ben Advisors and its research affiliate expressly disclaims any and all responsibility for any consequential loss or damage of any kind whatsoever resulting, directly or indirectly, from (a) the use of the Product, (b) reliance on any information contained herein, (c) any error, inaccuracy or omission in any such information or (d) any action resulting therefrom.

Disclosure

Z-Ben Advisors and its research affiliate, currently provides other products and services to some of the firms that are included in the Product. Z-Ben Advisors and its research affiliate may continue to have such dealings and may also have other ongoing business dealings with other firms provided for in the Product.

Copyright

The duplication of all or any part of the Product is strictly prohibited under copyright law. Any and all breaches in that law will be prosecuted. No part of the Product may be reproduced, transmitted in any form, electronic or otherwise, photocopied, stored in a retrieval system or otherwise passed on to any person or firm, in whole or in part, without the prior written consent from Z-Ben Advisors.

Introduction

The current wave of compliance-driven shareholder restructurings is coming to an end and the stock of Chinese FMCs which must, rather than might, deal is falling into short supply. After slightly more than a full year in which CSRC pressed all noncompliantly owned fund management companies in China to take the necessary steps to bring ownership in line with current regulations, only two FMCs remain. Both, however, are expected to complete their restructurings by the middle of this year. A new wave of M&A transactions will follow, although Z-Ben Advisors suspects it will be different in character and price than those that have gone before. Character will undoubtedly change, as many of the share sellers will have their eyes on a later IPO and prefer strategic stakeholders who can go the distance with them. Pricing will change partly because forced sellers have been driven from the market and partly because the general tone of M&A activity will shift from defense to offense. For prospective foreign buyers, **a working knowledge of how domestic FMCs are priced - and why - will become even more important.** Moreover, if those basic pricing lessons aren't learned, an even greater number of prospective entrants will waste time, money and energy failing to achieve a meaningful entry into one of the world's fastest-growing fund industries.

With recent transactions going for at or near 8% of AUM and with an absolute price tag now easily in excess of USD100m, price isn't something to get wrong. In our view, models for pricing a Chinese FMC have undergone substantial development in the past five years. Indeed, we can identify three distinct models which waxed and waned in popularity in that period and strongly suspect that the era of a fourth is about to dawn. For that reason, as much as any other, Z-Ben Advisors has chosen now as the time to present our first-ever Valuation Report, intended to ensure that the increasing number of clients who use our advisory services for their Chinese M&A activity can gain greater benefit from our research and analysis. In this report, readers will find **a complete overview of every publicly-recorded transaction in the history of the Chinese mutual funds industry as well as our best descriptive and prescriptive efforts to uncover the lessons they hold.** No prospective buyer, we believe, should make its first move towards a Chinese acquisition without digesting the contents of this report.

We'll let the next 50+ pages of analytical work speak for themselves. However, there is one caveat that we would ask readers to bear in mind as they pursue the contents of this report: price, in our view, is only the starting point and not necessarily the hard part. Almost none of the 80+ transactions identified in this report could be characterized as uneventful or unexceptional. Every **prospective buyer should stand ready to engage in complex (often multi-party, never single-issue) negotiations that may often appear to stray far from what a Western investment banker would consider familiar deal territory.** A majority were achieved at prices that commentators dismissed as too high on completion, then described as bargains for the buyer a year later. At the end of any analysis, price is merely an opinion. Moreover, as Z-Ben Advisors has found time and again, **price is only occasionally, and never reliably, the key to a deal's success.**

On this point, we are drawing our conclusions from our experience at the center of several deals reported herein. Top bidders buy themselves no particular edge, we find, when real competition exists for a FMC stake. Typically, far more important to closing a deal (and in no particular order) are: the quality of relationships with seller and operational management before the bid and during the bidding process; the seller's confidence that the

Introduction (continued)

buyer understands the role they are expected to play in the partnership; the operational entity's management attitudes; the regulator's short-term preferences and long-term plans; the quality of the bidder's advisors and, above all else, the patience and flexibility of the bidder. **Z-Ben Advisors cannot stress sufficiently the extent to which price is misunderstood as the key to a Chinese deal.** It is, without question, the deal element most susceptible to analytical attack, it is absolutely a useful element to understand from both the buyer's and seller's perspectives and it is frequently a difficult element to understand. However, **price is only one ingredient in a complex and often messy recipe.**

The point of this report, therefore, is not to hand readers the master keys to any desirable FMC property in China, although a better understanding of price will undoubtedly see many more bidders make it to the welcome mat. Rather, our intent is to make as explicit as possible what valuation mechanisms are likely to be found in China, how they will be used to the sellers' advantage and how they can become tools for buyers to better manage negotiations on one single dimension of a deal.



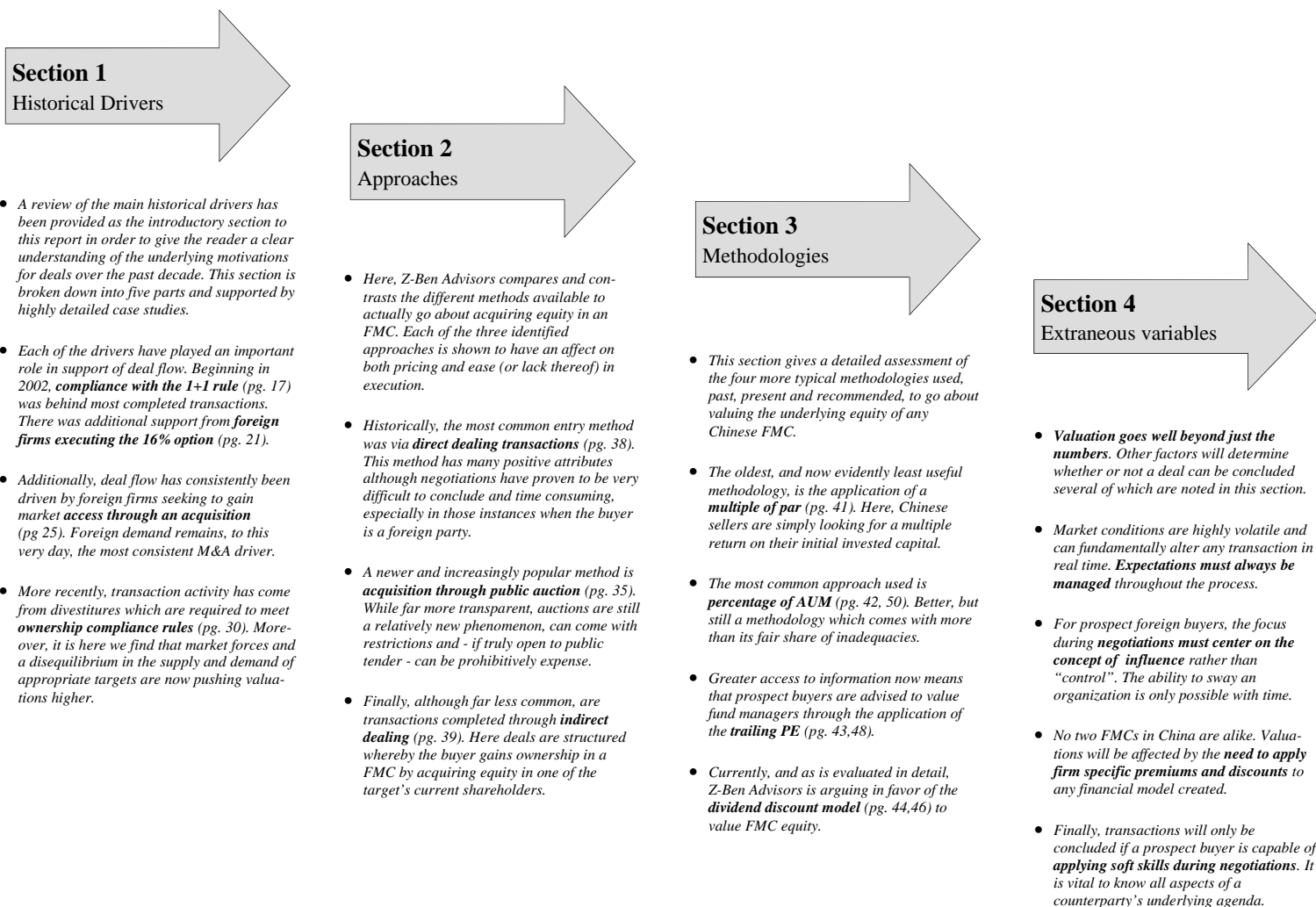
Peter Alexander
Principal
Z-Ben Advisors, Ltd

Table of Contents & Exhibits

1. Introduction	7	- Case Study 2: Harvest Fund Management	19
2. Executive Summary	9	Exhibit 1.16 Making a difficult choice <i>Harvest AMC pre- and post-deal shareholding structures</i>	
3. Key analytical findings	11	Exhibit 1.17 Valuation range bound <i>Comparable valuation as a multiple of par</i>	
4. Valuation Road Map	13	- Case Study 3: Changsheng Fund Management	20
		Exhibit 1.18 A near complete overhaul <i>Changsheng FMC pre- and post-deal shareholding structures</i>	
		Exhibit 1.19 The clearest of patterns <i>Comparable valuation as a multiple of par</i>	
Historical Perspective			
- Historical perspective & overview	14	- Driver II: Exercising the JV 16% option	21
Exhibit 1.10 A trend now set to decline <i>Total number of transactions by year (2000-2012e)</i>		Exhibit 1.20 The rarity of 49% ownership <i>JV ownership percentage by firm</i>	
- The market's impact	15	Exhibit 1.21 No easy task! <i>JV ownership pre- and post- 16% option</i>	
Exhibit 1.11 Timing no longer matters <i>Number of Transactions y-on-y vs. CSI 300 Index (2007-2009)</i>			
- The drivers of supply and demand	16	- Case Study 4: AIG-Huatai Fund Management	22
Exhibit 1.12 Putting the pieces together <i>Historical deal flow catalysts</i>		Exhibit 1.22 Perfect execution <i>AIG-Huatai FMC pre- and post-deal shareholding structures</i>	
- Driver I: Complying with the 1+1 rule	17	Exhibit 1.23 A bargain at 20% of AUM <i>Comparable valuation as a percentage of AUM</i>	
Exhibit 1.13 The first spark <i>Compliance deals, Timeline</i>			
- Case Study 1: Southern Fund Management	18	- Case Study 5: ABN Amro TEDA Fund Management	23
Exhibit 1.14 Multiple forced sales <i>Southern FMC pre- and post-deal shareholding structures</i>		Exhibit 1.24 Two birds, one stone <i>ABN Amro TEDA pre- and post-deal shareholding structures</i>	
Exhibit 1.15 A discrepancy in pricing <i>Comparable valuation as a multiple of par</i>		Exhibit 1.25 Back to normal <i>Comparable valuation as a percentage of AUM</i>	

Valuation Road Map

The following valuation report was developed with a single goal in mind: to **assist all prospect buyers to fully comprehend the dynamics of pricing the underlying equity of a Chinese FMC**. The report has been segmented into four separate sections (summarized below) is supported throughout by numerous case studies and provides complete pricing details of all publicly disclosed transactions.

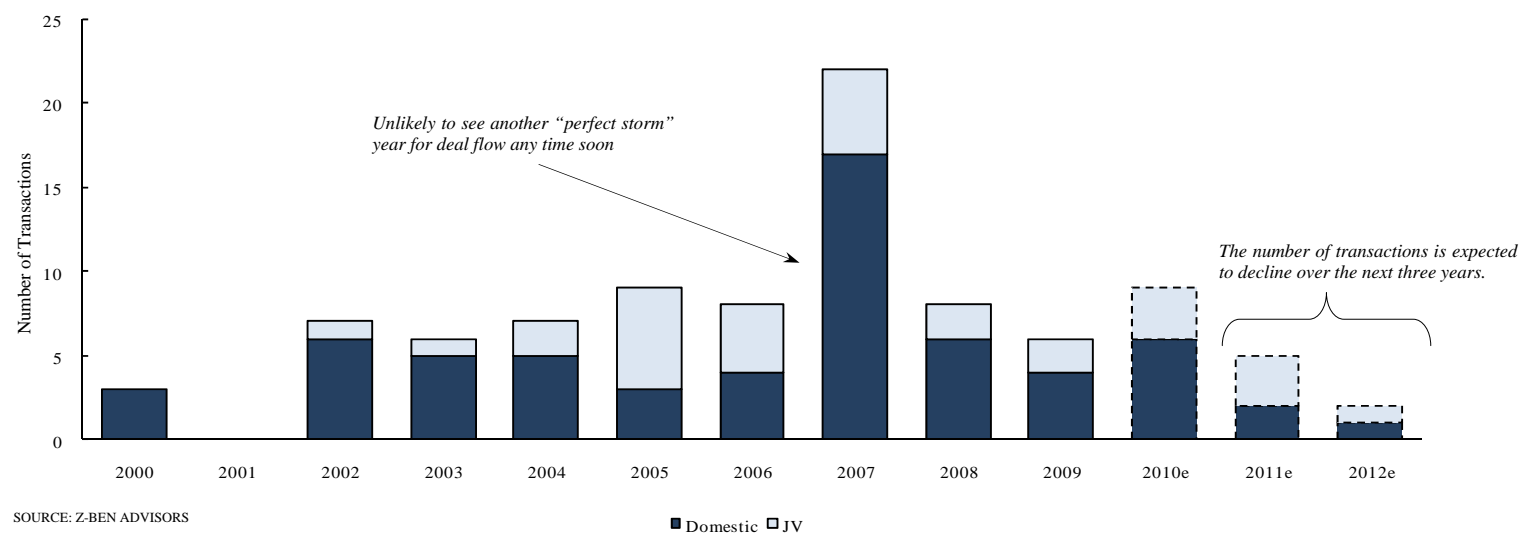


Historical Perspective & Overview

Over the past 12 years there have been a total of 84 transactions, of which Z-Ben Advisors has complete pricing details on 56 concluded deals. When assessing the longer-term trend in transaction activity the data clearly shows that there has been, for the most part, a consistent number of transactions concluded in each year. Z-Ben Advisors is now expecting this trend to change.

Exhibit 1.10: A trend now set to decline

Total number of transactions by year (2000—2012e)



- Even though there has been a relatively constant number of completed transactions annually Z-Ben Advisors research finds that just about each and every single deal exhibits a number of idiosyncratic qualities. Moreover, when it comes to valuing a FMC's underlying equity today, the projected **decline in the supply of acquisition targets should lead to higher pricing points** both in relative and absolute terms. Prospective buyers will need to factor this into their plans.
- From the perspective of the selling party, decisions to divest can be lumped into one of three broadly defined categories. There were a number of deals entered into so that ownership matched with regulatory requirements. Others were the result of China's entry into WTO, permitting foreign owners to increase their stake from 33% to 49%. Finally, there were those wherein a foreign institution simply sought out an attractive target and pursued the acquisition of a minority stake in a fund manager.
- Prospect buyers today are advised to **closely monitor the marketplace**. Targets for acquisition will be more difficult to identify but at the same time transactions are expected to be quicker to come to market.

Case Study 13: Generali & Guotai AMC

Exhibit 1.40: The Italian job

Guotai AMC pre- and post-deal shareholding structures

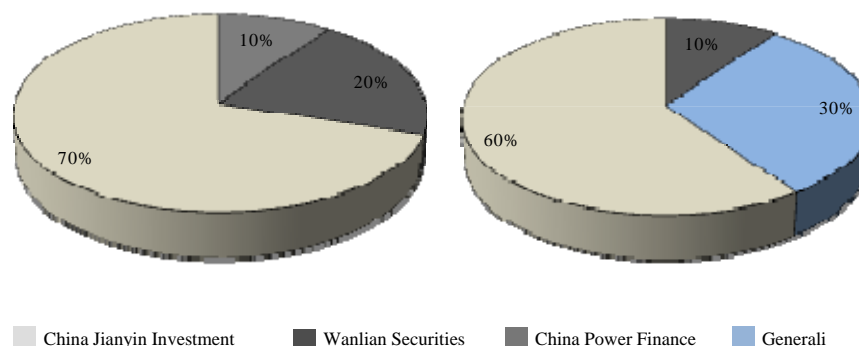
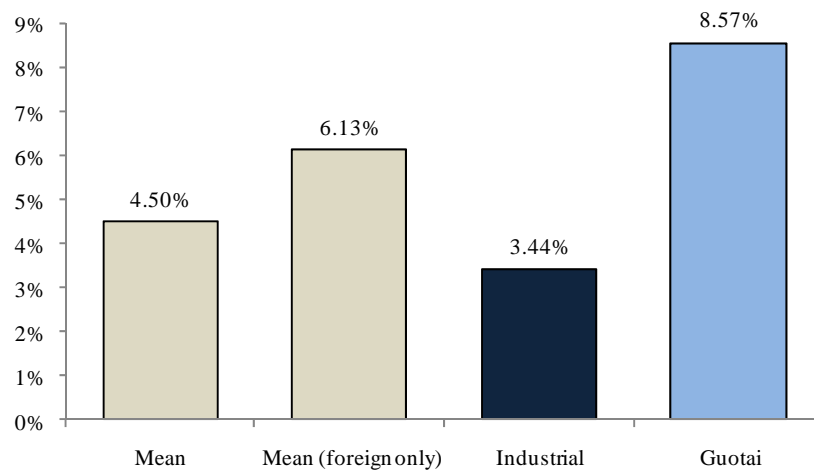


Exhibit 1.41: Going in high

Comparable valuation as a percentage of AUM



- It is expected that future sellers will attempt to apply the valuation used in the Generali/Guotai AMC transaction. With that in mind, it is of value to understand all of the relevant issues.
- Vital to the discussion is the fact that the Guotai AMC shareholders were under considerable pressure to amend the firm's ownership structure. The firm's largest shareholder held a 70% stake, well in excess of the permissible 49% cap.
- A commercial agreement to transact was reached on July 6, 2009 with all of the pertinent details and analysis provided below:
 - The parties reached an agreed upon **price of Rmb28.82/share**
 - Based upon the pricing point and with 110m shares in issuance, the FMC's **enterprise value totaled Rmb3,170m.**
 - At the time the deal was agreed to, the JV managed assets totaling Rmb36.99bn which then has the firm **valued at 8.75% of AUM.**
- Since the decision was made for the lead shareholder, China Jianyin Investment, to introduce a foreign firm as a new shareholder meant that it was no longer required to reduce its stake in the FMC to 49%.
- Negotiations commenced at a time when opportunities for a foreign firm to acquire a stake in a FMC were virtually non-existent thus affecting the pricing point. **Limited supply remains in effect today and should keep valuations at elevated levels.**
- It is important to recognize that the Generali/Guotai AMC deal isn't yet complete. CSRC approval is still outstanding. **Whenever any deal such as this is completed on business terms it is strongly advised that both parties withhold any communications (if possible).** A formal announcement should only be made after CSRC documented approval has been received.

Mr. Francois Guilloux
Director, Regional Sales
Dir: (86-21) 3857-1323
Tel: (86-21) 3857-1320 x. 230
francois_guilloux@z-ben.com

Z-BEN ADVISORS

At what price?

Methodologies for valuing Chinese fund managers

For those institutions interested in purchasing this report - inclusive of five hard copies per order - please complete the form below and return it by fax to (86-21) 3857-1322

Name: _____

Company: _____

Address: _____

Phone: _____

Email: _____

PRICE RMB 60,000.⁰⁰
USD 8,800.⁰⁰

Z-BEN ADVISORS

GC Tower, 21/F
1088 Yuanshen Road
Pudong New Area
Shanghai, China
200122

Tel: (86-21) 3857-1320
(86-21) 3857-1321

Fax: (86-21) 3857-1322

Email: info@z-ben.com