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ARE YOU HOLDING ANY HONGKONG SHARES ?
NO ! THEN, READ THIS !

During the remainder of this year and well into 2006, the equity markets of Asia are likely to surpass in competition those of the **U**nited **S**tates (US) and Europe, with emphasis on the 2 equity markets of the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

As the PRC, proper, as opposed to the HKSAR of the PRC, cranks up its sewing machines, its spinning and weaving machines, and its ancillary industries, which support the garment and textile industries of the country, in order to meet the demands for its products in the US and Europe, and as the HKSAR, as a service-orientated part of the PRC, proper, gears up to support *'big brother'*, so the HKSAR economy will stand to benefit, tremendously.

Outsourcers, such as Li and Fung Ltd (Code: 494, Main Board, The Stock Exchange of Hongkong Ltd), and exporters of garments, such as Top Form International Ltd (Code: 333, Main Board, The Stock Exchange of Hongkong Ltd) and Esprit Holdings Ltd (Code: 330, Main Board, The Stock Exchange of Hongkong Ltd), just to name 3 companies, which, immediately, come to mind, are all standing in line to experience increased volumes of activity, leading to bigger profits.

Other publicly listed companies of the HKSAR will, also, benefit, of course, and **TARGET** will expand on this theme, later on in this report.

The *'explosion'* in the HSKAR, brought about in part by the increased activity in the PRC, proper, in broader-based manufacturing, veering away, in part, from **I**nformation **T**echnology (IT), is the natural result of that which **TARGET** explained in last Wednesday's **TARGET** Intelligence Report, Volume VII, Number 35, headlined:

'***WATCH OUT, HERE COMES THE DRAGON OF THE EAST – AGAIN !***
THE DEATH KNELL TOLLS FOR AMERICAN MANUFACTURERS'

Last Wednesday's report outlined, in some detail, the immediate effect of the expiry of the **A**greement on **T**extiles and **C**lothing (ATC), an event, which took place on the last day of 2004.

The ATC was part of the World Trade Organisation's General Rules, but its life ended last December 31 and, today, the General Rules of the World Trade Organisation have superceded the 40 years of reign of the ATC.

The ATC was, in effect, a complicated system of import quotas which, on the one hand, guaranteed exporting countries of garments and textiles, a slice of an importing country's business in the High Street, but, on the other hand, it safeguarded the jobs of textile and garment workers in the importing countries.

The life of the ATC was nigh on 4 decades.

However, the ATC is, now, dead: Long live the free market!

The philosophy of the World Trade Organisation, of which the PRC is a full member, is trade liberalisation, reciprocity and non-discrimination among members of this international trade *'club'*.

The death of the ATC allows the PRC, proper, to become the world's undisputed *'tailor'*.

This is because the PRC, proper, owns more than 55 percent of all of the world's weaving machines as well as owning and operating about 23 percent of the world's spinning machines.

To the credit of the Government of the PRC, proper, its economic planners saw, some years ago, what would happen in the future: Appropriate steps were taken in good time in anticipation of the new world order as it affected the garment and textile industries of the country.

Today, the most-populous country of the world is turning up the speed on its spinning and weaving machines and is employing more and more workers to join its armies of existing workers to sew and to cut materials in order to clothe consumers of the US and Europe and, by so doing, it is hammering the nails into the coffins of many companies in Europe and the US where labour costs are far greater than those of the PRC, proper.

Where the HKSAR comes into the picture is that the 416 square miles, which, since July 1, 1997, when the PRC Government assumed sovereignty over the former British Colony, have become more and more of a service-orientated economy in support of the PRC, proper, with a host of services.

Probably, among its most important roles for the Government of the PRC is that the HKSAR is a place where, literally, hundreds of billions of dollars may be raised for any number of capital projects, from the construction of power stations to the expansion of textile and spinning factories, to the establishment of new industries in the IT field.

The equity markets of the HKSAR are internationally known and respected, having a well-established monitoring system for publicly listed companies and their managements, lest they stray from the straight and narrow.

Not so for the equity markets of the PRC, proper, which are just emerging, trying to get their sums correct and trying their luck as being a base to raise capital, but, only then, for the domestic market.

These markets have yet to graduate to bigger and better things.

Over the past 8 years, since the PRC Government established itself as the dominant political force in the HKSAR, it has *'milked'* the territory whenever it could by spinning off all manner of entities on the HKSAR equity markets.

International investors look to the HKSAR equity markets – there are 2 of them: The Main Board and The **G**rowth **E**nterprise **M**arket (The GEM) of The Stock Exchange of Hongkong Ltd – in order to jump aboard the bandwagon, rolling down from the north.

The PRC, proper, of course, has its own equity markets in major cities, but they are fledgling markets, not yet having anywhere near the status or stature of those of the HKSAR.

Some of the HKSAR Main Board, listed companies, which are quite likely to benefit in the months to come from the expansion of the PRC's garment and textile industries include:

Giordano International Ltd (Code: 179)	A manufacturer of garments
Esprit Holdings Ltd (Code: 330)	A manufacturer of garments
Moiselle International Holdings Ltd (Code: 130)	A manufacturer of garments
Veeko International Holdings Ltd (Code: 1173)	A manufacturer of garments
Peking Apparel International Group Ltd (Code: 761)	A manufacturer of garments
Li Ning Company Ltd (Code: 2331)	A manufacturer of garments
Bossini International Holdings Ltd (Code: 592)	A manufacturer of garments
Fountain Set (Holdings) Ltd (Code: 420)	A manufacturer of textiles

All of the above-mentioned companies are vendors of their own brands of clothing, having outlets in the HKSAR and the PRC, proper.

The combined turnovers of just these 8, publicly listed companies are in the tens of billions of Hongkong dollars, annually.

<u>But It Is Not All Beer And Skittles</u>

While it is indisputable that the PRC, proper, and the HKSAR are in for a wild ride in the coming months, there are still problems on the horizon for both economies.

The **O**rganisation of **E**conomic **C**ooperation and **D**evelopment (OECD) has recorded that exports of most Asian countries are losing momentum of late.

Exports, of course, are the driving force for Asia.

Any downturn in exports has an immediate and violent impact on the lives of the populations of the region, which is the world's most populous.

Coming to the rescue of falling exports to areas, such as North America and Europe, is intra-regional trade and inter-regional trade.

It stands to reason that such trade should escalate, also, in the next 18 months or so.

As this medium has reported in its weekly roundups of equity markets, trade between Japan and the PRC, proper, has been expanding, exponentially, over the past year, at least, taking up the slack from the flagging uptake in the US of a number of Japanese-produced products.

Also, as **TARGET** has touched upon, earlier in this report, large-exporting countries of Asia, such as the PRC, proper, Japan, Taiwan, South Korea, etc, have gone back to basics, having forsaken, to some extent, IT and IT-related industries, and, in their places, concentration has been in evidence in the manufacture of consumer durables and services.

The manufacture of such items does not require a knowledge of intergalactic travel and all that that entails, permitting Asia to dust off the manuals and restart the motors which, in days of yore, caused Asia to come to the attention of governments of North America and Europe because of the quantities and relative cheapness of Asian-produced consumer durables and services.

The problem inherent in the production of such consumer goods is that profit margins tend to be lower, relative to the production of hi-tech products.

This is likely to result in a deceleration of the profits for many a company in Asia , but it will, at the same time, guarantee a profit for them, moderating, only, the pace of economic growth in the region.

As profit margins decline, no doubt, entities in the PRC, proper, will look to impose austerity measures in order to try to maintain a satisfactory level of profit.

Interest rates are another potential problem for Asia, of course, and, as the US jacks up its interest rates, Asia will have to follow suit.

Again, this will be a constraining element in the formula of manufacturing and could inhibit expansion in some areas.

Manufacturers will, as a matter of necessity, have to consider the recurrent costs of debt service in addition to capital repayment, leading to the retirement of debt.

Higher oil prices will tend to be another problem with which Asian industry will have to contend, especially for Japan and the PRC, proper, because the higher costs of energy mean that such costs must be to sent down the line to the consumer.

The closer at hand that goods may be sold, the relatively cheaper will be the cost to the consumer, hence inter-regional and intra-regional trade will become more and more important for 2004 and 2005.

In the case of publicly listed Li Ning Company Ltd (Code: 2331, Main Board, The Stock Exchange of Hongkong Ltd), one noted how, in a fairly short space of time, this producer of garments, mainly sportswear, has gone from its humble beginnings to a multi-billion-dollar empire.

And emphasis in this company's case was on selling its products in the PRC, proper, almost exclusively.

(For more about this company, please read **TARGET** Intelligence Report, Volume VII , Number 20, published on January 28, 2005)

As the wealth effect kicks in, in the PRC, proper, and more millionaires are created, again the HKSAR stands to benefit because companies and their senior managements will establish a presence in the HKSAR if for no other reason than as a public relations's exercise.

They will require, among other things, high-grade commercial and residential accommodation in order to dress up their HKSAR presence.

There is almost guaranteed to be an increase in the demand for housing of all kinds in the HKSAR, and companies, such as Midland Realty (Holdings) Ltd (Code: 1200, Main Board, The Stock Exchange of Hongkong Ltd), stands in good stead to be able harvest huge profits as the demand for all classes of property picks up since this company is the largest and most-dominant property agency of the area.

And so it will go on, with suppliers of all kinds of goods and services, benefitting from the PRC's more broadly based manufacturing infrastructure.

To mention just some of the publicly listed companies of the HKSAR, which are likely to benefit, they include:

Hanny Holdings Ltd (Code: 275)	A manufacturer of toys
Johnson Electric Holdings Ltd (Code: 179)	A manufacturer of mini-motors
Sa Sa International Holdings Ltd (Code: 1780)	A retailer of cosmetics
Egana Goldpfeil (Holding) Ltd (Code: 48)	A manufacture of leather goods
Phoenix Satellite Television Holdings Ltd (Code: 8002)	A television broadcaster in the PRC, proper
The Bank of East Asia Ltd (Code: 23)	A retail bank
BOC Hongkong (Holdings) Ltd (Code: 2388)	A retail bank
Guoco Group Ltd (Code: 53)	A diversified banking group
Hang Seng Bank Ltd (Code: 11)	A retail bank
CITIC International Financial Holdings Ltd (Code: 183)	A wholesale and retail bank

Summary: It would appear, on the face of it, that it is likely to pay handsome dividends in the months to come if one were to invest in select shares, listed on The Stock Exchange of Hongkong Ltd.

However, there are many rubbish companies, listed on the 2 equity markets of the HSKAR: One has to be very careful before buying into this market, especially so for shares, listed on The GEM.

The companies, referred to in this report, are not meant to be an indication of **TARGET**'s preferred choice of publicly listed companies, but only companies, which are likely to be recipients of gains from the fallout of the wealth effect in the PRC, proper.

TARGET's policy is not to endorse any company or product; and, no member of **TARGET**'s staff holds any shares in any of the companies, mentioned in this report.

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