

# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES

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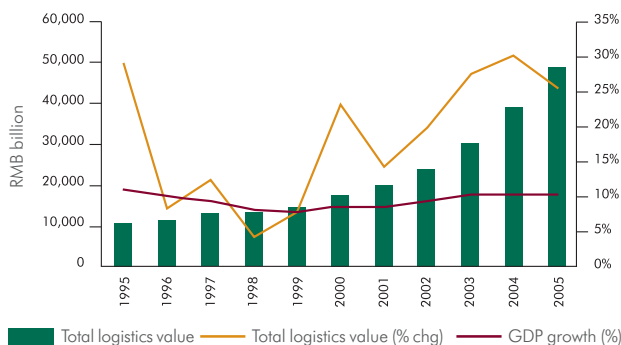
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With over a decade of rapid growth in the national economy as a result of its reform and opening-drive, China has emerged as one of the world's most favoured investment destinations and has become a global manufacturing centre as well. Robust domestic economic conditions, the entrenchment of globalization and outsourcing trends and the buoyancy in inter- and intra-regional trade flows have underpinned strong demand for logistics services and fuelled the phenomenal expansion of China's logistics industry in recent years. For much of the past decade, the pace of expansion in China's logistics industry has exceeded that of national GDP growth. While the domestic logistics industry is still in a nascent stage of development, given the country's vast geography of 9.6 million sq km - the world's third-largest country - and the largely supportive policy environment, China still provides considerable untapped potential market for logistics operators and real estate investors.

In tandem with the rapid market expansion, revenue generated by logistics services is also surging, amounting to an industry total of RMB 1.879 trillion in 2005, an increase of 12.7% y-o-y. Breakdown of the revenue structure reveals that transportation continues to account for the largest share, or 84.7% of the industry's total income. However, the growth rate of this component, at 10.5%, is amongst the slowest of all revenue components and lags behind other higher value-added services such as packaging (29.9%), information and related services (28%) and distribution (28%). Meanwhile, revenue from the provision of inventory storage services, the second largest income source, witnessed an increase of 26.7% from a year earlier.

## CHINA'S GROWING ATTRACTIVENESS TO GLOBAL LOGISTICS FIRMS AND CERTAIN KEY MARKET CHARACTERISTICS

China Logistics Market on Fast Track

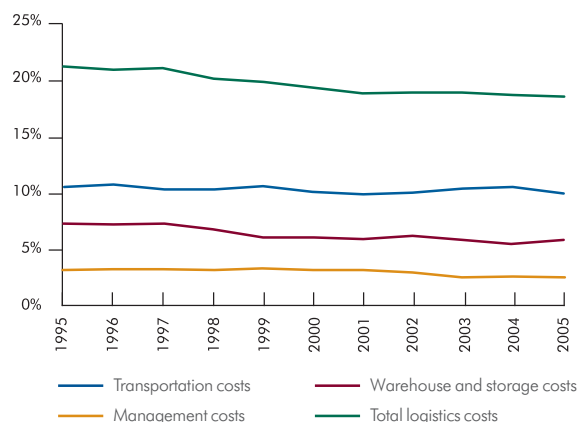


Source: China Federation of Logistics and Purchasing

**Persistent rapid industry growth:** China's logistics industry continues to witness a very high annual rate of increase, registering 23% CAGR in total logistics value for the period 2000-2005, more than double the pace of expansion of the overall economy, which grew by 9.4% annually, on average, within the same time frame.

In 2005, despite the imposition of macro-economic control measures to cool off the economy, China's logistics market continued to move along a firm upward trajectory, forging ahead by 25.2% over the previous year to reach RMB 48.058 trillion, 4.7 times the total logistics value a decade ago, in 1995.

## Declining Logistics Costs in China (% of GDP)



Source: China Federation of Logistics and Purchasing

## Fragmented market structure with great consolidation potential:

One commonly cited characteristic regarding China's logistics industry is its relatively high cost structure (including cost items such as transport costs, warehousing and storage, management costs, packaging, processing and distribution costs, loss and damage costs, and interest costs incurred in carrying out the logistics activities), which accounted for 18.6% of China's GDP as of 2005. Although exhibiting a mild declining trend from 21.2% in 1995, this figure nevertheless is considerably higher



# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES

compared to the corresponding ratio (approximately 10%) in developed economies such as Japan and the United States. This is primarily attributed to the backward logistics infrastructure and fragmented nature of the industry in China, which comprises a large number of small and medium-sized, regional logistics service providers which are inefficiently managed, have relatively low technology content and provide low quality service. There are approximately 730,000 logistics enterprises operating in the country, the majority of which are traditional companies providing only transportation services<sup>1</sup>. Expenditure on logistics in general is relatively high in China as compared with other countries, with a logistics user survey conducted in 2005 by the China Supply Chain Council revealing that the logistics costs of finished products is around 11%, while some industry professionals reportedly put the figure as high as 20-25%.

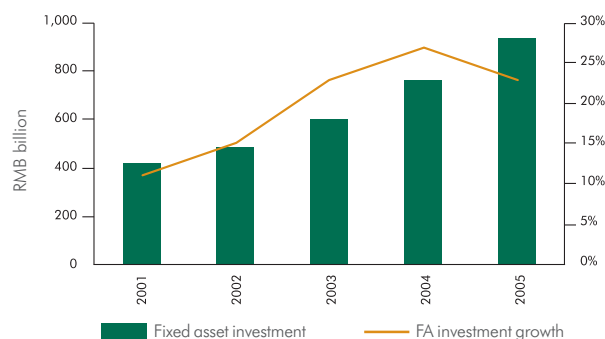
As a result, although there is sizeable potential for the development of China's logistics industry, its present fragmented and inefficient structure means that future growth is likely to occur in tandem with a broad move towards consolidation, spurred by the increasing penetration of international logistics companies with professional services.

**Robust economy and buoyant international trade:** Booming merchandise trade coupled with robust conditions in the domestic manufacturing sector are the twin forces driving the rapid expansion of China's logistics business. Last year, China's economy grew 10.2%, to RMB 18.3 trillion, marking the fourth consecutive year with GDP growth of over 9%. The economy continued to maintain its strong momentum in the first half of 2006, posting 10.9% growth, buoyed by strong investment growth and the vigour of China's export sector.

In 2005, China's external trade reached US\$1.422 trillion - comprising US\$ 660.1 billion in imports and US\$ 762 billion in exports - the third largest volume of any country in the world, and surging by 23.2% over the previous year. Chinese exports rose 25.2% in the first six months of this year whilst the country's imports grew by 21.3%.

In the Eleventh Five-year Plan (2006-2010), the Chinese government targets 7.5% annual GDP growth, as compared to the 9.5% realized in the Tenth Five-year Plan period. Though somewhat conservative, the steady economic growth should help to sustain the continued influx of foreign investments and underpin the rising trend of retail sales, hence continuing to fuel demand for imports. At the same time, China's foreign trade, which has consistently grown at a faster rate than GDP after its accession to WTO membership in 2001, ranging from 20-37% in the past four years, is expected to continue to follow a rising trend over the short-to-mid term, supported by a generally positive economy.

## Fixed Asset Investments Related to Logistics During the Tenth Five-Year Plan Period



Source: China Federation of Logistics and Purchasing

**Improved logistics infrastructure:** According to statistics from the China Federation of Logistics and Purchasing (CFLP), total fixed asset investments relating to the logistics sector rose 22.8% in 2005, reaching RMB 929.3 billion. This comprises mainly capital investments in transportation, which amounted to RMB 775 billion and represented an increase of 22.6% from the previous year. Meanwhile, warehousing and storage has attracted relatively smaller interest, accounting for RMB 35.6 billion in investment value, an increase of 4.4% y-o-y.

Surging investments in the transport and logistics infrastructure - which grew by an annual rate of 19.8% in the Tenth Five-year Plan period (2001-2005) - contributed positively to ease the pressure brought to bear on the traffic system by rising logistics demand, while also helping to improve the efficiency of logistics operations by resolving some transportation "bottleneck" problems and reducing logistics costs (transportation accounts for 55% of total logistics cost as of 2005). The actual progress achieved in the construction of various basic types of transport infrastructure in China in the Tenth Five-year Plan period is summarized in the following table:

## Length of Transport Routes in China

Unit:km	Railways	Roads	Inland	
			Waterways	Pipelines
2001	70,100	1,698,000	121,500	27,600
2002	71,900	1,765,000	121,600	29,800
2003	73,000	1,809,800	124,000	32,600
2004	74,400	1,870,700	123,300	38,200
2005	75,000	1,930,500	123,300	40,000(est)

Source: Report of China Logistics Development 2006, China Machine Press; 2005 Statistical Communique on the Road and Water Transport Industry Development, Ministry of Communications of the People's Republic of China

In 2005, the freight volume handled by all means of transportation reached 18.37 billion tonnes, up 7.7% over the previous year. Road transport remains the dominant mode of freight forwarding in China. The freight volume transported by road was 13.29 billion tons, up 6.7% y-o-y. This must be viewed against the backdrop of a continued high level of investment in road construction, which amounted to RMB 548.5 billion in 2005, bringing the total length of roads in China to 1.93 million km. Of this total, the length of highway routes in operation in China now amounts to some 41,005 km, an increase of 19.6% y-o-y and the second longest system in the world, supporting the steady growth in domestic freight traffic. Meanwhile, freight transport by water, civil aviation and pipeline all witnessed rapid increases, with near or above double-digit growth in both freight volume and freight turnover. China's port industry has experienced significant development in recent years, supported by the buoyant conditions in foreign trade and improvement in freight

handling capacity, along with the completion of many new terminals with large-sized, specialized berths and deep-water routes. Based on statistics released by the Ministry of Communications (MOC), the volume of ports' throughput in China totaled 4.85 billion tons in 2005, up 16.4% and 120% over the previous year and 2000, respectively.

With respect to container operations, the total throughput handled in China's ports grew 22.8% in 2005. Between 2000 to 2005, container throughput in China's ports increased from 22.63 million TEUs to 75.64 million TEUs, representing a CAGR of 27.3%. China's container industry is expected to continue to develop rapidly, handling throughput of over 100 million TEUs in 2010 and 200 million TEUs in 2020, according to forecasts by the MOC<sup>2</sup>. In 2005, Shanghai and Shenzhen achieved container throughput of 18.1 million TEUs and 16.2 million TEUs, respectively, which ranked them as the third and fourth largest in the world, behind Singapore and Hong Kong.

### 2005 China's Total Freight Volume by Type of Transport

	Freight Volume (Million tons)	Y-o-Y % Change	Freight Turnover (100 Million tons-km)	Y-o-Y % Change
<b>Total</b>	<b>18,370</b>	<b>7.7%</b>	<b>78,330</b>	<b>12.8%</b>
Road	13,290	6.7%	8,574	9.3%
Railway	2,700	8.2%	20,731	7.5%
Waterway	2,110	12.8%	48,058	16.0%
Civil aviation	3.07	10.8%	79	9.9%
Pipeline	270	10.6%	889	12.4%

Source: Statistical Communique of the People's Republic of China on the 2005 National Economic and Social Development

### Container Throughput in China's Major Ports

	2000 ('000 TEU)	2004 ('000 TEU)	2005 ('000 TEU)	% Chg (2004-05)
Shanghai	5,612	14,554	18,084	24.3%
Shenzhen	3,994	13,659	16,197	18.6%
Qingdao	2,120	5,140	6,307	22.7%
Ningbo	902	4,005	5,208	30.0%
Tianjin	1,708	3,816	4,801	25.8%
Guangzhou	1,431	3,304	4,683	41.7%
Xiamen	1,085	2,872	3,342	16.4%
Dalian	1,011	2,212	2,655	20.0%

Source: China Ports Yearbook 2005 and www.portcontainer.com

### Container Throughput of the World's Top Ten Container Ports<sup>3</sup>

	2000 ('000 TEU)	2004 ('000 TEU)	2005 ('000 TEU)	% Chg (2004-05)
Singapore	17,090	21,330	23,190	8.7%
Hong Kong	18,100	21,980	22,600	2.8%
Shanghai	5,610	14,550	18,080	24.3%
Shenzhen	3,990	13,660	16,200	18.6%
Busan	7,540	11,440	12,520	9.4%
Kaohsiung	7,430	9,710	9,470	-2.5%
Rotterdam	6,280	8,280	9,290	12.2%
Hamburg	4,250	7,000	8,090	15.6%
Dubai	3,060	6,430	7,620	18.5%
Los Angeles	4,880	7,320	7,480	2.2%

Source: Maritime and Logistics Development Unit of the Economic Development and Labour Bureau, Hong Kong SAR Government and www.portcontainer.com

<sup>1</sup> Source: "Logistics industry on fast track", 27 Dec 2004, <http://www.tdtrade.com>

<sup>2</sup> Source: Prospectus of the Dalian Port (PDA) Company Limited

<sup>3</sup> Figures rounded to the nearest 10,000

# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES

**Rising demand for retail logistics:** China's fast-paced economic growth has led to substantial development of the domestic retailing industry. Total retail sales of consumer goods registered 12.9% growth in 2005, largely supported by the continued rise in urban disposable income, which rose by a real 9.6% within the same year. Encouraged by the enormous potential of China's retail market, which boasts a population of 1.3 billion and is underpinned by a booming economy, as well as the regulatory change which saw China fully open up its retail sector to foreign participation from year-end 2004 onwards, overseas retailers from around the globe are making a strong push to enter or expand in China's markets. This process has accelerated this year as local governments were given the autonomy to approve retail investment projects, and over 1,000 applications by foreign retailers and wholesalers for setting up wholly foreign-owned enterprises (WFOE) in China have been approved in the past year, according to a Wall Street Journal report.

## Upbeat Retail Sales Momentum Set to Continue



Source: National Bureau of Statistics of China

The modern chain store retail format has been gaining huge popularity in China, a trend further stimulated by the influx of sizeable numbers of foreign operators. France-based Carrefour added 16 more stores in China last year, with the total number of outlets under the Carrefour logo rising from 62 to 78 as of end 2005. The U.S. discount giant Wal-Mart also expanded its retail operations, opening another 13 stores in 2005 to total 56 stores in China. It plans to open 18-20 more stores in the country in 2006, according to the company's website.

The wave of expansion of foreign retailers and the exponential growth of chain store operations, particularly the increased diffusion to the second and third-tier cities in China's Northeastern region and the Great West during recent years, have boosted demand for distribution and other supporting logistics services. Meanwhile, the foreign retailers are not only keen to tap into the growing retail pie in China, many have increasingly looked upon China as a prime sourcing base for buying locally manufactured goods for both domestic sales and export to their overseas

network. A number of the leading multinational retailers in China, including Carrefour, Wal-Mart, Metro and Auchan reportedly procured products worth more than RMB 200 billion in China in 2005. Carrefour, for example, purchased goods worth RMB 36.8 billion in China in 2005, up from RMB 25.7 billion a year ago.

To support the growing scale of sourcing activities in China, more foreign retailers have invested in building in-house logistics centres in key locations. Wal-Mart, for instance, is completing the construction of a new 77,000 sq m global procurement centre in Shenzhen, scheduled to open in the second half of 2006. Last year, the home-furnishing retailer B&Q unveiled its plan to construct a logistics centre in Chongqing in the heart of western China. Occupying a site area of approximately 10,000 sq m, the logistics centre will be B&Q's fourth such facility in China. Following the footsteps of other MNCs such as Wal-Mart, Carrefour, B&Q, Tesco, IKEA and Samsung, which operate global or regional procurement offices in the southern city of Shenzhen, IBM recently announced the relocation of its global sourcing centre to Shenzhen.

## PHASED OPENING OF LOGISTICS MARKET TO OVERSEAS INVESTORS AND OTHER CONDUCTIVE GOVERNMENT POLICIES

**Impact of WTO mandated market opening measures:** The phased deregulation of China's domestic logistics market since the country's accession to WTO membership in 2001 has played an instrumental role in driving the influx of foreign logistics service vendors into China in recent years. During this five year period, the Chinese government has gradually removed the restrictions on foreign investment holdings in companies across the range of logistics sub-sectors. For example, foreign investors were permitted to establish majority-owned courier service joint ventures (JVs) one year after accession, with all restrictions removed four years after this date. China also allowed foreign service suppliers to set up wholly-owned storage and warehousing and freight forwarding companies within three and four years after its WTO entry, respectively. By December 2005, China's logistics sector was almost fully opened to overseas investment through the WFOE structure, with a few exceptions such as rail freight transport (to be opened by December 2007) and maritime cargo handling (restricted to JVs).

**Supportive measures by the central government:** With the WTO accession making way for foreign service suppliers to enter China's market, a series of Central Government policy initiatives relating to the logistics sector in the past few years has provided an additional layer of support, helping to fuel the development of the industry.

In August 2004 nine ministries and bureaus, led by the National Development and Reform Commission and the Ministry of Commerce, jointly promulgated a directive "Notice on the Opinions for Promoting the Development of Modern Logistics Sector in China" which laid down a series of supportive measures to encourage investment in the domestic logistics sector, such as abolishing various pre-approval items for logistics company registration; improving taxation treatment of logistics enterprises by way of unifying taxes payable by all branches into taxes payable by a single entity at the headquarters level; removing all administrative charges not in compliance with state regulations and accelerating the consolidation of local logistics resources and the construction of regional logistics centres. The directive furthermore called for the provision of preferential financing, encouraged further opening of the sector including the use of foreign capital, equipment and technology in construction and operation of logistics facilities, while also setting out a commitment to simplify customs procedures.

**Eleventh Five-year Plan:** In the Eleventh Five-year Plan, drawn up by the Chinese Central Government in March 2006, a modern logistics sector is earmarked as a pillar industry for focused development in the period 2006-2010. Some of the key initiatives to support the logistics sector set forth in the 11-5 Plan include building large logistics hubs and regional logistics centres; fostering the formation of professional logistics enterprises, encouraging the development of third-party logistics and the

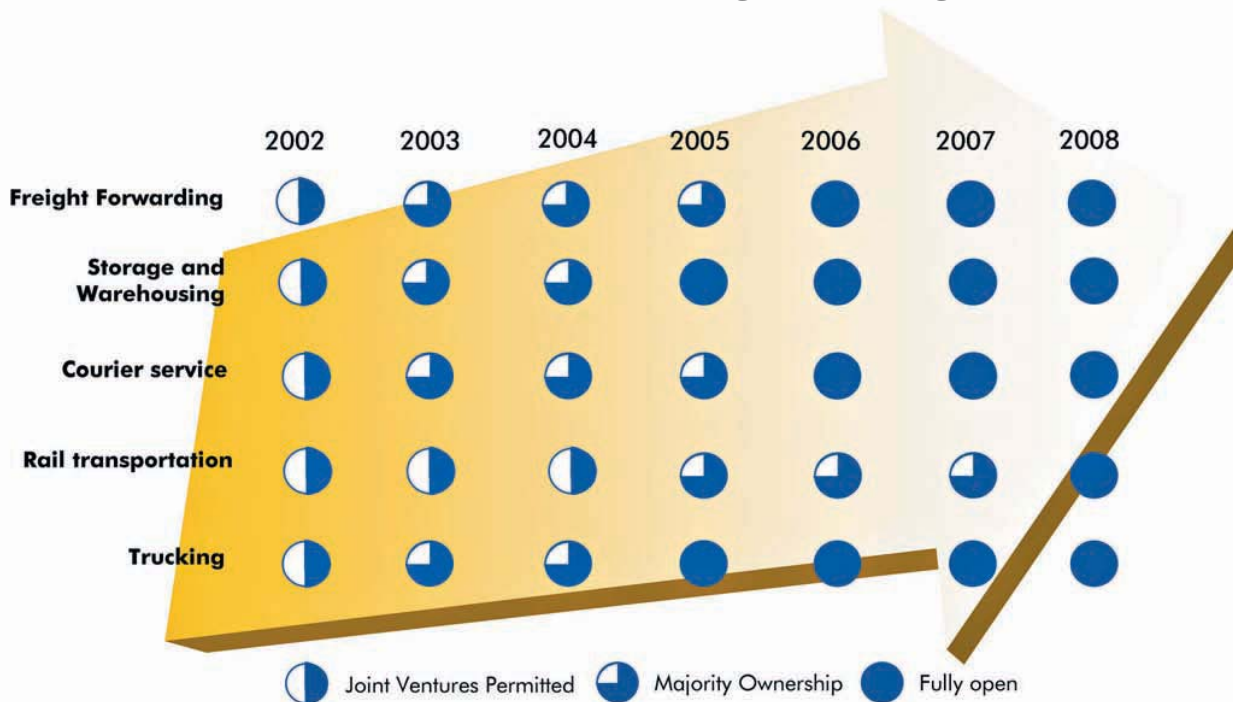
adoption of new technologies and IT applications in logistics operations, as well as promoting the modernization of in-house logistics processes.

Viewed from a higher level, the policy to develop the logistics sector is complementary with the other major strategic goals set out in the 11-5 Plan. These targets notably include accelerating the development of tertiary industry, encouraging domestic consumption and promoting stronger bonds between the more economically-advanced and the less-developed cities/regions in order to fulfill the goal of achieving coordinated regional development.

### THE EMERGING THIRD-PARTY LOGISTICS MARKET

**Rapid growth in third-party logistics:** Although the third-party logistics (3PL) market is still in a nascent stage of development in China, it is a thriving market segment, fuelled by WTO-related policy change and the intensifying competition amongst suppliers of manufactured goods, which is leading to more efficient and professional supply-chain management so as to improve products' cost-competitiveness in the marketplace. The 3PL industry in China had an estimated market size of RMB 40 billion in 2001, rising at an astounding pace, with over 70% of the companies reportedly achieving annual revenue growth exceeding 30%, according to Mercer Management Consulting.

### China's WTO Commitments Relating to the Logistics Sector



# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES



<p><b>Foreign logistics companies</b></p> <ul style="list-style-type: none"> <li>▪ APL</li> <li>▪ Maersk</li> <li>▪ HTB</li> <li>▪ Panalpina</li> <li>▪ Exel</li> <li>▪ Danzas</li> <li>▪ TNT</li> <li>▪ Schenker</li> <li>▪ FedEx</li> <li>▪ UPS</li> <li>▪ DHL</li> </ul>	<p><b>Emerging logistics companies</b></p> <ul style="list-style-type: none"> <li>▪ EAS</li> <li>▪ ST-Anda</li> <li>▪ PGL</li> <li>▪ Hurry Top</li> <li>▪ China Overseas Logistics</li> <li>▪ Jiuchuan Logistics</li> </ul>
<p><b>Internal logistics departments of Chinese companies</b></p> <ul style="list-style-type: none"> <li>▪ Annto Logistics</li> <li>▪ Haier Logistics</li> <li>▪ Attend Logistics</li> <li>▪ Ding Xin Logistics</li> <li>▪ TCL</li> <li>▪ Bright Dairy &amp; Food</li> <li>▪ Konka</li> </ul>	<p><b>Traditional Chinese transportation companies</b></p> <ul style="list-style-type: none"> <li>▪ COSCO</li> <li>▪ Sinotrans</li> <li>▪ CMST</li> <li>▪ China Shipping</li> <li>▪ China Resources</li> <li>▪ China Post</li> <li>▪ CRMLC</li> <li>▪ CRE</li> </ul>

Source: Mercer Management Consulting (2002)

The market for logistics outsourcing is expected to continue its fast-track growth, and was estimated to have reached RMB 100 billion by 2005, with annual growth estimated at around 25% annually in the 2001-2005 period. The market share of 3PL players, meanwhile, is expected to rise to 6% or above by 2010, up from 3% in 2004<sup>4</sup>, as the market continues to evolve and foreign logistics players continue to enter the scene. Amongst the main demand drivers for 3PL services are the increased presence of multinational corporations in China, especially those with local manufacturing bases or large retail networks, such companies tending to have more sophisticated logistics requirements, ranging from imports and exports, domestic distribution and implementation of China sourcing strategies.

Broadly speaking, third party logistics companies can be categorized into four distinct groups. These comprise firstly companies transformed from traditional Chinese state-owned shipping and freight forwarding companies such as COSCO, Sinotrans and China Railway; in the second category are the internal logistics divisions of Chinese manufacturers which also provide some outsourcing services, some of which have spin-off potential; the third category of service providers are emerging Chinese logistics firms, comprising primarily private specialist companies focusing on a few industrial sectors, such as Shenzhen Gongsuda Logistics and PG Logistics. The final category is multinational logistics providers, most of which possess advanced technical expertise but are relatively weaker in local distribution capabilities.

Since the 1990s, a number of foreign logistics companies have successively followed their clients to China in meeting their worldwide logistics needs. However, due to the former policy restrictions, such operations were predominantly in the form of Sino-foreign joint ventures (JVs) with local partners. DHL-Sinotrans, FedEx-DTW, TNT-Marchplus are all cases in point. Other top multinational market players, such as UPS, APL, NYK Logistics, Nippon Express and Maersk have also opened offices in various Chinese cities and are investing heavily in the development of their logistics networks.

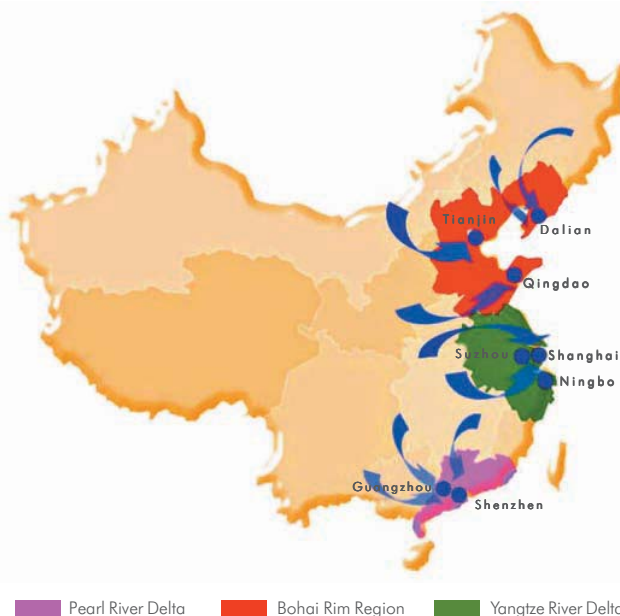
With the full opening of China's logistics market to investment by wholly foreign-owned companies in December 2005, many foreign logistics providers seized the opportunity to begin ratcheting up their investment plans in China and revisit their strategies and present operating modes. Against this background, one emerging theme was some overseas logistics operators breaking up with their existing partners or buying out the equity shares of the Chinese parties in their PRC joint ventures. Mergers and acquisitions (M&A) involving logistics companies have also been on the rise since 2005. This route is being viewed by some foreign logistics players as a short-cut to quickly establish/expand their footprint and gain access to strategic assets in China, whereas some smaller local businesses sought to exit their investments in the wake of heightening competition and increasing market consolidation. The following list highlights some significant M&A activities in China's logistics market over the past 24 months :

- In 2004, the Dutch TNT Group announced the termination of its cooperation with Sinotrans Limited, ending their 15-year collaborative relationship
- In December 2004, UPS reached an agreement with its partner Sinotrans Limited to take over direct control in their JV's international express business in 23 locations in China for a reported total consideration of US\$ 100 million payable in three installments
- In January 2006, FedEx announced a deal with its partner, Tianjin Datian W Group (DTW), to buy out the latter's 50% share in the International Priority Express joint venture founded in 1999. This US\$ 400 million-acquisition deal also includes the domestic express assets owned by the DTW Group, which span 89 locations across China
- In September 2006, TNT completed the acquisition of the HOAU Logistics Group, thereby linking TNT's global network with HOAU's well-established road transport capacity as one of China's leading freight and parcels transportation operators. HOAU controls some 3,000 trucks and over 1,100 hubs and depots

- In June 2006, Keppel Telecommunications & Transportation Ltd strengthened its business presence in China by acquiring a 35% stake in Wuhu Annto Logistics Company under the Midea Group Co. Ltd and Foshan Shunde Jiuren Logistics Co. Ltd. The purchase price of RMB 49.9 million represents about 4 times the net asset value of Annto (RMB 35.9 million x 35%) as of end 2005, which has more than 90 transportation, distribution and warehousing facilities

While the trend towards establishing or converting JVs into wholly-owned logistics companies is becoming more prevalent, Sino-foreign cooperation is unlikely to lose its appeal over the short to medium term, as it still offers a number of significant advantages. For instance, foreign companies may leverage on the Chinese partners' established client base (mainly local), relationship with local governments, local market knowledge and domestic facilities and transport network, which are crucial when penetrating into other specialized industries and geographically helpful when trying to establish operations in second-tier cities. A recent example saw COSCO collaborating with TNT to establish an equal JV to be based in Qingdao and Guangdong, aimed at tapping into the growing business opportunities in both China and the Asia-Pacific logistics market. The JV will benefit from COSCO's injection of its home-appliance logistics business, and TNT's introduction of its Pallexon logistics business in Australia.

## INVESTMENT OPPORTUNITIES: A REGIONAL PERSPECTIVE



<sup>4</sup> Source: "Business Strategies of Hong Kong Logistics Companies Targeting the China Market", March 2004, Hong Kong Trade Development Council Research Department

China, the world's fourth largest economy and with a vast expanse of land resources, is characterized by huge economic disparities between its various constituent regions. The most economically advanced regions are mainly located around the coastal areas in Eastern China, whereas Central and Western China have developed somewhat more slowly to date.

At present, most of the economic activities and the related logistics hubs, from which China import the raw materials and ship manufactured goods to overseas countries, are concentrated around three key regions in China along the southern, eastern and northern coast: the Bohai Rim region - notably including Beijing, Tianjin, Dalian and Qingdao; the Yangtze River Delta - mainly covering Shanghai, Ningbo, Suzhou, Nanjing, Hangzhou and Wuxi; and the Pearl River Delta with the key cities of Shenzhen and Guangzhou.

### Bohai Rim Region

The Bohai Rim Region is the economic region consisting of the Liaoning Peninsula, Shandong Peninsula, the two municipalities of Beijing and Tianjin, and the adjoining Hebei Province.

As the national capital, **Beijing** is an important transportation hub and its advanced transport infrastructure provides convenient interlinkage between international airport, railway and highway networks.

From the standpoint of the logistics industry, Beijing is a crucial market, with demand for logistics services underpinned by a number of positive factors, including the fact that the city will be hosting the 2008 Olympics; is home to Zhongguancun, China's largest trading market for IT and computer accessory products, and boasts one of the nation's largest retail markets. Logistics relating to Beijing's IT, retailing, automobile and express delivery industries and air freight forwarding continue to provide significant development potential.

Currently, Beijing's logistics parks are primarily located in two regions: the Beijing Airport Logistics Park, and the areas surrounding the Beijing Economic-Technological Development Zone near the Beijing-Tianjin Expressway to the southeast of the city. However, the building of new logistics facilities has become somewhat difficult as the land supply in major industrial districts continues to diminish after many years of development activity.

The Beijing Airport Logistics Zone, located in Shunyi District, where it enjoys a direct connection to the Beijing international airport in the south, is the only international air-cargo hub and logistics zone in Beijing. Since its establishment in 2002, the zone has successfully attracted a number of international logistics companies. For example, TNT last year entered the

# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES



Airport Logistics Zone, developing the company's first integrated express and logistics centre in China, covering an area of 12,000 sq m. With TNT injecting a capital outlay of RMB 120 million in the project, it is estimated that the new facility has the capacity for handling 130,000 parcels per year.

Going forward, with a view to improving the capital's logistics network to provide stronger support to the 2008 Olympic Games, the Beijing authorities have slated three logistics zones for priority development, namely the Beijing Airport Logistics Zone, Tongzhou Logistics Park in Majuqiao county to the southeast and the Liangxiang Logistics Park in Fangshan District.

**Tianjin** is an important coastal and industrial city, with one of the largest ports in northern China. Currently, logistic activities in Tianjin are

concentrated around Tianjin Airport and in the Binhai New Area where Tianjin Port and the Tianjin Economic-Technological Development Area (TEDA) are located.

Development of the Binhai New Area (BNA) is high on the central government's list of priorities: it was included in the Eleventh Five-Year Plan as one of the principal economic goals, and was also designated by the State Council as a pilot zone for comprehensive reform - similar to Shanghai's Pudong New Area - where it will be used as a testing ground for various reform initiatives including financial market deregulation, such as the launching of onshore, industry-specific investment funds, venture capital investment, liberalization of foreign exchange management policies and the use of offshore financing.

In May 2006, the State Council issued a policy directive to expedite the development and opening-up of the BNA. Covering an area of 2,270 sq km and with a population of 1.4 million, the BNA is slated to be transformed into a modern manufacturing and R&D hub and an international shipping and logistics centre for northern China. The BNA is positioned to provide a fresh impetus for invigorating the inland regions and act as a gateway to promote further integration between northern China and the global economy.

According to Tianjin's municipal planning, the city's international logistics activities will be mainly backed by the Tianjin Port, Tianjin Airport, Tianjin Free Trade Zone and TEDA. Meanwhile, to complement and support the future expansion and development of the BNA, in August the State Council endorsed the establishment of the Dongjiang Bonded Port Zone. The planned 10 sq km-Dongjiang Bonded Port Zone (DBZ) is located within Dongjiang Port, which is currently under construction in Tianjin, and



Source: www.wikipedia.org; CBRE Research

## Major Logistics Parks Established/ Under Construction in Beijing

Name	Location	Functional Positioning	Development Scale	Current Status
Beijing Airport Logistics Zone	Linked to the Beijing Capital Airport, 15 km from downtown city area and 180 km from Tianjin	Provides a logistics platform for the distribution of import/export goods, procurement and wholesaling	Total planned area of 6.2 sq km	Approved for establishment in 2002, now in operation
Beijing Tongzhou Logistics Park	Located at the junction of the Sixth Ring Road and Beijing-Tianjin-Tangshan Expressway	A pivotal logistics base oriented as a highway-sea freight transport hub, with multiple functions of modern logistics, inland port and product processing	Total planned area of 5.04 sq km	Approved for establishment in 1998, now in operation
Beijing Southwest Integrated Logistics Park	Located in Liangxiang, Fangshan District, traversed by the Beijing-Guangzhou and the Liangxiang-Huangchuan railway routes	To be developed into an inland logistics hub with focus in railway container transportation, integrated with road transport functions	Phase I covers an area of 0.33 sq km	Preliminary construction works in progress

**Major Logistics Parks Established/ Under Construction in Tianjin**

Name	Location	Functional Positioning	Development Scale	Current Status
Tianjin Port Cargo Distribution Centre	Southwest of Nanjiang Port area	Functions as a distribution, processing and trading centre for non-containerized energy-related cargo such as coke, coal and oil	Occupies 12 sq km, incl. 1.56 sq km business area; 6 sq km coal operation area; 4.44 sq km mineral ore and oil product storage area	Approved for establishment in 2001, and now in operation
Tianjin Port Container Logistics Centre	Situated at Beijiing Port, adjacent to Tianjin Free Trade Zone and Tianjin Economic-Technological Development Area	Container logistics centre conveniently linked to the railway and highway networks connecting to various cities	Occupies 5.4 sq km site area	Expected to be completed before 2010
Dongjiang Bonded Port Zone	Situated at Dongjiang Port area, Binhai New Area	Functional focus on international transshipment, distribution, global procurement, entrepot trade and export processing	Covers an area of 10 sq km, comprising part of the logistics processing and the wharf operation area	First phase of the logistics and assembly area (2 sq km) slated to be finished by 2008
Tianjin Airport International Logistics Zone	Located to the northwest of Binhai International Airport	Provides multiple functions of bonded warehousing, value-added processing, distribution, exhibition, and office operations	0.55 sq km in total developable area	Approved for establishment in 2000, and now in operation

comprises part of the larger wharf operational zone and the logistics and processing zone within the Port. The DBZ will provide functions such as international forwarding, distribution, procurement, entrepot trade and export processing. The project's first phase, encompassing an area of 2 sq km, is expected to begin construction in early 2007.

On the back of the central government's strategy to develop the BNA and the continued investment in improving the infrastructure of the Tianjin Free Trade Zone, Tianjin's logistics market will likely witness rapid development in the future. Its growth will be further underpinned by the forecast increase in cargo throughput and container handling capacity of Tianjin Port to 300 million tons and 10 million TEUs respectively, in 2010, up from 241 million tons and 4.8 million TEUs in 2005<sup>5</sup>.

**Yangtze River Delta**

As a leading economic region and overseas investment focal point, the Yangtze River Delta (YRD) is comprised of a cluster of cities with Shanghai in the leading position, and 15 other cities in southern Jiangsu and parts of Zhejiang Province. According to data from the National Development and Reform Commission's website, YRD generated a GDP of RMB 3.39 trillion in 2005, an increase of 13.4% y-o-y and representing 17.2% of the country's aggregate output. Currently, much of this area is in the middle or more advanced stages of industrial development, enjoys comparatively higher urbanization levels and is gradually evolving into a new

<sup>5</sup> Source: "Development of the Tianjin New Coastal District (Binhai New Area)", www.investteda.org



Source: InvestHK

international manufacturing base. The YRD is a key engine driving the growth of China's exports, while its domestic customer market has also developed significantly in recent years. Total imports and exports in the YRD region grew 25.2% to US\$ 502.5 billion in 2005 and the area achieved a retail sales volume worth RMB 1.07 trillion, rising 14.4% y-o-y, accounting for 35% and 16% of the respective national totals.

# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES



**Shanghai** is China's largest economic and financial centre. The logistics industry has already developed into one of the city's pillar industries, having achieved added value of US\$ 15 billion in 2005, or the equivalent of 13% of the city's GDP. The cargo throughput handled in Shanghai reached 443 million tons in 2005, up 16.9% over the previous year, making it the busiest port in the world. With the commencement of operations of the Yangshan Port Phase I in December 2005 and the full opening-up of the logistics industry for wholly-foreign owned operators, these two significant events have already injected new momentum into the Shanghai logistics industry in 2006. Another positive factor that bodes well for the sustainable development of the industry is the strong support from the government, most crucially the provision of preferential policies. For example, Pudong New District last year unveiled a new rule in which it will provide up to 50% refund in income tax payments for newly established logistics enterprises within the area for a period of three years.

Demand for logistics properties has been especially keen, from both an investment and occupational standpoint. Phase I of Prologis Park Lingang, co-developed by Prologis and Shanghai Lingang, has almost reached full occupancy although it was only opened at the beginning of 2006.

Meanwhile, due to the intensive use of industrial land in Shanghai, land supply remains restricted, leading to a sharp spike in land prices, which increased 9.5% during the first six months of 2006.

## Pearl River Delta

The Pearl River Delta (PRD) economic zone was the first region in China to undergo reform and opening to foreign investment, and remains one of the country's fastest-growing regions. The zone consists of nine cities in southern Guangdong and is anchored by the main urban centres of Guangzhou and Shenzhen. It covers a total area of 41,698 sq km. The PRD region has a vibrant logistics sector, due in large part to its status as China's main workshop. It has served as an outsourcing base for Hong Kong industrialists who began relocating factories to the region to take advantage of China's cheap land and labour resources during the 1980s. Today the PRD has evolved into one of the world's leading manufacturing and exporting bases for a vast spectrum of products such as garments and textiles, electrical appliances, electronics, chemicals, metal products, telecommunications, computers, equipments and machinery, automobiles and parts.

There are a number of positive attributes underpinning **Guangzhou's**

## Major Logistics Parks Established/ Under Construction in Shanghai

Name	Location	Functional Positioning	Development Scale	Current Status
Shanghai Wusong International Logistics Park	Baoshan District	An integrated logistics park for international intermodal container transportation and steel distribution	Occupies site area of 7.5 sq km	Approved for establishment in 2003, and now in operation
Shanghai Waigaoqiao Bonded Logistics Park	Located within the Shanghai Waigaoqiao Free Trade Zone	Provides the four main functions of international transshipment, global distribution, global procurement and entrepot trade	Occupies 1.03 sq km in area, with 140,000 sq m of container transshipment zone already completed	Approved in 2003 and launched operations in 2004
Yangshan Deep Water Port Logistics Zone	To the south of Shanghai Donghai Bridge	Information exchange, logistics services, export-oriented industries development	Total planned area of 13.8 sq km, of which the first phase is around 3.8 sq km	Approved for establishment in 2002, and now in operation
Northwest Logistics Park	Located at the intersection of No. 204 and 312 highways and SH-Ningbo expressway, and the SH-Ningbo and SH-Hangzhou railway routes	An integrated logistics park focusing on inter-provincial distributions	Occupies around 4 sq km in site area	Approved for establishment in 2002, and now in operation
Pudong Airport Logistics Park	Adjacent to Pudong Airport	Top-class international airport logistics hub serving the Asia-Pacific region	N/A	220,000 sq m (site area) cargo area and 385,000 sq m (site area) warehouse area supervised by the Customs completed

**Pearl River Delta Economic Zone**



great potential as the PRD's logistics hub. These include the city's location at the core of the PRD, its dominance as a regional economic centre and its relatively strong transportation network, which provides access to all five transport modes - port, inland waterway, airport, railway and highway. The U.S. express carrier FedEx is one of the most active players keen to tap into the future expansion opportunities in China and in Guangzhou. FedEx is now constructing a new Asia Pacific hub in the vicinity of the Baiyun International Airport. When completed in December 2008, it will replace its existing hub in the Subic Bay of Philippines.

With a planned investment of US\$ 150 million, FedEx's new regional air cargo hub comprises a 82,000 sq m-facility to be constructed on a 63-hectare site. The FedEx transport and distribution hub is expected to bring economic benefits totalling US\$ 11 billion to China's economy by 2010, according to the company's announcement. Other companies including UPS, TNT, BAX and Maersk have also opened offices in Guangzhou.

The Guangzhou government has been explicit in its ambition to develop the municipality into Southern China's modern logistics centre within 5 to 10 years. The municipal government's Eleventh Five-Year Plan places a strong emphasis on advancing the development of the logistics sector, which is one of the seven service industry segments earmarked for focused support and investment. The government aims to promote the 3PL business and attract more integrated logistics providers from abroad by leveraging on the agglomeration effect and the improved airfreight handling capacity from the new Baiyun Airport and the FedEx hub. Other stated goals under the plan are to accelerate the construction of three pivotal international logistic parks (Guangzhou Airport International Logistics Park, Nansha International Logistics Park, and Huangpu International Logistics Park) along with five other regional logistics parks positioned to handle domestic logistics flows.

**Shenzhen**, located at the southern edge of the PRD, adjoining Hong Kong, was one of the first four special economic zones (SEZs) established

**Major Logistics Parks Established/ Under Construction in Guangzhou**

Name	Location	Functional Positioning	Development Scale	Current Status
Guangzhou Airport International Logistics Park	Adjacent to the new Baiyun Airport	International logistics hub with main focus on airfreight logistics and related high value-added industries, with secondary focus on domestic regional logistics	Planning still under revision	Under construction, expected to be completed in 2010
Nansha International Logistics Park	Adjacent to Nansha port area of Guangzhou	International logistics hub established to promote the interaction and linkage of shipping services and export-oriented industries	Planning still under revision	Expected to be completed in 2010
Huangpu International Logistics Park	Adjacent to Guangzhou Huangpu port and Xinsha port areas, and the Guangzhou-Shenzhen railway	Aims at developing bonded logistics, port logistics and railway logistics; seamlessly integrating the free trade zone logistics and the nearby Guangzhou port	Planning still under revision	Expected to be completed in 2010

# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES



by the Central Government at the commencement of the program of Economic Reform and Opening. Since its establishment in May 1980, the Shenzhen SEZ has evolved into a strong industrial-based, export-oriented economy. It is also one of China's leading foreign trade ports and has a relatively advanced base of service industries, as compared to other PRD cities.

Shenzhen's special geographical location - as part of the PRD workshop and a neighborhood of Hong Kong - favourably positions it for developing international logistics. Due to factors such as the cost differentials in terms of the higher cost of transporting containers by road, together with higher terminal handling charges, as well as the converging service quality,

some freight forwarding and container logistics are increasingly being transferred from Hong Kong to Shenzhen.

## Other regions/ localities

In addition to the above-mentioned mega-economic circles, there are also promising opportunities for the logistics industry in other localities and inland cities, including Xiamen, Wuhan, Chengdu and Chongqing, as the Chinese government continues to pour money into improving the transport infrastructure as called for by the Eleventh Five-Year Plan. At the same time, the Great West development initiative will undoubtedly work to propel the economic development of leading cities in the Western region generally.

## Major Logistics Parks Established/ Under Construction in Shenzhen

Name	Location	Functional Positioning	Development Scale	Current Status
Yantian Logistics Park	Warehousing and storage area for the Yantian Port	International container forwarding, warehousing, disassembly and reassembly, processing and customs check point	Occupying 0.4 sq km	Now in operation
Qianhaiwan Marine Logistics Park	Qianhaiwan in Nanshan district	Container storage, international transshipment and forwarding, processing, automobile trading; bulk cargo dispatch by road and port	Completed 100,000 sq m (site area) of storage zone together with a 250,000 sq m-container yard	Under construction and partly in operation
Airport Logistics Park	Near the Shenzhen International Airport	Air cargo park with emphasis on facilitating domestic freight transport, and further developing international freight transport	Planned area of 1.16 sq km	Phase 1 already in operation
Pinghu Logistics Park	Pinghu, Longgang District	Comprehensive logistics park focusing on the land transport of cargo, including such functions as wholesaling and distribution; container forwarding, storage and transit hub for Pearl River Delta region	First phase development covers an area of 4.4 sq km	Under construction, expected to be completed in 2008
Sungang - Qingshui River Logistics Park	Luohu District	Specializes in intra-city delivery services, with focus in specialised logistics markets (e.g. housewares, auto parts and accessories, light industrial goods) and 3PL	Occupying 0.5-0.6 sq km	Under construction, expected to be completed in 2008
Longhua Logistics Park	Bao'an District	An intermodal container transportation hub, import-export freight forwarding centre supporting the port, and mainly serving the Hong Kong-Shenzhen region, with coverage over the PRD and inland areas	Planned area of 0.67 sq km	Under construction, expected to be completed in 2008

## REAL ESTATE STRATEGY AND THE IMPLICATIONS FOR PROPERTY INVESTORS

To accommodate their business expansion plans in China, many international 3PL companies, as well as manufacturers and retailers, have rapidly growing requirements for warehouse and distribution facilities. The buoyancy of demand is driven mostly by large-scale logistics users, who are particularly impacted by the lack of modern warehouse facilities built to international standards with respect to specifications such as floor-to-ceiling height, security, loading and unloading capacity and ventilation conditions.

Traditionally, when faced with supply constraints, many companies with more sophisticated needs and large storage space requirements tend to construct build-to-suit premises for self-occupation. First-tier cities, due to persistent high levels of foreign investment, thriving foreign trade and well-developed infrastructure, are the preferred choice for major retailers and third party logistics operators setting up regional distribution and logistics centres. For instance, UPS announced in 2005 that it had signed an agreement to build an international air hub at Shanghai's Pudong Airport. The planned 5,000 sq m-UPS logistics centre is scheduled for completion in 2007, while UPS is further entitled to expand it by at least 10,000 sq m. Meanwhile, as noted earlier, FedEx and TNT have chosen to establish their regional logistics bases in Guangzhou and Beijing respectively.

Since 2005, logistics facilities have emerged as a new focal point in China's property investment market, driven by the strength in demand for international-grade logistic facilities, the surging third-party logistics market and optimism concerning the stimulating effect of China's market-opening moves.

Consequently, more end-users are now renting space from third party logistics developers and investors, rather than going through the process of acquiring land and developing their own facilities. The third party will go through the procedures for acquiring land in the industrial zones and building the ready-made premises for long-term rental income, or on a pre-leased basis, according to the specifications provided by the tenant. One successful case of such a build-and-lease undertaking was Macquarie Goodman, which in October 2005, secured a deal to develop a design-built warehouse/distribution centre for the 3PL service provider, Exel Logistics at the Kangqiao Industrial Park in Pudong, Shanghai. The project is scheduled to be completed in phases between late 2006 and July 2007. Under the agreement, Macquarie Goodman committed to invest A\$31.8 million to acquire land and develop the warehouse on behalf of Exel, which, in turn, agreed to lease the facility for seven years.

For logistics end-users, such "custom-build and lease" arrangements offer a number of key advantages. Firstly, this is a more convenient approach than developing the property themselves. Secondly, it poses a much smaller burden to tenants' balance sheets, thereby allowing them to concentrate their resources on business development and expansion. By leasing rather than owning their logistics assets, the real estate risk largely shifts to the developer/ investor, but is still being partially borne by the tenant who is typically "locked" into a long-term lease.

There are in general two alternative routes for foreign investors to take part in China's fast-growing logistics property market: direct asset acquisition of completed properties with existing tenants, or real estate development, such as custom-build agreement with individual customers.

The logistics sector in Shanghai has been particularly active from an investment standpoint, with several overseas funds making their first-stage acquisitions in 2005. Industrial assets typically offer higher yields than other asset classes due to their locations in urban fringe industrial zones, with gross yields estimated to reach 9% to 11% in Shanghai. This fact, combined with their generally more stable rental income, makes them a highly sought-after asset for inclusion in REIT portfolios. REITs that have acquired China industrial facilities include the Singapore-listed Mapletree Logistics Trust, which concluded a milestone deal to purchase the Ouluo Logistics Centre in Pudong, Shanghai for RMB 120 million in November 2005. This was followed by AMB's acquisition of a 17,094 sq m warehouse facility, the Jiuting Distribution Centre together with an adjacent site in Songjiang, Shanghai for around RMB 70 million the following month.

Nevertheless, real estate development remains the most commonly adopted investment strategy for interested investors, given the dearth of investible-grade logistics properties available on the market. Prologis is amongst the leading overseas investors in China's nascent logistics market. Notable investment deals made by the company since its entry into China in 2003 include: establishing a joint venture with Suzhou Logistics Centre Co., Ltd. to co-own and develop a pipeline of projects in the Prologis Park Suzhou; investing to build a logistics park sitting on a 3.2 sq km site in Lingang New City, Shanghai with an investment of US\$ 14.9 million in Phase I, and a 97,547 sq m-distribution park consisting of four facilities, to be developed in two stages at the Beijing Airport Logistics Park for US\$ 36 million in total planned investment; and partnering with a subsidiary of the Tianjin Economic and Technological Development Area to jointly invest US\$ 45 million in the phased development of a bonded logistics park within the area.

Recently, Prologis announced that it has signed multiple agreements to build over 280,000 sq m of industrial and distribution space in various

# MATURATION AND GROWTH OF CHINA'S LOGISTICS INDUSTRY: TRENDS AND OPPORTUNITIES



locations, thereby expanding its in-country logistics network to cover Qingdao, Hangzhou and Ningbo. This milestone logistics development undertaking in China, which involves commitment of investments totaling over US\$ 90 million in the initial stage, clearly highlights the underlying strength of demand for modern logistics facilities in China, and demonstrates the strong appetite of logistics property investors to expand their property portfolios into second-line cities, well beyond the existing logistics hubs in Beijing, Shanghai and Guangzhou.

Mapletree Investments Pte Ltd has entered into agreements involving properties in Tianjin, Wuxi and Shanghai in 2006. In Jiangsu Province, immediately north of Shanghai, Mapletree will develop 215,000 sq m of warehouse and logistics facilities in Wuxi through a joint venture with the Wuxi New District Government, and it has invested in two warehouses presently under construction in Shanghai's Lingang Free Port that will total 46,500 sq m. In its first venture into Tianjin, announced in July, it will develop logistics facilities in the Tianjin Airport International Logistics Zone yielding 54,000 sq m of warehousing space in two phases.

Foreign investors may also take note of the burgeoning opportunities offered by the rapid expansion of logistics business in the Bonded Logistics Zones (BLZs) and the Bonded Logistics Centres (BLCs). BLZs are entitled to a number of preferential taxation policies - they allow companies to store imported goods and materials on a bonded basis pending sale to the domestic market, whereas domestic goods that enter the park are considered exports and immediately qualify for a VAT refund. The State Council has already approved the establishment of eight BLZs in China, most notably Shanghai's Waigaoqiao, as well as Qingdao, Ningbo, Dalian, Zhangjiagang, Xiamen Xiangyu, Shenzhen Yantian and Tianjin as trials to

encourage synergies between the export processing and entrepot trade activities in the nearby free trade zones and the sea ports. In a related development, mid 2005 saw the Customs General Administration in the PRC issue new regulations enabling the establishment of Bonded Logistics Centres. With functions not dissimilar to the BLZs, such as bonded warehousing and simple processing services, BLCs are also entitled to the "off-shore" treatment in the form of VAT refunds. Given the favourable tax treatment available, these areas/centres have rapidly become the preferred locations for the logistics and warehousing operations of export-oriented manufacturers, traders, 3PL companies and the procurement arms of international corporations.

While the huge potential for the logistics industry in China is beyond dispute, investors need to be prepared to face certain policy restrictions and administrative hurdles before they can gain access to the market. These include :

- Tighter control over approval by the relevant authorities, which is impacting on China's industrial zones in general amid the prevailing macro-economic policy imposed by the Central Government in its bid to ease fixed asset investment growth.
- Due to the extensive use of suburban land for industrial purposes in recent years, land supply has tightened considerably in the leading industrial parks in Beijing and Shanghai. Further compounding the problem is the reluctance of the authorities to grant land for the logistics business, which does not generate large tax revenues for local governments, while consuming as much space as other industrial facilities.
- Various policies regarding the sales of industrial land are under review. The Ministry of Land and Resources issued its "Criterion of Land Use Right Transfer by Bidding, Auction and Listing (Draft for Collecting Suggestions)" at the end of 2005. It mandated that the transfer of land-use rights for industrial land be effected through a "Bidding, Auction and Listing" mechanism. The new regulation has taken effect from August 2006, and it is witnessed as putting considerable upward pressure on the price of industrial land. This turn of events would, however, benefit early market entrants, as their investment holdings in China will be buoyed considerably by appreciation in the underlying land assets.





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