World's second-biggest economy expected to grow again in 2009 despite global downturn

China's show of strength

An old Chinese curse is 'May you live in interesting times', and for stock market punters these are interesting times indeed. As most economies around the world are expected to shrink in 2009, many by as much as 5%, China seems to have escaped this 'curse' with GDP growth during the Year of the Ox widely expected to reach between 6% and 8% this year.

The Chinese government's target of 8% growth may look modest compared with the double-digit increases seen between 2003 and 2007, but a closer look at what is happening in China shows the country is now moving away from its reliance on export to nurture internal growth. This bodes well for the future as it means China has more control over its economic progress.

It is also potentially good news for UK investors who have access to around 50 Aim-listed companies operating in China. Several of these are well placed to benefit from increased spend, either from the average consumer or as the effects of the government's fiscal stimulus package of at least 4 trillion yuan (£390 billion) starts to trickle through. Investors with an appetite for emerging market risk should look at miner **Prosperity Minerals (PMHL:AIM)**, pharmaceutical group **Hutchison China MediTech** (HCM:AIM) and tech stock **BlueStar SecuTech (BSST:AIM)**. Broader exposure can be gleaned through a pair of exchanged traded funds (ETFs), namely **iShares FTSE/Xinhua China 25 (FXC)** and **Lyxor's ETF China Enterprise (LCHN)**.

Building blocks

Shares in Prosperity Minerals have shot up 37% since tipped as a Play of the Week (*Shares*, 30 April) and as a trader of iron ore and manufacturer of cement there is every reason for the group to continue to do well. The Chinese infrastructure spend should boost demand for services provided by building groups, which also include **West China Minerals (WCC:AIM)**, for several years to come, as plans are drawn up for a massive boost in the building of roads, bridges, schools, hospitals and private homes.

Telecommunications are the other so-called utility expected to see increased investment, and a key beneficiary should be **China Shoto (CHNS:AIM)**. The firm beat expectations when last month it reported a 70% increase in annual revenues to £183 million and the group is sitting pretty as the key producer of industrial batteries and power supply systems widely used by the telecoms industry. Leading mobile phone group China Mobile has committed to 375 billion yuan ($54.5 billion) in capital expenditure over the next three years, three-quarters of which will be used for third generation mobile technology roll-out.

China Shoto's management reassured investors at last month's results of its commitment to corporate governance, an issue UK investors should bear in mind when investing in a company based and operating in a foreign country. That the management owns large stakes in the company is another good sign, as this aligns their interests with those of investors.

Technological strides

BlueStar SecuTech is doing brisk trade as a supplier of digital video recorders and network monitoring platforms to financial groups, which are obliged by law to have a camera at every automated teller machine (ATM) connected to one recorder unit. The compulsory five-year replacement cycle is promising for the company, and the group has announced a number of new contract wins this year. Like China Shoto, BlueStar now even pays a dividend, and confirmed earlier this month final results will be in line with expectations, at 154 million yuan ($22.4 million).

Software group **Geong (GNG:AIM)** has a 17% share in the budding Chinese EMC (enterprise content management) market. April's trading update spoke weakening demand from manufacturing customers, but both telecoms and financial services areas are performing well.

Power needs

The State Grid Corporation of China expects the country's power demand will more than double by 2020, to 7.7 trillion kilowatt hours compared with last year's need of 3.4 trillion. Analysts estimate this to represent an annual growth rate of about 8% per annum, significantly above the 3% projected growth rate of coal production.

The Chinese government is not keen on foreign companies coming in to take their natural resources, but there are a few energy plays available for UK investors. Coal bed methane specialist **Green Dragon Gas (GDG)** is making good progress as it extracts natural gas resources trapped inside coal mines. **Polo Resources (PRL:AIM)** operates next door in Mongolia, but a partnership with one of the world's largest coal companies, Peabody, means it is likely to soon become a major supplier to coal-hungry China.

China also offers a number of plays on gold to UK investors, one of the more promising being **Leyshon Resources (LRL:AIM)**. The group has struggled with financing issues, but is now hopeful of starting up its gold mine in the next

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few years.

Wind and sun

China is making strides in the alternative energy space, with installed wind power capacity growing by 105% last year to reach 1.5% of the country's total installed capacity. A predicted 64% growth this year would bring output to a total of 20 million kilowatts.

Solar power has also got a significant boost this year with a generous subsidy from the Chinese government. Solar wafer producer **ReneSola (SOLA:AIM)** is among Aim's most successful green companies, but the subsidy should help ease some of the pricing pressure felt across the industry. Effective immediately, Chinese schools, hospitals and government buildings can claim back around 60% of the cost of installing a solar panel. Solar cell and module manufacturer **Jetion Holdings (JHL:AIM)** was named the fastest-growing technology company in China by Deloitte last year, and last month's final results saw a 328% increase in pre-tax profits, to $20.1 million. This represents a 451% increase in photo voltaic module shipments.

Healthcare focus

China recently announced plans for a 850 billion yuan ($123 billion) healthcare reform, which will provide basic healthcare for its 1.3 billion citizens. This could release yet more money into the economy as Chinese people no longer have to save so much to cover rising medical bills. The improved public health network should also benefit pharmaceutical groups such as Hutchison China MediTech, which house broker Investec expects to see grow by 20% per annum over the next few years. Revenues are derived from both prescription and over-the-counter drugs, as well as from the widely used traditional Chinese remedies.

Shares in **China Medical Systems (CMSH:AIM)** spiked to a year high of 176p earlier this month following the group's final results, which revealed a 50% rise in dividend payments to a 6% yield. Gross profits rose 33% to $44.8 million, as the company enjoys exclusive distribution rights to a number of branded drugs in China. House broker Seymour Pierce believe the group could achieve at least 30% growth per annum for the next couple of years.

More money to spend means more money to travel, a potential benefit for **ET-China (ETC:AIM)**. Shares in the travel services provider have reflected the fact growth plans have taken longer than expected to yield results, not least as the Beijing Olympics did not provide the expected sales boost. The group is now looking to take advantage of difficulties among smaller competitors and in March the group announced the acquisition of Yoee.com, which sells air tickets online.

Savings and loans

Government-influenced spending will account for around three-quarters of China's GDP growth this year, according to estimates by the World Bank. The government will fund 70% of the £390 billion committed through bank loans. UK investors cannot gain exposure to Chinese banks through the London market, but one way to achieve this would be through the **Henderson Far East Income fund**, whose biggest holding is the Bank of China.

Manager Michael Kerley believes China is looking particularly attractive right now, and speaks warmly about opportunities in the financial sector. 'Banks are the key opportunity right now,' states Kerley. He points out cost-cutting among the big international banks has shifted their focus from emerging markets, hence improving conditions for local Asian players.

A fifth of Keeley's fund is currently invested in China, with another 18% in Hong Kong. Financials, telecoms and industrials make up the main sector holdings, supporting the trend of growth fuelled by domestic rather than export demand. 'The long-term story favours Asia over the rest of the world,' says Kerley.

While he thinks the short term will remain volatile, investors with an eye on the medium or longer term should take advantage and get in now. He acknowledges there is always a risk attached to trading in emerging markets, 'but I don't think the risk premium should be what it has been for Asia. I think that right now the risk is elsewhere'. ■

World's largest economies ($ millions)

USA	$13,751,400
China	$7,096,671
Japan	$4,297,171
India	$3,096,867
Germany	$2,830,135
UK	$2,142,959
Russian Federation	$2,087,449
France	$2,077,952
Brazil	$1,832,983
Italy	$1,802,177

SOURCE: WORLD BANK, APRIL 2009. DATA ON A PURCHASING POWER PARITY (PPP) BASIS FOR 2007.

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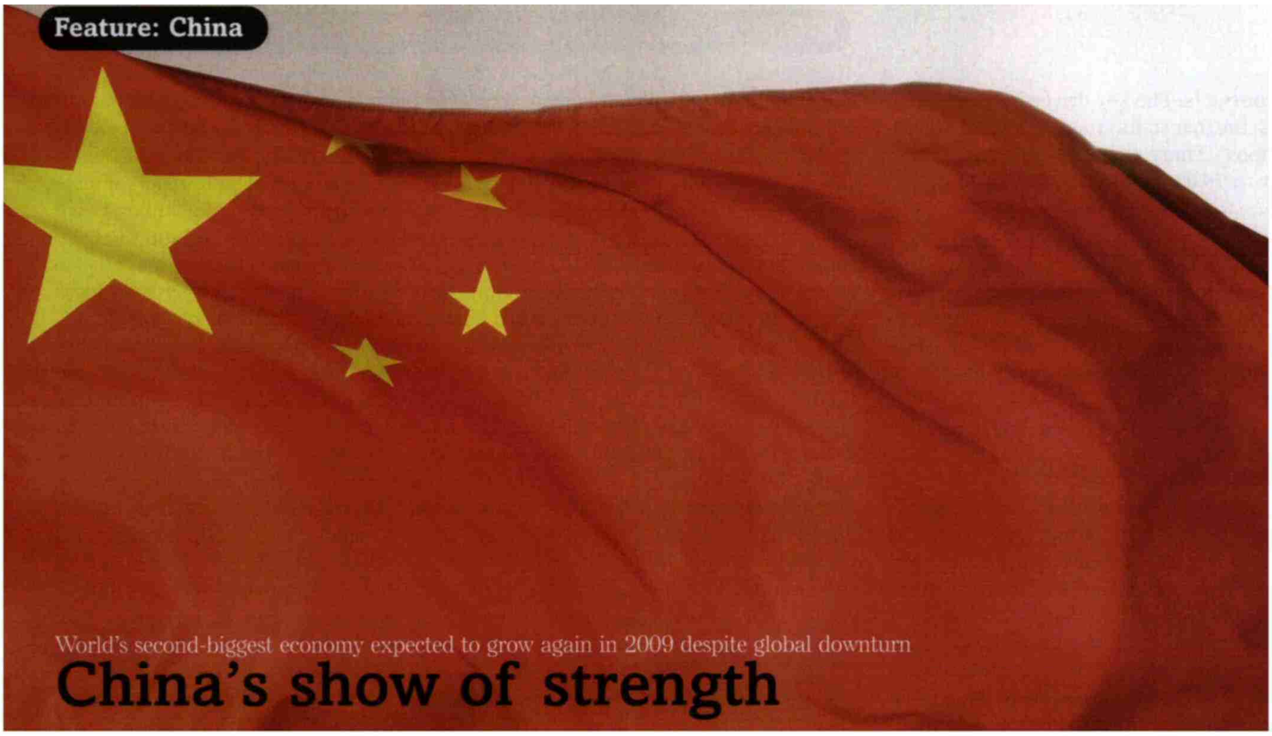

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