Reform of China's Split-Share Structure Takes Shape

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I. The Chinese Government Bites the Bullet

In China listed companies can issue two classes of shares: those which are listed on an exchange and can be freely bought and sold by normal investors (tradable shares) and those which cannot (nontradable shares). The existence of nontradable shares, which account for more than 60% of all shares issued, has been the biggest impediment to the development of China's equity market and has caused the government a headache for many years.

Following the publication in January 2004 of a blueprint for reforming the country's capital markets (the "State Nine Opinions"),[1] the government has set about implementing its proposals in earnest. One of the most important is its proposals for solving the problem presented by the existence of nontradable shares. On 29 April 2005 the government set about dealing with the problem by means of a pilot program involving four medium-sized companies. This was followed, on 17 June 2005, with the announcement of a second phase, involving 42 companies (see Appendix 2).

There have been several previous attempts to release these nontradable shares onto the market, but each has ended in failure as the stock market has reacted very negatively to the prospect of a huge increase in supply as well as to the offer price of the shares. Similarly, the stock market correction that began in 2001, when the market peaked, and has continued to this day was triggered by the government's announcement in June 2001 of its intention to release state-owned shares onto the market.[2]

The government has learnt some lessons from its past failure, and its latest program takes into account both trading conditions on the secondary market and the interests

1 State Council, "Some Opinions of the State Council on Reform, Opening and Steady Growth of Capital Markets," 31 January 2004.

2 The proposal, which was to sell the equivalent of 10% of a company's state-owned shares every time it held an initial public offering or rights issue and to use the proceeds of the sale to top up the Social Security Fund, triggered a sharp decline in the stock market and was withdrawn soon afterwards.

of the owners of tradable shares. In addition, by allowing companies to draw up their own proposals for dealing with the problem, the government has averted the kind of blanket rejection by both the market and investors that has characterized its previous attempts at reform.

Let us now take a look at the first phase of the government's program (i.e., the phase that began in April and involved the first four companies) and analyze how the market and investors reacted. Then we shall take a look at the 42 companies involved in the second phase of the program and consider its likely impact on China's stock market.

II. The Proposed Solution to the Problem of Nontradable Shares

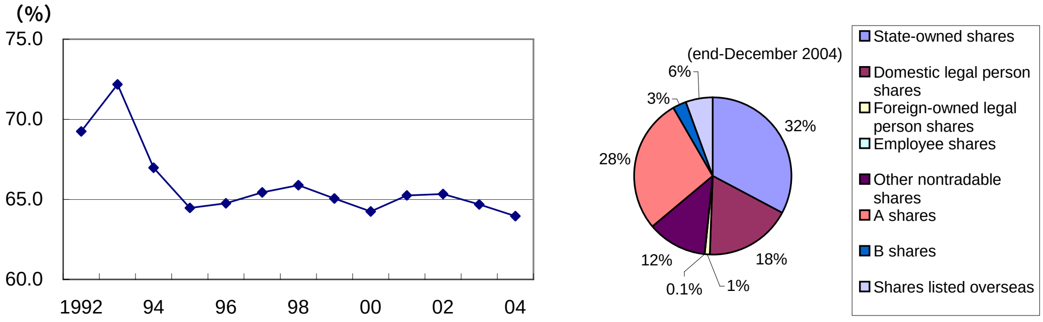
1. The problem of nontradable shares

Both tradable and nontradable shares entitle their owners to exactly the same rights (e.g., to vote or to receive a dividend). However, there are major differences between the two classes of shares in terms of ownership and liquidity. Most tradable shares have been issued to the general public—either in an initial public offering or, subsequently, as a rights issue. These may be renminbi-denominated shares listed on one of the domestic stock exchanges (A shares), foreign currency-denominated shares listed on one of the domestic stock exchanges and originally intended for foreign investors (B shares),[3] or shares listed overseas (e.g., in Hong Kong or New York).

Nontradable shares include shares issued to the founders of a company at the time of its founding or incorporation, shares that have since been issued to strategic business partners, and shares that have been issued to employees. This class of shares accounts for more than 60% of the shares issued by Chinese companies (see Figure 1).

3 Chinese investors with access to foreign currency have been allowed to buy and sell such shares since February 2001. B shares traded on the Shanghai Stock Exchange are denominated in US dollars, while those traded on the Shenzhen Stock Exchange are denominated in Hong Kong dollars.

Figure 1 Nontradable Shares as a Percentage of Listed Shares Outstanding



Source: NICMR, from CSRC and Shenzhen Securities Information Co. data.

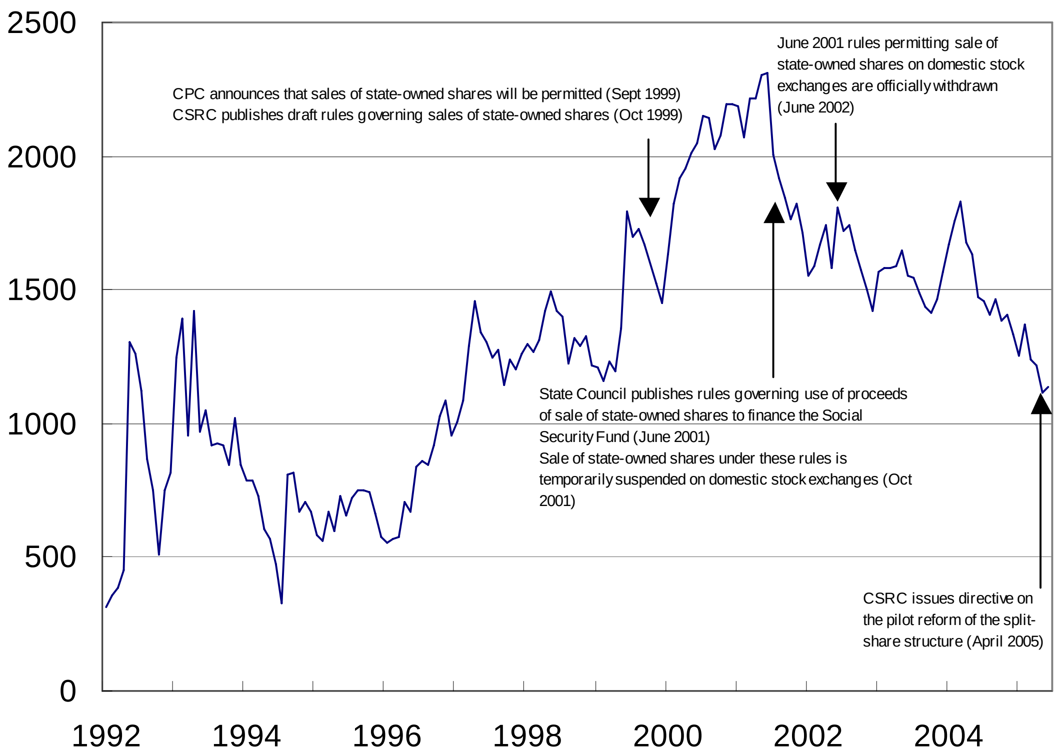
When an initial public offering is held in China, only the new shares that are issued can be traded on a stock exchange: existing shareholders are not normally allowed to trade their shares. In other words, existing shareholders in China normally do not have the opportunity to realize the value of their shares in a company when it goes public. There are two reasons for this. First, the main aim of setting up stock markets in China was to enable state-owned enterprises to raise capital. Second, the government wanted to maintain its control of these enterprises.

Unable to benefit directly from an initial public offering by selling their shares, existing shareholders have had an incentive to try to benefit in other ways when a company goes public, and this has given rise to various abuses, especially when there is a controlling shareholder. These include using the proceeds of a rights issue to lend money to the parent company or an affiliated company, and forcing the company concerned to engage in an asset transaction on unfavorable terms.

Since the People's Republic established its first stock exchange in 1990, it has built up a regulatory framework modeled on that of the major industrialized countries. At the same time, its stock markets have gone through cycles where excessive booms and widespread fraud have been followed by increased regulation. China's current rules, whether it be those governing the securities market, disclosure or corporate governance, are second to none. In spite of this, abuses by listed companies and major shareholders continue, and the stock market has been in decline ever since 2001. Much attention has been paid in recent years to the underlying problem—the unparalleled existence of nontradable shares.

As was mentioned above, the previous attempts to sell nontradable shares all took place when the market was at a peak (i.e., during a bull market), and ended in failure when the market reacted adversely (see Figure 2). The latest attempt, however, has taken place during a bear market, when there is a clear need for action that will support the market. In this regard, too, the attitude of the authorities this time is different. Share prices have fallen since the program was announced, and there have been the usual rumors that the government will back down. However, the chairman of the China Securities Regulatory Commission (CSRC), Dr. Shang Fulin, has stated that there is no turning the clock back and emphasized the need for reform.[4] Furthermore, on 27 June Dr. Shang held a press conference at the State Council on the subject of the program (the first ever to be held there by a chairman of the CSRC) and again voiced his strong support for the program.[5]

Figure 2 Shanghai A Share Index



Source: NICMR, from Bloomberg data.

There has also been support at a national level. For example, on 30 May of this year the CSRC and the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) jointly issued statements stressing how important the program was for reform of the stock market and how necessary it was for all those involved to give it their support.[6]

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4 China Securities Interactive, 17 May 2005.

5 With regard to the reform of China's split-share structure, Dr. Shang also stated (1) that no list of companies for a third phase existed, (2) that, depending on how the second phase went, the scope of reform in the next phase would be extended to cover all listed companies, and (3) that, in future, companies holding an initial public offering would not have any nontradable shares (existing shareholders would be able to sell their interests on the market).

6 CSRC and SASAC, "Opinion on Successfully Conducting Pilot Reform of Split-Share Structure," 30 May 2005.

2. The latest program's consideration for the interests of owners of tradable shares

The government has learnt a bitter lesson from its previous attempts to release nontradable shares onto the stock market, which failed because they destroyed investor confidence, and has this time taken pains not to repeat the mistake and to safeguard the interests of the owners of tradable shares. The program has three main features: (1) it attempts to be flexible rather than impose a one-size-fits-all solution; (2) it leaves the final decision to shareholders (especially the owners of tradable shares); and (3) it tries to deal with short-term market volatility.

1) The program's flexibility

When the CSRC announced the first phase of the program on 29 April,[7] it made no mention of any specific measures to deal with the problem of nontradable shares. When the CSRC previously carried out a public consultation on the issue, it received more than 4,000 suggestions.[8] However, the fact that all of these suggestions had disadvantages as well as advantages and none was clearly better than the others was itself the biggest impediment to finding a solution.

This time the CSRC has been careful not to impose a solution and has allowed companies to come up with proposals of their own. Although some observers see this as an attempt by the authorities to pass the buck, it does enable companies to decide what is the best solution given their particular shareholder structure and financial situation. By eliciting a wide range of responses, such an approach should also reduce the risk of the market moving in one direction in response to a one-size-fits-all solution, as happened on the previous occasions.

The four companies involved in the first phase of the program have already sounded out the views of their shareholders at extraordinary shareholders' meetings, and, in all four cases, the owners of nontradable shares proposed that the owners of tradable shares receive compensation (e.g., in the form of bonus shares or cash). Leaving aside the issue of whether owners of tradable shares should be compensated, the type of compensation proposed and the thinking behind it varied considerably from company to company, and the discussions that were held with shareholders and market professionals elicited a wide range of reactions. In the case of the 42 companies involved in the second phase, the response has been even more varied, with some companies proposing the use of partial reverse stock splits, others the use of warrants, and yet others the use of options. Of the 40 companies that had submitted proposals by 15 July, one had proposed the use of a reverse stock split, one the use of a share buyback, and four the use of stock options, while 11 proposed that owners of

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7 "Directive on Problems in Trying to Solve the Split-Share Structure of Listed Companies," CSRC Directive No. 32 (2005).

8 Chi Hung Kwan, "The Reform of State-Owned Enterprises in China," Nomura Capital Market Review, Summer 2005.

nontradable shares should buy shares if the share price fell below a certain level (see Figure 5 and Appendix 1).

2) Respecting the wishes of owners of tradable shares

After they draw up their reform proposals, companies have to submit them to a meeting of their board of directors and then to an extraordinary meeting of their shareholders. The details of the decision by the board of directors are normally published, and shareholders vote on the proposals at an extraordinary meeting after they have had an opportunity to study the details. In other words, it is the shareholders who have the final say on whether a company's proposals are accepted and implemented.

Proposals are accepted or rejected on a two-thirds majority of those taking part in an extraordinary shareholders' meeting, and the procedure is the same as that for a special resolution on important matters such as mergers, demergers and amendments to a company's articles of incorporation.

Nor is it any longer enough for votes to be put to all the shareholders together: the approval of two-thirds of the owners of tradable shares must now be sought separately. The CSRC adopted this system in December 2004 for resolutions on rights issues and important asset transactions in order to safeguard the rights of the owners of tradable shares.[9] As the issue of what to do about nontradable shares is of major concern to owners of tradable shares, the same system is now used for votes on this issue.

In addition, companies are now required (1) to announce extraordinary shareholders' meetings at least three times in order to encourage owners of tradable shares to attend and (2) to ballot shareholders via the Internet for at least five days, while independent directors (i.e., the equivalent of external board members) may collect proxies from owners of tradable shares.

3) Dealing with share price volatility

What happens to nontradable shares, which account for two-thirds of shares issued in China, will clearly have a major impact on the stock market, and there are likely to be attempts to use this impact to gain an unfair advantage. Abuses such as insider trading and market manipulation have long existed on the Chinese stock market and are one of the reasons why investors have lost confidence in it. The announcement of 29 April is an attempt to ensure adequate transparency and to prevent such problems occurring. For example, trading in a company's shares is suspended from the day on

9 "Some Rules for Providing Greater Protection for the Interests of Owners of Public Investor Shares," CSRC Directive No. 118 (2004). The directive, which was promulgated and came into effect on 7 December 2004, not only requires companies to seek separate approval from owners of tradable shares but also seeks to improve the system of independent directors, disclosure rules, and distributions to shareholders.

which the company announces its intention to reform its split-share structure to the day on which it announces its actual proposals as well as from the record date for the right to attend an extraordinary shareholders' meeting to the day on which the results of a vote are publicly announced. Although suspending trading in a company's shares deprives shareholders of their right to buy and sell shares in that company, attempts to prevent market abuses are traditionally regarded as more important in China than ensuring continuity of trading.

The program also forbids companies from deliberately publishing misleading information on how they are going to implement their reforms and requires them to promptly confirm or deny the truth of any rumors about these reforms circulating in the media.

The program also seeks to avoid a situation where a sudden and massive release of shares onto the market upsets the demand-supply balance. Even if a company's reform proposals are approved at an extraordinary shareholders' meeting, the owners of nontradable shares will have to wait at least a year before they can sell their shares on the stock market. Also, anyone owning at least 5% of a company's nontradable shares will not be permitted to sell more than 5% of the shares on issue for 12 months (or more than 10% for 24 months) after the one-year restricted period.[10] Such shareholders are also required to issue an announcement every time they sell 1% of a company's shares in order to give the widest possible publicity to information about disposals by major shareholders.

III. Ensuring That Owners of Tradable Shares Are Compensated

1. The response of shareholders to reform proposals

Of the four companies involved in the first phase of the program, three (Hebei Jinniu Energy Resources, Sany Heavy Industry and Shanghai Zi Jiang Enterprise) had their reform proposals accepted at extraordinary shareholders' meetings, while one (Tsinghua Tongfang) had its proposals rejected because it failed to obtain the approval of two-thirds of the owners of its tradable shares even though it obtained the approval of two-thirds of all its shareholders.

[10] This means that, if a company's nontradable shares are held by a minority of its shareholders, they are likely to be released more slowly into the market than if they were widely held. The authorities appear to have taken into account the likely impact of this on the market when choosing the companies for the first phase of the pilot program as the nontradable shares of all four are held by a minority of their shareholders.

All four companies proposed to offer the owners of their tradable shares compensation in the form of bonus shares or cash (see Figure 3). Normally, the value of all a company's shares would be expected to be the same if they grant their owners the same rights (e.g., the right to vote, to claim a dividend, to claim a liquidation distribution and to subscribe to new shares), and the price of the shares would be expected to reflect that. In China, however, (1) the fact that the stock market had declined significantly following previous attempts to dispose of state-owned shares, (2) the fact that nontradable shares are normally bought and sold at their net asset value when such transactions are conducted privately, and (3) the fact that it had been assumed that nontradable shares would never be listed led people to assume that any move in this direction would trigger a stock market correction and to take the view that owners of tradable shares should be compensated in some way for any losses suffered as a result of such a correction. Frequent cases of major shareholders forcing listed companies to engage in improper transactions in order to line their own pockets only reinforced this widely held view.

Figure 3 Comparison of Proposals of Four Companies Involved in First Phase

Short name	Tsinghua Tongfang	G Jinniu	Zi Jiang Enterprise	G Sany
Official name	Tsinghua Tongfang Co. Ltd.	Hebei Jinniu Energy Resources Co., Ltd.	Shanghai Zi Jiang Enterprise Group Co., Ltd.	Sany Heavy Industry Co., Ltd.
Listing	Shanghai	Shenzhen	Shanghai	Shanghai
Main activities	Production and sale of personal computers, peripherals, IT products, and software	Extraction and sale of coal	Manufacture of PET bottles and plastic products	Manufacture of construction machinery
Sales	RMB8.1bn	RMB2.4bn	RMB2.7bn	RMB2.6bn
Total assets	RMB9.0bn	RMB3.6bn	RMB6.7bn	RMB4.3bn
Nontradable shares (%)	52.48%	72.11% (see Note 3)	58.47%	75%
Major shareholders	Tsinghua Holdings Co. (state-owned shares) 50.4%	Xingtai City Mining Industry (state-owned shares) 72.11% (see Note 3)	Shanghai Zi Jiang (Group) Co Ltd (private legal person shares) 36.83% Shenshida Investment (Sino-foreign legal person shares) 21.30%	Sany Group Co., Ltd. (private legal person shares) 72.42%
Proposal	The company will carry out a 1.47515609-for-1 stock split and transfer the new shares that the major shareholders (i.e., owners of nontradable shares) would have received to owners of tradable shares. Owners of tradable shares will receive 10 new shares, 3.56 of which are, in effect, compensation, for every 10 shares they hold.	The owners of nontradable shares will give the owners of tradable shares 2.5 shares for every 10 shares they own.	The owners of nontradable shares will give owners of tradable shares 3 shares for every 10 shares they own.	The owners of nontradable shares will give owners of tradable shares 3.5 shares and RMB8 for every 10 shares they own.
Computational basis	No details provided. (The proposal simply says that general shareholders will receive a bigger share of the company's profits as their ownership will increase from 47.52% to 64.42%.)	The company estimated the P/E ratio of its shares once they are all tradable from that of its international competitors (i.e., it expects the ratio to decline) and calculated the number of shares it would have to transfer to its general shareholders in order for the market capitalization of the shares they own to reach this level when all the shares become tradable.	The theoretical share price after the reform was calculated by dividing the shareholder value before all the company's shares become tradable (i.e., [(number of nontradable shares × NAV per share) + (number of tradable shares × average price of the shares during the 30 days before the reform)]) by the total number of shares. This share price was then used to calculate the theoretical profit that would be earned by the owners of nontradable shares when all the shares became tradable (i.e., [(theoretical share price - NAV per share) × number of nontradable shares]. This profit would be returned in full by allotting shares to the owners of tradable shares.	The difference between the theoretical P/E ratio when all the shares become tradable (10x) and the P/E ratio at the time of the initial public offering (13.5x) will be regarded as the profit earned by owners of nontradable shares when all the shares become tradable. The owners of nontradable shares will be required to compensate owners of tradable shares by at least this amount in the form of shares and cash.
Restrictions on major shareholders	They will not be allowed to sell any of their shares for the first 12 months. They may sell up to 5% of their holdings during the following 12 months and up to 10% during the following 24 months.	The major shareholder will not be allowed to sell any of its shares for the first 24 months. During the following 18 months it will be allowed to sell up to 5% of its holdings. This will be at a price of not less than RMB8.71. (This floor will be adjusted for distributions and stock splits, rights issues, etc.)	They will not be allowed to sell any of their shares for the first 12 months. During the following 12 months they will be allowed to sell up to 4% of their holdings. (However, this will only be allowed if the share price is more than 110% of its average for the 30 days to 29 April 2005. The share price will be adjusted for distributions and stock splits, rights issues, etc.) Moreover, they will be allowed to sell up to 10% of their holdings during the following 36 months.	They will not be allowed to sell any of their shares for the first 12 months. The top shareholder, Sany Group Co., Ltd., will not be allowed to sell any of its shares for the first 24 months. During the following 12 months it will be allowed to sell up to 10% of its holdings. (However, this will only be allowed if the share price is more than 112.1% of its closing price on 29 April 2005 (i.e., RMB19) for five consecutive trading days. The share price will be adjusted for distributions and stock splits, rights issues, etc.)
			The second-largest (i.e., the Sino-foreign) shareholder will be subject to the following restrictions. It will not be allowed to sell any of its shares for the first 12 months. It may sell up to 5% of its holdings during the following 12 months and up to 10% during the following 24 months.	
Additional changes		A floor will be maintained under the price at which shares are sold.		The number of shares will be increased by 0.5 shares.

Notes: (1) The short names of Jinniu Energy Resources and Sany Heavy Industry have been changed to include the "G" that shows that they are subject to reform.

(2) The sales figures are for fiscal 2004, while the total asset figures are for end-December 2004.
(3) This figure would be 66.1% if all the convertible bonds issued by the company were converted into tradable shares.
Source: NICMR, from company data.

In their actual proposals, the four companies clearly stated that the owners of nontradable shares should compensate the owners of tradable shares for sharing the right to dispose of their shares on the market. Although each company's proposals (e.g., for the number of shares that the owners of tradable shares would receive in return) varied in detail, investors are likely to have been swayed less by the number of shares on offer than the thinking behind a company's calculations and its willingness to safeguard the interests of the owners of tradable shares.

Let us take a closer look at the proposals of Tsinghua Tongfang, which were rejected. The company proposed a stock split where all the new shares would be offered to the owners of tradable shares. The actual ratio proposed was 10 shares for 10. However, the company failed to explain properly how it had arrived at this number.

Also, the decision to carry out a stock split looked suspiciously like an attempt to make the number of shares offered to owners of tradable shares appear greater than it really was even though the effect was basically the same as if the owners of nontradable shares had simply transferred their existing shares. In other words, what appeared to be an offering of 10 shares for 10 actually involved the owners of tradable shares receiving only 3.56 shares for every 10 shares from owners of nontradable shares as compensation since the 10 shares offered to the former included the number of tradable shares that increased as a result of the split.[11] Moreover, the company's explanation of how it proposed to safeguard shareholder value was very misleading.[12] Finally, the proposed selling restrictions on major shareholders were the minimum

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11 Increase in the number of shares = 4.75 shares for every 10 shares owned;
transfer from owners of nontradable shares = (10 - 4.75) shares = 5.25 shares;
compensation = [(5.25/14.75) × 10] shares = 3.56 shares for every 10 shares owned.

12 The company's explanation was as follows:
(1) shareholder value belonging to owners of nontradable shares before reform program = NAV per share × number of nontradable shares;
(2) shareholder value belonging to owners of tradable shares before reform program = share price before reform program × number of tradable shares;
(3) share price after reform program = share price before reform program × number of shares outstanding before split ÷ number of shares outstanding after split;
(4) shareholder value belonging to owners of nontradable shares after reform program = share price after reform program × number of shares owned after reform program (the same as before);
(5) shareholder value belonging to owners of tradable shares after reform program = share price after reform program × number of shares owned after reform program.
The company maintained that, because both (4) and (5) are greater than (1) and (2), the interests of both classes of shareholders had been safeguarded. However, the calculation is illogical in that, whereas it uses both net asset value (NAV) per share and the share price to calculate shareholder value before the reform program, it uses only the share price to calculate shareholder value afterwards.

required by the program—in contrast to those of the other three companies, which were more onerous than those required by the program.

The fact that the shareholders of Tsinghua Tongfang rejected the company's proposals appears to have been because its explanation and its proposed safeguards for the interests of the owners of tradable shares compared unfavorably with those of the other three companies.

Jinniu Energy Resources and Sany Heavy Industry both based their compensation proposals on the assumption that their P/E ratios after the proposals were implemented should be lower than they were before and used this to calculate the new share price. They then calculated (1) the loss that the owners of tradable shares would incur as a result of the share price decline and (2) the number of bonus shares they would have to offer them in order to offset this loss. In other words, their assumption was that their P/E ratios before the proposals were implemented were higher than they should have been. Both companies used more or less the same method to calculate the number of bonus shares , but Jinniu Energy Resources based its calculation of P/E on an international comparison whereas Sany Heavy Industry failed to provide a proper explanation. Also, both companies' proposed selling restrictions on major shareholders applied for longer periods than those in the program and also took their share price into account.

Although the calculation method used by Zi Jiang Enterprise was similar to that used by Tsinghua Tongfang, the definition of the concept of shareholder value it used to calculate the theoretical price of its shares after its proposals were implemented was more consistent than that of Tsinghua Tongfang, and its proposed selling restrictions on the owners of nontradable shares were more onerous.

In addition, Sany Heavy Industry and Jinniu Energy Resources amended their proposals after consulting the owners of their tradable shares. While Sany agreed to offer the owners of its tradable shares an additional 0.5 shares, Jinniu put a floor under the price at which its major shareholders could sell their shares.

This suggests that whether or not the companies' shareholders accepted the companies' proposals ultimately depended on the extent to which the companies took account of the interests of the owners of their tradable shares.

2. Market reaction

Let us now consider how the stock market has reacted to the CSRC's program. After the program was announced on 29 April, the Shanghai A share index declined and has since trended sideways. In the media it was reported that the decline in the index and its subsequent failure to recover were similar to the market's reaction to the previous reform programs.

As we have seen, however, the program takes more account of its likely impact than the previous attempts to release state-owned and nontradable shares onto the market did. Figure 4 plots the share prices of the four companies involved in the first phase of the program in the period since the program was announced. Apart from Jinniu Energy Resources, which issued convertible bonds, which the holders have been hurrying to convert before it implements its proposals, the share prices of all the companies rose after the program was announced and then declined sharply on the day trading began in the bonus shares offered to the owners of the tradable shares.

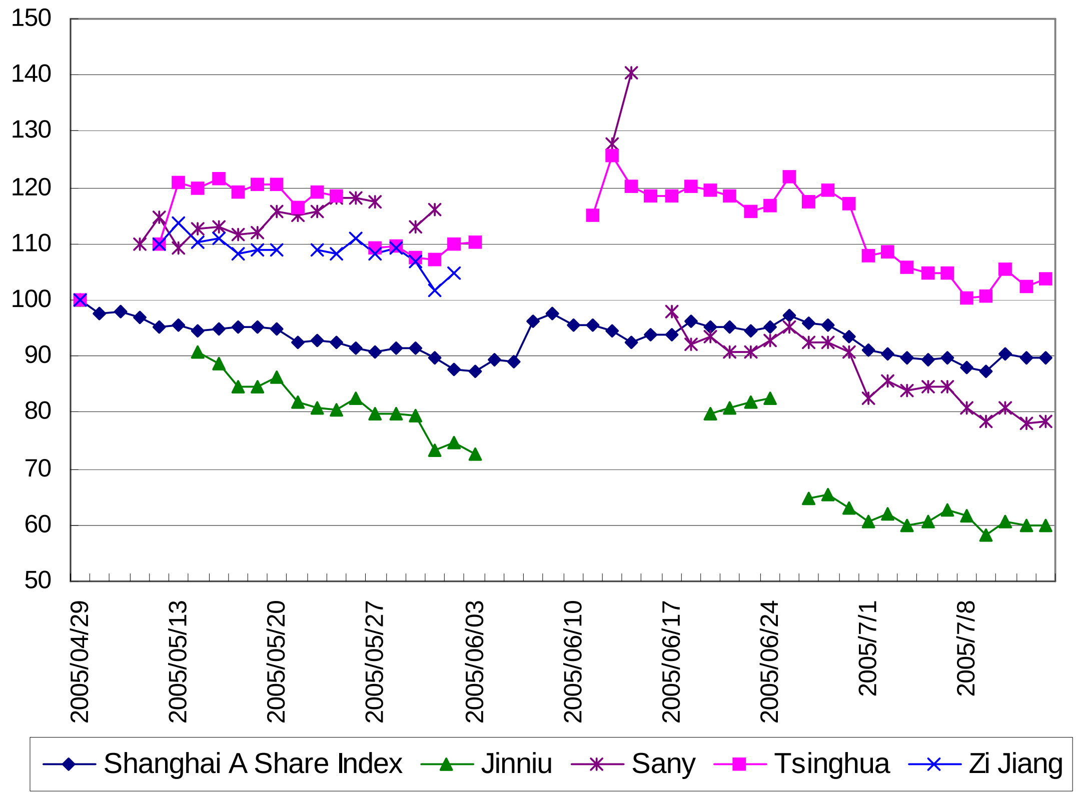
In the case of the three companies, investors appear to have interpreted the proposals that the owners of nontradable shares should compensate the owners of tradable shares by offering them bonus shares and cash (see above) as positive for share prices.

Moreover, as the proposals envisaged, the increase in the number of tradable shares led to a decline in the price of the shares. The extent of the decline was either more or less the same as or slightly less than the value of the bonus shares.[13] Therefore, when the nontradable shares are listed and if the prices of the companies' shares decline for a second time, there may be complaints from the owners of the tradable shares.

It is interesting to note that the share price of Tsinghua Tongfang did not decline when its proposals were rejected and has since held up well. This is probably because its shareholders have welcomed its announcement that it will amend its proposed compensation plan.

[13] The share price of Jinniu Energy Resources declined by 22% to 5.84 renminbi on the day the bonus shares allotted to the owners of tradable shares were listed (28 June). However, as one share before the reform program was now 1.25 shares as a result of the bonus, shareholder value per share was actually 7.3 renminbi (5.84 × 1.25)—only 1.8% less than the share price (7.44 renminbi) on the record date for the bonus allotment (24 June). Similarly, the share price of Sany Heavy Industry declined by 30% to 8.305 renminbi. However, shareholder value per share was actually 11.2 renminbi (8.305 × 1.35)—only 5.9% less than the share price (11.91 renminbi) on the record date for the bonus allotment. Moreover, Sany Heavy Industry's shareholders received a cash payment (0.8 renminbi per share) in addition to bonus shares.

Figure 4 Share Prices of the Four Companies



Note: The share prices have been rebased to 29 April 2005 = 100.
Source: NICMR, from Bloomberg data.

3. The second phase of the program

On 17 June the CSRC announced that the program was being extended to cover 42 other companies. Although the market had been expecting this to some extent, there was surprise at the scale of the extended program.

Among the 42 companies are some large state-owned enterprises, including the second- and third-largest companies in terms of market value (Baoshan Iron & Steel and China Yangtze Power), and the market value of the 42 companies is equivalent to 10% of total market value. The list also includes seven (or one quarter of the weight) of the 50 companies that make up the SSE 50, the Shanghai Stock Exchange's Blue Chip Index. As trading in these companies' shares was suspended on the day following the announcement and will remain suspended until they announce their official proposals, the impact on the market is likely to be quite significant. That the authorities have nevertheless gone ahead with their program indicates just how committed and confident they are that it will resolve the problem of nontradable shares.

Like the first four companies, the second list includes a significant proportion of private companies as well as state-owned enterprises. In the case of 28 (or two-thirds) of the companies, less than one-third of the shares outstanding are owned either directly by the government or state-owned enterprises.[14] The proportion of nontradable shares varies considerably (and more than in the case of the first four companies)—from more than 80% to less than 40%.

The 42 companies also vary considerably in terms of size—from companies such as Baoshan Iron & Steel, capitalized at more than 80 billion renminbi, to companies capitalized at less than 1 billion renminbi (i.e., less than the market average). The companies also vary in terms of indicators based on share price and earnings (e.g., P/E ratio, P/B ratio and ROE) rather than being simply a certain level above the market average.

Of particular interest is the fact that a large proportion (10) of the companies are listed on the Shenzhen Stock Exchange's SME Board, which was established only in June 2004. Many of these are private-sector companies, and, of these, many are quite profitable (e.g., in terms of ROE). Many seem to have been chosen because it is not long since they were listed and their capital structure is largely unchanged. This would make it relatively easy to balance the interests of their different shareholders. As in the first phase of the program, however, none of the companies have issued either H or B shares.

As with the first four companies, most of the second group of companies have proposed that the owners of their nontradable shares should offer the owners of their tradable shares bonus shares or cash by way of compensation. Although the number of shares on offer does not vary very much, some of the companies have proposed new forms of compensation (e.g., partial stock splits, warrants and options), as was mentioned above. Different approaches have also been proposed for restricting sales by the owners of nontradable shares. Such differences have had a certain impact on share prices since trading resumed after the proposals were announced.

As of 15 July 2005, 26 of the stocks have risen and 14 declined since the program was announced, with two stocks underperforming the index (see Figure 5). In the case of the first four companies, share prices rose in the wake of the announcement only to decline sharply when the bonus shares offered to the owners of tradable shares were listed. In the case of the second group of companies (and partly as a result of the experience with the first group), share prices appear to have reflected how investors have rated their proposals. As with two of the companies in the first group, some companies in the second group have announced that they will amend their proposals after consulting their shareholders.

[14] This only takes account of the shares owned directly by the government or state-owned enterprises. In fact, the government probably also owns shares indirectly via a number of holding companies.

Figure 5 Reform Proposals and Share Prices of the 42 Companies Involved in the Second Phase

Company (Phase 2)	Listing	Compensation to owners of tradable shares	Restrictions on owners of nontradable shares	Changes to proposals	% change in share price between 17 June (day before trading suspension) and 15 July	% change in share price - % change in index
Shenzhen Agricultural Products	Shenzhen	Put options	extension, price		8.5%	16.8%
Jilin Aodong Medicine Industry Group	Shenzhen	0.6074-for-1 reverse split, RMB1.86		cash	-	-
SGIS Songshan	Shenzhen	3.5 shares, (compensation scheme)	extension, price, purchase	shares, extension, price	1.9%	10.2%
Shandong Luxi Chemical	Shenzhen	4 shares	extension, price	shares	2.0%	10.3%
Zhejiang NHU	SME Board	3.5 shares	extension, price	shares, extension, price	7.6%	15.9%
Zhejiang Weixing Industrial Development	SME	4 shares	price	shares	-3.1%	5.2%
Zhejiang Transfar	SME	4.5 shares	price	price	6.7%	15.0%
Huangshan Novel	SME	4 shares	extension, price	extension, price	7.9%	16.2%
Zhejiang Hangzhou Xinfu Pharmaceutical	SME	4.5 shares	extension, price	shares, price	-1.4%	6.9%
Zoje Sewing Machine	SME Board	4.5 shares	extension, price, purchase	price	11.0%	19.3%
Sichuan Haite High-tech	SME	3.8 shares			1.5%	9.8%
Suning Appliance Chain Store (Group)	SME Board	2.5 shares	extension, price, purchase		-2.5%	5.9%
Fujian Septwolves Industry	SME Board	3 shares, put options, performance-related bonus	price		4.5%	12.8%
Zhejiang Supor Cookware	SME	3.5 shares	extension, price	price	5.7%	14.0%
Shanghai Port Container	Shanghai	2.2 shares, RMB10	hold, payout	shares	-1.8%	3.6%
Baoshan Iron & Steel	Shanghai	2.2 shares, call options	hold, price, purchase		3.3%	8.7%
Citic Securities	Shanghai	3.5 shares, (compensation scheme)		shares	-1.0%	4.4%
Henan Yinge Industrial Investment Holding	Shanghai	4 shares	extension, price	shares	-2.1%	3.3%
Wuhan Humanwell Hi-Tech Industry	Shanghai	2 shares, performance-related bonus	extension, price, purchase	price	-4.8%	0.5%
Guangzhou Development Industry (Holdings)	Shanghai	2.8 shares	hold, purchase	shares, purchase	-10.1%	-4.7%
Zhengzhou Coal Industry & Electric Power	Shanghai	3.8 shares, share buyback	extension, hold, price	shares, hold	-2.9%	2.5%
Guangzhou Kingfa Sci. & Tech.	Shanghai	3 shares, RMB1.4, (compensation scheme), performance-related bonus	extension, price		10.1%	15.4%
Jilin Wuhua Group	Shanghai	5 shares	extension, price		13.3%	18.7%
Huafa Industrial Share	Shanghai	3 shares (for employees share: 0.7 shares)	extension, price, restriction		4.3%	9.7%
Zhejiang Longsheng Group	Shanghai	4 shares	purchase		8.0%	13.4%
Beijing Hualian Hypermarket	Shanghai	2.3 shares, performance-related bonus, (compensation scheme)	extension, price, purchase		-	-
Canal Scientific and Technological	Shanghai	3 shares	extension, price	shares, price	12.2%	17.5%
Aeolus Tyre	Shanghai	4.2 shares	extension, price		9.3%	14.7%
Jiangsu Hengtong Photoelectric Stock	Shanghai	4.5 shares	extension, purchase	shares, purchase	8.6%	14.0%
Sinochem International	Shanghai	1.75 shares, RMB5.58, (compensation scheme)	extension, price	shares	-4.8%	0.5%
Jiangxi Changli Automobile Spring	Shanghai	3.5 shares	hold, price	shares, price, hold	-5.9%	-0.5%
Zhejiang Huahai Pharmaceutical	Shanghai	2.5 shares, RMB4.643	price, purchase	cash, price	12.1%	17.5%
Baoding Tianwei Baobian Electric	Shanghai	4 shares	extension, hold,		-0.1%	5.3%
Handsome Electronics	Shanghai	4 shares, (compensation scheme)			15.0%	20.4%
Zhejiang Wolong Hi-tech	Shanghai	3.5 shares	price, purchase	price	8.5%	13.8%
Henan Zhongfu Industry	Shanghai	1 share, additional cash payment depending on share price	price		-	-
Shenergy	Shanghai	3.2 shares	extension, hold, payout, purchase		-4.8%	0.6%
Shanghai Hongsheng Technology	Shanghai	5 shares			7.5%	12.9%
Shanghai Oriental Pearl (Group)	Shanghai	4 shares	hold		9.5%	14.9%
SDIC Huajing Power Holdings	Shanghai	2.6 shares	extension, hold		-0.7%	4.6%
China Yangtze Power	Shanghai	1.42 shares, RMB4.14, (performance boost, warrants)	hold	warrants	3.1%	8.4%
Baosheng Science and Technology Innovation	Shanghai	3.5 shares	extension, price	extension	1.2%	6.6%
				Average	3.5%	
			Shanghai A Share		-5.4%	
			Shenzhen A Share		-8.3%	

Notes: (1) The compensation is for every 10 shares owned.

(2) The "compensation scheme" in the above table is a stock compensation scheme for directors and officers of the company concerned—not compensation for the owners of tradable shares. Similarly, the granting of warrants and the commitment to a "performance boost" from higher electricity prices in the case of China Yangtze Power do not necessarily apply only to owners of tradable shares.

(3) The terms used under "Restrictions on owners of nontradable shares" have the following meaning:

"extension": the period for which the selling restrictions in the CSRC directive apply has been extended;

"price": there are restrictions on the price at which owners of nontradable shares may sell those shares;

"purchase": the owners of nontradable shares have to commit themselves to purchasing shares during future periods of share price weakness;

"hold": the major shareholders have to commit themselves to holding not less than a certain number of shares for a certain period;

"payout": the major shareholders have to commit themselves to proposing that the company maintain a certain minimum payout ratio; and

"restriction": the major shareholders may not hold more than a certain number of shares.

(4) The % change in shareholder value after adjusting for the number of shares takes into account any increase in the number of shares as a result of the compensation.

Source: NICMR, from Bloomberg data.

IV. Remaining Issues

1. Regulatory gaps

As we have already seen, the Chinese government has made a great effort this time to resolve the issue of nontradable shares. This is also evident from the various regulatory reforms that have accompanied the program (e.g., exemption from stamp duty and income tax on the disposal of shares and cash payments). However, there is some concern that overeagerness to support the stock market (e.g., by (1) introducing equity derivatives, which had previously not been allowed because of their possible impact on investors and share prices, (2) introducing rules governing share buybacks, which were not supposed to have been permitted under China's Company Law, and (3) easing restrictions on takeovers by major shareholders as part of the process of acquiring tradable shares[15]) may have led to some hasty changes that may have a negative effect on the market (e.g., as a result of misunderstandings by investors and an inadequate response from the authorities).

For example, if a company decides to use (recently introduced) stock options to compensate the owners of its tradable shares and this results in a greater loss of opportunity for the option writers (the owners of its nontradable shares), the question arises how it is going to ensure the integrity of execution. A similar problem arises where the owners of a company's nontradable shares are obliged to purchase its shares during periods of weakness. There are also cases where the new rules for nontradable shares appear not to have been thought out enough. For example, there have been cases where the resumption of trading in a particular stock has been delayed because the owners of a company's nontradable shares have included some foreign investors and the rules governing share disposals by foreign investors have been unclear.[16] There have also been cases where discrepancies have developed between stock indices and the price of an exchange-traded fund (ETF) because trading in that ETF has continued in spite of the fact that trading in the constituent stocks has been suspended (see Figure 6). In addition, there are likely to be cases involving all sorts of inadequacies and inconsistencies.

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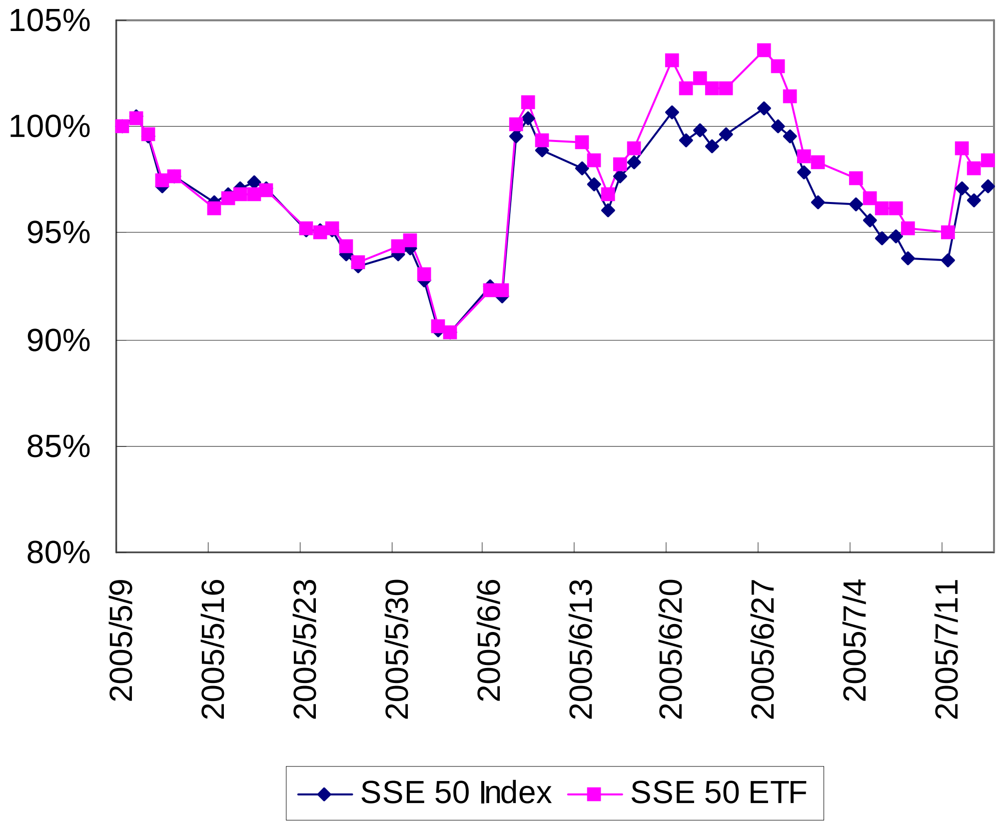
[15] During the two months after a company's proposal for reforming its split-share structure has been adopted, the takeover rules that normally bind major shareholders (i.e., owners of 30% or more of the shares) will be relaxed. Major shareholders will be required to announce their acquisition plans at the same time as the reform is proposed and will not be allowed to sell the shares they have acquired for six months.

[16] Although Zi Jiang Enterprise's proposal was adopted at an extraordinary shareholders' meeting on 13 June 2005, trading in the company's shares had still not been resumed as of 15 July as a result of disagreement over the status of non-Chinese shareholders.

Figure 6 Shanghai 50 Index and Shanghai 50 ETF



Note: The indices have been rebased to 9 May 2005 = 100.
Source: NICMR, from Bloomberg data.

2. More corporate restructurings

Enabling investors to cash in their nontradable shares in a company should also encourage them to invest in that company. As existing shareholders in Chinese companies were unable to use initial public offerings as an opportunity to make a secondary offering of their shares, the only way for them to dispose of shares in unlisted companies was to sell their shares privately at net asset value. At his press conference on 27 June the chairman of the CSRC hinted that, when initial public offerings resumed, no distinction might be made between tradable and nontradable shares in newly listed companies. Enabling investors to dispose of their shares in the stock market should encourage more private equity investment and make it easier for state-owned enterprises to restructure—one of the biggest challenges now facing China.

This would create more business opportunities for Chinese securities companies, which are currently suffering from the effects of the bear market, and enable them to put to better use the nontradable shares that they acquired as part of their efforts to win mandates for initial public offerings and which have since become idle assets.

It should also make it easier for Japanese and other foreign companies operating in China to sell their local subsidiaries and to use mergers and acquisitions to expand their operations. In turn, this should enable them to invest more effectively and restructure more easily.

(Appendix 1) Main Reform Proposals of Companies Involved in Second Phase

Company	Compensation to owners of tradable shares	Selling restrictions on the owners of nontradable shares
Baoshan Iron & Steel	The owners of nontradable shares will give the owners of tradable shares 2.2 shares for every 10 shares they own and a European-style call option (covered warrant with an option to buy one share) with a strike price of RMB4.5 and 378 days to expiry.	They will not be allowed to sell any of their shares for the first 12 months. Nor will they be allowed to sell any of their shares on the market for the first 24 months. Moreover, they will be allowed to sell their shares if the share price exceeds RMB5.63. (The share price will be adjusted for distributions and stock splits, rights issues, etc.) Their ownership ratio must not fall below 67% during the first three years after the reform. If the share price falls below RMB4.53 during the first two months after the reform, they will be obliged to purchase up to RMB2.0bn worth of shares.
China Yangtze Power	The company will carry out a 1.421-for-1 stock split, and the owners of nontradable shares will give the new shares they receive to the owners of tradable shares, who will receive 1 share for every 10 shares they own from the owners of nontradable shares. The company will pay all shareholders a cash dividend of RMB1.74 for every 10 shares they own, and the owners of nontradable shares will pay this to the owners of tradable shares, who will receive RMB4.14 in compensation from the company for every 10 shares they own. In addition, the owners of nontradable shares will give the owners of tradable shares 0.2496 shares for every 10 shares they own. EPS will be boosted by RMB0.025 by increasing electricity charges. (For every 10 shares they hold, the company will give all shareholders one European-style warrant (an option to buy 1.5 shares) with a strike price of RMB5.5 and 18 months to expiry.)	They will not be allowed to sell any of their shares for the first 12 months. The top shareholder will not be allowed to sell any of its shares for the first 24 months and it must maintain an ownership ratio of at least 55% until 2015.
Shanghai Port Container	The owners of nontradable shares will give the owners of tradable shares 2.2 shares for every 10 shares they own and RMB10 in cash.	They will not be allowed to sell any of their shares for the first 12 months. The top shareholder will not be allowed to sell any of its shares for the first 24 months. During the following 12 months it will be allowed to sell up to 5% of its holdings. Also, it will be required to keep at least 51% of its shares for the first five years. Furthermore, after the reform, it must commit itself to proposing to the general meeting of shareholders every year that the payout ratio should be at least 50%.
Citic Securities	The owners of nontradable shares will give the owners of tradable shares 3.5 shares for every 10 shares they own. Also, as part of the company's stock compensation scheme, senior managers will be given 30 million shares (1.2% of shares outstanding) at net asset value.	They will not be allowed to sell any of their shares for the first 12 months. Shareholders owning at least 5% of the shares outstanding will be allowed to sell up to 5% of their holdings during the following 12 months and up to 10% of their holdings during the following 24 months.
Shenzhen Agricultural Products	Owners of tradable shares will be given an option to sell tradable shares to the State-Owned Assets Supervision and Administration Commission of Shenzhen Municipality during the last five days of the twelfth month following the reform at RMB4.25—a 26.87% premium on the price of the shares before the reform. (The share price will be adjusted for distributions and stock splits, rights issues, etc.) Owners of legal person (i.e., nontradable) shares (other than state-owned shares) will be given the option to sell half their shares to management at RMB3.4-3.66 (the price before the reform). Management will be required to deposit security of RMB0.8 per share.	They will not be allowed to sell any of their shares for the first 12 months. Nor will they be allowed to sell any state-owned shares on the market for the first three years. During the first year they will not be allowed to transfer any shares. During the following two years they will only be allowed to transfer shares by block-trading them . However, the price must not be less than the strike price of the options given to the owners of tradable shares. Members of the management will not be allowed to sell their shares on the market for three years. Depending on market conditions, the State-Owned Assets Supervision and Administration Commission of Shenzhen Municipality may purchase up to 5% of shares outstanding during the first two years after the reform, but it may not sell those shares during the following six months.
Jilin Aodong Medicine Industry Groups	The company will carry out a 0.6074-for-1 reverse split of all nontradable shares. It will then pay all shareholders a cash dividend of RMB1.07 for every 10 shares they own, and the owners of nontradable shares will pass this on to the owners of tradable shares, who will receive compensation of RMB1.86 for every 10 shares they own.	They will not be allowed to sell any of their shares for the first 12 months. Thereafter, the top shareholder will not be allowed to sell more than 2% of the shares outstanding each year. The second-largest shareholder will be allowed to sell up to 5% of its holdings during the following 12 months and up to 10% during the following 24 months.
SGIS Songshan	The owners of nontradable shares will give the owners of tradable shares 3.5 shares for every 10 shares they own. Also, as part of the company's stock compensation scheme, senior managers will be given 67.05 million shares (5% of shares outstanding) at net asset value.	They will not be allowed to sell any of their shares for the first 12 months. Thereafter, shareholders owning at least 5% of the shares outstanding will not be allowed to sell any of their holdings during the following 24 months. (The exception to this is any shares that they transfer as part of the company's stock compensation scheme.) They may not sell their shares for less than RMB5. (The share price will be adjusted for distributions and stock splits, rights issues, etc.) If within the first two months of the reform the share price falls below 115% of the ex rights price prior to the reform, the holding company will be required to purchase up to RMB200 million worth of shares or 5% of the holding company's equity, but it may not sell those shares during the following six months.
Fujian Septwolves Industry	The owners of nontradable shares will give the owners of tradable shares 3 shares for every 10 shares they own. The owners of tradable shares will receive options to sell up to 20% of their shares to the holding company at a price of RMB5 per share if the share price remains below RMB5 for 10 out of 20 consecutive trading days after the reform. (The share price will be adjusted for distributions and stock splits, rights issues, etc.) If the company's recurring profit for 2005 and 2006 does not increase by at least 20% year on year, the owners of nontradable shares will give the owners of tradable shares 0.5 shares for every 10 shares they own.	They will not be allowed to sell any of their shares for the first 12 months. They will be allowed to sell up to 5% of their holdings during the following 12 months and up to 10% during the following 24 months. However, this will only be allowed before 31 December 2007 if the share price is more than 110% of its price prior to the announcement of the reform. (The share price will be adjusted for distributions and stock splits, rights issues, etc.)
Wuhan Humanwell Hi-Tech Industry	The owners of nontradable shares will give the owners of tradable shares 2 shares for every 10 shares they own. If the company's recurring profit for 2005 does not increase by at least 20% year on year or if the company does not receive a clean bill of health from its auditor, the owners of nontradable shares will give the owners of tradable shares an additional 10% of the shares they own.	The top shareholder will not be allowed to sell any of its shares for the first 60 months. Thereafter, it will be allowed to sell up to 15% of its holdings every year. If during the first two months after the reform the shares trade at less than RMB3 for five consecutive trading days, the top shareholder will be required to purchase up to 5% of the shares outstanding. (The share price will be adjusted for distributions and stock splits, rights issues, etc.) However, it may not sell those shares during the following six months. Other owners of nontradable shares will not be allowed to sell any of their shares for the first 12 months. They will be allowed to sell up to 5% of their holdings during the following 12 months and up to 10% during the following 24 months. However, no owners of nontradable shares will be allowed to sell their shares unless the share price is more than 185% of the average share price for the 30 days prior to the announcement of the reform (or RMB6). (The share price will be adjusted for distributions and stock splits, rights issues, etc.)
Zhengzhou Coal Industry & Electric Power	The owners of nontradable shares will give the owners of tradable shares 3.8 shares for every 10 shares they own. After the reform, the company will buy back and amortize up to 200 million of the shares held by the owners of nontradable shares or 24.69% of the company's equity. The purchase price may be not more than 86.17% of the average share price for the first 30 days after the reform or less than net asset value. If the proposal for a share buyback is rejected at a general shareholders' meeting, the owners of nontradable shares will sell up to 200 million shares to strategic investors.	They will not be allowed to sell any of their shares for the first 24 months. The exception to this is if shares are sold as part of a buyback or to strategic investors in accordance with a resolution approved at a general meeting of shareholders. Thereafter, owners of nontradable shares will be allowed to sell up to 5% of their holdings during the following 12 months and up to 10% during the following 24 months. The top shareholder will be required to maintain ownership of at least 51% of the shares outstanding. Furthermore, it will not be allowed to sell any of its shares unless the share price is more than RMB4.6 for five consecutive trading days. (The share price will be adjusted for distributions and stock splits, rights issues, etc.) If strategic investors acquire any shares from owners of nontradable shares, they will not be allowed to sell those shares during the following 24 months. After that, they may sell up to 5% during the following 12 months and up to 10% during the following 24 months.

Note: The three companies with the largest market value and seven companies with distinctive reform proposals have been selected.

Source: NICMR, from miscellaneous sources.

(Appendix 2) List of Companies Involved in the First Two Phases of the Reform of China's Split-Share Structure

Name	Main products/activities	Listing	Sponsoring securities company	Total assets (RMB100mn)	Market value (RMB100mn)	Net profit (RMB10,000)	y/y % change	P/E	P/B	ROE	Nontradable shares
Shenzhen Agricultural Products	Wholesaling of agricultural products	Shenzhen	Boshi Securities	41.0	13.2	1,058	-84.5	113.3	0.9	0.8	38.6
Jilin Aodong Medicine Industry Group	Pharmaceuticals	Shenzhen	Minsheng Securities	25.2	20.7	11,685	17.9	17.9	1.6	9.0	46.4
SGIS Songshan	Iron & steel	Shenzhen	Southwest Securities	110.1	47.7	94,826	-3.4	5.0	1.0	18.9	55.8
Shandong Luxi Chemical	Chemicals	Shenzhen	West China Securities	30.9	16.1	11,779	47.8	10.5	1.0	9.4	71.2
Zhejiang NHU	Organic compounds	SME Board	First Capital Securities	16.0	12.4	7,261	4.8	17.0	1.7	10.0	73.7
Zhejiang Weixing Industrial Development	Buttons	SME Board	Dongguan Securities	3.8	6.2	2,494	25.3	25.0	2.6	10.6	71.9
Zhejiang Transfar	Chemicals	SME Board	Orient Securities	4.6	10.1	5,256	33.6	19.2	2.7	13.9	75.0
Huangshan Novel	Wrapping paper	SME Board	Orient Securities	4.8	6.8	4,368	2.2	15.4	2.0	12.8	75.0
Zhejiang Hangzhou Xinfu Pharmaceutical	Vitamins, etc.	SME Board	Shenyin & Wanguo	3.6	10.8	3,252	25.7	25.6	2.7	10.5	71.4
Zoje Sewing Machine	Sewing machines	SME Board	Everbright Securities	9.3	10.0	3,475	16.6	18.1	1.5	8.6	69.8
Sichuan Haite High-tech	Aircraft maintenance	SME Board	Industrial Securities	5.1	12.7	3,654	9.4	23.0	2.0	8.8	69.4
Suning Appliance Chain Store (Group)	Retailing of electrical equipment	SME Board	Changjiang BNP Paribas Peregrine	20.5	60.1	18,120	83.2	16.5	3.6	21.8	73.2
Fujian Septwolves Industry	Clothing & accessories	SME Board	Daton Securities	3.5	7.7	2,889	15.7	20.4	2.0	9.6	70.6
Zhejiang Supor Cookware	Cooking equipment	SME Board	Guosen Securities	13.6	20.3	6,315	-17.4	24.5	2.3	9.5	74.9
Shanghai Port Container	Container transportation	Shanghai	Guotai Junan Securities	130.1	292.1	115,574	15.7	25.3	4.3	17.0	76.7
Baoshan Iron & Steel	Iron & steel	Shanghai	Guotai Junan Securities	642.6	856.3	939,523	34.7	6.5	1.5	22.4	77.9
Citic Securities	Securities	Shanghai	Huaxia Securities	132.1	146.9	16,569	-54.7	84.6	2.7	3.1	83.9
Henan Yinge Industrial Investment Holding	Paper & pulp	Shanghai	Haitong Securities	14.7	12.5	4,530	48.0	28.0	2.6	9.6	60.8
Wuhan Humanwell Hi-Tech Industry	Pharmaceuticals	Shanghai	Donghai Securities	18.3	6.7	4,022	31.1	16.6	1.2	7.4	42.5
Guangzhou Development Industry (Holdings)	Electric power	Shanghai	CITIC Securities	108.3	114.7	78,444	-2.5	9.8	1.0	10.7	74.2
Zhengzhou Coal Industry & Electric Power	Coal production & processing	Shanghai	China Euro Securities	26.4	30.5	15,826	85.9	18.8	2.0	10.2	73.3
Guangzhou Kingfa Sci. & Tech.	Plastics	Shanghai	GF Securities	16.6	26.7	10,465	13.1	19.6	2.5	12.7	74.3
Jilin Wuhua Group	Sale of PCs and peripherals	Shanghai	Southwest Securities	7.6	7.7	2,998	77.4	24.8	1.9	7.4	57.3
Huafa Industrial Share	Property development	Shanghai	Guolian Securities	23.2	13.8	8,579	52.5	16.1	1.4	8.7	70.0
Zhejiang Longsheng Group	Dyes	Shanghai	China Euro Securities	21.3	28.8	15,684	25.8	13.9	2.4	16.9	74.9
Beijing Hualian Hypermarket	Retailing	Shanghai	CICC	22.8	20.3	9,725	50.6	20.7	2.9	13.8	60.2
Canal Scientific and	Clothing & accessories	Shanghai	Tebon Securities	16.2	11.5	10,422	19.3	11.0	1.1	10.4	48.3
Aeolus Tyre	Tires	Shanghai	Central China Securities	22.0	16.9	7,665	20.3	22.1	2.4	10.9	70.6
Jiangsu Hengtong Photoelectric Stock	Fiber-optic cable	Shanghai	Ping An Securities	11.6	8.6	4,036	10.4	21.4	1.4	6.5	72.3
Sinochem International	Sale of chemical products	Shanghai	CITIC Securities	53.3	70.2	79,770	204.5	5.9	1.8	30.8	67.8
Jiangxi Changli Automobile	Truck components	Shanghai	Guosen Securities	13.4	8.5	7,518	43.9	5.7	0.7	12.8	60.0
Zhejiang Huahai Pharmaceutical	Pharmaceuticals	Shanghai	China Merchants Securities	9.0	31.3	11,911	50.2	20.3	3.1	15.2	65.0
Baoding Tianwei Baobian	Transformers	Shanghai	Founder Securities	26.7	25.8	5,109	28.5	52.1	2.7	5.3	72.7
Handsome Electronics	Financial services systems	Shanghai	CITIC Securities	4.5	6.3	2,239	-38.4	18.8	1.2	6.1	75.0
Zhejiang Wolong Hi-tech	Motors	Shanghai	Shanxi Securities	8.7	8.3	6,054	68.4	13.5	1.7	12.2	67.9
Henan Zhongfu Industry	Aluminum	Shanghai	Golden Sun Securities	36.2	7.8	8,075	8.6	9.7	1.0	10.1	63.0
Shenergy	Investment (electric power, energy)	Shanghai	CITIC Securities	179.5	208.7	115,959	2.2	18.0	2.3	12.9	77.1
Shanghai Hongsheng	Digital electronics	Shanghai	GF Securities	18.7	10.6	3,908	31.2	27.4	5.6	20.5	86.4
Shanghai Oriental Pearl	Media	Shanghai	Guotai Junan Securities	56.0	122.2	31,700	22.1	38.5	3.8	9.8	77.2
SDIC Huajing Power Holdings	Electric power	Shanghai	Guotai Junan Securities	90.1	45.4	32,846	52.9	13.9	3.4	24.4	61.9
China Yangtze Power	Electric power	Shanghai	GF Securities, CITIC Securities	331.3	641.8	303,897	111.4	20.9	2.9	13.9	70.4
Baosheng Science and Technology Innovation	Electric wire & cables	Shanghai	Huatai Securities	9.7	6.8	3,952	25.3	17.2	1.2	7.1	62.5
Hebei Jinniu Energy Resources	Coal production & processing	Shenzhen	Guotai Junan Securities	36.4	71.0	38,126	178.7	10.1	1.9	19.1	67.8
Sany Heavy Industry	Construction machinery	Shanghai	China Euro Securities	43.2	40.7	32,729	0.8	12.5	2.1	17.2	75.0
Tsinghua Tongfang	Production & sale of PCs and peripherals	Shanghai	Southwest Securities	90.6	50.0	11,590	2.3	43.1	1.7	3.9	52.5
Shanghai Zi Jiang Enterprise	Plastic products	Shanghai	Guosen Securities	67.3	39.9	21,582	-9.1	18.5	1.5	8.0	58.5
			Average for listed companies	46.2	22.73	12,631	32.1	21.75	2.07	9.0	63.8

Notes: (1) The share prices are the closing prices for 17 June 2005. However, in the case of Jinniu Energy Resources, Sany Heavy Industry, Tsinghua Tongfang and Zi Jiang Enterprise, they are the closing prices for 29 April 2005. Total assets are as at end-FY04; net profit is the figure for FY04.

(2) The average P/E and P/B ratios for listed companies are the figures for end-2004.

(3) The data for state-owned shares include both shares owned directly by the state and shares owned indirectly via state-owned companies.

(4) The shareholder data for Baoshan Iron & Steel and Jinniu Energy Resources are for end-April 2005 and 22 June 2005, respectively.

Source: NICMR, from miscellaneous sources and Panorama Network.