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

In this issue, we first provide an overview of the Hong Kong initial public offering ('IPO') market for the first six months of 2012 and the outlook for the remaining months of the year. We then discuss the important public consultation by the Securities and Futures Commission ('SFC') on the regulation of IPO sponsors. We also bring you updates on other key market and regulatory developments since our April 2012 issue. Other notable market or regulatory matters highlighted in this issue include:

- A Plain Language Guide was published by The Stock Exchange of Hong Kong Limited (the 'Exchange') in April 2012 to assist issuers to understand and comply with the connected transaction rules.
- The Exchange provided guidance on the disclosure of the use of proceeds by applicants in listing documents.

- The SFC highlighted certain deficiencies it noted in its review of listing application materials in its latest edition of the Dual Filing Update.

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 2012 IPO Market: Interim Review and Outlook

After three consecutive years being the world's leading market for funds raised¹ through IPO from 2009 to 2011, Hong Kong descended from the No.1 position in terms of funds raised through IPO in the first half of 2012 ('1H 2012'). The Nasdaq Stock Exchange ('Nasdaq'), the New York Stock Exchange ('NYSE') and Shenzhen Stock Exchange are currently in the top three slots. In 1H 2012, the amount of funds raised for new listings in Hong Kong was HK\$30.6 billion, representing a decline by 82 percent compared to HK\$174.7 billion in the same period a year earlier ('1H 2011').

The number of IPOs completed on the Exchange (including transactions on the Growth Enterprise Market, or GEM Board) was 31 in 1H 2012 (excluding one Main Board issuer listed by introduction²). For the same period in 2011, the number of IPOs completed was 34 (excluding three Main Board issuers listed by introduction).

The largest Hong Kong IPO in 1H 2012 was the HK\$14.4 billion H-share listing of the Chinese securities company, Haitong Securities Co., Ltd. followed by the Canadian oil explorer, Sunshine Oilsands with HK\$4.49 billion of funds raised. No other IPO transactions of similar size have been seen so far this year with most of them being smaller transactions in terms of funds raised. Excluding the Haitong Securities IPO, the average offering size in 1H 2012 was approximately HK\$500 million. Please refer to the appendix for a listing of the IPOs completed in 1H 2012. Compared to the IPOs that were completed in 1H 2011, which included a number of transactions with more than HK\$10 billion of funds raised (such as Glencore (HK\$77.8 billion), Prada (HK\$19.2 billion), Samsonite (HK\$10.1 billion), Shanghai Pharmaceuticals (HK\$16.0 billion) and MGM (HK\$12.6 billion)), the offering size in 2012 has been significantly smaller and the majority of them were priced at the bottom of the marketed range.

¹ Funds raised in an IPO transaction represent proceeds from the offering of new shares as part of the IPO.

² An introduction is an application for listing of shares already in issue where no marketing arrangements are required. Since only existing shares are listed by introduction, accordingly, no new shares are issued upon IPO and hence no additional funds raised.

Investors have turned cautious amid fears of the Eurozone crisis and the slow down of the China economy. They are also less likely to invest in new shares when there are other companies currently trading at a low valuation relative to potential earnings in the equity market. With increasingly volatile markets, demands from strategic or cornerstone investors have become more and more crucial to the completion of an IPO, especially when there is an insufficient demand in the public subscription tranche as the sentiment of retail IPO investors continues to be weak. The U.K.-based jeweller Graff Diamonds Corp. that had planned to raise over US\$1 billion postponed its IPO (which did not have any cornerstone investors) in late May, citing adverse market conditions. A few Chinese financial institutions which have plans to raise sizeable amount of IPO proceeds are also waiting for a "good time" to launch their listings in Hong Kong.

Despite the outlook for the second half of 2012 remains difficult, it may be desirable for a potential listing applicant to make use of this time to prepare for and/or proceed with the listing application, so that it will be ready to launch the IPO when the market recovers. We expect the Hong Kong IPO market will gradually improve with an increase in transaction volumes and average offering size in the second half of the year. China's stimulus plan, which includes the easing of banks' reserve requirements and a cut of the benchmark lending and borrowing rates, which will lead to the injection of more liquidity into the economy, is seen as a positive sign for the PRC and Hong Kong region. A total of 12 companies launched IPOs on the Exchange in the first two weeks of July, raising total funds of HK\$12.1 billion. As the equity market continues to improve, we expect issuers which postponed their IPO plans earlier this year will make a last attempt to push deals through before the end of the year.

2 Consultation Paper on the Regulation of IPO Sponsors

On 9 May 2012, the SFC published a consultation paper on proposals to enhance the regulation of IPO sponsors, which the SFC referred to as 'key gatekeepers of market quality' in the consultation paper.

The SFC has been concerned that standards of sponsor work have fallen short of reasonable expectations, and noted that in a number of cases sponsors did not substantially complete their due diligence before making a listing application. The intended objectives of the proposals put forward in the consultation paper are to address such issues and improve the quality of sponsor work in IPO transactions.

Among the key proposals, the more significant aspects of the proposed regulations are as follows:

- The SFC proposed that prior to the submission of the listing application, the sponsor should have completed all reasonable due diligence on the listing applicant; come to a reasonable opinion that the information in the draft listing document is substantially complete; and be satisfied that the listing applicant is ready to be listed. A sponsor is also required to maintain adequate records in relation to its work.
- The Application Proof (i.e. the first draft of the listing document submitted with a listing application) should be made publicly available on the Exchange's website when the application is made.

- The SFC proposed that either a sole independent sponsor should be appointed for each listing transaction or there should be a limit on the number of sponsors that can be appointed for each listing transaction.
- The SFC proposed to make clear that a sponsor has civil and criminal liability for untrue statements (including material omissions) in a prospectus.

Since the launch of the consultation, there have been extensive discussions among the public and market participants on the key proposals. Set out below are some of our observations:

- Under the current vetting process, the IPO listing document and all other submissions to the Exchange and the SFC are made on a confidential basis until these materials are finalised and issued. Public exposure of the Application Proof is intended to encourage the submission of a high quality and substantially complete first submission draft which reflects a thorough understanding of the listing applicant. Knowing that the Application Proof which discloses the identity of the sponsor will be a public document, the sponsor is encouraged to ensure the completeness and accuracy of the Application Proof as much as possible.

We support the SFC's objective of encouraging the submission of a high quality first submission draft and acknowledge the intended benefit of requiring the publication of the Application Proof as noted above. However, we share the concern of a number of listing applicants and market practitioners that the public release of the initial Application Proof will mean release of commercially sensitive information when the listing applicant is still a private company. This might cause valid concerns for the listing applicant who may consider the release of such information to be potentially harmful to the interests of the business. This is particularly relevant considering that it is not uncommon for a listing applicant to decide not to proceed with the IPO at a later stage.

- The SFC believes that with the appointment of more than one sponsor in an IPO transaction, the more widely duties and functions are spread among multiple sponsors, the greater is the risk of fragmentation of work, gaps and overlaps, which adversely affect the quality of the sponsor's work.

While some market participants agree with the SFC's views, we note that others are hesitant to rule out cases where, as a result of particular facts and circumstances, the presence of more than one sponsor in a single transaction could be beneficial to a listing, for example by allowing a listing applicant to draw on a broader range of expertise and experience. We also note that there has not been sufficient empirical evidence that suggests a strong correlation between the quality of sponsors' work and the engagement of only one sponsor in each IPO transaction. As a result of the above, we do not find strong grounds for limiting the number of sponsors to only one per transaction. We do, however, support limiting the number of sponsors for an IPO transaction to a number that the market considers reasonable.

and allowing only the appointment of sponsors who meet the Listing Rules independence requirements.

- Sections 40 and 40A of the Companies Ordinance impose civil and criminal liability for untrue statements (including material omissions) in a prospectus on, among other groups of persons (such as the directors of the listing applicant), each person that has authorised the issue of the prospectus. The SFC's consultation paper notes that although it has been argued that sponsors fall under the category of persons having authorised the issue of the prospectus, there is no Hong Kong case law to support such argument. The SFC believes there is merit in removing this ambiguity by clearly identifying sponsors as also being liable for untrue statements in prospectuses. In particular, the SFC believes that imposing such a liability regime will further encourage sponsors to prepare and review disclosures in a prospectus critically so as to provide a high level of assurance that the information disclosed is accurate, relevant, concise and meaningful for investors.

In contrast, some market participants question whether prospectus liability would realistically encourage better quality disclosure. We note that there are other related issues to be considered in connection with explicit sponsor liability, for example, whether modifications should be made to the existing sponsor defences from liability and the relevance of actual reliance on a prospectus as a prerequisite for private rights of actions. The SFC has noted that it intends to address these issues in separate consultations. Given the significance of the matter, we believe the issue of sponsors' liability for untrue statements in prospectuses should be the subject of further consultation.

The original deadline for submission of comments to the SFC was 6 July 2012. Following market requests, the consultation period has been extended to 31 July 2012.

<http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=12PR46>

3 Other Market and Regulatory Matters

SFC's Dual Filing Update – Deficiencies in Listing Application Materials

In its latest edition of the Dual Filing Update in July 2012, the SFC highlights certain deficiencies in its review of listing application materials which include the following:

- Assertions of critical importance in some listing application materials were based on assumptions that were apparently at odds with observable facts. One of the cases that the SFC cited was a property developer outside Hong Kong which submitted a forecast with forecast average selling prices that were approximately 30 percent higher than the historical average, despite a subsequent substantial price-cut for one of the

developer's property projects. It was questionable whether the forecast was prepared on reasonable grounds and after careful consideration.

- The initial listing application materials in some cases were apparently incomplete and not ready for regulators' review. Among the examples cited by the SFC were a few cases where the initial draft listing documents submitted to the regulators contained not only due diligence questions requesting information from the listing applicants regarding their customers or directors, but also obvious errors and inconsistencies that were attributed to 'inadvertent typos' when queried.
- Many draft listing documents failed to provide meaningful disclosures on the listing applicants' risks, historical financial performance and future plans. An example cited by the SFC was a case where the initial draft listing document merely stated that the decrease in the applicant's gross profit margin was because "[the] rate of increase in cost of sales was faster than the rate of increase in revenue", without stating clearly the specific reasons for the change. The SFC also cited an 'extreme' case where the use of proceeds disclosed in the initial draft listing document was substantially revised after the regulators enquired about the details of the applicant's future plans, which raised concern on whether the original future plans were determined after careful consideration.

The SFC noted that for some of the cases quoted in the Dual Filing Update, the listing application simply did not proceed after the regulators raised concerns on the above deficiencies. For cases which continued to proceed, substantial subsequent amendments were made to the draft listing document.

The findings of the SFC in the Dual Filing Update are consistent with the general observations noted by the SFC in its May 2012 consultation paper on the regulation of sponsors discussed above, where the SFC noted issues in relation to the quality of sponsors' due diligence before making listing applications.

<http://www.sfc.hk/web/doc/EN/speeches/public/dual/Jul12.pdf>

Plain Language Guide on Connected Transaction Rules

The Exchange has published a plain language guide on connected transactions rules contained in Chapter 14A of the Listing Rules (the 'Plain Language Guide'). The Plain Language Guide includes illustrative examples and diagrams, for example, in explaining the definition of a 'connected person,' and covers the Listing Rules requirements on connected transactions and the related interpretations in Listing Decisions and Frequently Asked Questions issued by the Exchange. The Plain Language Guide does not form part of the Listing Rules but will be a useful tool for issuers in understanding and complying with the complicated connected transaction requirements under the Listing Rules. We welcome this as a move of the Exchange in stepping forward and taking the initiative to provide useful information to users of the Listing Rules.

http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/ctguide_e.pdf

The Exchange's Letter to Issuers on Continuous Disclosure Obligations

The Exchange issued a letter to issuers on 10 May 2012 to remind them of the disclosure obligations under the Listing Rules in light of certain recent enquiries made to the Exchange concerning issuers' handling of market comments and negative publicity on their accounting and corporate governance issues. The Listing Rules require issuers to keep investors and the public fully informed of all matters that might affect their interests. An issuer's directors are reminded to assess whether a disclosure obligation arises in circumstances involving speculation or rumour and the importance of establishing procedures in monitoring share price movements and news, comments or reports relating to the issuer in the market.

<http://www.hkex.com.hk/eng/rulesreg/listrules/listletter/Documents/20120510.pdf>

Guidance Letters

During the second quarter of 2012, the Exchange continued to publish various guidance letters on IPO applications and disclosures in listing documents. Below are some highlights of these developments.

- In [Guidance Letter 33-12](#) (April 2012), the Exchange gives guidance on the disclosure of the intended use of proceeds by applicants in listing documents. Disclosure issues highlighted in the Guidance Letter include the following:

Proceeds for general working capital

- Where a new applicant has no current or specific plans for the proceeds, or a material portion of them (generally 10 percent or more), this fact and the principal reasons of the offering must be disclosed.
- The Exchange considers that references to 'working capital' or 'general corporate purposes' do not constitute current or specific plans for the proceeds unless a reasonably detailed explanation is given of how the working capital is to be applied or what the general corporate purposes are.

Proceeds for acquisition of properties

- Where the proceeds will be used to acquire properties from any connected persons or their associates, the Use of Proceeds section of the listing document must disclose the basis for determining the cost of the acquisitions.

Proceeds for acquisition of businesses

- The Exchange considers that the identity of the businesses or, if not yet identified, the types of businesses to be sought and the status of negotiations must be disclosed.

Proceeds for discharge of debt

- Where the proceeds will be used to discharge debt, the listing document must disclose the interest rate and maturity of the debt, and how the borrowing was used if the debt to be discharged was incurred within one year before the date of the listing application.

The Guidance Letter also discusses other disclosure requirements in the listing document, including proposed capital expenditures and the order of priority of the use of proceeds. It further describes the requirement for an announcement to be made when there is a material change of use of proceeds after listing.

- The Exchange gives guidance on disclosure of hard underwriting arrangements in [Guidance Letter 34-12](#) (April 2012). Hard underwriting arrangements may include an underwriting agreement pursuant to which the underwriters agree to commit to purchase a fixed value of shares not taken up under the public offer and/or international placing on the condition that the final offer price is fixed at the low end of the IPO offer price range. In contrary, under a typical 'soft' underwriting arrangement for a Hong Kong public offer, the underwriters are entitled to terminate the underwriting agreement with immediate effect if any of the events (for example, a material adverse change in the financial position of the listing applicant) as stipulated in the agreement occurs prior to 8:00 am on the date of listing. The listing applicant generally pays a fee for hard underwriting and such arrangements are usually in place when the demand for the offer shares is not expected to be strong.

The guidance requires that the disclosure of the salient terms of the hard underwriting agreement in the prospectus should generally include the date of the agreement, amount underwritten, conditions, grounds for termination and fees. If the hard underwriting agreement is entered into after the prospectus is issued, the issuer is required to issue a supplemental prospectus to disclose the salient terms of agreement described above.

- In [Guidance Letter 35-12](#) (May 2012), the Exchange clarifies the difference between a profit forecast (which means any forecast of profits or losses) and a profit estimate (which is an estimate of profits or losses for a financial period which has ended, but for which the results have not yet been audited or published). The Guidance Letter reiterates that the inclusion of a profit forecast in the listing document is purely voluntary but that the submission of profit and cash flow forecast memorandum to the Exchange remains a requirement as part of the IPO application process whether or not a profit forecast is included in the listing document.
- The Exchange presents its observations on the risks involving distributorship business models and gives guidance on disclosure in the prospectus in [Guidance Letter 36-12](#) (May 2012). The Exchange notes that the terms 'distributorship', 'franchising', and 'consignment' cover a wide range of different business models and the use of these terms in a listing document is insufficient to convey the true nature of an applicant's business. Therefore, the Exchange expects that a listing applicant clearly explain its business model in the prospectus and the sponsor must perform sufficient due diligence work in relation to the fairness and reasonableness of sales to distributors recorded during the track record period and the disclosures made in the prospectus.

The guidance also discusses areas of concerns arising from business models that involve sales of goods or services through multi-level distributors including inventory risk, timing of revenue recognition, cannibalisation (i.e. the applicant's profits from royalty payments received from distributors for initial set up, which may not be sustainable when there are too many distributors in the market), recoverability of accounts receivables and credit

management policy and independence of distributors, and the requisite disclosures in the prospectus.

- In June 2012, the Exchange published two Guidance Letters in respect of the disclosure of indebtedness, liquidity, financial resources and capital structure ('Liquidity Disclosure') in a listing document. [Guidance Letter 37-12](#) is largely a reproduction of the Exchange's letter to market practitioners dated 21 July 2008 regarding Liquidity Disclosure in a new applicant's listing document with modifications based on the subsequent letter issued by the Exchange to market practitioners dated 5 October 2009. The guidance is intended to assist new applicants and their advisers to prepare the Liquidity Disclosure in the prospectus.

In [Guidance Letter 38-12](#), the Exchange clarifies that the latest date for the Liquidity Disclosure should be a date no more than two calendar months before the date of the prospectus. In addition, the statement in the prospectus by the applicant's directors confirming no adverse change in the financial or trading position is now required to cover the period since the end of the period reported on in the accountants' report up to the prospectus date. This represents a change to the previous practice whereby such confirmation made by the directors of the new applicant in the prospectus generally covered the period from the end of the period reported on in the accountants' report up to the 'latest practicable date', which meant a date no more than 10 calendar days before the date of the prospectus.

Listing Decisions

- In [LD 30-12](#) (April 2012), the Exchange considered whether an IPO applicant's financial and operational reliance on its parent company rendered the IPO applicant not suitable for listing. It was noted by the Exchange that (i) the IPO applicant had been very reliant on sales to the parent company during the track record period, (ii) it received significant advance payments from the parent company, which was a major funding source for the IPO applicant to finance its operations, and (iii) the parent company's financial results had been adversely impacted by the continued downturn in the industry in which it operated. Based on the above, the Exchange concluded that the IPO applicant had not yet demonstrated its operational and financial independence from its parent company.

The Exchange further considered that the IPO applicant's significant reliance on its parent company also raised the issue of the sustainability of its business and its suitability for listing under Listing Rule 8.4. The Exchange determined that the IPO applicant should take concrete steps to address the issue of reliance on its parent company before the Exchange would consider any further review of the listing application.

- In [LD 31-12](#) (May 2012), the Exchange considered whether the disclosures relating to the allegations in a complaint against certain members of the IPO applicant, a mineral company under Chapter 18 of the Listing Rules, were adequate and whether a waiver of the profit test requirement under Rule 8.05(1) should be granted under Rule 18.04. The Rule states that if a mineral company is unable to satisfy, among others, the profit test in Rule 8.05(a), it may still apply to be listed if its directors and senior managers have sufficient experience relevant to the exploration and/or extraction activities that the mineral company is pursuing.

The Exchange initially decided that the application for waiver of Rule 8.05(1) under Rule 18.04 should not be granted because the IPO applicant had not demonstrated to the Exchange's satisfaction that it has a clear path to commercial production. The Exchange also considered the disclosures relating to the allegations in the complaint were unclear and limited. Subsequently, the IPO applicant progressed to commercial production and re-submitted a new listing application with enhanced disclosures in the listing document addressing the Exchange's concerns relating to the allegations. It also commenced to prepare a detailed mining plan with a detailed production schedule. Based on the enhanced disclosures, the Exchange agreed to grant a waiver of Rule 8.05(1) under Rule 18.04 and the listing was permitted to proceed.

- In [LD 32-12](#) (June 2012), the Exchange granted a waiver to a mineral company from the requirement to include a competent person report (the 'CPR') on certain mines that were considered insignificant within its portfolio in the listing document on the conditions that (i) material information of these mines was disclosed in the listing document; (ii) the mineral company undertook to prepare and issue a CPR for each of its mining interests when the information necessary for the preparation of a CPR was available; and (iii) the mineral company reported in its annual reports the status of each of these mines and the management's intention with respect to these mines.

Appendix: First Half 2012 IPO Activities

A summary of the companies listed in Hong Kong during the first six months 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	
Total funds raised in Q1 2012			\$9,607,535,570		
1329	Juda International Holdings Limited	02/04/12	\$55,000,000	1.1000	
1322	CW Group Holdings Limited	13/04/12	\$216,125,000	1.3300	
1613	Synertone Communication Corporation	18/04/12	\$99,000,000	0.3300	
1366	Jiangnan Group Limited	20/04/12	\$546,416,000	1.4200	
2623	China Zhongsheng Resources Holdings Limited	27/04/12	\$159,604,800	1.2300	
6837	Haitong Securities Co., Ltd	27/04/12	\$14,383,140,000	10.6000	
695	Dongwu Cement International Limited	13/06/12	\$137,500,000	1.1000	

Main Board (continued)				
Stock code	Company name at time of listing	Date of listing (dd/mm/yy)	Funds raised (HK\$)	IPO subscription price (HK\$)
3663	Xiezong International Holdings Limited	18/06/12	\$186,000,000	0.9300
816	Huadian Fuxin Energy Corporation Limited	28/06/12	\$2,475,000,000	1.6500
1258	China Nonferrous Mining Corporation Limited	29/06/12	\$1,914,000,000	2.2000
Total funds raised in Q2 2012				\$20,171,785,800

Total funds raised on Main Board in 1H 2012 **\$29,779,321,370**

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
Total funds raised in Q1 2012				\$189,800,000
8219	Branding China Group Ltd.	27/04/12	\$99,000,000	1.9800
8030	Flying Financial Service Holding Ltd.	07/05/12	\$175,860,750	0.6500
8240	China City Railway Transportation Technology Hldgs Co. Ltd.	16/05/12	\$200,000,000	1.0000
8232	China U-Ton Holdings Ltd.	16/06/12	\$142,800,000	0.3400
Total funds raised in Q2 2012				\$617,660,750
Total funds raised on GEM in 1H 2012				<u>\$807,460,750</u>

Total funds raised in Hong Kong in 1H 2012 **\$30,586,782,120**

(Source: The Stock Exchange of Hong Kong Limited)

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