Corporate earnings are up in China

- Northern European companies bullish over profit growth

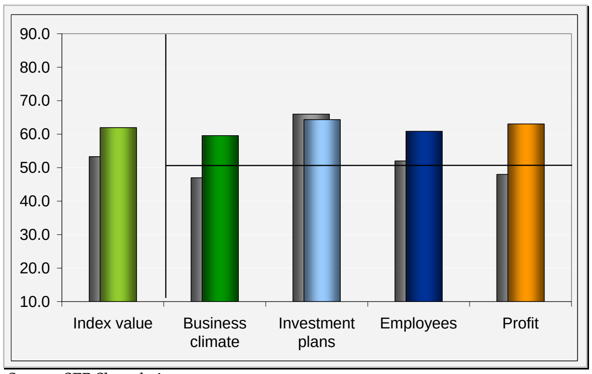
Senior managers at Northern European subsidiaries in China are considerably more optimistic about the short-term business situation than they were six months ago and see a turnaround in both sales and profits on the Chinese market.

Two-thirds, or 65%, of companies expect their profits to increase in the coming six months as compared to 22% in March this year. 53% see the business conditions as favorable or very favorable (29% in March).

Half of the companies are planning to recruit more staff, up from one-third in March, whereas the percentage of companies planning further investments has fallen from 67% to 61%.

SEB's China Financial Index reached 62 in September, up from 53 in March.

SEB's China Financial Index



Source: SEB Shanghai

In SEB's China Financial Survey, senior managers at around 50 subsidiaries of major Nordic and German companies in China were asked about their expectations of their own business as well as the macro and financial environment. Overall, managers believe that the economic downturn has bottomed out and expect growth to accelerate in the short term.

Despite the global crisis, not one company in the survey is planning to scale down either by divesting or reducing staff numbers. On the contrary, the "wait and see" approach that most companies had in March is now tending towards a "carefully expand" strategy, to be better positioned for success as the economy improves.

Our conclusions

China's massive stimulus package is having an obvious spill-over effect on business prospects for North European companies in China. While the global financial crisis has had a strong impact on exports out of the country, the domestic market has proven more resilient. Regardless of whether or not one believes official Chinese statistics, companies see a quick upturn in sales in China. If head offices share local management views, this may lead to more investments, as China gains importance relative to other markets.

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SEB

Confidence Up

China the only growth market in 2009

China's economy grew by 7.9% in the second quarter and few economists believe that China will not achieve the official full-year target of 8%. The key to growth has been huge bank lending. Close to USD 1.1 trillion was distributed in new bank loans during the first six months of the year as compared to USD 358.5 million during the same period last year. Although some 20% of new lending flowed into the stock market, the majority of funds has been used to finance government investment, based on the premise that if the government spends, the private sector will do so too. Even if the sharp increase in lending is a cause for concern in the medium to long term, it is having the expected positive effects in the short term. China is projected to post by far the highest growth figures among the major economies in 2009 as well as over the next two years.

GDP growth
Year-on-year percentage change

	2008	2009	2010	2011
United States	0.4	-2.5	1.8	2.3
Japan	-0.7	-5.6	1.5	1.9
China	9.0	8.0	8.0	8.0
Euro zone	0.6	-3.9	1.2	1.8
United Kingdom	0.7	-3.9	1.5	2.0
Sweden	-0.2	-5.0	2.0	2.6
Norway	2.1	-0.9	2.6	2.2
Denmark	-1.0	-4.0	0.3	1.3
Finland	0.7	-5.1	0.9	2.0
Nordic countries	0.4	-3.6	1.5	2.1
Baltic countries	-1.0	-15.6	-2.6	3.2
OECD	0.6	-3.9	1.3	1.9
World, PPP	3.1	-0.9	3.4	4.1
World, nominal	2.0	-1.6	2.7	3.4

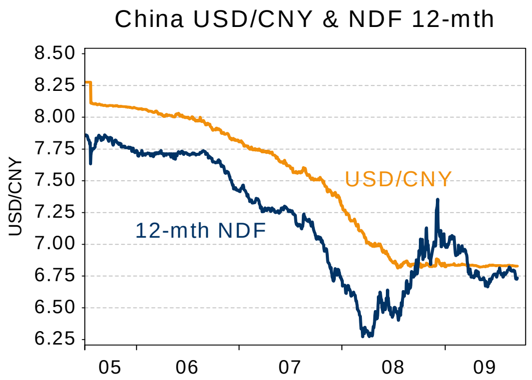
Source: OECD, SEB

Source: SEB, Nordic Outlook, September 2009

Hence, it comes as no surprise that Northern European companies are bullish over the Chinese market. With modest growth in almost all other markets, the expected high growth in China in 2009-2011 is a reason for further expansion in China even if downscaling may be on the agenda elsewhere in the world

RMB will be stable or appreciate again - Interest rates have bottomed out

A third of managers expect the RMB to start appreciating again against the USD in the coming six months while 62% believe it will remain unchanged. Although China scrapped the USD-peg in 2005 in favor of a basket of currencies, the RMB/USD exchange rate has been managed in the range 6.81 – 6.89 since August last year. Non-deliverable forward contracts indicate that the RMB will appreciate by 1.3% against the US dollar in the coming year.

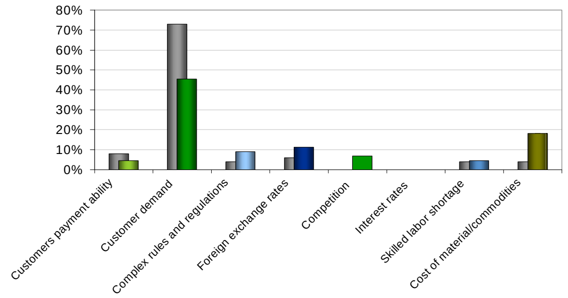


61% of companies believe that interest rates will be unchanged and 36% believe that they will go up during the next six months, which is fundamentally different from the situation six month ago, when 74% believed interest rates would fall.

Customer demand returning

In March, 73% of respondents viewed customer demand as their main business concern. In September that figure has fallen to 45%. Material costs and competition were the second and third biggest concerns for subsidiaries in China.

Concerns 2009/2010



Source: SEB. Grey stacks are companies' choices of main concerns in March, six months ago.

Survey Results

Information about the Survey

The SEB China Financial Survey is based on input from CEOs and CFOs at 50 subsidiaries of major Swedish, Danish, Finnish, Norwegian and German companies. Most of the companies have a global turnover of over EUR 500 million. The survey is web-based and confidential and was carried out during the period September 8 – 16, 2009.

Subject: Business Climate / Profit Expectations

Northern European subsidiary managers in China have a considerably more positive view of the business climate for the coming six months, compared to six months ago. 46% (25% in March) of companies expect business conditions to be favorable over the coming six months and 7% (4% in March) believe they will be very favorable. Only 11% believe that conditions will be unfavorable compared to 35% in March, and no company expects very unfavorable conditions (6% in March).

When asked about profit expectations, 61% expect profits to increase as compared to 22% in six months ago, and two companies (4%) believe that profits will improve considerably. Only two companies (4%) expect falling profits (32% in March).

While Chinese exports (of which approximately 60% is produced by foreign invested companies) fell for the tenth consecutive month in August, there are clear signs that the Chinese domestic growth is picking up. Official data reported a 7.9% GDP growth in the second quarter. Manufacturing output was up 12.3% in August (10.8% in July) and retail sales were up 15.5%. Although one could question both the credibility of official statistics in China and the sustainability of the current rebound, it is obvious that it is having a positive effect on corporate earnings, at least in the short term.
(See graphs 1 and 3, p. 5)

Subject: Employee Structure

Even in the middle of the financial crisis, there were no major lay-offs among foreign companies in China. As managers in North European companies become increasingly bullish, they are now planning to increase staff. 43% plan to increase staff numbers and 7% are planning significant increases. This can be compared to 29% and 3% respectively in March this year.
(See graph 4 on page 5)

Subject: Fixed Asset Investment Plans

Of the companies, 50% will make modest investments in the coming six months, and another 11% are planning major investments during the same period.
This is actually down slightly from March which seems to indicate that current sales volumes do not yet require greater manufacturing capacity. Sales and profits are up and companies employ more people, but they are not altering their investment plans much compared to March. One possible explanation is that they never really changed investment plans even when the financial crisis reached its climax. Investment decisions are typically taken by head offices and there may be a lag between market information and investment decisions. If the current upturn is sustainable, this should lead to an increase in investments in our next survey six months from now.
(See graph 2 on page 5)

Subject: Average Outstanding Account Receivables days

In most annual surveys conducted by various chambers of commerce in China over the last 10 years, foreign companies have highlighted payment terms and the issue of actually being paid on time, as one of the main challenges in China. Based on this survey, only a small minority of Nordic

and German corporates have average outstanding account receivable days of more than 90 days. 16% reported less than 30 days, 47% have 30-60 and 27% have an average of 60-90 days. There is no real change from the last survey in March.
(See graph 5 on page 5)

Subject: Funding Needs

57% of managers expect funding needs to remain unchanged during the coming six months, whereas a third expect funding needs to increase. 11% foresee a decrease in funding needs. Considering that investment plans have fallen slightly, this seems logical. On the other hand, increased sales should lead to a greater need for working capital. Based on discussions with clients, we know that many companies have reduced stock and are sitting on substantial cash positions at the moment, which could be one reason why funding needs are not going up.
(See graph 6 on page 5)

Subject: FX and Interest Rates

The view that the Chinese economy has bottomed out can be seen from managers' views of interest rates and the RMB exchange rate. Only one company believes that interest rates will fall further. 61% believe that rates will stay at current levels in the coming six months, whereas 36% expect rates to go up. Both deposit rates and lending rates are regulated in China and the current lending rate for a 12-month bank loan is 5.31%. The 12-month deposit rate is 2.25%. Given that China had a CPI of -1.2%, while PPI was -7.9%, in August, China still has fairly high real interest rates.

More managers expect the RMB to start appreciating against the US dollar after more than a year of stable RMB/USD rates. 33% expect the RMB to appreciate over the coming 6 months compared to 24% in March. However, most companies – 62% - still believe that the RMB will remain stable against the dollar. A stable RMB/USD exchange rate is one of the main reasons why as many as 70% of Northern European companies use the USD as their main trading currency in China. 30% use either the EUR or Scandinavian currencies. For the latter, the relevant question is how the USD will develop against these currencies. Since exactly six months ago, March 22, up until September 22, the RMB has depreciated by 7.12% against the EUR, 15.53% against the SEK, 7.43% against the NOK and 7.50% against the DKK. This may be one reason why as many as 50% (39% in March) are now hedging some or most of their FX flows on the on-shore forward market, and another 23% are hedging via their head offices through NDF-contracts .
(Please see graphs 7 and 8 on page 5 plus graph 9 and 10 on page 6)

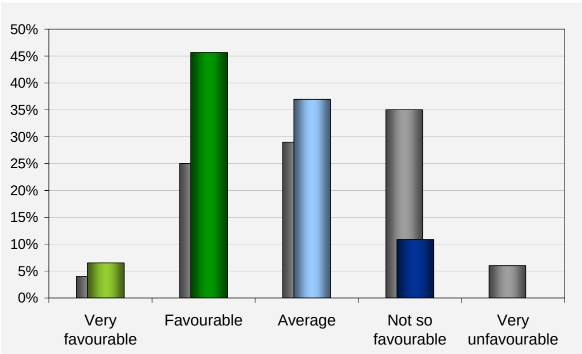
Subject: Main Concerns

The major concern for local management remains customer demand, although this is much less of a problem today than it was six months ago. In September, 45% rated it as their main concern compared to 73% in March. The three biggest changes since our last survey are that raw material costs, foreign exchange rates and competition are now mentioned as major concerns. As discussed above, the RMB exchange rates against all currencies except the US dollar have been fairly volatile. Raw material costs have risen substantially during the last six months. Copper for example is up more than 50% and the price of nickel has increased even more.
(See graph 11 on page 5)

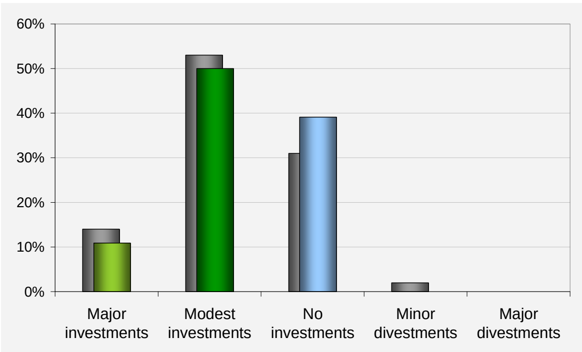
China Financial Index - Composition

The SEB China Financial Index in March had a value of 62, indicating a positive attitude. A value of 50 would indicate a neutral view. The index is based on four components with the following ranking in this survey: General Business Situation – 60, Profit Expectations – 63, Investment Plans – 64, and Employment Plans – 61. (see the graph on page 1)

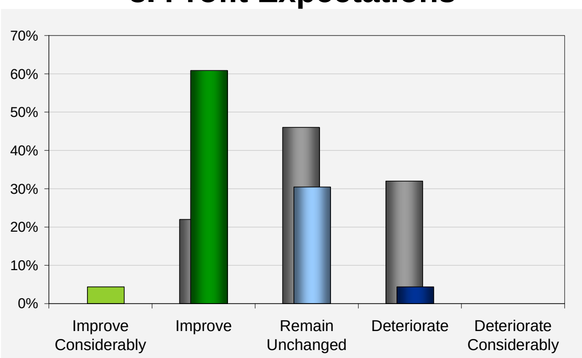
1. Business Conditions



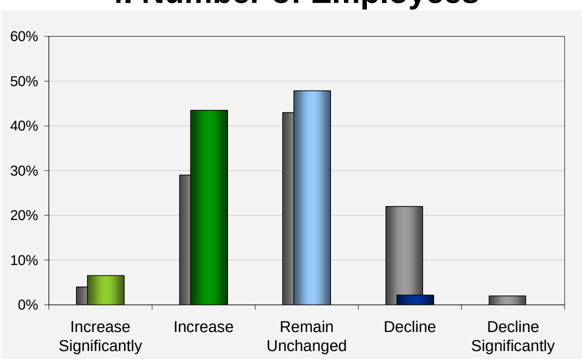
2. Fixed Asset Investment Plans



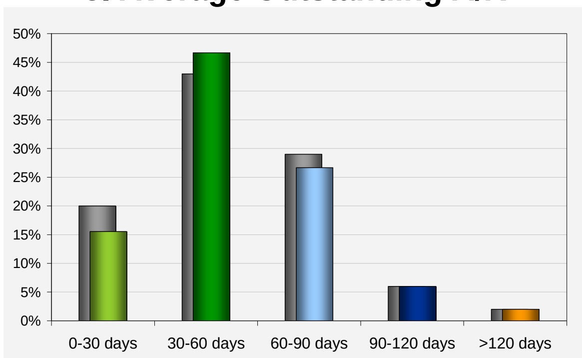
3. Profit Expectations



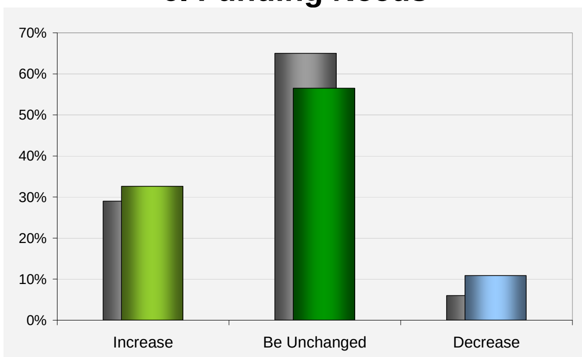
4. Number of Employees



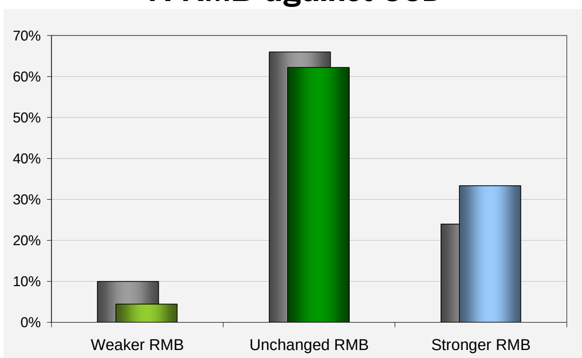
5. Average Outstanding A/R



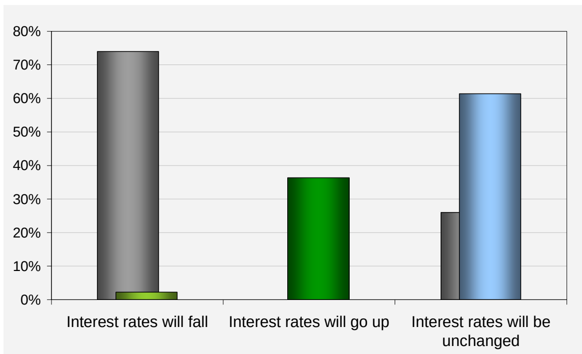
6. Funding Needs



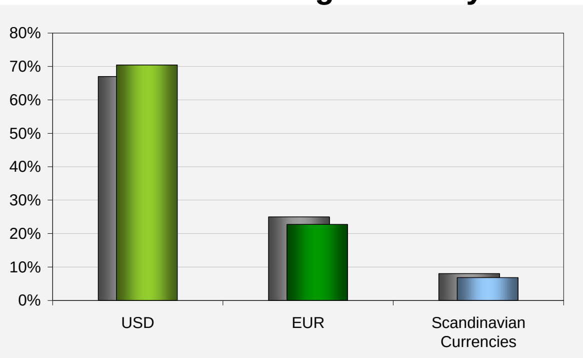
7. RMB against USD



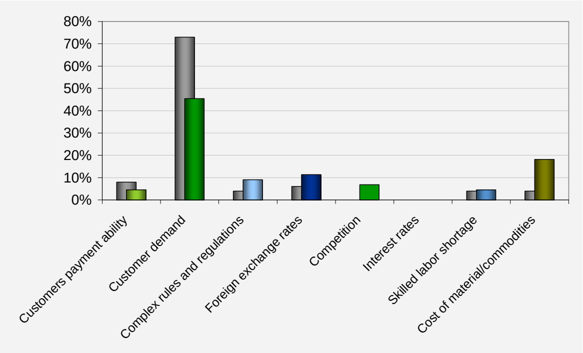
8. RMB Interest Rates



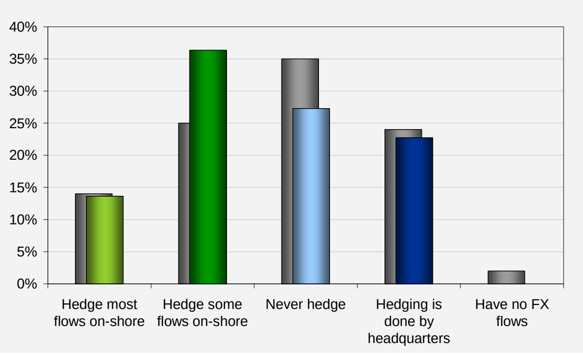
9. Main Trading Currency



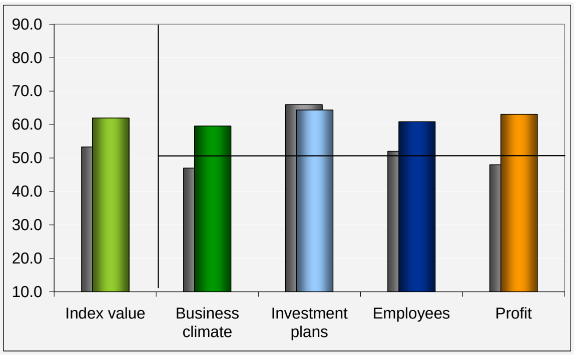
11. Main Concerns



10. Hedging Strategy



12. Main Index



Financial Data

Macro Data (% changes)	2005	2006	2007	2008	2009 to date
GDP	10.4	11.6	13.0	9.0	7.1
CPI	1.8	1.5	4.8	5.9	-1.1
Industry Output	16.4	16.6	18.5	12.9	7.0
Exports	18.2	24.7	21.7	17.3	-23.4
Imports	22.2	13.9	25.7	18.5	-19.0

On-shore deposit rates, major currencies, below 3m USD equivalent

On-shore interest rates (%)	*Current*	3M	6M	9M	12M
USD	0.1500	0.4000	0.7500	0.8500	0.9500
EUR	0.1000	0.6550	0.9550	0.9775	1.0000
JPY	0.0001	0.0100	0.0100	0.0100	0.0100
HKD	0.0100	0.1500	0.3000	0.4000	0.4500

RMB Interest Rates (PBOC Regulated)

PBOC Rate 090318 (%)	*< 6M*	6M-1Y	1Y-3Y	3Y-5Y	> 5Y
Lending Rates	4.86	5.31	5.4	5.76	5.94
PBOC Rate 090318 (%)	***Current***	**3M**	**6M**	**1Y**	**2Y**
Deposit Rates	*0.36*	1.71	1.98	2.25	2.79

FX Indicative Spot and Forward Rates

		21/Dec/09	22/Mar/10	21/Jun/10	21/Sep/10
FX	***21/Sep***	**3M**	**6M**	**9M**	**12M**
USD/CNY	*6.801*	6.837	6.834	6.830	6.830
EUR/CNY	*9.999*	10.050	10.041	10.036	10.042
GBP/CNY	*11.036*	11.105	11.099	11.100	10.100
JPY/CNY	*7.409*	7.478	7.483	7.491	7.513
HKD/CNY	*0.877*	0.883	0.883	0.883	0.884
SEK/CNY	*0.972*	0.997	0.998	0.998	0.998
DKK/CNY	*1.324*	1.350	1.347	1.346	1.344
NOK/CNY	*1.134*	1.155	1.150	1.146	1.141

All indicative rates as per 2009-09-21

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