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INSIDE

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To China, In Good Company

Where Simon Murray, Asia Industrialist, Author, Explorer, Is Steering $$$

The icy stare over yonder is coming from a chap named **Simon Murray**. *The photo was taken last year, on one of the 58 days he and a fellow named Pen Hadow spent tramping unsupported across 750 frozen miles of Antarctica, from its coast to the South Pole—because it is there and to raise money for the Royal Geographic Society. The stunt put him in some demand as a motivational speaker for young people, whom he invariably favors with a quotation of uncertain provenance: "Do not follow where the path may lead, but go instead where there is no path and leave a trail." He then segues into pure "Simonese" as he gets specific:*

" People have to stop simply going to school, going straight to university, becoming investment bankers, making a pile of cash, hating what they do, playing a couple of rounds of golf and dying. There has got to be more to life than that!"

There certainly has been in his life. A couple of years earlier, on a friend's dare, Simon completed, at age 60, the 150-mile Marathon des Sables across the Moroccan desert. The letters C.B.E. (Commander of British Empire) tacked onto the end of his name by the Queen in 1994 for his services to Hong Kong didn't seem to slow him a bit.

Simon brushes aside inquiries about the sanity of such extreme adventures with a shrug. "I do these things from time to time. It is impetuous. The opportunity is there and I say yes." In so doing, he betrays the attitude and approach to life that landed him on a tramp steamer headed for South America, and then in the French Foreign Legion for a 5-year stint, when he was still barely more than a slip of an English lad. Also, the drive that propelled him to Asia in the mid-'Sixties, and then into the top ranks of a couple of the region's storied trading houses, **Jardine Matheson** *and* **Hutchison Whampoa**, *as well as into the driver's seat at* **Deutsche Bank**'*s Asian operations. Have I mentioned that Simon also built and then sold to Hutchison his own regional project engineering and energy trading group and then oversaw Hutchison move into the energy business, a huge expansion of its port operations, and still found time shepherd its pioneering cellular telephone venture,* **Orange**, *into a global brand? Or to write a book?* **Legionnaire,** *a riveting diary of his adventures in the French Foreign Legion, was first published in 1978 and is about to be re-issued by a major U.S. publishing house.*

Simon set out again on his own, setting up Hong Kong-based **Simon Murray & Associates**, *and* ***GEMS*** [General Enterprise Management Services Ltd.], *its private equity investment arm in 1998, characteristically, just as virtually every other investor was fleeing Asia—and it's worked out just fine. I caught up with him last weekend, as he took a brief breather at his English country house.*

KMW

You've been in non-stop meetings, I gather, on at least three continents with potential investors in your new Asia fund?

Yes, well, I'm afraid the pace does tend to get a little frantic with the holidays approaching. But we've already raised about $130 million of the $300 million we're working towards. We have a little bit more time and I think we will get there. We have plenty of people we still have to see. But it is hard work, as it always is, to raise investment capital.

Let's start out, by making it clear—especially because I'm going to be using a photo of you in Antarctica—that you're not planning to sell igloos to Eskimos or anything of the sort—

Quite right. GEMS , the investment arm of my private equity group, is in the midst of raising what would be our third private equity fund to invest in China and the Asia Pacific Region. The last two were $255-260 million in size. Our timing on this one is good and bad. It depends how you look at it—good because there is a lot of interest now in what is happening in Asia, particularly China, India and, to some extent, Japan. But there also are *a lot* of people raising money just now, so the process is very competitive and not so straightforward as we might wish.

> **"Dealing in China has its own peculiarities and difficulties and its own particular color of quicksand. But in a sense, those risks are no different from those faced by someone in Europe who invests in the States without learning the rules and gets ripped off."**

What sorts of things will GEMS be doing with the capital you raise?

Well, we are in the growth capital sector. We have done a bit of buyout work, but that is not so easy in China—although, in Japan and Korea you can do buyouts. Anyway, with the growth capital we raise, we plan to take minority stakes in businesses with which we are familiar, and in companies we know well.

Only *minority* stakes?

A lot of people are relatively uncomfortable with minority stakes. But we feel relatively comfortable with the people we are dealing with. We are particularly comfortable that we know the businesses in which we invest—because if we don't know them and if we have not had personal experience in them, then they are *not* for us. We are only in industries with which we are familiar.

When you say, "growth capital," is that what we refer to here as venture capital?

No, it is an extension of standard equity capital rather than what I would call venture capital, which is start-up. The companies we invest in are already in business. They have a few years under their belts. They are usually profitable by the time we get there. But they need expansion capital for the next phase of their development. They could go to banks, if the banks are in a lending mood. Or, if they are big enough or ready enough, they could go to the capital markets themselves. But our niche is to fund them for two or three years before they are ready to go to the capital markets, then to ride with them into the capital markets. That's an important part of our eventual exit strategy, obviously.

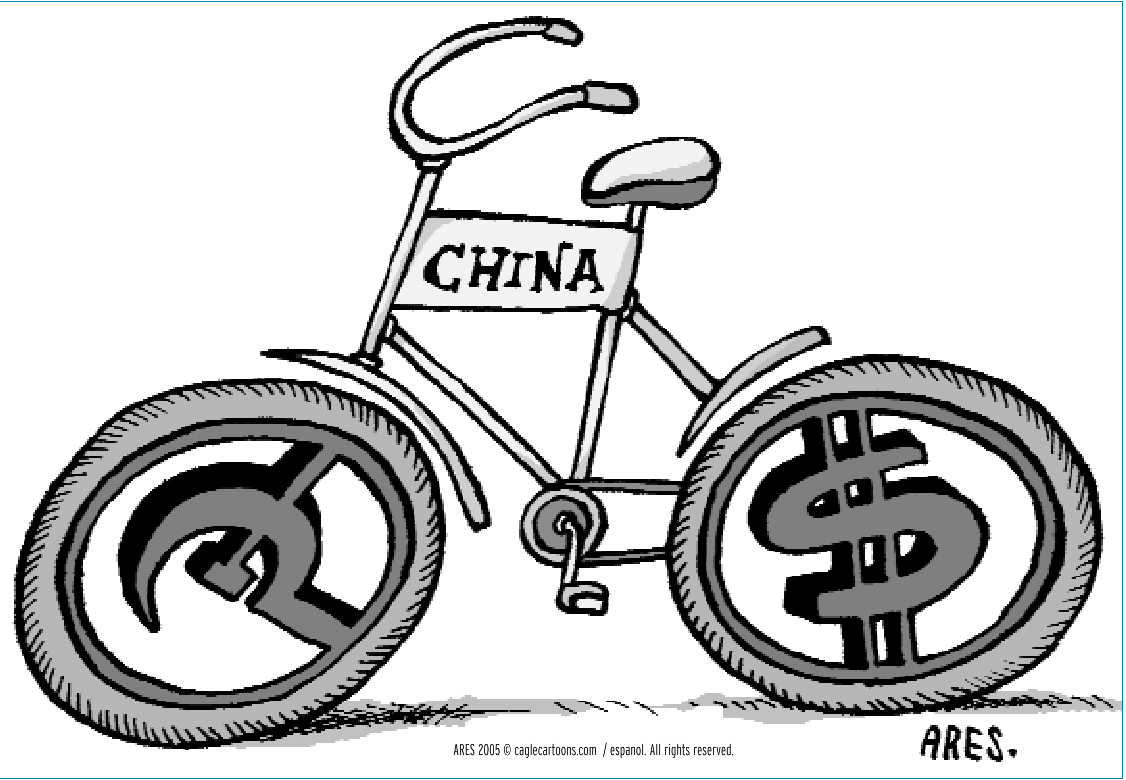
Are you meeting much resistance from potential investors worried that China is awash in excess capacity and being flooded with investment dollars?

There *is* a lot of money coming this way. To some extent, to a lot of people, it does look like too much money and not enough good deals. But we are fortunate in some ways. We have been here a long time. I have had the same team since we started GEMS in 1998. I have been in Asia for 40 years and most of my guys have been here for between 15 and 20 years, at a minimum. So we have a very good network. I also think that the kind of companies that we are looking for do not necessarily want to be approached to sell their businesses. They are not looking for someone to take control of their companies. But they are prepared to release some equity. They are prepared to take some dilution, but they want to keep their businesses. To that extent, we are welcomed, because we are not perceived as a threat to take over the business. Secondly, there is a perception that we understand their businesses and can bring operational experience to them.

You're not merely financial investors?

Scarcely. We were the first company to invest in **China National Offshore Oil Co.** (CNOC) before it went public. I got to know them long before that. I had become chairman of Husky Oil when Hutchison Whampoa acquired it. I knew CNOC's chairman. We played golf together, etc. There was a relationship, a realization that we had a mutual understanding of the business. They were looking for $450 million at that time. Although our fund, because of its size, was limited back then to putting only about $30-$35 million in any one deal, we were followed into the deal relatively quickly by some investors in our fund, who also invested directly in CNOC. For instance, **AIG** and Hutchison, which invest with us, both also invested directly in CNOC. We have had other experiences like that. Especially some of the biggest corporates who have invested with us, Mitsubishi, Mitsui, GE, etc., have really invested through GEMS because we are small, we are local. We move relatively fast. So they look for co-investment opportunities alongside us—and when we find something, they can bring considerably greater force, in financial terms, to bear on some of those opportunities. To some extent, that's why they join our party, to follow along.

Should I presume, then, that your earlier funds have generated plump returns?
Well, I wouldn't say we've done *famously*. Our second fund's performance, we feel very comfortable about, though it's relatively early to say so definitively. Especially because we lost probably a year in it because of the SARS epidemic. We were simply unable to travel. We couldn't go to China. People stopped moving. So some of our investments are still under two years old and we have not exited from them. But where we have made exits, so far we feel very comfortable on fund No. 2. With fund No. 1, we have so far paid back all of the original capital invested and we still have another year to run. But it's return is not going to be dramatically positive. We probably will end up with a 10% return on a per annum basis. That is not fantastic for a fund in the private equity business.



No. But when was that fund put to work?
Well, that's just it. Those funds were invested between 1998 and 2002, which was not the greatest period to be in Asia. So 10% per annum is actually extremely good by comparison with other Asian funds invested during 1998 to 2002. In fact, I would say that those were the worst four years we have had in Asia in the last 14. You are familiar with the Asian Collapse, if that is the right phrase?

I remember calling it the Asian Contagion.
As you know, I've lived in Asia for a long time. You could have sat in Hong Kong and watched Asia's GDP grow 8% per annum for 20 years, across the board. That is what we became familiar with. Then the great crash came in 1998, beginning with the collapse with the Thai bhat and then running rapidly through Korea–and the rest is history. Asia simply went out of business–largely because currencies were mismatched. Most of the debt was in eurodollars. The eurodollar was strengthening and Asian currencies were falling. They had massive debt. Interest rates were rising and everybody got into a huge amount of trouble. The crash in Asia was blamed on all sorts of causes: the arrival of China in the world market–and Russia, for that matter–in 1990, after which China began to siphon off a huge amount of Asia's traditional export business. At the same time, Japan began a nosedive south and stayed in that mode for probably 13-14 years. Japan is the engine room of Asia. I mean, the Japanese economy is two times greater than that of all of the rest of Asia put together– including China–so when Japan is not moving, the whole of Asia tends to go into sulk mode as well–and that was also happening in this period. So those were very bad years in Asia, not only for private equity boys but also for banks. Many foreign banks lost billions of dollars in Asia and, of course, the stock markets suffered dramatically, as well. Having said that, that period wasn't that great in the U.S., either–

Well, the first couple years of that span were pretty sweet for bubble investors here.
Sure, but from 1998-1999 to 2002-2003, the U.S. capital markets probably diminished in value by 50%. Everybody suffered, but it was particularly tough in Asia. Prior to that, we'd had volatility in Asia, but it was usually restricted to a particular country or a particular couple of countries. In this case, it was the whole of Asia. There was nobody above water, so to speak, at that time.

And there had been a tremendous foreign investment boom in Asia leading up to that crash–
A lot of it went into massive infrastructure projects and was accompanied by massive debt, usually with a currency mismatch. Those massive projects often had relatively slow paybacks, as well, so when things started to go south, it was very, very difficult to rustle up the cash to pay back debt. Then came the collapse, as you know. So we *are* pleased that we got all our money back for our investors in that fund, and it has, as I said, one more year to run. We have an IPO scheduled for the first quarter of next year, so we should finish up okay. But I am not asking for medals. Granted, on a relative basis, I suppose that fund will end up in the top 5% for performance over that stretch, but when that's because everybody else has done really poorly, not cause for a big hurrah. Preservation of capital when you run a small fund like mine is hugely important.

I'd argue it's important in a fund of any size.
True. But I think that if you have $15 billion in your fund and you drop a billion dollars in Asia. it's irritating, but it is not the end of the world. The big funds, of course, know that. I suspect that we'd be astounded if we knew how much some of these big global funds lost over the period that we are talking about–and not just in Asia, of course. All of them wandered into the tech sector. In the telephone sector *alone*, I read in the *Financial Times* that $3.5-to-$3.7 trillion was lost.

You bear some modest responsibility for the cellular revolution, do you not? I must say, in the U.S., the industry still leaves a lot

to be desired. My fourteen-year-old son erupted at the breakfast table when he caught sight of a cell phone ad, in the *FT*, showing a happy African tribesman chatting away. "How come *he* can get service, and I still can't use my cell phone in the middle of Maplewood, NJ?" Needless to say, he has no patience with explanations that involve counterproductive technical standards or community opposition to ugly cell towers.

That reminds me–years ago, when I was running Hutchison, I was very heavily criticized for the mobile telephone business, Orange, we had started in London. But an experience I had near Lahore, Pakistan, spurred me on. I was driving along in a Jeep, in a desert, when I saw in the distance a little cloud of dust. When I arrived there, it was a shepherd with a whole bunch of goats–who was standing there, using a mobile telephone. I found that encouraging. Actually, the growth of that business is amazing in places like rural China. A guy in the sticks in China will buy a mobile telephone before he will buy a car. He probably lives in a place where he will never, ever, in his life have the means to get to, say, Shanghai or Beijing. Which is where his children probably have gone, because about 20 million people leave the rural areas every year to go to the cities, looking for jobs. Yet with his mobile telephone, he will be able to speak to his son or daughter, even if he may actually never see them again. So the mobile telephone has become more important to some of these people in rural China and, indeed, in rural India, than a motor car or television or refrigerator–all of which used to be right at the top of the buying list. By contrast, in the U.S., some of the big telephone companies like **AT&T** were *very* slow to catch onto the mobile business. In fact, I wrote a letter to *The Times* [of London] about two months ago, when "poor, old AT&T" was being taken over. My letter recounted how I went to see AT&T in 1990 or '91. There were 16 people in that boardroom and I was trying to get them to buy into my then-little telephone company, Orange, in London. They looked down their noses at me and said, "We have not formulated our strategy (attitude) on mobile telephones." It was as though I was some guy with a couple of tin cans with a string between them. They just couldn't see mobile phones, nor could **BT** or **Deutsche Telecom** or **France Telecom** or any of the other big telephone companies, for that matter. They were in such dominant positions in the industry–making so much money charging filthy prices for international calls and all the rest of it–that there was very little competition. It was up to the **Vodaphone**s and so on to actually make mobile telephones happen.

Sure. The AT&Ts and BTs of the world had huge imbedded legacy costs—billions in outmoded assets—to protect.

They just did not see it, it wasn't going to happen, that was the end of it. Really, we have the same thing happening again today. We have things like voice over internet protocol [VOIP], coming along and yet the mobile telephone companies are not recognizing it–or just sort of hoping, "It is not going to happen."

Getting back to China, is that really the best destination for investment capital today, given the flood of money that's already flowing in that direction, not to mention little items like political risk and its lack of transparency?

You know, these days we are all global investors, whether in Mexican mortgages or Colombian this or Chinese that. And everything we do as investors is done on a comparative basis. Probably everything we do in life. We tend to lump the world into three or four regions. We have the United States, Europe, Asia. We have other lumps as well, but those are the three that people look at in broad terms. Well, today Europe, while it is a great place for buying cheap assets and it probably is a great place for M&A business, suffers from the perception that the Continent is sluggish, there is no growth, it is tied up in all sorts of social issues. Germany is sort of locked. There is no growth there. France has massive problems with its labor laws. You cannot fire anybody, therefore you won't hire anybody. If you take a country like Franc, where some 50% of the economy is owned by the government, that means, theoretically anyway, that 50% of the workforce works for the government. That is *not* an exciting environment that people want to invest in. Then you have the States with lots of question marks. Nobody bets *against* the U.S., the biggest market in the world, etc. But what does all this mean about oil prices? Where is the U.S. dollar going? What is the foreign policy of the United States, where is that going to lead it? What is happening in Iran? Is the Middle East going to go pop? Where are the Americans on North Korea? After all, if you invest in a country where you expect the currency to go south, that means when you put 10 bucks in, you may make a 30% return on the activity–but you may lose 25% on the currency. That makes it tough. I think there is more of a perception these days that the States is opaque, difficult to see. It's probably difficult for Americans to see, too. But it's certainly difficult for the outsider to see where this is all going to end up.

It's not easy for *this* American—

That's my point. By contrast, Asia simply looks good. You have China racing away, growing at 8.5-9%. You have India growing at 8.5-9%. You have Japan certainly back on track. It has its confidence back. It looks as though its motor is ticking back over again. If you take just what we'd call the middle class element of the populations of those three countries, China and India and Japan, that alone is a consumer market of 300 or 400 million people.

What are you calling middle class?

You probably have about 18%–20% of the Chinese population that we call middle-class consumers. They have mortgages; they have televisions and cars. They have telephones and so on. In India, maybe 20–25% of the population is in that category. So then, adding in Japan, one easily gets to a total of 300-400 million people in Asia's consumer market. And they like Armani and everything that goes with it. All you have to do is go to Shanghai to see that the shops are full of this stuff. Japan's population is around 130 million, and is certainly a mature population. But it's also a rich population, because they save so much money. And when they start spending, they *know how to spend*. So there is a lot of consumerism in Asia and it looks exciting. A lot of money is going in there because on a comparative basis, Europe and even the States, to some extent, look pretty dull.

The only problem is that it is a pretty well-known story at this point. Couldn't a contrarian find better values in, say, cheap European assets?

You *can* find cheap assets in Europe. But what you won't find are growth stories. That is what you are looking at in China and in India. That is what is pulling people along or pulling people in. Besides, while it is a well-known story, it gets better every day. You mentioned political risk. The difference between China 10 years ago, China 5 years ago, and China today, is immense. They now have thousands and thousands of lawyers, In fact, I happen to know that there are more qualified lawyers in China today than in the rest of the world put together. They have Ph.D.s coming out of their ears. They joined the World Trade Organization. After four or five years, that is starting to really help things along.

So it's gold rush time?

Don't get me wrong, they still have got a long way to go. There are difficulties and differences. China's priority is *stability.* And the key to stability, as they see it, is employment. Better keep the boys employed, that will keep them happy. Therefore they have to keep this money coming in, investments going, etc. Sometimes, in China's public sector, you can find that your agenda as a private equity investor turns out to be very different from the agenda of the guy sitting on the other side of the table–who is a representative of the state. It is very difficult dealing in that environment, especially compared with dealing with somebody in the private sector who has essentially the same desires as you. ("Let's get together and cut costs and make some money.") When you are dealing with the state, it is, "Let's get together and get 2.5 million people employed." That can lead to a lot of misunderstandings– and a lot of people have come back from China with empty pockets.

Not exactly a great pitch, coming from someone trying to gather growth capital to invest there. But there clearly *is* a certain tension to doing business in China, since you can't really assume the profit motive–

Well, what is clearcut, on the whole, in China is whether you are dealing with the private sector or with the government. One of the things we did at Hutchison a long time ago was buy the container port in Shanghai. It was quite clear who we were dealing with then –and it was a very difficult negotiation. One of the things they said early on was that I would not be allowed to fire anybody and that I'd employ 750,000 people–which made the negotiations slightly sluggish at the front end. We had to get around those sorts of things before we could move forward. You are absolutely right, there is a lot of grey. What I am saying is that it is getting better– better every day. But it certainly isn't perfect. Dealing in China has its own peculiarities and difficulties and its own particular color of quicksand. But in a sense, those risks are no different from those faced by someone in Europe who invests in the States without learning the rules and gets ripped off. The whole world has been revealed as a pretty unsafe sort of place. Where were Enron and Worldcom invented, after all? Nonetheless, in Asia, a man with experience, a man who is cautious, it going to be safer. Still, where there were only a handful of accountants there a decade ago, today there are thousands of foreign accountants in China. There are hundreds of investment bankers there, hundreds of foreign lawyers.

Suddenly you're describing some sort of hell–

I hear you! Seriously, though, what all those professionals *can* do is make your journey safer. Most of the money that we have made in China has been in commodities. We had a *very* good run in forestry, where we've now sold our business. But that brings to mind an interesting peculiarity of China. The forestry company was not allowed to buy land because we were a foreign entity. We also were not allowed to rent the land. So we worked out a deal with the minister of forestry and with the local partners whereby they *gave* us the land for a period of 50 years, *gave* it–g-a-v-e it. In return for which we *gave* them, or agreed to give them, 30% of the trees when we cut them. This arrangement worked extremely well. We had 800,000 hectares of land on which we grew tress. I think we planted 550 million trees. That business was very profitable and did extremely well. We have exited it. It is now a public company, floated on the Canadian stock market. We did the national steel company, NatSteel, in Singapore, a buyout. All of its steel was going to China and we eventually sold the company to the Tata Group in India. We had aluminum on the eastern boarder with Russia, which we've sold, but that metal was also going to China. We were invested in the oil business, as I mentioned, via China National Offshore Oil Co., CNOC. China was guzzling all that oil and still is. So we've fared very well in the commodity sector in China. Subsequently, we have invested in the consumer sector by buying into a company building supermarkets, which is a good place to be in China today. It's amazing to see all these Chinese rushing around supermarkets buying things like *Head & Shoulders* shampoo and all kinds of other western goods. But that is the way of the world; that is the way it is today in China.

You're talking about China's major cities, I assume, when you talk about all this consumerism.

Yes. But the city sector is very important for China. Where a lot of people in the West go wrong is they think that China is a massive sweatshop. So, therefore what one should be doing is buying into slave labor camps in China where you've got 3-4 million people making widgets at one-tenth the price that those widgets are made in Europe or the States. They assume that has got to be a success. But that is where you run into all these problems of mandatory labor employment and so on. You *think* you are going to go over there, cut costs, fire half the staff, put in some new machinery and everything is going to be terrific–but that is where it often goes wrong.

There's quite a debate in this country about whether China harbors threatening global ambitions. The extreme right has even accused your former employer of fronting for Beijing.

Yes, Yes. This is a very difficult issue because America is so split on it. And because China is also split on it. China is half and half. China has an equivalent right wing who thinks that *they* should be tougher. "We want to take Taiwan, why are we being stopped from doing this by the U.S.? To hell with them, we have got to make our own way" and so on. But the other half of China is saying, "No, we have to be amenable and responsible and participate in these talks with Northern Korea. We have got to play our role. The Americans are actually the people that we should be forming a relationship with. They are buying all of our stuff–40% of our exports are textiles and they go to America. America is upset with that, so we should respond by finding ways to take the pressure off the States– either increase our prices or do something with our currency." So there's a real split of opinion in China, just as there is in the U.S., where you have one side arguing, "We're breeding a rival to be rich and strong which is ultimately going to be difficult," while the other is saying, "No, in China's history, there is no indication at all of serious territorial ambition. They have had a few border scraps with India, they have had some with Russia. They have had their ups and downs over offshore oil fields with the Japanese. But the history of China is *not* one of vigorous expansion, territorial or otherwise, even in the periods when they were pretty wealthy"– and I am going back a *long* way when I say that.

Exactly. That's truly ancient history. What about *today*?

My view is that I would prefer to see the better side of China. I think they are moving in the right direction. I went there first in 1970, when they all wore the same suits, buttoned up to the neck, and they were either blue or brown. Everyone was on a bicycle. Even in 1980, there were only four private cars in all of China. But in 1970, it was the *most horrible* place. It was absolutely depressing, everybody *looked* depressed. I remember going along one day with a Chinese guy and there was a man selling peanuts along the side of the road. It was winter and it was *cold*. I said, "There you are, at least there is a little bit of capitalist free enterprise." But he said, "No, he works for the state."

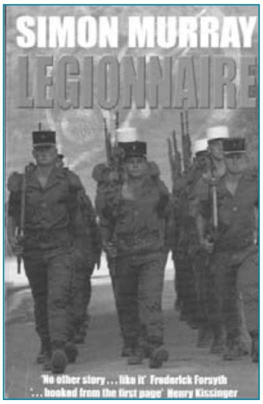
Unreal. We forget already–

There he was, this poor bloke, selling peanuts for the state. So when I compare how it was then to China today, it is simply another planet. Granted, I am going back a long way. But you don't have to. Even 10 years ago, in Shanghai, lots of soulless buildings were being built with a lot of the money coming from overseas Chinese, sucking up like hell to Deng Xiaoping. They were pouring money in for all the wrong reasons. They were investing just to be *seen* to be there, so that when Hong

Kong eventually went back to China, the party would would be good to them. Today, Shanghai is absolutely swinging. I was there a few months ago for the Grand Prix. There were about 300,000 people there, screaming their heads off as as the cars were whizzing past. If you go into Shanghai, the restaurants are spilling onto the streets, there is *al fresco* dining, disco music at every bar, the girls wear Armani skirts and things like that. There's a feeling of vibrance and goodwill and everybody is feeling better. Now, I don't think that you can slip back into the old ways from there– even if it is only 20% of the population that is now in the cities. Nor do they. But the state is making damn sure that they don't go too far the other way, either. So this is a slowly, slowly, inch-by-inch progression into a better way, more pluralism. Dare I say it? into more freedoms. Clearly, it is not as fast as many people in the States would like. But China is going in the right direction.

Isn't one of China's big problems the vast gulf between the economic miracle of its cities and the unimaginable deprivations in its enormous backwaters?

Of course. I recognize that it is a different story in the rural areas–



China's leaders must have nightmares about what it could do to the stability they prize so highly.

Yes, and I expect China is going to have its difficulties. I don't know if it will conflate into a Berlin Wall or into a repeat of Tiananmen Square. But it is very difficult to give people every day a little bit more–especially people who have, in the rural areas, next to nothing–without them one day getting a little bit too much momentum. Then they suddenly want it all in one day and they'll come spilling over the wall–and that is not so easy. That is a big difference between China and India. Although to this extent they have similar characteristics: 25% of India is middle class, 75% prays for rain every day. So the haves and have-nots are greatly divided in India, as well as in China. But India is a democracy and every five years or so they let off a lot of steam. The pressure cooker has a release valve. They change the government and they feel good for having thrown out the existing players. China has *no* release valve. There is no way they can get rid of this or that. They live under a very firm, dominating and, to the way we see things, unfair government hand, that is far less visible to the rest of the world than it is out in the sticks. Every so often you get scraps of information: at some factory that employed three hundred people, there has been a riot because the workers haven't been paid for six months. They go on a rampage. The army goes in and zaps everybody and 25 people are killed. Or all the workers end up in jail. When you read about that, you get scared all over again. But it was 10 times worse, even 10 years ago.

So give thanks for not being born a Chinese peasant?

Yes, well, there *is* a transformation going on, but it's a progression, and the pace is very unsatisfactory for a lot of people. Still, my own view is that we should not alienate China, we should try to embrace China and work with them. When I saw CNOC trying to buy Unocal–

You weren't surprised that it was rebuffed, were you?

Well, the reaction was a little bit clumsy, in the sense that CNOC's bid was rejected for probably the wrong reason. I mean, if America is the great bastion of free markets, what was its rejection of CNOC's bid telling the Chinese? That was the sort of reaction you'd expect in France or Germany, but not in the States. I mean, the Germans come over and buy all the banks in London, but as soon as we go to buy one of their banks, they freak out. I think that we are going to see more bids by the Chinese. They have $700 billion in reserves. They are making money in terms of their current account; their exports are going well. They will most likely be like the Japanese years ago; they are going to start buying some brand names.

Why *brand* names, when they have such a voracious need for commodities of every stripe?

They need everything. But you saw **Lenova** buying up the **IBM** laptop business not long ago. I think we will see the Chinese buying all sorts of things that they can introduce into the Chinese consumer market and make money on. Western brand names are exceedingly valuable in China, because they don't have any brands. I remember many years ago, while CEO at Hutchison, I was in a joint venture with **Procter & Gamble**. We put up a factory in China to make Procter & Gamble's *Head & Shoulders* shampoo. If I remember, the cost of the enterprise was about $100 million, mostly equity, and Hutchison put in $30 million. Well, 10 years later, Procter & Gamble bought Hutchison out for a total of about $2.5-$2.8 billion. Now, you know P&G would only do that if things were going well. The Chinese go *nuts* for western and American brand names. And the one thing about China that *is* different from the rest of the world (apart from India) is volume.

Don't tell me, it's potentially "enormous."

You don't really understand, none of us *really* understands, how big that market is, until we see it motoring in China. Once we get to that point, it is simply incredible. I know, for years, we have all said, "Well, if you just sell one *Mars* bar to every person in China, you'll sell a billion *Mars* bars and won't that be terrific." But until you actually deal in China, you don't really get the feel of that. I mean, look at things like mobile telephones in China compared to the rest of the world, it is simply extraordinary what goes on there. It is so huge, it is so dynamic. We have never seen anything in our lives like the growth, particularly in consumerism, that we see in China today. It's mind-blowing. Then, on top of that you have to add in India and Japan, so you have a consumer market in Asia that is beyond mind-blowing. I remember looking at some figures on vodka consumption some years ago. I was told that the consumption of vodka in the West was 150 million cases a year, which seemed to me like a huge amount of vodka. Then I was told the Russians drank twice as much as the rest of the world put together. So there was a truly huge amount of vodka being consumed in Russia. But when you go to China, if anything at all is being consumed by the boys, the numbers easily shoot to three or four times that. I am not talking just about vodka. I am talking about *anything* that catches on in China–boy, it goes. So if you get a good brand name–it doesn't have to be an American brand name, any Western brand name that can really motor–into China, ooh, you can make *a lot* of money. It's exciting.

Which is why your third fund will be looking to invest in the smallish Chinese companies that tend to partner with Western companies to make that sort of thing happen?

Yes, we tend to look at companies that have an enterprise value of $100 million to, say, $500 million. They may be looking, at a particular moment in time, for anything from $60 million to $400 million in growth capital. Clearly, if it's a $400 million ticket, we will participate instead of providing the entire tranche. In the CNOC deal I referred to earlier, they were looking for $450 million, so we participated.

How do you come up with enterprise values for the Chinese companies you invest in? There still aren't vibrant capital mar-

kets there to provide any reality checks on valuations.
Well, the private sector in China is growing very rapidly and is probably much larger than it was perceived to be even a few years ago. Even though China favors the public sector–state-run companies get preferential treatment when it comes to listing on the stock market and so on–

One of the reasons Chinese-listed stocks have been such dogs.
Yes. There's a huge overhang of shares, because the state owns 50% of these companies and sells shares whatever it feels like it, whenever it needs more cash, etc. All this means that to do valuations, you have to do your homework, you have to do your due diligence. Just like you do in the States, you look at multiples of EBITDA. You buy on multiples. We look at the balance sheets, we look at the assets of the companies. We look at the sector. Is a company in a sector that is growing, or is it not? So the valuation is not that different in terms of the approach than we would use in the States or Europe. What *is* different is that you *do* have to do a *huge* amount of due diligence in China. And nonetheless very often, you simply do not have the supporting documentation that you would expect to find in a western company. Very often, too, you *can* be given information that is indeed untrue.

What fun!
That's not-so-different than anywhere else, really. You can go talk to Bernie Ebbers about that!

Point taken. But aren't you really implying that if you don't speak Chinese, or haven't been networking across Asia for the last 40 years, you'd be a fool to rush in?
No, I don't think I am saying that. But I am saying that you were absolutely right when you said at the outset that China is a risky place for investors. None of us is *that* familiar with the place, though we get more and more familiar every day. So we are all liable to being taken. You are on foreign ground. I don't *live* in China–well, I do live in Hong Kong–but we are still exploring China in many ways.

As a Hong Kong's business leader, you played a very prominent role in orchestrating the former British colony's peaceful return to China. What's your take on the city now? I've heard it's spiraling into decline.
Hong Kong is going through a difficult phase. It has slightly lost its definition. There doesn't seem to be a *strategy* for what happens next. I think it is more about *hope*. They have great relationships in China, there is a lot of wealth in Hong Kong, which is moving into China. But I think they also are in denial about certain things. For years, Hong Kong sold itself as *the* gateway to China. "If you want to live in China, you had better come to us first because we are the guys who know." But, in fact, they are *not* the guys who know. They've made lots of mistakes up in China as well. I think that Hong Kong has to recognize that Shanghai and other cities in China are going to grow and develop, whether people in Hong Kong like it or not. Today, when you stand in central Hong Kong and look up at the sky, you see planes flying over that are *not* landing in Hong Kong. They are going straight to Shanghai or Beijing or other big towns in China. And there are many. So where does all this leave Hong Kong? I used to think that the best way forward for it would be to become the Zurich of Asia, the financial center, where people would want to keep their money, because of its tax laws and legal structures and all that stuff. But Hong Kong has slipped a little on that score and a great deal of the banking cache, if you will, has gone to Singapore.

Leaving Hong Kong with—not much?
Well, Hong Kong still has a great port. But there are lots of great ports being built in China every day. Some of them are being built by the people of Hong Kong. Meanwhile, as a banking center, Hong Kong isn't quite the bastion of free enterprise that it was before–there are some grey areas. Yes, Hong Kong is a great place to be, most of all, I think, it is a bazaar, a marketplace–which Singapore is not. But its definition is not clear, and it is being kept up–property prices are strong and so on–by mainland Chinese with money who are coming in and buying. The question is what happens next? What is the engine room of Hong Kong is not clear to me anymore, and not clear to many. Hong Kong is floundering around a bit.

In sharp contrast to most other cities in the region.
Yes, well they all have their own national identities, whether they are in Thailand, Korea, Singapore, Malaysia. But Hong Kong, while it *is* part of China now, is sort of half in, half out. This "one country, two systems" business is all a bit vague.

More a marketing slogan than a strategy?
Well, it sounded great at the time. Although it didn't draw the Taiwanese in, as it was meant to, it did bring Macau in. And Macau is flourishing. It is at least as big as Las Vegas. And growing so fast.

Proving the Chinese love to gamble.
Yes, well, the Las Vegas boys are in there. I mean it has turned into a pretty horrible place. It used to be lovely, quiet. Now it is an absolutely dreadful, awful place. Gambling brings lots of things with it, apart from money. You only need to go there if you're manic about one-armed bandits. But at least it is making money hand over fist and knows exactly what it is doing. Macau is the biggest casino in the world and it is China's casino–because there are *no* other casinos anywhere in China.

You expect Macau to *keep* that monopoly, considering how much the Chinese traditionally loved to gamble?
Well, they love gambling but they also are *very* conscious of–how should I say it?–what gambling can do to poor people. It can make poverty 10 times worse. So if you were to decide, "I would like to build a casino in Shanghai," the answer would be, "No." If you then asked, "Well, when do you think we can do that?" This is what you'd hear: "Call again in 30 years' time." Yet Macau is part of China and they are gambling there, so what is the difference? It really is "One country, two systems." That is their response.

You mentioned earlier that you think Japan is finally emerging from its long economic funk?
What finally has happened is that they have taken a lot of the debt off of the corporations and pushed that over to the government. The Japanese government now has debt of 135% of GDP or so. But corporate balance sheets are clean and the companies are feeling better about themselves. Most importantly, they have their confidence back. When that happens, people start making investments again and the music begins again. That is what is happening in Japan. They are putting money back into the system. Of course, Japan was dying from a deflation, rather than inflation, and we know about that–1929 was all about deflation. Nothing was happening. It was just on freeze. Now it is thawing. You feel good when you visit there again. The restaurants are full again. And confidence does wonders for stock markets.

Amen.
It also changes ratings, perceptions of future value. You know, if you make $100 a year and you are increasing your profits 10% per annum, yes, it is very nice. But if you are rated at a multiple of 10 times earnings and the following day you are re-rated to 15 times earnings, well, the

value of your company goes up 50% with the stroke of a pen. That's better than nice, it's exciting. And that's what we are beginning to see again in Japan. They are getting their P/E ratios back up again. So we should see the Japanese stock market continue to appreciate, which will get everybody up and running. Of course, there are still issues with insurance companies and banks, which are not out of the woods yet. But you have to remember that they are functioning in an environment of interest rates at 0- to-1%- 2% that enables people to get out of bed and start moving again.

I have to ask, before signing off, how did you end up going off to Asia after doing your grueling tour in the French Foreign Legion?

I got to Asia in 1966. I joined Jardine Matheson, the old British trading company, in Hong Kong. I didn't have any degrees or anything, but here's what happened: A week after I came out of the Foreign Legion, an uncle who was in the Foreign Office threw a cocktail party for me. It happened that he had a very great friend who was a managing director of Jardine Matheson in Southeast Asia. As I was being introduced to him, my cousin came up to me and gave me a brown paper parcel. I opened it up and inside was a shirt and pair of pants, a pair of socks and a handkerchief. He said, "This came back from the laundry after you left for the Legion and I have been keeping it for you for five years." So I said, "That is fantastic, because actually it is all I have, apart from the suit that I am wearing." Well, my uncle's friend from Jardine Matheson was hugely impressed that anyone could have so little. We had a long talk and got on extremely well. So he said, "If you are ever out in Asia, come see me." A year later, after I got some money together, I took a trip to Asia and stayed with him. After about a week, he said, "You should be out here, working with us." Then he signed me on.

Presumably not, right away, as a top executive?

Hardly. But they did have a habit of throwing you right into the deep water. They moved me to Thailand. I became the head of the industrial sales department there on Day 1. It was one salesman and me. I was selling lavatories at one end of town and selling steel from Broken Hill Proprietary in Australia at the other. I was selling selling nuts and bolts from the UK. I was selling asbestos, if you can imagine that, from Canada. I had a wonderful time. The Vietnam War was on and America was using Thailand as a base, so I ended up supplying steel-framed buildings from an American company to the U.S. forces to build their air bases. I was also supplying them with just about everything you can think of, from weighing machines to gas turbines to whatever. Then I went back up to Hong Kong and Jardine said to me, you have an engineering background (just because I *once* worked for eight months in an iron foundry in Manchester when I was 18). Anyway, I ended up running Jardine's engineering business, which was pretty substantial in Hong Kong–lifts and air conditioning–for a few years. I eventually left Jardine to start my own business. While at Jardine I had worked very extensively with the Japanese as their agent for power generation equipment, and had a terrific relationship with them. So when I went out on my own, Mitsubishi gave me $2 million as a retainer–I was to be an advisor for 8 years–which was a terrific start. Then I got N.M Rothchilds involved as a partner and we started pursuing capital intensive engineering projects around the region. We had a very good run, but I could see, when the price of oil ran up in the early 1970s, that the power stations in the region, which were then burning oil, were going to have to switch to coal when they built their next generation of plants. So I got into the coal business. I was bringing coal from South Africa to Hong Kong. I had a wonderful coal trading business. Then in 1984, I sold the whole thing to Hutchison Whampoa because Li–Li Ka-shing, who owns it–wanted me to come run Hutchison. I stayed there for about 10 years.

It must be strange, considering that 40-plus years ago you were in Algeria with the French Foreign Legion trying to put down an Arab revolt, to see Paris 'burbs being torched by Arab youths–

Yes, the riots in France have to do with social problems that started then–if not earlier. You have to remember that the French had this concept–which was clever but inaccurate–that their colonies were part of metropolitan France. So they didn't call them colonies. And as residents of "metropolitan France," the people of Algeria were entitled to live in France and go to French schools and so on–and many did. In return, they had to do their national service in the French army. So when I was in Algeria we were fighting the *fellagha*, rebels who wanted Algerian independence. But alongside us, we had Algerian forces wearing French uniforms. They were wonderful soldiers. Well, after the final French vessel left Algeria in 1967, it's believed that the Algerians killed 130,000 of the loyalists they left behind for collaboration with the French. The French like to create the impression that they were wonderful to all their colonies but actually they were anything but. They are extremely racist–though they deny it. I remember driving through Marseilles one evening 10 years ago and seeing all these fires burning with crowds of Algerian refugees sitting around them trying to keep warm. They were living in the streets. So what is happening now has been waiting to happen for a long time. In my view, it has *nothing* to do with terrorism. It is purely coincidence that its timing seems to be connected to it. But the terrorists, if they have any sense, will use this unrest as an excellent cover to make mischief.

Enough said. Thanks, Simon.