



*China and its Companies*  
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**Headed the Right Way?**  
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Several weeks ago, I took the opportunity to perform an exhaustive due diligence on several industrial companies scattered across China. Eight days, 9 flights and 42 hours of flying time later I came away with distinct views on these companies and the overall state of China. The trip was especially timely. Sizeable new bond issuance by Chinese companies and the almost concurrent governance scandals at former bell-weather issuer Sinoforest and other Chinese companies led to sharp price volatility and apprehension over investing in Chinese corporate securities. Also, China's central role in sustaining global growth – its world leading consumption of iron ore and corn for instance – has come under intense investor scrutiny as it juggles the contradictory goals of suppressing inflation and a latent housing bubble while stimulating domestic consumption and minimizing unemployment and unrest.

I came away from the trip convinced that: 1) the Chinese industrial companies I visited are “real” and have sizeable manufacturing installations that appear to be operating at full capacity due to robust domestic demand; 2) many of these companies are grappling with the same types of issues other rapidly growing companies in other countries have struggled with before – these range from proper disclosure and governance to more efficient inventory management to minimizing environmental footprints; 3) the relatively short operating history of these companies and the resulting absence of a track record with which to judge the competency and trustworthiness of key shareholders and managers creates risk for investors that should be reflected in significantly wider yields than comparably rated global peers.

As for China, economic growth continues to be impressive – I barely recognized the Beijing skyline because it has been remade (and also because of heavy smog). Similarly, Hohhot, the capital of Inner Mongolia, showed clear signs of recent investment. China's physical infrastructure is impressive- whether it be modern expressways stretching into interior regions like Inner Mongolia or its telecom network that enabled us to stay in touch even while stranded in a regional airport.

At the same time, after years of torrid growth, the challenges faced by its policymakers are formidable, perhaps more so than in the past. Channeling eager investment capital into productive uses to ensure balanced development and an improving standard of living for all Chinese will likely be an area of future regulation. For instance, much of the wealth generated by commercializing coal extraction in Inner Mongolia appears to have gone into large expanses of new housing of questionable need. Indeed, as with its nascent industrial companies, China's software – its management and policy making skills- face serious tests. China's continuing ability to juggle rapid growth with equitable wealth distribution and inflationary pressures will be put to the test.



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