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Publisher's Note

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Preface

While many books exist on the subject of merchant banking, or investment banking as it is known in the US tradition, there are few publications which specifically address the subject in the Hong Kong context. We believe that it is of value both to outside professionals coming to work in this market, and to local students of banking and finance, to have a book which explains in detail the major merchant banking products in the Hong Kong context. In writing this book we have attempted to provide a thorough analysis of the main products as well as giving the full flavour of their development locally.

The information provided in this book comes mainly from published sources, but many of them are specialised publications and government reports which most readers would have neither the time nor the inclination to explore. Much information has also been provided by those active in the markets and without the generous help of such colleagues and friends the book would not have been possible.

The staff of the HKMA were particularly generous in sparing time for meetings and in providing facts and figures. We are indebted to Ms Priscilla Chiu, Ms Grace WK Lau, Mr Kevin Woo, Mr Danny SY Leung, Mr Fred Lau and Mr KF Li for their invaluable input. At the Stock Exchange of Hong Kong we would like to thank Mr Robin Barrie for his help. At the SFC we received valuable input from Mr Bill Weeks and Mr Richard Yin. At the HKFE we are most grateful to Ms Susan Lai for her help. At the MTRC we would like to express our thanks to Mr Jimmy Lau for his input.

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Finally, we would like to thank our long suffering spouses for their patience and help.

Authors' Note

Given the transfer of Hong Kong to Chinese sovereignty, which took place between the writing of the text and its publication, it seems appropriate to reflect briefly on the effect of this historic event on the local merchant banking market.

There are two themes which emerge from any discussion of the Hong Kong markets since the June 1997 handover. The first is relief that the event is now behind us and that the speculation over what will happen can be replaced by active pursuit of business. The second theme is the strong 'China Fever' which has gripped the markets since the months leading up to the handover.

In both the bond and syndicated loan markets the first of these two themes has been very much in evidence. The syndicated loan market saw many new and ever larger transactions over 1997. However, it was the local bond market, which was rather dull in 1996, that produced the most spectacular issues in 1997. In late July, Hutchison Whampoa launched a \$1 billion Hong Kong Dollar bond issue which doubled in size to \$2 billion before closing, making it the biggest ever fixed rate bond in the local market. This issue toppled the 'biggest ever' title of less than 3 months which had been established by the \$1.5 billion bond for the US Government backed mortgage corporation, Fannie Mae, in May. August also saw the biggest ever asset backed security transaction in Asia with the launch of a floating rate US\$500 million transaction for a single project, Hong Kong's Citibank Plaza.

It was not the transfer of power, but rather the currency crisis in Southeast Asia over the summer of 1997, which threatened to disturb the local debt markets. By the time of going to print it appeared probable that investor fears related to those events would be the only immediate cloud on the horizon for these markets.

In the ever dominant Hong Kong equity market it was the second of the two themes, 'China Fever', which was most in evidence. The raging bull market of 1996–1997 pushed the Hang Seng Index up 55% from 10,700 in August 1996 to 16,673 in August 1997. However, very much more dramatic was the boom in Chinese related shares. The Hang Seng China Enterprise Index increased a heady 126% over the same period from 760 in August 1996 to 1,722 in August 1997. While the average price/earnings ratios (a measure of the relative expensiveness) of Hong Kong shares in general stood at 18 times in August 1997, that of the China Enterprises stood at 30 times. At the same time, indicators of general interest in the stock markets such as subscription levels for IPOs became increasingly unreal. The dubious

distinction of all time record for oversubscriptions in an IPO in Hong Kong was gained by Beijing Enterprises with an oversubscription rate of 1,276. This issue tied up \$250 billion dollars, or the equivalent of half Hong Kong's foreign exchange reserves.

The derivatives market also followed the China theme with the introduction on the HKFE in September of the first Red Chip Futures contracts on the new Red-Chip Index. After one month the HKFE was proclaiming the dramatic success of this instrument, although at the time of going to print it may still be too early to give a definitive judgement on the subject.

The bucket of cold water which was tipped over the market ten years to the week from the date of the stock market closure in October 1987 reduced the value of the Hang Seng Index by 40% from its August high. This 'price correction' may have been considered overdue by many market analysts. However, it was apparently triggered not by concerns over Hong Kong itself but as a result of the regional sweep of collapsing markets. The truly global nature of all major stock markets, including Hong Kong, was illustrated again in October 1997 when the New York market saw its biggest one day drop since 1987, apparently as a direct result of the Hong Kong fall. There were two important differences from the collapse a decade earlier. Firstly, the contagion was moving in the opposite direction this time, from Hong Kong to New York. The second was that the Hong Kong market appeared to handle the dramatic drop in values with barely a hiccup in 1997, contrasting so dramatically with 1987. This is perhaps the greatest testament to the Hong Kong market having come of age.

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HONG KONG
NOVEMBER 1997

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