

July 29, 2011

Dear clients and colleagues,

An old Chinese saying goes: "If you want to be rich, you must first build roads." The infrastructure development was a key priority in China's past Five-Year Plan (2006-2010), and successfully stimulated the economy during the financial crisis. In 2009 alone, China built and expanded 35 airports, opened 557 km of railways, paved 98,000 km of highway and speeded up subway projects nationwide.

The rapid expansion of high-speed railway network used to be the glorious highlight of China's transportation infrastructure boom. However, the collision of two bullet trains last Saturday raised lots of criticism and concern on the hasty construction. The Ministry of Railways fired several top officials, namely the chief, deputy chief and Chinese Communist party Secretary at the Shanghai Railway Bureau. We believe the shocking accident will trigger a nationwide safety check of the transport network. New project approvals are likely to be delayed.

Last Wednesday Chinese Premier Wen Jiabao addressed that the country's high-speed rail development must be balanced with its broader transport agenda. Let us look into details of this agenda outlined in the new Five-Year Plan (2011-2015).

China invested over 4.7 trillion yuan (US\$713 billion) in land and marine infrastructure during the previous Five-Year Plan and will maintain that pace over the next five years. Key targets in the new Plan are as follows.

- Length of highway network will reach 83,000 km (currently 74,000 km)
- Length of high-speed railway will reach 45,000 km (currently 10,000 km)
- Total number of airports will reach 220 (currently 175)
- A new airport will be built in Beijing

The massive scale of transportation infrastructure in China is understandable, considering China's land area of 9.6 million km² and 1.3 billion population. Logistics costs account for 18% of GDP in China, compared to 8% in the EU and 9.5% in the US. An efficient transport system across the country will no doubt support the increasing urbanization and booming domestic economic activities. In particular, the expanded network will branch out to many rural areas, spread resources and bridge the income gap.

Currently road transport accounts for 74.1% of the country's freight traffic and 94.5% of passenger volumes.

Railways

China's long-term objective is to expand the railway network to 120,000 km from the current 91,000 km. To put the figure into perspective, the railway length in the US is over 200,000 km. By 2015, China plans to connect every city with a population of at least 500,000 (about 240 cities) and invest 700 billion yuan annually in rail projects.

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Highways

In the next five years, China plans to build seven new highways originating from Beijing, nine running north to south, and eighteen running east to west. The objective is that by 2015 all townships and 90% of villages are accessible by vehicles. In 2010 1,200 townships and 120,000 villages still had no paved roads. Current highway network in China covers 74,000 km, ranked number two in the world after 100,000 km in the US interstate system.

Waterways

The Plan aims to build up a network to connect inland waterway and ports to allow smooth cargo transportation. China has 110,000 km of inland waterway, accounting for 67% of marine freight volumes in 2010. Coastal ports can be divided into five clusters, including pan-Bohai Rim, Yangtze River Delta, Southeast coast, Pearl River Delta and Southwest coast.

China ranks first in the world in terms of both cargo throughputs by weight and by the number of containers handled. In 2010, its cargo throughput achieved 8.93 billion tons, up 16.7% y/y. The container throughput reached 146 TEUs, up 19.4%. Shanghai overtook Singapore to become the world's largest container port in 2010.

Aviation

In the next five years, China plans to invest more than 1.5 trillion yuan in the aviation industry. Besides increasing airport coverage, it also aims to increase the number of airplanes to over 4,500 from 2,600.

Guidelines on foreign investment

The Plan encourages foreign investors to invest in high-end manufacturing, high-end technology, modern service, new energy and environment-friendly industries in general. The Catalogue for the Guidance of Foreign Investment is currently being revised and expected to be released later this year. Here are some current guidelines related to foreign investment in the transportation industry.

Restricted Foreign Investment industries

- Railway freight transportation
- Railway passenger transportation (Chinese partner shall hold the majority of shares)
- Highway passenger transport
- Enter-leave country fleet operation
- Water transportation (Chinese partner shall hold the majority of shares)
- General aviation companies engaging in photographing and prospecting (Chinese partner shall hold the majority of shares)

Prohibited Foreign Investment industries

- Air traffic control

Have a good weekend.

The Global Alpha team

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