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Hong Kong's No. 1 broker may someday be the biggest stockholder in America's No. 1 broker.

Merrill Lynch Is Bullish on Fung King Hey



by LOUIS KRAAR

Few Americans have ever heard of Fung King Hey, the Hong Kong businessman pictured on the opposite page, but he is the hero in a success story of epic proportions. Fung, now 60, arrived in Hong Kong from China in 1948 with several hundred dollars and today has a personal fortune estimated at \$300 million. Just 13 years ago, starting with seven people, he set out to build a brokerage house, modeled in his mind's eye on Merrill Lynch, and he is now the boss and principal owner of the biggest brokerage in Hong Kong. Several weeks ago he concluded a deal that could make him the biggest individual stockholder in Merrill Lynch itself.

The deal linked up financial heavyweights from three continents in what Fung calls a trilateral relationship. Merrill Lynch bought substantial stakes in two of Fung's companies: 25% of Sun Hung Kai Securities, the brokerage, and 15% of Sun Hung Kai Bank. Fung, in turn, may end up owning a substantial stake in Merrill Lynch. Of the approximately \$82-million purchase price, mostly paid in convertible debentures, Fung got nearly \$62 million. His debentures can be converted into more than 1.7 million shares of Merrill Lynch, over 4% of the outstanding stock. The third party in the linkup was a big French bank, Paribas—more fully, Banque de Paris et des Pays-Bas. Paribas had bought into Fung's companies much earlier, in 1978; it now owns 10% of Sun Hung Kai Securities and 25% of Sun Hung Kai Bank.

Trilateral cooperation is already under way. The three allies are planning, for example, to combine forces in a new investment bank, Sun Hung Kai International, to handle corporate financing and takeovers for Asian clients. Two-partner ventures are also in prospect. Paribas and Merrill Lynch

Fung, whose formal education ended with primary school, arrived in Hong Kong in 1948 with less than a thousand dollars. He is now worth \$300 million.

both envision benefits in working with each other, as well as with Fung. Jean-Yves Haberer, 49, chairman of Paribas, says he hopes that having "some links and intimacy" with Merrill Lynch can lead to ventures elsewhere with the U.S. company. Merrill Lynch and Fung are talking about working together in Singapore and perhaps in the People's Republic of China.

Though the two hefty Western outfits now own large shares of his brokerage and bank, Fung remains firmly in control of both. He is still the principal stockholder. What's more, his trilateral partners know they could not hope to run the Hong Kong businesses as well as he can—being Chinese is a main source of those businesses' success. In the words of William Arthur, 49, chairman of Merrill Lynch International: "We look at Sun Hung Kai as being a Chinese enterprise. Our role will be a supporting one, and the driver will be Chairman Fung."

Ten times around the boat

Thriving on customers who value secrecy, Fung rarely reveals much about his business or himself. In a departure from the past he and his associates talked freely with FORTUNE about the broader strategy behind the alliance with Merrill Lynch. Fung chose to begin aboard his luxurious yacht *Bo Bo*, meaning "beloved one," his wife's nickname in the Cantonese dialect. That's what he speaks; his English is still skimpy. Before sitting down to talk he swam around the boat ten times. Sunning himself on the deck, he described how he is trying "to realize a dream."

Part of that dream is to institutionalize his companies, breaking with the Chinese tradition of keeping business a family affair. Neither of his two sons has shaped up as a promising successor. Instead Fung mostly relies on an ambitious team of Hong Kong Chinese managers in their 30s. Now he can back them up with the technical expertise of Merrill Lynch as well as Paribas.

His grand design, Fung says, includes creating "a multinational financial super-market." This means offering his clients

more American products and services, such as cash management accounts that allow easy switching of funds between money market deposits and portfolio investments. In addition Fung says that he will "leverage up on" Merrill Lynch's vast American sales network, which he could never duplicate alone, to lure U.S. investors into his markets. Merrill Lynch expects to gain from a greater flow of investments to and from Asia, where most economies are still growing vigorously despite the stagnation in the U.S. and Europe. Paribas has already picked up much profitable banking business from Fung, including participation in loans to his blue-chip customers.

A web of connections

Fung was a big-timer even before he linked up with Paribas and Merrill Lynch. His brokerage and bank have combined assets of some \$1.3 billion. Sun Hung Kai Securities accounts for about one-quarter of the trading in the Hong Kong stock market, which despite its volatility has been the world's best performer over the past ten years or so in terms of capital appreciation. Operating round the clock to tap markets in Western time zones, Sun Hung Kai also handles precious metals, commodity futures, real estate, and China trade.

Brokerage and bank thrive on Fung's web of regional connections, extending from gold buyers in Indonesia to government leaders in the People's Republic of China. Merrill Lynch embraced Fung mainly for his links to the most affluent investors in Southeast Asia—the overseas Chinese. This apolitical minority, totaling more than 23 million, is the region's predominant business force. Acting on its own, even sophisticated, resourceful Merrill Lynch would be unable to gain their loyalty, which must be cultivated through personal and cultural bonds. Says Roger Birk, 52, chairman of Merrill Lynch: "I don't think you can make significant progress in this region without a force like Sun Hung Kai."

Fung has patiently developed loyalty



Formalizing a new three-way alliance, Fung clasps hands with Jean-Yves Haberer, 49, at left, chairman of the French bank Paribas, and Roger Birk, 52, chairman of Merrill Lynch. The two Western companies have acquired stakes in Fung's brokerage and bank, in what he calls a "trilateral relationship."

and trust in overseas Chinese communities over the years. He does it, he says, through "mutual assistance" and common friends—the chemistry that brings people together. As he puts it, "My great strength, I feel, is in personal relationships."

Up the mountain

Having learned business amid wars and revolution, Fung seems to exude an inner calm. With a smile on his porcelain-smooth face, he says he never counts his personal assets but reminds himself of a Chinese proverb: "He who does not know how tall the mountain is will always climb higher."

Fung has already done quite a bit of climbing. He was born into a middle-class trading family in Guangdong province in southern China, but his formal education ended with primary school because Japanese troops invaded the country. In his teens, Fung quarreled with his stepmother and left home. He learned something about financial business while working for a money exchange firm in China during World War II.

As a risk taker, he gained his most valuable experience from failures. In 1946 he raised money in Guangdong to buy live tropical fish to sell in Taiwan. During the rough journey on a small boat, Fung was supposed to operate an air pump to keep the cargo alive, but he got seasick and the fish perished. "I lost all my hard-earned capital," he recalls. Undeterred, Fung mortgaged the boat in Taiwan and bought

fresh fruit to sell in Hong Kong, but he encountered a storm en route and that cargo rotted. "All I got for my entrepreneurial efforts," Fung says, "was a load of debts." The setback, he adds, taught him "the importance of adequate planning."

Later Fung managed to set up his own flourishing money changing firm in China, but just before the Communists came to power in 1949 he hurriedly left the country and went to Hong Kong to start over again. The Korean war provided him with another chance to make money. The U.S. and its allies had imposed an embargo on trade with China, but Fung sold goods to the nearby Portuguese colony of Macao, which sent them on to the People's Republic. Fung wound up with enough capital to enter the real estate business in the late 1950s, when Hong Kong was flooded with Chinese refugees looking for apartments. He swiftly made his first millions.

Once more, however, he ran from trouble. When Communist-led riots erupted in Hong Kong in 1967, Fung and his family fled to Canada. Before leaving he hedged his bets by buying property at prices sharply depressed by the rioting. A year later he returned to a stable Hong Kong, where real estate prices had already started rebounding. "I had laid a solid foundation for my personal fortune," he says.

Fung's profits went into starting Sun Hung Kai, a name that comes from three Chinese characters denoting innovative, expansive, and foundation. He became the first Hong Kong broker to offer free analy-

sis of companies, which Sun Hung Kai published in both English and Chinese. Robert Fell, Hong Kong's commissioner for securities, observes, "Fung, as much as anyone, was responsible for getting the man on the street into the stock market." His sales force went after small investors as well as large, and the firm prospered marvelously from Hong Kong's wave of speculative investment in the early Seventies. The stock market there is a virtually unmonitored casino, where players gamble on rumors and insiders often trade on exclusive information.

A cloud that passed

The market collapsed in 1974, prompting some investors to start calling Sun Hung Kai "the big crocodile"—a creature that can eat you alive. "Whenever the stock market goes down," Fung says, "I have a double dose of the proverbial headache because we are often accused of manipulating the market." He insists that Sun Hung Kai buys and sells only on behalf of its clients. Fung's company rode out that brief market bust by diversifying into other activities, such as gold. After the market recovered, Sun Hung Kai went public, with Fung retaining 56% of the equity.

In late 1978 a financial crisis threatened Fung. Stories swept through Hong Kong that his brokerage house had sustained heavy losses in gold and securities trading. Anxious depositors began withdrawing money from Sun Hung Kai Finance, a subsidiary that performed many functions of

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Many of Fung's brokerage clients buy gold as a hedge against political trouble and inflation. Here a dealer checks purity by the old method of rubbing gold against a black touchstone and comparing the color of the streak with a chart.

a bank. As Fung tells it, his firm "came under a cloud as a result of irresponsible and malicious rumors." His colleagues suspect they were started by jealous competitors.

The support that Fung rallied was impressive testimony to his influence among both capitalists and Communists. Paribas, which had just purchased a stake in Sun Hung Kai to get a foothold in Asia, pumped in loans. Simultaneously, Peking's state-owned Bank of China provided what Fung describes as "more support and encouragement." The Communist bank is believed to have quietly approached Hong Kong authorities, who are eager to stay on good terms with China. The colony's financial secretary, who had never expressed public support of any company, announced that Sun Hung Kai was sound.

Devoted to discretion

Fung came out stronger than ever. He spun off the finance subsidiary—now Sun Hung Kai Bank—into a separate public company, and investors quickly snapped up shares. The government recently gave it a full banking license, the first to a local institution in 17 years.

All the while, Fung's companies have been racking up profits. In the past five years Sun Hung Kai Securities has increased its earnings almost eightfold to



Fung visits his trading room, which handles 25% of Hong Kong's stock transactions.

\$32.6 million last year, while the bank's profits have nearly tripled to \$12.6 million. Then there's Fung's real estate company, partly owned by his brokerage house; during the same period its assets increased by a factor of 44 to \$277 million.

Having faced persecution and greedy tax collectors in their adoptive lands, many wealthy Chinese look for safe places to stash part of their money. Fung King Hey, whose brokerage is devoted to discretion, offers customers lots of ways to protect their assets. For instance, the firm sells gold bars to hoard as a hedge against both currency and political risks. Buyers pick up the gold legally in Hong Kong or Singapore, devising their own methods of getting it to other lands. Fung's most vital commodity, however, is business intelligence. He often guides clients into seemingly obscure investments in Hong Kong, which has no capital gain taxes and minimal requirements for corporate disclosure.

For example, Fung's brokerage house recently helped float a new Hong Kong company, First Pacific Holdings. It is a vehicle for Liem Sioe Liong, Indonesia's leading Chinese businessman and a partner with close relatives of President Suharto. Liem's enterprises include the largest private bank in Indonesia, as well as a big cement company and a flour mill. He and fellow investors intend to use First Pacific to hold some foreign financial institutions, including 80% of the Hibernia Bank of San Francisco. The acquisition, already arranged, will cost about \$100 million.

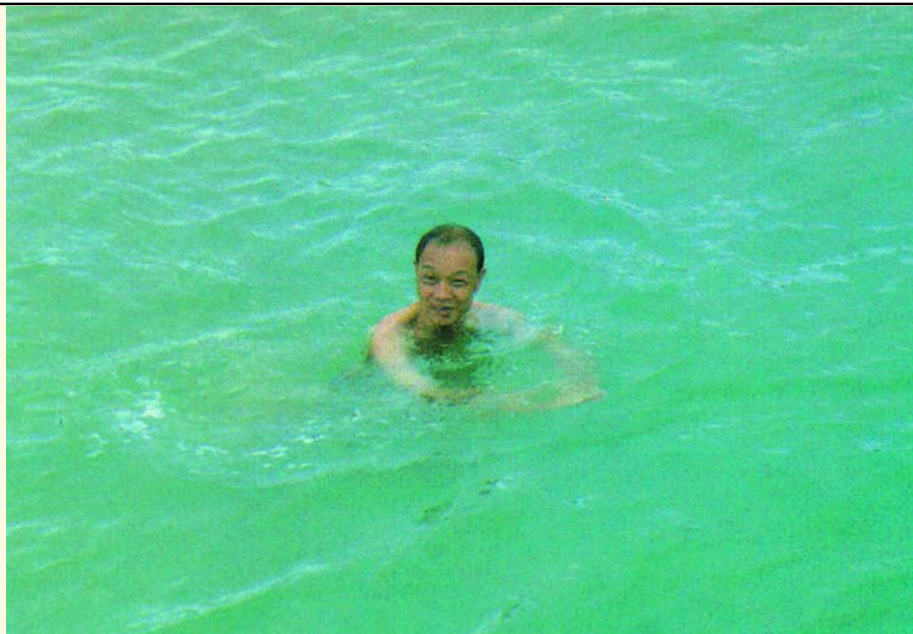
His close tie to the People's Republic, Fung says, "is purely a business relationship." He has invested in a hotel and office complex in Guangzhou (formerly called Canton), near his old hometown. His China trade subsidiary maintains offices in Peking and Shanghai, mainly as go-betweens for Western corporations trying to crack the market. His staff is trying to find openings for sales or investment for such clients as Eaton Corp., Honeywell, and AEG Telefunken. Fung stresses that doing business with China "should really be long term." He should know, for Sun Hung Kai is just beginning to show a marginal profit there after four years.

A search for something to buy

Fung long wanted a U.S. partner to give his firm greater durability, but never made quite the right connection until he got involved with Citicorp. Robert E. Fallon, 34, a vice president of its investment banking arm in Hong Kong, learned of Fung's aspirations in the course of writing a prospectus for a \$30-million Eurobond issue by Sun Hung Kai last year. Fallon, who can converse in Cantonese, helped sell Fung on letting Citicorp serve as his adviser.

In January Fung went to New York with two of his executives to go shopping. He wanted to acquire a substantial interest—as much as 30%—in an American securities company or investment bank. Citicorp had lined up some candidates. During his four-day visit, Fung sounded out five firms. As one of the aides who accompa-

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Lean and agile at 60, Fung often swims around his yacht in Hong Kong harbor.

nied Fung says, "We couldn't find anything attractive enough to buy." Apparently the rejects included two firms with which Sun Hung Kai had collaborative arrangements for selling each other's services: Bear Stearns, a brokerage house, and ACLI International, a commodity trader owned by Donaldson Lufkin & Jenrette.

As matters turned out, Fung became a seller rather than a buyer on his U.S. expedition. On his last day in New York he met with Citicorp Chairman Walter Wriston and began expounding his scheme for a financial supermarket with international partners. Fallon, who attended the meeting, said it produced "a certain catalytic effect." Wriston, according to Fung, suggested that he should talk with Merrill Lynch—and arranged an appointment with Chairman Birk that very afternoon.

Birk was impressed with Fung. "He's not a man of small talk, and that appeals to me," he remarked afterward. More to the point, Merrill Lynch had already decided that it needed a stronger presence in Asian markets. In just 45 minutes the two men agreed to set up company task forces to explore a possible deal.

To hide the mating dance, participants used code names for their companies: silver for Merrill Lynch, gold for Sun Hung Kai, and platinum for Paribas, which played a role as a large shareholder in Fung's firms. As Fallon says, "We just couldn't afford leaks, and things had to move fast with three public companies involved." Nonetheless the covert negotiations dragged on four months, largely over the price Merrill Lynch would pay for shares of Fung's companies. Fung got a

good price: about 50% above market, an indication of how highly Merrill Lynch valued his regional connections. Birk's friend Wriston helped convince him that those connections were worth paying for.

Fung, who ordinarily doesn't drink, took a sip of champagne after completing the negotiations in Hong Kong during a weekend in May. He had much to celebrate. Apart from the business advantages he expects to derive from the trilateral relationship and the good price he got for the shares he sold, the linkup with Merrill Lynch brought Fung psychic satisfaction—greater respectability and status. As one of his advisers says, "Fung didn't do this deal for money, but for respect and acclaim." Adds a leading Hong Kong businessman who has been skeptical about Fung's swashbuckling ways: "Frankly, he was never considered blue-chip here until this wedding with Merrill Lynch."

An American parachute

The deal also nicely covers Fung's greatest downside risk, Hong Kong's uncertain political future. Britain holds most of the colony under a lease that expires in just 15 years. The prevailing view is that the People's Republic, which gets about 40% of its foreign exchange from Hong Kong, will content itself with symbolic gestures of sovereignty and let the colony's flourishing economy alone. "China," says Fung, "needs Hong Kong in its present form." In case he's wrong, though, he now has a substantial fortune safely in America—those Merrill Lynch debentures.

Over the next few years he will have to decide when and at what pace to convert

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Fung's strategy involves potential conflict.

the 23-year debentures into stock. The conversion price works out to \$35.60 a share vs. the recent market price of \$29. His advisers say he may wait three years—no great hardship since he will be collecting 10.3% interest, more than \$6 million a year. He can't wait indefinitely though; certainly his Merrill Lynch associates expect him to trade debentures for equity in due time.

For all the advantages he expects to gain, Fung's strategy of aligning Sun Hung Kai with Westerners involves risk and potential conflict. One of Fung's senior executives warns: "No other U.S. financial joint venture with Asians has really been successful. Making this one work will take a lot of understanding and communication." The differences in business practices between a freewheeling Hong Kong firm and a member of the Wall Street establishment may be difficult to resolve. Fung's firm has dashed ahead by taking greater risks to reap bigger rewards, worrying less about internal controls than Merrill Lynch does. Closing that gap in operating style, the senior executive says, will entail a great deal of travel back and forth and add other overhead costs as well. "Our profits," he predicts, "may dip for a while."

Only a Chinese answer

None of this appears to worry the boss, though. Fung, who sees every setback as a valuable experience, seems a happy man. Early each morning, before his usual 12-hour working day, he goes for a long walk in the cloud-shrouded peaks of Hong Kong and thinks about the future. It must look pretty good to him now. His trilateral relationship has strengthened the business he created and, in his view, ensured its continuation. Eddy Y. C. Lau, 36, deputy chairman of Sun Hung Kai Bank, says, "Fung believes that this will make Sun Hung Kai last forever."

That taken care of, Fung can turn his active mind to another problem, one that can have only a Chinese, not a Western, answer. Eventually, he says, he wants to find a business successor "and walk off into the sunset." ■