



# Environmental Monitoring Report

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**PRC: Actis China Fund 2, L.P.**

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**Asian Development Bank**

# China Fund 2: Annual report on HSES

March 2009

## 1. Introduction

It is indicated, under section 35 of the Actis China Fund 2 Environmental Management System (EMS):

*“The fund manager will prepare and submit annual reports on the performance of its portfolio against its policies. The report will be submitted to fund investors as promptly as possible, but not more than 90 days after the close of the relevant financial year, and will contain a list of investment applications received, investment applications refused, reasons for refusal, investments approved, and justification for approval. Actis will describe (i) whether each investment is new, or provided for the expansion or modernization of an existing company; (ii) investment classification based on HSES risks; (iii) key HSES issues identified, and mitigation or corrective measures proposed; and (iv) investee companies compliance with the fund’s HSES policies. Based on investments’ review and monitoring, Actis will describe the status of investee companies’ compliance with its policies including details of any relevant incidents or accidents, which have occurred during the year, and correction actions taken.”*

This report has been created to meet this need and will be made available to all investors in the Actis China Fund 2. The report is divided into the following sections:

- Section 2: General fund information for 2008 (including deals considered, reasons lapsed or agreed)
- Sections 3, 4 and 5: New Company Reports (Specific investee company information on those companies held in the portfolio for a full financial year for the first time, ie that were made in 2007)
- Section 6: Health & Safety, Environmental, Social and Business Integrity Update - updates on previously reported investments
- Section 7: Environmental Social and Governance (ESG) Procedure Verification Report

Sections 3, 4 and 5 of this report cover the performance of Shunda, Springstar Inpac and WSP Holdings, respectively. Each section contains:

- An introduction to the investment
- Key HSES Issues and Risks Identified (including risk and quality of management ratings and highlighting relevant areas for monitoring compliance with policies)
- Actis actions taken to implement HSES policy (including checklists, review and visits)

Section 6 provides an HSES update for China Wolfberry, Grentech, Highland Petroleum, Suntech, Taizinai Biotechnology, and YuHua, respectively. These updates focus on Actis' ESG management in 2008 and should be read in conjunction with the three previous reports for a complete understanding of the ESG issues that have been addressed by Actis through its interaction with each investee company.

## 2. General Fund Information for 2008

In total, 202 investments were considered in 2008. All but 12 of these failed to reach the regional screening stage, i.e. before serious consideration had been given to the investment.

Out of the remaining 12:

- Three were approved by Actis final Investment Committee (IC) and closed:
  - Ambow Education Holding, an educational service provider
  - 7 Days Group Holdings, a budget hotel chain
  - Xiabuxiabu Holding, a fast-food hot pot restaurant chain
- Nine were subsequently lapsed, all purely on commercial grounds
- As China Fund 2 is now fully invested, no additional investments are under consideration

More detailed reports will be provided in next year's report on Ambow, 7 Days and Xiabuxiabu, when these investments have been in the portfolio for more than one year.

### 3. Shunda Holdings

#### 3.1 Introduction to the investment

Shunda manufactures mono-crystalline silicon (mono-si) ingots and wafers used in the production of solar power cells and modules. Founded in Jiangsu Province in October 2003, it has grown rapidly and is now one of China's top manufacturers of mono-si ingots and wafers.

China Fund 2's investment in Shunda Holdings (Shunda) was closed in 2007. In May 2008, China Fund 2 sold its investment in Shunda to Suntech and another investor.

#### 3.2 Key HSES issues and risks identified

No major unmitigated HSES risks were identified during the ESG due diligence process. The initial ESG ratings are summarized in the table below:

	Sector and country risk	Quality of management
Health and safety	Medium	Good
Environment	Medium	Good
Social	Medium	Good
Business integrity	Medium	Good
Climate Change	Medium	Good

#### 3.3 Actions taken to implement HSES policy

A visit to Shunda was carried out by a member of the Actis ESG team in February 2007. Recommendations were made for improvements in H&S and environmental management systems. In addition it was recommended Shunda develop formal Health and Safety and Environmental management systems eg ISO 14001/OHSAS 18001 (Or equivalent) to manage the increase of HSE risk associated with the new chemical plant that was under construction.

As a result of this exit, Actis did not proactively engage with Shunda on ESG issues in 2008.

## 4. Springstar Inpac

### 4.1 Introduction to the investment

Hebei Inpac Group (“Inpac”) is a Chinese printed paper packaging (“PPP”) manufacturer. Inpac has successfully emerged as one of the top-class PPP suppliers in China over the past few years.

Inpac provides one-stop services to its customers, who consist of mainly MNCs. Inpac has strong domestic growth potential through established relationships with rapidly growing FMCG businesses. In addition, it has the opportunity to build on this foundation by the selective addition of new customers and related products.

Inpac sources raw materials (primarily papers and inks) independently and produces a wide-range of products, from corrugated paper boxes to inside pulp trays, user manuals to special gift boxes. It also offers customised printed paper packaging services, including outer structural designing for handset boxes and logistics services.

China Fund 2’s investment in Springstar Holdings Ltd (“Inpac”) was closed in 2007.

### 4.2 Key HSES issues and risks identified

ESG issues were identified using the Actis checklists and information provided in Inpac’s customer audits. As part of the investment approval process, it was recommended that the following ESG elements should be reviewed with management following the completion of the investment:

- Working hours and overtime (to ensure compliance with Government legislation)
- Provision of safe working equipment
- Indoor air quality

The initial ESG ratings are summarized below:

	Sector and country risk	Quality of management
Health and safety	Medium	Good
Environment	Medium	Good
Social	Medium	Good
Business integrity	Medium	Good
Climate Change	Medium	Good

### 4.3 Actions taken to implement HSES policy

A member of ESG team visited Inpac in February 2007. It was noted that Inpac:

- has independently certified environmental (ISO 14001) and quality (ISO 9001) systems in place. In addition, Inpac undergoes regular audits from its customers.
- has reduced the exposure of workers to solvent through the installation of vapour extraction and water based paint (During the site tour one of the ventilation systems was not working.)
- has moved to a three-shift system and therefore the working hours/overtime issue identified during due diligence no longer occurs

However, various housekeeping issues were noted (eg inconsistent wearing of personnel protective equipment, trip hazards, etc) and it was recommended that Inpac consider implementing the Health and Safety management system OHSAS 18001, or similar.

Inpac has a very active board which holds quarterly meetings to make assessment on the business development and management and make adjustments accordingly. However, Inpac does not have any board sub-committees, such as an Audit Committee or Compensation Committee, which we believe would help improve governance. Actis is working to improve the functioning of the board, including the possible addition of such committees.

## 5. WSP Holdings Limited

### 5.1 Introduction to the investment

Founded in 1999, WSP Holding Limited (WSP) is a leading Chinese manufacturer of OCTG (oil country tubular goods), listed on the NYSE.

WSP offers a comprehensive range of over 400 types of seamless OCTG products to its customers, including both American Petroleum Institute (API) products and non-API products. In March 2008, the company obtained a manufacturing licence for seamless pressure pipes, which allows WSP to enter the supply-constrained market for power plant turbine makers.

WSP distinguishes itself by the quality of its products, its customer-oriented research and development and technical capabilities, its competent and technical sales team, its experienced management team and the quality of its after-sales support. WSP is engaged by its customer for well design and provides its customers located in China with on-site support, which includes engineering assistance to address technical difficulties that may arise before, during and after the installation of its products.

WSP has obtained various HSES and quality certifications including:

- ISO/TS 29001 - This is available for use by manufacturers of oil and gas industry equipment and materials (upstream and downstream), service providers to the oil and gas industry, purchasers of equipment, materials, and services. The document can also be used for organizations to perform auditing and certification.
- ISO 9001:2000 (Quality Management System)
- ISO 14001:2004 (Environmental Management System)
- API (5CT-0552, 5D-0067, 5L-0418, 7-0488, Extension 7/11)

Actis invested in WSP in October 2007.

### 5.2 Key HSES issues and risks identified

An extensive ESG checklist was completed as part of the due diligence process and no major unmitigated HSES risks were identified. The initial ESG ratings are summarized in the table below:

	Sector and country risk	Quality of management
Health and safety	Medium	Good
Environment	Medium	Good
Social	Medium	Good
Business integrity	Medium	Fair
Climate Change	Medium	Fair

### **5.3 Actions taken to implement HSES policy**

The Board of Directors of WSP adopted a code of business conduct and ethics in October 2007. This code indicates that each employee has an obligation to comply with all laws, rules and regulations applicable to the Company operations. These include, without limitation, laws covering bribery and kickbacks, copyrights, trademarks and trade secrets, information privacy, insider trading, illegal political contributions, antitrust prohibitions, foreign corrupt practices, offering or receiving gratuities, environmental hazards, employment discrimination or harassment, occupational health and safety, false or misleading financial information or misuse of corporate assets.

## **6. Health & Safety, Environmental, Social and Business Integrity Update**

### **6.1 Introduction**

All the following investments have been reported on in previous years:

- China Wolfberry
- Grentech
- Highland
- Suntech
- Taizinai
- YuHua

This section provides a brief update.

### **6.2 China Wolfberry**

China Fund 2 made an expansion capital investment in China Wolfberry, a producer of herb wine with perceived health benefits, in 2004.

During the four years of investment, Actis has worked with the company to strengthen its financial reporting through training and the recruitment of a CFO and financial controller. China Wolfberry has improved some of its outstanding regulatory issues, including pollution control, registration of trademarks, health and hygiene permits.

Recent audit results show that financial reporting remains substandard however. Governance is also an issue. Actis is now pushing for the full redemption of its loans.

### **6.3 Grentech**

Grentech is an integrated service provider for cellular telecommunications network operators. Actis completed its exit from Grentech in 2007.

### **6.4 Highland Petroleum**

Highland Petroleum designs and manufactures a wide range of oil extraction equipment, including drilling rigs, artificial lifts and oil country tubular goods (OCTG). The company has achieved ISO14001 (an international Environmental Management Standard) and OHSAS18001 (an international specification for occupational health and safety). No major ESG issues were raised in 2008.

### **6.5 Suntech**

Suntech specialises in the research, development, manufacture and sale of crystalline silicon solar cells, modules and photovoltaic (PV) powered products. Actis completed its exit from Suntech in 2007.

### **6.6 Taizinai Biotechnology**

At the time of investment, Taizinai was one of the largest and best known brands of lactobacillus drinks in China. While the Chinese dairy industry as a whole was severely tarnished by the melamine scandal in late 2008, Taizinai was not implicated. However, Taizinai's financial performance deteriorated in 2008. An agreement has been reached with the local government to inject new funding into Taizanai and Actis believes this will lead to an improvement of HSES issues, particularly the timely payment of employees and suppliers.

#### **6.7 YuHua**

Yuhua's principal business is designing and engineering GSM / GPRS mobile phones. Yuhua was sold in December 2006. The Fund retains warrants, which were issued free of cost.

## 7. ESG Procedure Verification Report

### 7.1. Introduction

This report summarises how Actis met its commitment to Responsible Investment (RI) in 2008 and specifically covers investments made since 2004

As part of its commitment to RI, Actis:

- assesses the impact of all new investments in each of Actis's Five ESG Principles (see below) as an integral part of the appraisal process
- requires the management of investee companies to sign an undertaking confirming that it will operate in line with the ESG Code
- gives new investments a risk rating against the ESG Principles to determine the appropriate level of management and monitoring required
- assists investee companies in developing action plans to address areas of non-compliance with the ESG Principles
- encourages the managers of investee businesses to adopt and implement policies relating to the areas of the ESG Principles, particularly where the business entails specific risks
- encourages the managers of investee businesses to work towards continuous improvement in these areas.

The commitment to responsible investment is measured against:

- ESG issues and investee company undertakings
- ESG inherent risk ratings
- ESG policy implementation and action plans
- Commitment to continuous improvement

### **ACTIS'S FIVE ESG PRINCIPLES**

Actis expects all its business partners in particular to understand the importance of integrating the management of environmental, social, governance and climate change issues fully into their business processes. Actis has therefore developed five policies which cover all aspects of Actis's business dealings.

- Environmental
- Climate change
- Health & Safety (H&S)
- Business integrity
- Social

## 7.2 ESG Issues and Investee Company Undertakings

This table indicates whether (1) ESG risks have been reviewed at Investment Committee (IC) and (2) Investee Company ESG undertakings have been included in the appropriate documentation.

NEW INVESTMENT (2008)	SECTOR	IC RISK REVIEW	UNDERTAKINGS INCLUDED IN LEGAL DOCUMENTATION
<b>Africa</b>			
Copperbelt	Mining Exploration	Yes – IC 552A	Placement letter (01 07 08), page 6
Poulina	Food based conglomerate	Yes – IC 559D	MD signed ESG undertaking (correspondence dated 16/01/09)
Momen	Consumer Business	Yes – IC 526A	Convertible Finance Agreement, Clause 9
Alstom	Manufacturing	Yes – IC 532B	Shareholders agreement, Clause 8
<b>South Asia</b>			
Paras	Consumer Business	Yes – IC 537A	Shareholder agreement, Schedule 5
<b>China</b>			
Xiabuxiabu Catering	Retail	Yes – IC 539A (minutes)	Share purchase and share subscription agreement, Section 6.9
7 Days Group	Services	Yes – IC 568A	Amended and Restated Shareholder agreement, Section 10
Ambow	Services	Yes – IC 561A	Series D Preferred Shares Purchase Agreement, Exhibit J
<b>ASEAN</b>			
Teknicast	Manufacturing	Yes – IC 557A	Investment Agreement, Schedule 12
<b>Real Estate</b>			
Ikeja Mall	Property - Africa	Yes – IC 553A (minutes)	Investment Agreement, Clause 13 and Schedule 4
Vaishnavi	Property - India	Yes – IC 535C	Share Subscription and Shareholders Agreement Annex 9

### 7.3 ESG Inherent Risk ratings

Risk ratings are completed in respect of each of Actis's five ESG Principles, based on the inherent risks of the country and sector. Ratings were completed for all new investments in 2008.

	ENVIRONMENT	CLIMATE CHANGE	HEALTH & SAFETY	BUSINESS INTEGRITY	SOCIAL
<b>Africa</b>					
Copperbelt	High	Medium	High	High	High
Poulina	Medium	Low	Medium	Low	Low
Momen	Low	Low	Medium	Medium	Low
Alstom	Medium	Low	Medium	Low	Low
<b>South Asia</b>					
Paras	Medium	Low	Medium	Low	Low
<b>China</b>					
Xiabuxiabu Catering	Low	Low	Medium	Medium	Medium
7 Days Group	Medium	Medium	Medium	Medium	Medium
Ambow	Medium	Medium	Medium	Low	Medium
<b>ASEAN</b>					
Teknicast	Medium	Low	Medium	Low	Medium
<b>Real Estate</b>					
Ikeja Mall	Medium	Medium	High	Medium	Medium
Vaishnavi	Medium	Medium	Medium	Medium	Medium

#### **7.4 ESG policy implementation**

Investment managers (often in their roles as non-executive directors) are responsible for ensuring that investee companies implement policies aligned to Actis's five ESG principles. In 2008 over 30 investment professionals attended the Actis Investment Essentials training. One session in this course specifically covered key ESG issues and how these should be considered during the investment process. In addition each attendee was provided with an (in-house developed) ESG guidebook.

Pre-investment ESG issues are reviewed as an integral part of the investment committee process. Post investment each investment is reviewed twice a year with ESG issues being included as part of this process.

The internal specialist (two person) ESG team provides support and guidance to investment managers at each stage of the investment cycle. Pre investment the ESG team help deal teams with ESG screening and due diligence, post investment with ESG issues associated with portfolio management. This assistance can include carrying out investee company visits, drafting ESG terms of reference as well as document review.

A sub-committee of the main Actis supervisory board, the "ESG Committee", meets twice a year as part of their ongoing monitoring process.

#### **7.5 ESG action plans and a commitment to continuous improvement**

Actis continues to strive to be a leader in the application of good ESG principles in private equity. It was therefore decided in 2008 that an ESG management section would be added to each investment once a year as part of the main investor reporting process (please refer to the Q4 investor reports).