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AsiaInfo-Linkage: SEC Scrutiny And Concerns Over Financials Lead To High Risk Of Go-Private Deal Collapsing

November 12, 2012

Executive Summary

Amidst a storm of investor distaste for U.S.-listed Chinese equities, and with its shares trading at a fresh 5-year low earlier this year, AsiaInfo-Linkage, Inc. (ASIA) followed the precedent of numerous other Chinese companies in announcing it had received a "Go-Private" proposal on January 20, 2012. From the very beginning, the announcement was vague and specified only that the offer was "at a premium" over the current stock price. ASIA's shares had closed at $8.60 two days prior, but leapt to a high of $12.50 following the announcement and settled at $11.78. Investors breathed a sigh of relief that Citic Capital China Partners was named as a potential partner in the transaction. **Today, after more than 9 months, and no deal even remotely close to being announced, investors are ascribing an irrational hope and probability that their shares will be purchased for anything close to the current price of $10.50**. Given the weak fundamental backdrop in the China telecom and IT services market, concerns about the company's VIE structure, close scrutiny by the SEC, and potential for its financials to be overstated, a fair value target for ASIA's stock price is $6.50 per share.

History Tells Us Go-Private Deals Are Likely To Fail

The easiest and quickest way for Chinese companies to scare off short sellers is to create the perception that their stock is in demand, and an interested party, or parties, are willing to purchase all the shares at a substantial premium. This tactic was used earliest by companies such as Fushi Copperweld (FISN) in October 2010, and later by Harbin in 2011. The Harbin takeover saga was well chronicled here on Seeking Alpha, and was a painful drama lesson lasting 1 year that taught short-sellers that you can't stop easy money from doing non-economic deals in China.

The latest headline grabbing deal for 2012 was that Focus Media (FMCN) has drawn the attention of a consortium of buyers for $27.00/share, valuing the company at approximately $3.5 billion. According to the press release, the consortium received a "highly confident" letter from bankers, which provides a limited form of assurance that the buyers are serious and have access to capital. Interestingly enough, CITIC Capital China Partners was also named as a potential buyer of Focus Media.

It appears that that CITIC has chosen to pursue Focus Media, and all but abandoned its interest in acquiring ASIA. This conclusion is supported by additional information provided by the company in their limited updates on their strategic review process. Consider that in March, ASIA announced that it has:

"D*etermined to solicit interest from, and engage in discussions with, other potential qualified parties regarding a potential transaction*."

The company's last update came on July 30th when the company stated briefly in their second quarter earnings press release that:

"*The process remains ongoing. However, there can be no assurance that any definitive offer will ultimately be made, or that any transaction will be approved or consummated by the Company.*"

After more than 8 months without a bona fide offer, it should be incredibly obvious that ASIA is unlikely to see a going private deal consummated. What also makes us suspicious is that no price for ASIA was ever indicated, just like the purported unsolicited offer at a "substantial premium" that ChinaCast (CAST) received in November 2011. ChinaCast shareholders should have well sold that news when they got it -- their stock has since be delisted to the Pink Sheets and trade for pennies. Furthermore, ASIA also suffers from operating under a VIE structure, which is coming under increasing regulatory scrutiny. This structure may certainly narrow the universe of potential buyers interested in exploring a go-private transaction with ASIA.

Unfortunately, there is also little objective evidence from the options market to confirm that any transaction is imminent. For a company of ASIA's market cap, there is very little open interest of call options through the end of the year and no unusual activity that indicates a transaction with upside beyond the current share price.

What more can we learn from the history of Chinese go-private deals to indicate the likelihood that we have reached the correct conclusion? In the table below we've outlined a list of publicly announced going private transactions involving U.S. listed Chinese companies. In total, we've identified 31 deals going back more than 2 years.

Announced U.S. Listed Chinese Go-Private Offers

$ in millions

Indicative Offer Announced	Ticker	Company	Parties	Staus	Closed Date	Days to Close	Days Pending	Market Cap.	Deal Premium
10/15/2012	YONG	Yongye Int'l	CEO/Abax/Full Alliance/MSPEA	Pending	--	--	13	$334	38%
10/12/2012	NINE	Ninetowns	CEO/Directors	Pending	--	--	16	$71	76%
9/27/2012	KH	China Kanghui	Medtronic	Pending	--	--	31	$816	22%
9/26/2012	SVN	Seven Days	Sequoia/Carlyle/Chairman	Pending	--	--	32	$634	30%
9/12/2012	SSRX	3S Bio	CEO/Citic Private Equity	Pending	--	--	46	$301	29%
8/13/2012	JADE	LJ Int'l	CEO/FountainVest Partners	Pending	--	--	76	$59	11%
8/13/2012	FMCN	Focus Media	CEO/Carlyle	Pending	--	--	76	$4,366	16%
8/3/2012	SHP	ShangPharma	CEO	Pending	--	--	86	$142	32%
7/14/2012	WWIN	Winner Medical	CEO	Pending	--	--	106	$107	32%
6/4/2012	GU	Gushan Envt	CEO and Trillion Energy	Completed	10/17/2012	135	--	$31	181%
5/4/2012	CMMCY	China Mass Media	CEO	Pending	--	--	177	$12	24%
3/27/2012	HOGS	Zhongpin	CEO	Pending	--	--	215	$382	47%
2/28/2012	TBET	Tibet Pharmaceuticals	CEO	Withdrawn	--	--	243	$1	100%
2/21/2012	CTFO	China TransInfo	CEO	Pending	--	--	250	$144	13%
1/16/2012	JNGW	Jingwei	CEO	Completed	3/30/2012	74	--	$45	16%
1/20/2012	**ASIA**	**Asia-Info**	**CITIC Capital China Partners II**	**Pending**	**--**	**--**	**282**	**$878**	**--**
12/13/2011	WH	WSP Holdings	H.D.S Investments	Pending	--	--	320	$34	36%
11/15/2011	CAST	ChinaCast	Unnamed Institutional Investor	Pending	--	--	348	$24	--
11/23/2011	AMCF	Andatee China Marine Fuel	CEO	Withdrawn	--	--	340	$12	21%
11/21/2011	GEDU	Global Education and Tech.	Pearson	Completed	12/21/2011	30	--	$294	108%
11/14/2011	GRRF	China GrenTech	CEO/Affiliates	Completed	4/17/2012	155	--	$75	10%
10/17/2011	SNDA	Shanda Interactive	CEO	Completed	2/14/2012	120	--	$2,326	24%
7/26/2011	CADC	China Adv. Construction	CEO and COO	Pending	--	--	460	$7	33%
5/16/2011	CISG	CNinsure	CEO/TPG Asia, CDH Inservice Ltd	Withdrawn	--	--	--	$316	44%
5/20/2011	CFSG	China Fire and Safety	Amber Parent/Bain Capital	Completed	11/14/2011	178	--	$265	44%
5/3/2011	CSR	China Security and Surv.	CEO	Completed	9/16/2011	136	--	$583	59%
3/25/2011	FTLK	Funtalk China	Mgmt/Arch Digital/Capital Ally/Othe	Completed	8/25/2011	153	--	$424	15%
12/2/2010	CPC	Chemspec	CEO/Primavera Capital	Completed	8/19/2011	260	--	$288	28%
11/3/2010	FSIN	Fushi Copperweld	CEO/Abax Capital	Pending	--	--	725	$348	24%
10/11/2010	HRBN	Harbin	CEO/Abax Capital	Completed	11/3/2011	388	--	$754	20%
4/8/2010	TCM	Tongjitang Medicine	CEO/Fosun	Completed	4/15/2011	372	--	$117	22%
					Max	388	725	$4,366	181%
					Average	182	202	$458	40%
					Min	30	13	$1	10%

Source: Public press releases and filings

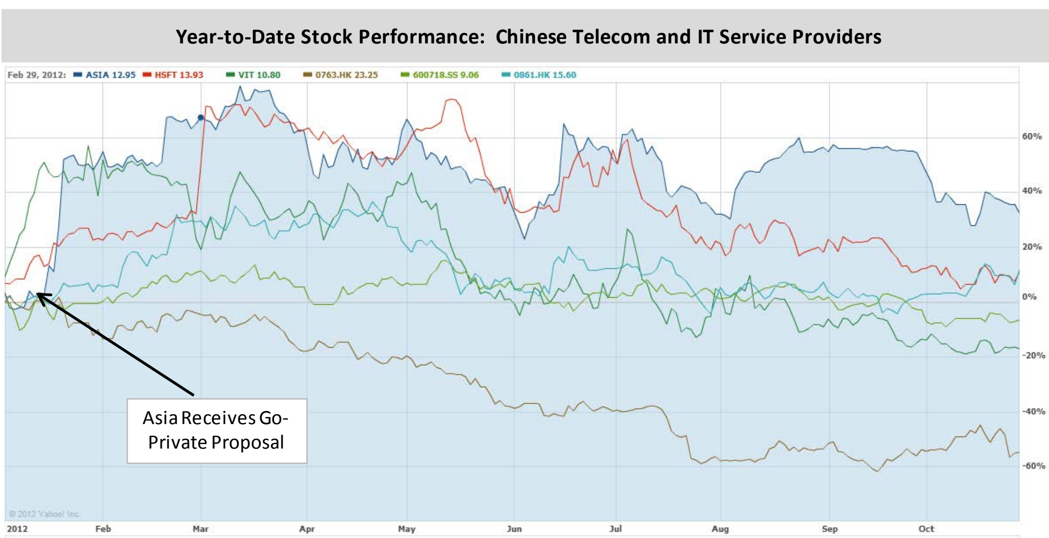
The results indicate that only 36% of the announced deals have closed, and they typically closed within 6 months. Only 2 out of 30 deals (6%) dragged on longer than ASIA's deal, and ended in a completed transaction. At its current market cap of $745m, ASIA's size dwarfs some of the other Chinese small caps that opportunistically announced going-private proposals. Even despite the supposed $257m of cash on ASIA's balance sheet, the financing requirement to take them private would be rather large and limiting for many potential buyers.

Buyers Unlikely To Emerge While Fundamentals Are Weakening

ASIA's core business is in telecom software solutions and IT services in China. Its main customers are China Mobile (CHL), China Unicom (CHU), and China Telecom (CHA). These three customers account for 99% of ASIA's revenues - clearly a loss or deferral of business from any one customer would have a detrimental effect on their business.

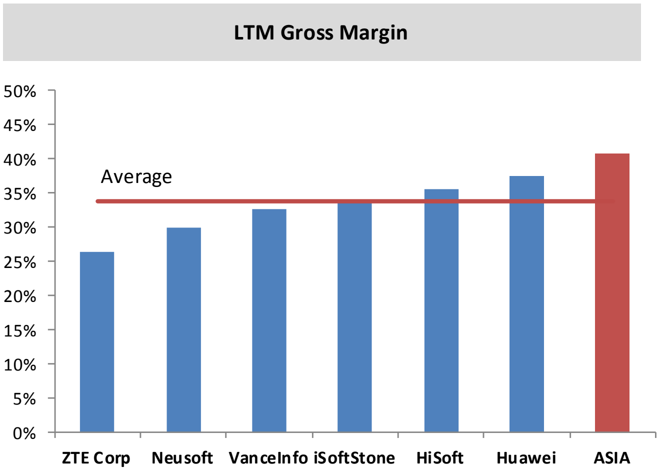
ASIA competes specifically with much larger competitors in the telecom space including ZTE (HK: 0673), Digital China (HK: 0861), Huawei and Neusoft (SHA:600718). If ZTE's disastrous quarter and earnings warning last week are any indication of market conditions in China's telecom service sector, ASIA shareholders are in for a rude awakening. ZTE's stock plummeted 15% after they warned of a future quarterly loss and commented that conditions could get even worse.

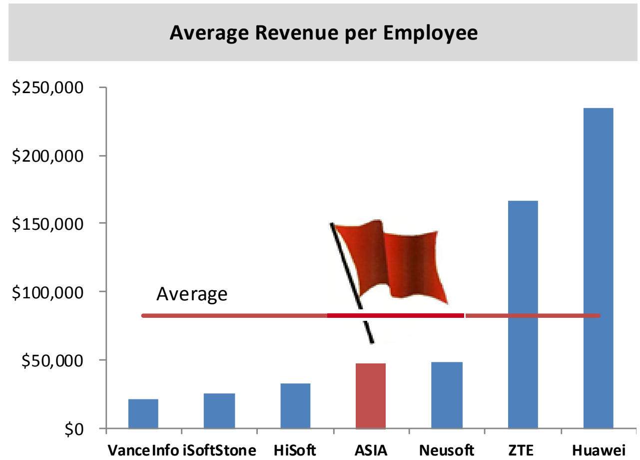
Conditions are not any better in the Chinese IT services sector, which includes companies such as VanceInfo (VIT), HiSoft (HSFT), and iSoftStone (ISS). Currently, the Chinese IT sector is under immense pressure to show growth and profitability. The recent stock-for-stock merger between VanceInfo and HiSoft illustrates the pressures facing the industry. Camelot Information Systems (CIS), a company we warned investors about in an article more than a year ago, continues to suffer and is facing declining earnings. Overall, the market is discounting future losses for Chinese telecom and IT service. The chart below shows the year-to-date stock price performance of ASIA vs. its peers. Every company is trading at or near its low, except for ASIA, which is being sustained on pure hope and speculation that a higher bid will emerge.

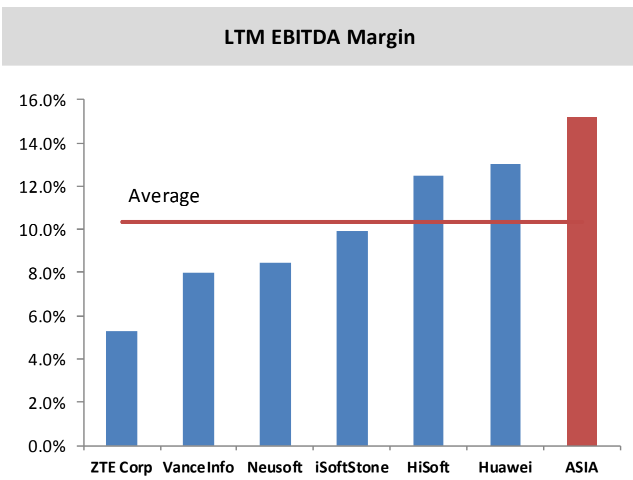


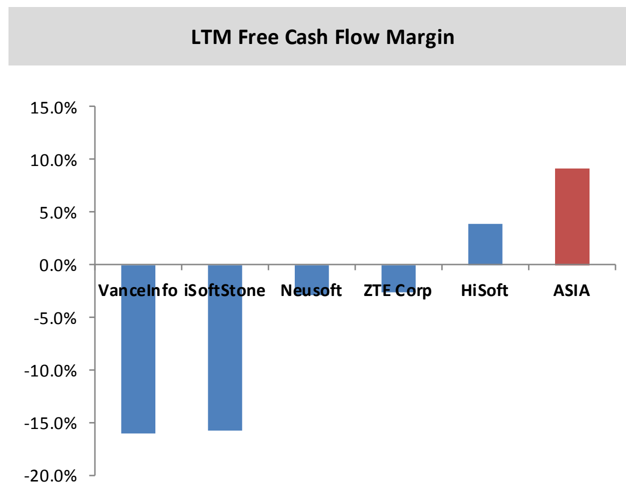
ASIA's Financials: Proceed with Caution, But Don't Just Take Our Word, Listen to the SEC

Perhaps another reason why no buyers are emerging for ASIA is skepticism around the quality of their financials. In the charts below, we see that ASIA is reporting a vastly superior gross and EBITDA margin, and is one of the few companies producing positive free cash flow in the last 12 months. What makes these results so remarkable is that ASIA has a relatively small workforce at just 10,541 employees, and operates in the highly competitive and regulated telecom niche. In this niche they compete most closely with global giants ZTE and Huawei, each with workforces of 87,000 and 140,000 employees, respectively. However, their average revenue per employee figures dwarfs ASIA's. This would indicate they are operating a vastly more productive and efficient operation then ASIA's business. Oddly enough, the margins tell a vastly different story that would lead investors to the opposite conclusion – that ASIA is highly efficient and/or does higher value-added and more profitable work than peers. The disparity is striking and difficult to reconcile. At the very least, it's a red flag that investors should proceed with caution.









Source: CapitalIQ and company financials
Note: Huawei figures based on yr end 2011

Given ASIA's red flag warning seen by the revenue per employee figures, we went one step further to investigate the issue. LinkedIn provides some valuable circumstantial evidence that bolsters the argument that their financials and/or its business size/scale is not as large as advertised. Consider that ASIA has a mere 385 LinkedIn members, which on a workforce greater than 10,000 would indicate a penetration rate of a paltry 3.7%. This figure puts them at the bottom of the heap. The result cannot easily be explained away either by the immaturity of their business since they were founded in 1993 – almost 20 years ago. Furthermore, few LinkedIn members seem even interested in following ASIA. It is also worth noting that on its LinkedIn profile, ASIA describes itself as employing "over 8,000 people worldwide," whereas its website and SEC filings paint a picture greater than 10,000.

Company	Year Founded	LinkedIn Members	Total Employees	% LinkedIn / Employees	LinkedIn Followers
Huawei	1987	40,209	140,000	28.7%	116,385
HiSoft	1993	1,293	7,321	17.7%	1,749
ZTE	1985	10,209	86,980	11.7%	21,348
VanceInfo	1995	1,484	15,605	9.5%	2,243
Neusoft	1991	1,582	20,000	7.9%	2,289
iSoftStone	2001	887	13,348	6.6%	1,443
ASIA	**1993**	**385**	**10,541**	**3.7%**	**642**

Source: LinkedIn as of 10/29/12 and SEC filings

http://www.sec.gov/Archives/edgar/data/1100969/000000000012028527/filename1.pdf

Conclusion

Given the body of evidence presented, we conclude that it is unlikely ASIA will complete a going-private transaction. The company has all but indicated that there are no serious buyers in the process, and the option market is indicating a minimal probability of an imminent deal at any significant premium to the current price. Our empirical analysis of Chinese go-private deals also ascribes a greater than 90% chance that ASIA never completes a transaction. Our suspicion is that no buyers will emerge due to the weak fundamentals in the China market, the risks inherent in the company's VIE structure, and the strong possibility that the company's financials cannot be relied upon. Once investors come to the realization that no deal will occur, ASIA's share price will fall closer in line to its peers, which are trading at 52 week lows. That puts our price target on ASIA at $6.50/share (45% downside).