cutting through complexity

Hong Kong Capital Markets Update

Issue 1 – April 2012

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Welcome to the April 2012 issue of KPMG China's Hong Kong Capital Markets Update.

This Hong Kong Capital Markets Update aims to bring you information on the last quarter's regulatory developments and market news which we believe will be of interest to you. This issue is divided into three parts: (i) Matters of interest to listed issuers; (ii) Regulatory developments update; and (iii) First quarter 2012 IPO activities. It covers the key developments in the Hong Kong capital markets during the first quarter of 2012, with a focus on those matters that may be particularly interesting to directors, management and other persons who are responsible for financial reporting on and/or compliance with the Hong Kong Listing Rules.

We hope you will find this Hong Kong Capital Markets Update both useful and relevant. If you have any questions on the information in this publication, please contact your usual KPMG contact or any of our Hong Kong Capital Markets professionals listed at the end.

1. Matters of interest to listed issuers

Financial Statements Review Programme Report 2011

As part of its regulatory function, the Hong Kong Stock Exchange (the 'Exchange') operates a Financial Statements Review Programme (the 'FSRP') under which it reviews, on a sample basis, listed issuers' published quarterly, interim and annual reports. The Exchange regularly publishes reports of its key findings and observations from the FSRP to increase issuers' awareness of the possible pitfalls in the preparation of their financial reports such that they may learn from others' experience and improve the quality of their own financial reports.

On 13 January 2012, the Exchange issued its third published report which summarises the key findings from its review of 100 periodic financial reports released by listed issuers between October 2009 and April 2011. The key findings and recommendations in the report are mainly related to the quality of financial disclosures, which are summarised as follows:

- Financial reports should include more information to provide readers with a better understanding of the nature and impact of significant events or material balances and transactions.
- More analysis of remuneration paid to auditors in respect of audit and non-audit services (for example, the nature of significant non-audit services and the fees paid) should be provided.
- Discussions in the Management Discussion and Analysis ('MD&A') should be consistent with the information included in the issuers' financial statements. In addition, issuers should include additional analysis and explanations in the MD&A to explain their performance and financial position, rather than merely repeating information presented in the financial statements in narrative form.
- There have been improvements in disclosures of connected and related party transactions, but the Exchange also indicates that further improvements can be made.
- Improvements should be made in respect of disclosures on financial instruments, and in particular convertible bonds, to make the financial statements more meaningful and useful. For example, during its review the Exchange noted that many issuers failed to disclose the key terms of the financial instruments, the methods and assumptions used by management in determining fair value, and details of the accounting treatment adopted.
- Discrepancies were noted in the interpretations of the relevant accounting standards on acquisitions and whether they should be treated as an acquisition of a 'business' or treated as an acquisition of 'assets and liabilities'. There were also instances where at the time of preparing the investment circulars, the pro forma financial information indicated that the transaction would be accounted for as a 'business combination', but the issuers did not explain in their subsequent financial statements why the transaction was later accounted for as an 'asset acquisition'.
- For investments in investee companies, an issuer should explain more clearly the accounting treatment of not consolidating an investee company when there is evidence that the issuer may

have a 'control' in the investee (for example, when the issuer has over 50 percent equity interest in the investee).

- Disclosure of assumptions and methods to arrive at fair values of investment properties, including the qualification and experience of valuers, should be improved.
- Improvements should be made on disclosures of assumptions and methods used by management to arrive at fair values of investment properties, including the qualification and experience of the valuers.
- Segment information should be balanced and consistent with information disclosed in other parts of the financial reports. For example, the discussions of segment performance in the MD&A should be consistent with the segment information presented in the financial statements.
- While materiality should be considered when deciding whether certain disclosures should be made, issuers should develop benchmarks together with other procedures on quantitative and qualitative aspects of materiality in their reporting systems so that they are consistently applied in the preparation of their financial statements.

In addition to these key findings and observations that are highlighted by the Exchange in the 'Executive Summary' section of the report, there are various other matters addressed in the report that directors and other persons responsible for financial reporting may find useful to take note of. Examples of these matters include:

- There were cases noted by the Exchange where a material goodwill impairment loss was recorded in the annual financial statements related to an acquisition that the issuer had completed during the same year. The Exchange indicated that sufficient details concerning the method and assumptions used in the valuation of a target company should be included in the investment circular and that any potential significant impairment of goodwill or other acquired assets should be considered by the issuers' auditors before the release of the investment circular. Also, the reasons for any significant changes in the value of the acquired business should be provided in the issuer's subsequent annual reports.
- During its review, the Exchange noted that for combinations of businesses or entities under 'common control', the merger accounting principles under Hong Kong Accounting Guideline 5 'Merger Accounting for Common Control Combinations' ('AG 5') were applied, which involved the restatement of the issuer's comparative financial statements 'as if' the common control merger had been completed on the earliest date of the periods being presented. Noting that currently there is no specific IFRS/HKFRS standard that addresses the appropriate accounting treatment for common control acquisition transactions, the Exchange indicated that there could be diversity in practice. The Exchange further expressed its view that the merger accounting approach prescribed in AG 5 should only be applied to special one-off circumstances (such as in preparing financial statements in the year of an IPO) and should not normally be applied for acquisitions made after the initial listing.
- The Exchange observed that modified auditor's reports on financial statements were issued in some cases due to the auditor's inability to obtain and examine the books and records of a disposed business or subsidiary when the auditor performed the annual audit. The Exchange reminded that if an issuer plans to dispose of a material business or subsidiary, if should make early arrangements to ensure that the transaction and the results

of the disposed operations up to the disposal date can be readily and properly included in the scope of audit of the annual financial statements.

It should be noted that so far as financial reporting standards are concerned, the recommendations included in the FSRP reflect the Exchange's own views and interpretations. Financial statements preparers and users are encouraged to refer to the original text of the relevant accounting standards and related authoritative interpretations before drawing conclusions on the applicability of the detailed comments in the FSRP to their specific facts and circumstances. For a copy of the FSRP report, please follow the link:

http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/frm-11.pdf

Consultation paper on Environmental, Social and Governance reporting guide

The Exchange published a consultation paper on 9 December 2011 to seek views on the proposed Environmental, Social and Governance ('ESG') Reporting Guide (the 'ESG Guide'). The purpose of the ESG Guide is to raise awareness of listed companies regarding ESG reporting and to encourage them to disclose more ESG information. The Exchange is not proposing that compliance with the ESG Guide be mandatory but it has indicated that the level of reporting obligation may be raised to 'comply or explain' in the future. The comment period ended on 9 April 2012.

Amendments to the Corporate Governance Code and Associated Listing Rules

Following the Exchange's publication of the Consultation Conclusions on Review of the Corporate Governance Code and Associated Listing Rules in October 2011, amendments have been made to the Corporate Governance Code (the 'Code') and the related Listing Rules (the 'Rules'). While not all of the amendments have the same effective date, most amendments to the Rules became effective on 1 January 2012. The amendments to the Code and certain other Rules became effective on 1 April 2012. In addition, the implementation dates of two particular new rules are as follows:

- A new rule in relation to the appointment of independent non-executive directors representing at least one-third of the board must be complied with by 31 December 2012.

- A new rule in respect of company secretary training will be staggered according to the date of appointment of an individual as the company secretary of a listed company.

The consultation conclusions and a set of frequently asked questions ('FAQs') relating to the Code and the Rules amendments released by the Exchange can be accessed via these links:

http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010124cc.pdf

http://www.hkex.com.hk/eng/rulesreg/listrules/listrulesfaq/Documents/FAQ_17.pdf

2. Regulatory developments update

During the first quarter of 2012, the Exchange published a number of Listing Rules amendments, listing decisions and guidance letters. Below are some highlights of the developments.

Amendments to Listing Rules

- The Main Board Listing Rule 8.21B has been repealed with effect from 1 February 2012. The repeal follows the implementation of the new Securities and Futures Commission ('SFC') rules relating to pre-listing research reports which came into effect on 31 October 2011. As a result, the inclusion of a profit forecast in an initial public offering ('IPO') prospectus is no longer a prerequisite for the inclusion of a profit forecast in the pre-deal research report. Prior to the repeal of Listing Rule 8.21B, a listing applicant was required to include in the IPO prospectus a profit forecast or other forward-looking statements in substantially the same form if the pre-listing research report issued by the sponsors, underwriters or their associates included a profit forecast or any such other forward-looking statements.

- The new and less onerous property valuation and disclosure requirements took effect on 1 January 2012. Among other relaxations, the new rules provide for exemptions from valuation and disclosure requirements in listing documents (for listing applicants) and investment circulars (for listed issuers) based on whether the property is material, and, for listing applicants only, whether the interest in the property is held as a 'property interest' (for example, investment property held to produce rental income and/or capital gain) or a 'non-property interest' (for example, property held for own use).

Listing Decisions

- In February 2012, the Exchange published two listing decisions in respect of the issuing of rights shares. In LD 25-2012, the Exchange confirmed that the issue of rights shares by a People's Republic of China ('PRC') issuer under a general mandate was not subject to the 20 percent discount limit on issue price under Main Board Listing Rule 13.36(5). In LD 26-2012, the Exchange allowed a listed issuer to seek a prior mandate from its shareholders for conducting a rights issue under Main Board Listing Rule 7.19(6) after shortening the mandate period.

- In LD 28-2012, the Exchange granted a listed issuer a waiver from the requirements for an accountants' report on an acquisition target that is listed on the Toronto Stock Exchange, on the condition that the circular would contain alternative disclosures proposed by the listed issuer in its waiver application.

- In LD 29-2012, the Exchange examined the circumstances under which a very substantial acquisition by a listed issuer constituted a reverse takeover transaction. The Exchange considered the transaction a reverse takeover under Main Board Listing Rule 14.06(6)(b) because (i) it was a very substantial acquisition; and (ii) the target company was to be acquired from the controlling shareholder within 24 months of the controlling shareholder gaining control of the listed issuer.

- During the first quarter, the Exchange added two United States jurisdictions, the state of Delaware in LD 24-2012 and the state of Maryland in LD 27-2012, to its list of overseas jurisdictions that it had ruled to be acceptable as an issuer's place of incorporation.

Guidance Letters

- In Guidance Letter 26-12 (January 2012), the Exchange provides its view on the risks involved in a listing applicant's business model that relies significantly on forfeited income from prepaid services and products. For purposes of the listing requirement under the 'profit test', the Exchange may consider an exceptionally high level of forfeited income in the applicant's income portfolio (compared to industry peers) as an indication that the forfeited income should not be included in the determination of the listing applicant's profit because such income may not be generated in the usual and ordinary course of the listing applicant's business. In addition, the Exchange may not consider the applicant suitable for listing if its reliance on forfeited income is significantly above industry norms or the applicant's business is associated with a high level of complaints from its customers and/or related legal claims.

  Further, the Exchange may require additional disclosures in the listing document of the details of prepaid packages giving rise to material forfeited income and the applicant's internal control procedures in handling complaints associated with the forfeitures.

- In Guidance Letter 27-12 (January 2012), the Exchange gives guidance on the disclosure in IPO listing documents in the "Summary and Highlights" section, which aims to ensure that the section (i) is comprehensible and readable; (ii) is concise, easy to read and in plain language; and (iii) enables investors to decide whether they might be interested in the offer, and therefore wish to read the rest of the listing document.

- In Guidance Letter 28-12 (January 2012), the Exchange sets out certain issues (for example, the price fluctuation of major food ingredients) that should be discussed and disclosed in detail in the listing document for an applicant engaged in the restaurant business to the extent that those issues are material to the activities and performance of the applicant.

- In Guidance Letter 30-12 (February 2012), the Exchange states that issuers should discuss material intellectual property rights in listing documents as part of the description of their businesses rather than as a separate list, and focus on which intellectual property rights would be meaningful to disclose to investors and would result in more relevant disclosure.

- In Guidance Letter 32-12 (March 2012), the Exchange sets out the guidance and clarification on the accounting and disclosure requirements in respect of subsidiaries or businesses acquired or agreed/proposed to be acquired by a new listing applicant during or after the track record period. A summary of the relevant requirements are set out as follows:

	After the track record period	During the track record period
Listing rules	➢ Main Board Listing Rules 4.04(2) and 4.04(4) or GEM Listing Rules 7.03(2) and 7.03(4)	➢ Main Board Listing Rule 4.05A or GEM Listing Rule 7.04A
Scope	➢ Acquisitions (including entered into any acquisition agreements and intention to acquire) of any subsidiary or business (including any equity interest in another company) after the trading record period (including the stub period)	➢ Acquisitions of a material subsidiary or business (including any equity interest in another company) during the trading record period (including the stub period)
Size test	➢ No size test	➢ 25 percent or more (major transaction or very substantial acquisition) ➢ By comparing the assets, profits or revenue of the subsidiary or business for the most recent financial year of the trading record period with the total assets, profits or revenue of the applicant for the same financial year
Disclosure requirements	➢ Financial information during the trading record period (including the stub period) ➢ In a note to accounts or separate accountants' report ➢ Full financial statements preferred but at least include income statement and balance sheet (including information required by Main Board Listing Rule 4.05 or GEM Listing Rule 7.04)	➢ Pre-acquisition financial information (from commencement of the trading record period to the date of acquisition) ➢ In a note to accounts or separate accountants' report ➢ Full financial statements (including information required by Main Board Listing Rules 4.04 and 4.05 or GEM Listing Rules 7.03 and 7.04)

3. First quarter 2012 IPO activities

A summary of the companies listed in Hong Kong during the first quarter of 2012 is listed in the tables below.

Main Board				
Stock code	**Company name at time of listing**	**Date of listing (dd/mm/yy)**	**Funds raised (HK$)**	**IPO subscription price (HK$)**
6830	Huazhong Holdings Company Ltd	12/01/12	$280,000,000	1.4000
1303	Huili Resources (Group) Ltd	12/01/12	$425,000,000	1.7000
1281	Kai Shi China Holdings Company Ltd	12/01/12	$135,000,000	0.9000
1263	PC Partner Group Ltd	12/01/12	$168,000,000	1.6000
1803	ASR Holdings Ltd	16/01/12	$93,000,000	0.9300
1312	Allied Cement Holdings Ltd	18/01/12	$165,000,000	1.0000
1972	Swire Properties Ltd	18/01/12	By introduction	By introduction
1315	Vision Fame International Holding Ltd	18/01/12	$90,000,000	1.2000
1830	Perfect Shape (PRC) Holdings Ltd	10/02/12	$220,000,000	0.8800
1210	Christine International Holdings Ltd	23/02/12	$400,000,000	1.6000
1266	Xiwang Special Steel Company Ltd	23/02/12	$1,325,000,000	2.6500
2012	Sunshine Oilsands Ltd	01/03/12	$4,487,235,570	4.8600
1300	Trigiant Group Ltd	19/03/12	$300,000,000	1.2000
1277	Kinetic Mines and Energy Ltd	23/03/12	$1,171,800,000	1.2600
1260	Wonderful Sky Financial Group Holdings Ltd	30/03/12	$347,500,000	1.3900

GEM				
Stock code	**Company name at time of listing**	**Date of listing (dd/mm/yy)**	**Funds raised (HK$)**	**IPO subscription price (HK$)**
8090	China Assurance Finance Group Ltd	06/01/12	$107,800,000	0.2800
8031	ETS Group Ltd	09/01/12	$42,000,000	0.6000
8242	Megalogic Technology Holdings Ltd	19/01/12	$40,000,000	0.8000

(Source: The Stock Exchange of Hong Kong Limited)

During the first quarter, 18 companies launched initial public offerings on the Exchange (including three transactions on the Growth Enterprise Market, or GEM Board), raising total proceeds of approximiately HK$10 billion, up from 15 listings during the same period in 2011, but down 44 percent when measured by total funds raised. Despite an almost 12 percent rally of the Hang Seng Index in the first quarter of 2012, the Hong Kong IPO market continued to be under pressure from a pricing perspective and the deals that were completed during the period were mostly smaller transactions that came with a lower valuation. The largest Hong Kong IPO in the first quarter was the HK$4.49 billion listing of the Canadian oil explorer Sunshine Oilsands Ltd, priced at HK$4.86 per share, which was at the bottom of the marketed range.

As many of the listing applicants adopt 31 December as their financial year end, those applicants who attempted to complete their listing during the first quarter of 2012 would be required to meet the revised conditions set out in Guidance Letter 25-11 (published in October 2011 and updated in November 2011 and March 2012) if they requested a waiver from the strict compliance with Main Board Listing Rule 4.04(1) (the 'Rule 4.04(1) Waiver'). Rule 4.04(1) requires a listing applicant to include in the accountants' report its historical financial information for each of the three years immediately preceding the issuance of the prospectus. The Exchange has in the past granted the Rule 4.04(1) Waiver to listing applicants who have difficulty producing the audited financial statements of the latest financial year end if they intend to issue prospectuses shortly after the year end. Among other requirements and guidance on prospectuses issued within three months of the applicant's financial year end, Guidance Letter 25-11 introduces a new condition for listing applicants issuing their prospectuses in the third month after their financial year end, stating that the applicant must disclose its financial information for the latest financial year end following the content requirements of a preliminary results announcement under Main Board Listing Rule 13.49.

In March 2012, there were only three prospectuses issued involving applicants that have a 31 December financial year end, two of which included the latest financial year end (i.e. 31 December 2011) in the track record period financial information. One of these listing applicants obtained the Rule 4.04(1) Waiver and complied with the revised conditions to disclose the financial information for the latest financial year end following the same content requirements as for a preliminary results announcement under Main Board Listing Rule 13.49 in a separate appendix to the prospectus.

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