

---

## INDUSTRY OVERVIEW

---

*This section contains information and statistics on the industry in which we operate. We have extracted and derived such information and statistics, in part, from various official or publicly available sources. In addition to statistics, market share information and industry data from publicly available government sources, certain information and data contained in this section are derived from Wind Info. As a leading integrated service provider of financial data, information and software in the PRC domestic market, Wind Info serves financial enterprises, including securities companies, fund management companies, insurance companies, banks and investment companies. The financial database of Wind Info contains comprehensive information on stocks, bonds, futures, foreign exchange, insurance, derivatives and the macro-economy. Historical data and market estimates provided by Wind Info are collected by Wind Info independently from various public information sources, including the SAC, the Shanghai Stock Exchange and the Shenzhen Stock Exchange. The information and data derived from Wind Info are not commissioned by us or the Joint Sponsors and can be accessed by all its subscribers.*

*We believe that the sources of this information are appropriate sources and have taken reasonable care in extracting and reproducing such information. We have no reason to believe that such information is false or misleading or that any fact has been omitted that would render such information false or misleading. The information has not been independently verified by us, the Selling Shareholder, the Joint Sponsors, the Joint Global Coordinators, the Joint Bookrunners, the Joint Lead Managers, the Underwriters, any of our or their respective directors, officers, employees, advisors, agents or representatives or any other party involved in the Global Offering and no representation is given as to its accuracy.*

### OVERVIEW OF THE PRC CAPITAL MARKETS

#### Development History of the PRC Capital Market

Since the establishment of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in 1990, the PRC capital markets have experienced rapid growth in scale and maturity.

#### *Stock Market*

The PRC stock market has grown significantly in several aspects, including the number of listed companies and the total market capitalization of listed companies. According to the CSRC, the number of listed companies in the PRC increased from 1,381 as of December 31, 2005 to 2,494 as of December 31, 2012, representing a CAGR of 8.8%. According to the Shanghai Stock Exchange and the Shenzhen Stock Exchange, the total market capitalization of listed companies in the PRC increased from RMB3.2 trillion as of December 31, 2005 to RMB23.0 trillion as of December 31, 2012, representing a CAGR of 32.3%. The PRC stock market ranked second in the world in terms of total market capitalization as of December 31, 2012 and ranked second in the world in terms of total trading turnover in 2012.

## INDUSTRY OVERVIEW

The PRC stock market has developed a multi-tiered structure with the launch of the SME Board in 2004 on the Shenzhen Stock Exchange and the ChiNext Board on the Shenzhen Stock Exchange in 2009 to facilitate equity capital raising of SMEs. From 2009 to 2012, the SME Board and the ChiNext Board grew significantly in terms of the number and the total market capitalization of listed companies, as set forth in the following table:

	<u>Dec 31,</u> <u>2009</u>	<u>Dec 31,</u> <u>2010</u>	<u>Dec 31,</u> <u>2011</u>	<u>Dec 31,</u> <u>2012</u>	<u>CAGR</u> <u>2009-2012</u>
<b>Number of listed companies</b>					
SME Board .....	327	531	646	701	28.9%
ChiNext Board .....	36	153	281	355	114.4%
<b>(RMB in billions)</b>					
<b>Total market capitalization of listed companies</b>					
SME Board .....	1,687	3,536	2,743	2,880	19.5%
ChiNext Board .....	161	737	743	873	75.7%

Source: Shenzhen Stock Exchange

The PRC stock market also recorded progress in developing an OTC market. In January 2006, a pilot board, known as the New OTC Board, was launched to provide an OTC market for quotations and transfers of shares of unlisted joint stock companies registered in the Zhongguancun Science and Technology Park in Beijing. According to the SAC, 207 enterprises had been listed on the New OTC Board as of December 31, 2012.

### ***Bond Market***

The PRC bond market has developed significantly since 2005 and has increased the scale of direct financing in China, which had been primarily limited to equity financing. Corporate bonds were introduced into the market and the enterprise bonds market experienced rapid growth after the simplification of the regulatory approval process. Furthermore, the issuance of short-term notes and medium-term notes also increased significantly. The introduction of subordinated bonds, financial bonds, hybrid bonds, and asset-backed securities has further diversified the structure of the PRC bond market and strengthened its role as a platform for financial innovation by securities firms exploring new financial products. From 2005 to 2012, the total proceeds raised from bond issuance related to corporate financing in the PRC grew at a CAGR of 44.3%.

The following table sets forth the amount of proceeds raised through certain major types of bond issuance by PRC enterprises for the periods indicated.

<b>(RMB in billions, except percentages)</b>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>CAGR</u> <u>2005-2012</u>
Enterprise bonds .....	60	62	111	157	325	283	252	650	40.4%
Corporate bonds .....	-	-	11	29	73	51	129	261	87.7% <sup>1</sup>
Financial bonds <sup>2</sup> .....	104	57	97	99	307	105	392	472	24.2%
Short-term notes .....	145	292	335	434	461	689	1,016	1,536	40.1%
Medium-term notes .....	-	-	-	174	691	497	820	1,170	61.1% <sup>3</sup>
Asset backed bonds .....	8	16	18	30	-	-	1	28	20.3%

Source: Wind Info

1 Growth rate represents CAGR for 2007-2012.

2 Financial bonds exclude those issued by policy banks.

3 Growth rate represents CAGR for 2008-2012.

---

## INDUSTRY OVERVIEW

---

### *Derivatives Market*

In recent years, the PRC derivatives market, and the futures market in particular, has experienced significant growth. According to the CSRC, total trading turnover of the PRC futures market grew from RMB21.0 trillion in 2006 to RMB171.1 trillion in 2012, representing a CAGR of 41.8%. The PRC commodity futures market has also developed rapidly to become one of the largest in the world. In April 2010, four CSI 300 Index Futures contracts started trading on the China Financial Futures Exchange, becoming the first financial futures in the PRC. In 2012, the total trading turnover of stock index futures amounted to RMB75.8 trillion, representing 241.1% of the stock market's total trading turnover during the same period.

In addition to commodity futures and stock index futures, other financial derivatives such as treasury bond futures, call and put warrants have also been issued in the PRC. Despite the relatively low trading volume of these financial derivatives, they are expected to have substantial growth potential.

### *Internationalization*

In November 2002, the CSRC and the PBOC launched a pilot program with an initial quota of US\$10.0 billion for QFIIs to invest in the PRC capital markets. In August 2006, the CSRC, the PBOC and the SAFE formalized the QFII program. The SAFE has increased the quota several times to the current US\$80.0 billion. According to the CSRC and the SAFE, there were 207 QFIIs as of December 31, 2012 with an aggregate approved investment quota of US\$37.4 billion.

In December 2011, the CSRC, the PBOC and the SAFE issued rules which permit the Hong Kong subsidiaries of qualified fund management companies and securities firms, as RQFII, to invest Renminbi from foreign exchange settlement into the PRC capital markets. Maximum investment quota of the pilot program was initially RMB20.0 billion and was subsequently raised to RMB70.0 billion in April 2012. According to the CSRC and the SAFE, there were 21 RQFIIs as of December 31, 2012 with an aggregate approved quota of RMB67.0 billion.

Parallel to the QFII and RQFII programs, the SAFE and the CSRC have established the QDII program to enable domestic institutional investors such as banks, securities firms, insurance companies and trust companies to invest in the overseas capital markets. The program also enables other domestic investors to invest in overseas capital markets through QDII funds and wealth management products. According to the SAFE, there were 107 QDIIs as of December 31, 2012 with an aggregate approved quota of US\$84.7 billion.

### **Characteristics and Development Trends of the PRC Capital Market**

Despite the rapid growth since 1990, the PRC capital markets are still in an early stage of development as compared with the more developed capital markets overseas.

### *Financial Disintermediation and Improvements in Financing Structure*

Currently, the primary source of financing for PRC enterprises is indirect financing through bank loans. Direct financing through equity and bond issuance is not as prevalent in the PRC as in the

## INDUSTRY OVERVIEW

more developed markets such as the U.S. The following table sets forth the total size of direct and indirect financing in the PRC and the U.S. in 2012:

	Direct financing (equity and bond issuance <sup>1</sup> )	Indirect financing (bank lending)	Total
	(US\$ in billions, except percentages)		
<b>PRC</b> .....	743	1,460	2,203
Proportion of total financing .....	33.7%	66.3%	100.0%
<b>U.S.</b> .....	3,864	545	4,409
Proportion of total financing .....	87.6%	12.4%	100.0%

*Sources:* Wind Info, SIFMA, Shanghai Stock Exchange, Shenzhen Stock Exchange, World Federation of Exchanges, PBOC, U.S. Federal Reserve Board

1 Bond issuance refers to those related to corporate financing (including corporate bonds, enterprise bonds, financial bonds other than policy-bank bonds, short-term notes, medium-term notes, asset-backed securities, convertible bonds and warrant bonds), but exclude debt issuance by various governmental agencies (such as MOF bonds, municipal bonds, central-bank bills, policy-bank bonds, international institutional bonds and government-backed institutional bonds). The U.S. dollar-RMB exchange rate used is based on the buying rate on December 31, 2012.

Further, the scale of the PRC direct financing markets is disproportionate to the scale of the PRC economy and presents significant growth potential. In particular, the PRC bond market is still under-developed as illustrated by the lower ratio of total outstanding bonds issued by PRC enterprises to nominal GDP and the PRC stock market's total market capitalization of listed companies as a percentage of the nominal GDP, as compared with those of developed countries. The PRC stock market's total market capitalization of listed companies as a percentage of the nominal GDP as of December 31, 2012, and the total bonds issued by corporate issuers outstanding as a percentage of the nominal GDP in the PRC as of December 31, 2011 were 44.4% and 9.2%, respectively, as compared to 117.9% and 34.6% in the U.S.

The imbalanced PRC capital markets have restricted efficient pricing and allocation of capital and impeded economic policies of the PRC Government to achieve sustainable growth and optimized structure of the economy. In order to address these issues, financial reforms are taking place in the PRC and are expected to lead to further disintermediation of the financial market and adjustment of financial sectors. Among the initiatives, the Twelfth Five-Year Plan has identified the accelerated development of the bond market as a key agenda and aims to (1) streamline the approval process, disclosure requirement and regulatory framework for bond issuance; (2) expand the size of bond market and promote product innovation and diversification; (3) improve the bond market infrastructure; and (4) create a sound system for the development of the bond market. Direct financing is expected to become increasingly important to the PRC financial system.

### *Diversification of Financial Products*

Currently, the types of financial products and services available in the PRC capital markets are relatively limited as a result of regulatory restrictions and low investor acceptance. For instance, issuance of asset-backed securities and exchangeable bonds is rare in the PRC bond market. The PRC markets for short-term notes are also significantly smaller than those in the developed markets. The PRC derivatives market consists primarily of commodity futures, while the only type of financial futures available is stock index futures. In contrast, a number of financial derivatives, including foreign exchange derivatives and interest rate derivatives, are actively traded in other major capital markets in

## INDUSTRY OVERVIEW

the world. The following table sets forth the number of financial futures contracts outstanding in the PRC and the U.S. in 2012:

U.S. (unit: number of contracts in millions)		PRC (unit: number of contracts in millions)	
Stock index futures	646.0	Stock index futures	105.1
Interest rate futures	995.7		
Foreign exchange futures	210.7		

Source: World Federation of Exchanges

The development of financial products and services in the PRC is expected to be driven by the increasingly diversified and sophisticated enterprises and investors, and their growing demand for investment options and corporate financing tools. The markets for stocks, bonds, and derivatives will continue to evolve with the introduction of new financial products such as fixed-income, structured products and asset-backed securities. For example, in 2012, asset securitization has been relaunched in the PRC market with the issuance of credit asset-backed securities, enterprise asset-backed securities, and asset-backed notes. In addition, liquidity management and short-term wealth management products will serve as useful tools to enhance the efficiency of client funds utilization. For instance, the Shanghai Stock Exchange is proactively promoting a pilot program for dealer-quoted bond repurchase transactions. Furthermore, it is believed that various new commodity and financial derivatives will also be introduced, including MOF bond futures which have been undergoing simulated trading since February 2012.

### *Continuing Evolution of the Multi-tiered Equity Market*

Presently, equity financing in the PRC is predominantly conducted on the main boards, while the effectiveness of the SME Board, the ChiNext Board and the OTC markets needs to be further enhanced to provide additional sources of financing to the PRC's SMEs and in emerging industries. In contrast to the structures of stock markets in developed markets such as the U.S., the main boards of the Shanghai Stock Exchange and the Shenzhen Stock Exchange account for the majority of the PRC stock market in terms of number of listed companies. The following table sets forth the number of companies listed on various tiers of stock markets in the PRC and the U.S. as of December 31, 2012:

U.S.		PRC	
New York Stock Exchange	2,339	Main Boards	1,438
NASDAQ	2,577	SME Board	701
OTCBB	2,047	ChiNext Board	355
Pinksheet <sup>(1)</sup>	6,201	OTC market <sup>(2)</sup>	256

Sources: Shanghai Stock Exchange, Shenzhen Stock Exchange, CSRC, Wind Info, World Federation of Exchanges, OTC Bulletin Board and OTC market

(1) Data as at February 20, 2013.

(2) Includes the New OTC Board only and excludes the New Regional OTC Boards.

In August 2012, the State Council officially approved the expansion of the New OTC Board beyond Zhongguancun Science and Technology Park in Beijing to include Zhangjiang Hi-Tech Park in Shanghai, Donghu New Technology Development Zone in Wuhan and the Binhai Hi-Tech Zone in Tianjin to further develop the fund raising and trading platform for enterprise in high-tech and other emerging industries. In addition, a number of New Regional OTC Boards are being established to trade the stocks of non-public companies that have significant growth potential. The Shanghai Equity Exchange (上海股權託管交易中心) and the Qianhai Equity Exchange (前海股權交易中心) in Shenzhen

---

## INDUSTRY OVERVIEW

---

commenced operation in February and May 2012, respectively. The development of regional equity depositary trading exchanges can provide effective financing channels for SMEs and, together with the main boards, the SME Board, the ChiNext Board, and the New OTC Board, form the multi-tiered equity market in the PRC.

### *Increasing Participation of Institutional Investors in the Capital Markets, Especially the Stock Market*

Individual investors have been the primary participants of the PRC stock markets. According to the Shanghai Stock Exchange, between 2007 and 2011, trading by individual investors accounted for 84.5% of the total trading turnover on average. Nonetheless, as the PRC capital markets, particularly the stock market, gradually mature, the participation by institutional investors has been increasing. Percentage of total trading turnover on the PRC stock market by professional institutional investors increased from 10.4% in 2007 to 14.4% in 2011.

Although we expect individual investors to remain the primary participants in the PRC capital markets, and particularly, the stock market, in the foreseeable future, investor composition will continue to diversify with greater participation of institutional investors.

- In July 2012, the CIRC relaxed the restrictions on equity investment and expanded the scope of investment for insurance companies meeting certain solvency requirements. According to the CIRC, the aggregate investment of PRC insurance companies amounted to RMB6,850.0 billion as of the end of 2012, including investment in securities investment funds in the amount of RMB808.0 billion, or 11.8% of the total, which may further increase as regulations are relaxed.
- The PRC corporate profits and wealth have been increasing rapidly, in line with the PRC's economic growth. However, the ratio of corporate pension funds to GDP in the PRC was only approximately 1% as compared with 68% on average for OECD countries, according to Wind Info. We believe that the PRC corporate pension funds have significant growth potential.
- The NSSF has been growing rapidly and actively investing in the capital markets. According to the NSSF, the fund held assets in the amount of RMB1,108.3 billion as of December 31, 2012 compared to RMB439.7 billion as of December 31, 2007, representing a CAGR of 20.3%.
- Foreign investment in the PRC capital markets has been gradually increasing. According to the SAFE, cumulative approved investment quota for QFII increased from US\$10.0 billion in 2007 to US\$37.4 billion in 2012, representing a CAGR of 30.1%, while cumulative approved investment quota for RQFII amounted to RMB67.0 billion as of December 31, 2012. In April 2012, the ceiling of QFII's investment quota was further raised by US\$50.0 billion to US\$80.0 billion. We expect that the QFII and RQFII business will continue to grow as regulatory requirements relax and the internationalization of Renminbi continues.



---

## INDUSTRY OVERVIEW

---

### *Globalization of the PRC Capital Market*

The PRC capital markets have been gradually opened up to foreign investors with increasing QFII quota and an expanding suite of investable securities. As the RQFII's pilot program is expected to expand to cover Taiwan, Macau and Southeast Asia, the overseas investor base in the PRC capital markets will become more diverse.

Meanwhile, the PRC domestic investors have increased their participation in the overseas capital markets. The PRC regulators are expected to continue increasing the QDII quota to enhance the convertibility of Renminbi capital accounts, and enable PRC individuals to invest overseas, including both industrial investments and securities investments.

In addition, the PRC capital markets will further open to overseas issuers for fund raising. The CSRC and the Shanghai Stock Exchange are planning for the establishment of the International Board, which would enable large multinational corporations to list on the Shanghai Stock Exchange and raise capital from the domestic market. The establishment and development of the International Board and the attraction of multinational corporate issuers to the PRC capital markets will be important to the PRC's goal of building a first-class international securities exchange platform.

## OVERVIEW OF THE PRC SECURITIES INDUSTRY

### **Development History of the PRC Securities Industry**

The PRC securities industry has grown substantially in terms of the number, size and business scope of PRC securities firms along with the development of the PRC capital markets.

According to the SAC, there were 114 registered securities firms in the PRC as of December 31, 2012. From December 31, 2006 to December 31, 2012, the PRC securities industry's total assets increased from RMB611.4 billion to RMB1.7 trillion, and the industry's total net assets increased from RMB105.0 billion to RMB694.3 billion, representing CAGRs of 18.8% and 37.0%, respectively. The industry's revenue and profits remained relatively stable during the recent global financial crisis. According to the SAC, from 2006 to 2012, the PRC securities industry's total revenue increased from RMB63.6 billion to RMB129.5 billion, and the industry's total net income increased from RMB25.5 billion to RMB32.9 billion, representing a CAGR of 12.6% and 4.4%, respectively. During the same period, the industry's average net profit margin was 37.9%.

## INDUSTRY OVERVIEW

### Competitive Landscape in the PRC Securities Industry

Currently, market concentration is low among the 114 registered securities firms in the PRC securities industry. The following table sets forth the revenues, net assets, total assets, net capital, net profit as well as rankings and market shares of the top ten PRC securities firms in terms of revenue by business segment as of September 30, 2012:

Top Ten Securities Firms (Based on revenue)	Revenue	Market share (%)	Net assets	Market share (%)	Total assets	Market share (%)	Net capital	Market share (%)	Net profit	Market share (%)
(RMB in millions, except percentages)										
CITIC Securities	5,875	6.1%	71,059	10.4%	117,767	7.5%	41,107	8.5%	2,408	9.1%
Haitong Securities	5,456	5.7%	57,041	8.4%	101,508	6.5%	37,909	7.9%	2,332	8.9%
Guangfa Securities	4,929	5.2%	31,344	4.6%	71,902	4.6%	21,201	4.4%	1,700	6.5%
Guotai Junan	4,761	5.0%	27,617	4.1%	71,846	4.6%	20,046	4.2%	1,658	6.3%
Guosen Securities	4,142	4.3%	18,214	2.7%	54,259	3.5%	11,979	2.5%	1,294	4.9%
Galaxy Securities	3,722	3.9%	17,005	2.5%	53,857	3.4%	12,619	2.6%	1,090	4.1%
Huatai Securities	3,370	3.5%	30,271	4.5%	65,922	4.2%	20,563	4.3%	1,131	4.3%
China Merchants Securities	3,221	3.4%	24,579	3.6%	68,259	4.4%	13,803	2.9%	1,099	4.2%
Shenyin Wanguo	2,768	2.9%	16,419	2.4%	43,945	2.8%	13,059	2.7%	971	3.7%
China Securities	2,633	2.8%	11,044	1.6%	41,451	2.7%	8,841	1.8%	652	2.5%
<b>Total</b>	<b>40,878</b>	<b>42.8%</b>	<b>304,594</b>	<b>44.8%</b>	<b>690,717</b>	<b>44.2%</b>	<b>201,127</b>	<b>41.7%</b>	<b>14,336</b>	<b>54.4%</b>

Top Ten Securities Firms (Based on revenue)	Securities brokerage net revenue <sup>(1)</sup>		Margin financing and securities lending net revenue		Investment banking net revenue <sup>(2)</sup>		Asset management net revenue	
	Ranking	Market share (%)	Ranking	Market share (%)	Ranking	Market share (%)	Ranking	Market share (%)
CITIC Securities	11	2.6%	7	6.8%	1	11.3%	2	8.4%
Haitong Securities	6	4.3%	1	9.4%	7	3.8%	27	1.1%
Guangfa Securities	5	4.6%	5	6.9%	3	6.3%	4	4.9%
Guotai Junan	4	4.6%	2	8.8%	8	3.4%	1	10.1%
Guosen Securities	2	4.8%	10	5.4%	2	8.9%	16	2.0%
Galaxy Securities	1	5.2%	6	6.8%	11	3.0%	24	1.2%
Huatai Securities	3	4.7%	3	7.3%	9	3.3%	9	3.7%
China Merchants Securities	9	3.1%	8	6.7%	10	3.1%	8	3.7%
Shenyin Wanguo	7	4.1%	4	7.3%	17	0.5%	15	2.2%
China Securities	10	3.0%	11	4.1%	23	2.2%	21	1.4%
<b>Total</b>		<b>40.9%</b>		<b>69.5%</b>		<b>45.7%</b>		<b>38.7%</b>

Source: SAC

(1) Based on the net revenue of securities brokerage business.

(2) Based on the net revenue of underwriting and sponsorship as well as financial advisory services for M&A and restructuring.

Each business segment within the PRC securities industry has its own unique competitive landscape:

- Brokerage Business.** Brokerage revenue of PRC securities firms is primarily channel-based and derived from commissions earned from acting as brokers in the buying and selling of securities. A homogenous business model in the traditional brokerage business has resulted in intense price competition and downward pressure on commission rates in recent years. As the business transforms from a channel-based revenue model to a



---

## INDUSTRY OVERVIEW

---

diversified revenue model focusing on wealth management and other value-added services, we expect brokerage business participants to increasingly compete by providing differentiated client services, offering comprehensive wealth management products (including investment, financing, liquidity and trading products), and focusing on marketing initiatives. In the first three quarters of 2012, the top ten securities firms in terms of net brokerage revenue accounted for 41.4% of the industry's aggregate net revenue, an increase from 39.8% in 2010.

- **Investment Banking Business.** The investment banking market in the PRC is relatively concentrated with tiered competitive landscape. Leveraging advantages in capital strength, IT infrastructure and shareholder background, large securities firms are more competitive in winning large-scale securities underwriting mandates, while regional securities firms are able to leverage their differentiated strategies to win small- to medium-scale underwriting mandates. According to the Wind Info, aggregate proceeds raised from equity and debt issuance in the PRC in 2012 amounted to RMB1.9 trillion, of which the top three and the top ten securities firms accounted for 28.6% and 58.1%, respectively.
- **Asset Management Business.** The PRC securities industry's asset management business is relatively concentrated with competition focusing on areas such as brand, investment research, product innovation, cross-selling capabilities, capital base, pricing and performance. According to the SAC, as of September 30, 2012, the top three securities firms accounted for 32.9% of the industry's total AUM.
- **Emerging Business Segments.** The emerging business segments in the PRC securities industry primarily include (1) capital-based intermediary business such as margin financing and securities lending, securities-based lending, and market-making, (2) investment banking services such as share quotation and transfer in OTC markets, and (3) asset management services such as client cash management and private equity fund management. Given the relatively short operating history of the emerging business segments, the competition in these segments tends to be less intense compared to that of the traditional brokerage, investment banking and asset management businesses. However, in the long term these emerging business segments are expected to become significant sources of revenue for securities firms and are thus subject to increasingly intense competition. Access to capital and ability to innovate are expected to become two major factors driving the competitive landscape of the emerging business segments.

### Growth Drivers of the PRC Securities Industry

Despite two decades of growth, the scale of the PRC securities industry is still small relative to the scale of the PRC economy, the PRC financial industry and the securities industry in more developed markets overseas. According to the SAC and the SIFMA, the total assets of the securities industry in the PRC as of December 31, 2012 and the U.S. as of December 31, 2010 were RMB1.7 trillion and US\$4.6 trillion, respectively; and the total revenue of the securities industry in the PRC for 2012 and the U.S. for 2010 were RMB129.5 billion and US\$254.7 billion, respectively.

As a result of the imbalanced development of PRC capital markets and the reliance on bank lending by PRC enterprises, commercial banks have accounted for a disproportionately large portion of the assets of the PRC financial industry as compared to insurance companies and securities firms. As financial disintermediation and market-oriented regulatory reform further progress in the PRC, we believe the core capabilities of PRC securities firms in wealth management and direct financing

---

## INDUSTRY OVERVIEW

---

intermediation will be considerably enhanced with increasing number of innovative products and businesses.

With enhanced capabilities and increasingly diversified client needs, it is expected that the scale, business and profit model of the PRC securities industry will significantly improve. It is also expected that the relaxed regulation, product innovation and normalization of financing channels will increase the PRC securities industry's leverage ratio and in turn increase the industry's return on net assets.

### ***Transformation of the PRC Capital Markets is the Fundamental Driver of the Securities Industry's Growth***

The increase in scale and enhancement in structure of the PRC capital markets are fundamental drivers for the PRC securities industry. The development of multi-tiered capital markets, the growing participation of institutional investors, and the increase in the diversity of securities products are expected to benefit the PRC securities industry by creating new client base, generating additional sources of revenue, and shifting competition among securities firms from price competition towards competition on the quality of differentiated product and service offerings.

### ***Transformation of Client Composition Results In Increasingly Diverse and Sophisticated Needs for Investment and Financing***

The PRC securities industry's client base is becoming increasingly diverse and sophisticated as a result of the rapid growth of the PRC economy, the accumulation of personal wealth, the increasing participation of institutional investors, and the enterprises' continuing growth. Securities firms currently provide services primarily to individual investors and will provide services to more and more high-net-worth individuals and institutional investors in the future. Meanwhile, as large PRC enterprises become more mature, their need for financing and financial advisory services also becomes more diversified and internationalized, while SMEs have become new drivers for the revenue growth of the PRC securities industry.

### ***Market-oriented Regulatory Reform***

The CSRC has adopted a series of strict measures for business regulation, internal control and risk management of PRC securities firms, which have helped the PRC securities industry to navigate through the global financial crisis in 2008. The CSRC has also promulgated rating-based systems and merit-based regulatory policies to supervise the PRC securities firms and encourages securities firms with effective risk management to expand business operations. Recently, as part of the transformation of the capital markets, the regulatory framework of the PRC securities industry is gradually evolving towards a more market-oriented regime with more simplified approval processes, enabling the industry to meet client demands through innovation, realize differentiated competition, and establish a sustainable profit model. For instance, in October 2011, the CSRC promulgated the Provisional Guidance on the Business (Product) Innovation of Securities Companies (證券公司業務(產品)創新工作指引(試行)). After the Innovation Convention held by the SAC in May 2012, the PRC securities regulators have further adopted a number of measures to encourage innovation, signaling the PRC securities industry's entry into a new era. We believe this trend will facilitate the growth of the PRC securities industry, accelerate industry consolidation and enhance securities firms' competitiveness. In addition, the market-oriented regulatory reform is expected to lead

## INDUSTRY OVERVIEW

to transformation of the business model of PRC securities industry. As securities firms are capable of underwriting securities in the primary markets, developing financial products and distribution of business products in the secondary markets, it is expected that PRC securities firms will be able to evolve as a primary intermediary in the capital markets by fully leveraging on the synergy among different businesses as the financial disintermediation proceeds. In particular, the CSRC issued the Administrative Measures on Asset Securitization of Securities Companies (證券公司資產證券化業務管理規定) in March 2013 to encourage securities firms to innovate, enrich fixed-income products and develop asset securitization business. According to the Measures, asset-backed securities can be traded on stock exchanges, OTC markets and other trading venues, enabling PRC securities firms to provide market-making services for such securities. For more information on the regulatory environment for the securities industry in the PRC, please see “Regulatory Environment—Regulatory Environment of the PRC—Regulation on Operations.”

### Characteristics and Development Trends of the PRC Securities Industry

We believe the rapid evolution of the market, client structure, and regulatory environment creates a prime opportunity for the PRC securities industry to reposition itself within the capital markets and financial system. As the primary intermediaries in the capital markets, securities firms will gradually develop into comprehensive financial service platforms connecting the investment and financing needs of investors and enterprises. The development trends of the PRC securities industry primarily include the diversification of businesses and products, increases in financial leverage ratio, internationalization of business operation, and the continuing increase in industry concentration.

#### *Diversification of Businesses and Products*

PRC securities firms derive the majority of their revenues from the securities brokerage, investment banking and proprietary trading businesses. According to the SAC and the SIFMA, net revenue from securities brokerage business in the PRC securities industry accounted for 55.9%, 50.7% and 38.9% of the industry’s total revenue in 2010, 2011 and 2012, respectively, as compared to 18.4% for the securities industry in the U.S. in 2010.

Profitability of PRC securities firms are highly correlated with market performance due to their homogenous business structure and profit model. The following table sets forth the major market indicators of the PRC securities market and the total turnover and net profit of the PRC securities firms for the periods indicated.

	For the Year ended December 31,					
	2007	2008	2009	2010	2011	2012
CSI 300 Index (closing value) . . . . .	5,338.3	1,817.7	3,575.7	3,128.3	2,345.7	2,523.0
Increase (decrease) of CSI 300 Index during the period . . . . .	161.5%	(65.9)%	96.7%	(12.5)%	(25.0)%	7.6%
Daily stock trading volume (RMB in billions) . . . . .	190.3	108.6	219.7	225.5	172.8	129.5
Change (%) . . . . .	—	(42.9)%	102.3%	2.6%	(23.4)%	(25.1)%
Total turnover of PRC securities firms (RMB in billions) . . . . .	283.6	125.1	205.0	191.1	136.0	129.5
Change (%) . . . . .	—	(55.9)%	63.9%	(6.8)%	(28.9)%	(4.8)%
Total net profit of PRC securities firms (RMB in billions) . . . . .	130.7	48.2	93.3	77.6	39.4	32.9
Change (%) . . . . .	—	(63.1)%	93.6%	(16.9)%	(49.2)%	(16.4)%

Sources: Bloomberg, CSRC, SAC

---

## INDUSTRY OVERVIEW

---

It is expected that such situation will be alleviated by the diversification of businesses and products of the PRC securities industry.

### *Brokerage, Sales and Trading Business*

PRC securities firms are transforming from traditional channel-based brokerage businesses into comprehensive financial services platforms, in order to fulfill the needs of retail, high-net-worth and institutional clients for investment across multiple markets as well as investment-related financing, liquidity and trading services.

- *Wealth Management-Centric Comprehensive Revenue Model.* The rapid and steady growth of the PRC economy has contributed to a significant increase in resident income and wealth in the PRC. According to the NBSC, the PRC urban resident disposable income per capita increased from RMB7,703 in 2002 to RMB24,565 in 2012, representing a CAGR of 12.3%. According to the PBOC, the PRC's aggregate resident financial assets increased from RMB18.0 trillion in 2004 to RMB49.5 trillion in 2010, representing a CAGR of 18.3%. Driven by fast growing wealth, further reform of the PRC income distribution system, and an aging population, the PRC securities industry is expected to transform into a wealth management-centric comprehensive revenue model with a broader scope of financial products and investment advisory services that securities firms can offer. For more information on regulations on financial product distribution and investment advisory services offered by PRC securities firms, please see "Regulatory Environment—Regulatory Environment of the PRC—Regulation on Operations." Such transformation will enable securities firms to stabilize and diversify their sources of revenue by increasing advisory fees and commissions on product sales.
- *New Types of Securities including Commodity Futures and Financial Futures.* The Twelfth Five-Year Plan encourages the development of commodity and financial futures market. We expect that the institutional investors' increasing participation in the trading of futures will create more business opportunities for PRC securities firms and further diversify their source of revenue. In March 2013, the SAC promulgated the Regulation on Business of OTC Transaction of Financial Derivatives of Securities Companies (證券公司金融衍生品櫃台交易業務規範), which facilitates the financial derivatives transaction business of securities companies in China.
- *Capital-based Intermediary Securities Trading Services.* As regulatory restrictions relaxed over the past few years, the PRC securities industry has begun to offer a greater variety of capital-based intermediary securities trading services which utilize securities firms' own capital to facilitate trading, investments, or financing by clients. Such services include margin financing and securities lending, margin and securities refinancing, short-term securities-based lending, dealer-quoted bond repurchase transactions, and market-making activities.
- *Proprietary Trading.* Pursuant to rules promulgated by the CSRC, the permitted investment scope for securities firms' proprietary trading has been substantially expanded to include securities traded on exchanges, OTC markets and interbank market as well as wealth management plans of commercial banks and collective trust plans. Furthermore, PRC securities firms are permitted to invest in financial futures, commodity futures, spot contracts for gold and other non-securities financial products by establishing a subsidiary

---

## INDUSTRY OVERVIEW

---

for alternative investment. In addition, the proprietary trading business of securities firms will continue to innovate in capital-based intermediary trading services such as market capitalization management, financial futures hedging and arbitrage. A more diversified proprietary trading business will help reduce the adverse impact of market volatility and the reliance of securities firms' traditional proprietary trading on the stock market.

### *Investment Banking Business*

PRC securities firms' investment banking business is expected to transform from the equity financing-focused model to a comprehensive investment banking model, providing diversified financial services, including equity financing, debt financing, M&A and restructuring financial advisory, and cross-border financing and M&A services. The transformation will also diversify securities firms' sources of revenue from underwriting and sponsoring to financial advisory service and develop more market potential in debt financing and M&A.

### *Asset Management Business*

The asset management business of PRC securities firms is expected to become more sophisticated and specialized. In October 2012, the CSRC replaced the administrative approval requirement for collective asset management plans with post-issuance filing with the SAC, expanded the scope of investment and use of funds of collective asset management plans, and lifted the relevant investment restrictions on certain asset management business. As the variety of asset management products continues to increase and the regulatory restrictions continue to be relaxed, alternative asset management business such as private equity asset management is expected to grow rapidly and provide more instruments for investors to preserve and increase asset values in different market environments. Securities firms are also permitted to establish industrial funds or private equity funds as investment managers by investing a limited amount of their own capital as seed capital to share risks and rewards with other limited partners, which would enable securities firms to lever up the size of managed assets and earn management fees and performance fees in addition to investment gains.

### *Private Equity Investment Business*

The private equity investment business of securities firms is expected to transform from a pure proprietary investment business into an asset management business. In July 2011, the CSRC issued guidelines which (1) permits private equity investment subsidiaries of securities firms to raise funds through private placement and combine such funds with their own capital to engage in direct investment business, and (2) permits the private equity business to develop angel investment, venture capital investment and buyout funds.

---

## INDUSTRY OVERVIEW

---

### *Increase in Financial Leverage*

The leverage ratio of the PRC securities industry is relatively low due to strict regulatory requirements, the lack of sustainable and profitable uses of funds and the lack of stable and low-cost sources of funds. As compared to the securities industry in the U.S., the PRC securities industry has a relatively low leverage ratio, which has also constrained the industry's return on net assets. The following table sets forth the leverage ratios of the securities industry in the PRC and the U.S.:

	<u>PRC</u>	<u>U.S.</u>
Securities Firms' Total Assets (RMB in billions) . . . . .	1,720	30,716
Securities Firms' Net Assets (RMB in billions) . . . . .	694	1,458
Leverage ratio (Total assets/Net assets) . . . . .	2.5x	21.1x

Sources: SAC, SIFMA

Note: The PRC data is as of December 31, 2012. The U.S. data is as of December 31, 2010, as the data as of December 31, 2011 have not been released. The exchange rate is US\$1=RMB6.6227 and is based on the mid-price exchange rate announced by the PBOC on December 31, 2010.

As the regulatory environment gradually relaxes and the securities firms' capital-based intermediary and capital investment businesses continue to grow, the financial leverage ratio of the PRC securities industry is likely to increase.

First, the regulators are taking initiatives to improve the securities industry's capital management. In January 2012, the CSRC released a consultation paper on risk control indicators for PRC securities firms, which proposed to replace the current Net Capital ratios with the new core net capital to total assets ratios. In April 2012, the CSRC lowered the weighting factors used for the calculation of securities firms' risk capital reserve for their proprietary trading, asset management and brokerage businesses.

Secondly, securities firms have begun to deploy more capital to relatively more stable and profitable businesses, including margin financing and securities lending, dealer-quoted bond and fund repurchase products and securities-based lending transactions. These businesses typically require significant capital and enable securities firms to operate with greater financial leverage, diversify sources of revenue, and strengthen their capabilities to mitigate the impact of economic cycles.

Finally, the availability of stable and low-cost financing channels is gradually increasing. Securities firms are able to obtain low-cost funding through the issuances of corporate bonds, subordinated bonds, and convertible bonds as well as securities repurchases transactions. Since May 2012, a number of securities firms have issued short-term notes to replenish their working capital, which were the first issuances of such notes by PRC securities firms since 2005. In addition, certain securities firms have announced plans to issue corporate bonds to replenish their long-term capital. In March 2013, the CSRC issued the Tentative Provisional Administrative Measures on Debt Financing Instrument of Securities Companies (Draft for Public Commentary) (證券公司債務融資工具管理暫行規定 (徵求意見稿)) to provide specific provisions on securities companies' issuance of bonds and subordinated bonds and allow securities companies to issue depositary receipt as a new financing instrument in order to further broaden their financing channels.

### *Globalized Operation*

As the demand for overseas investment and financing services by PRC enterprises and individuals grows and the participation in the PRC capital markets by overseas institutional investors



---

## INDUSTRY OVERVIEW

---

increases, cross-border business is becoming a fast-growing area for the PRC securities industry. On the one hand, PRC securities firms are establishing dedicated international business departments to serve overseas institutional investors. On the other hand, a number of securities firms have expanded overseas to participate in the international capital markets. At present, 23 PRC securities firms have established overseas subsidiaries. The international business of PRC securities firms includes the following:

- *Serving Overseas Clients in Conducting Domestic Businesses:* PRC securities firms introduce overseas investors into the domestic capital markets by providing securities and futures brokerage services and distributing securities firms' wealth management products to QFII and RQFII clients. PRC securities firms also assist overseas investors in using QFII and RQFII quotas to invest in the PRC.
- *Serving Domestic Clients in Conducting Overseas Businesses:* PRC securities firms conduct QDII business and other offshore asset management business, assist PRC companies in listing on overseas exchanges, issuing offshore RMB bonds and conducting other offshore financing business and provide financial advisory services such as advisory services for cross-border M&A transactions.

### ***Increasing Market Concentration and Competitive Advantages of Large PRC Securities Firms***

Currently, market concentration in the PRC securities industry is low. Compared to other PRC financial industries, such as banking and insurance, the PRC securities industry still has significant potential for consolidation. In the first three quarters of 2012, the total combined market share for the top ten securities firms in the PRC was 42.8% in terms of operating income, while the total combined market shares of the top ten banks, life insurance companies as well as property and casualty insurance companies in the PRC were 76.9%, 86.9% and 85.2%, respectively.

Leveraging their strengths in business innovation, distribution capabilities, client base, capital base and human resources, large securities firms are expected to emerge as winners as the PRC capital markets and securities industry consolidate and transform, which will further increase the industry's concentration. The competitive advantages of large securities firms include:

- ***Comprehensive Financial Services Platform.*** Large securities firms can utilize their comprehensive set of licenses and financial services platforms to offer a full range of services, which provide them with significant advantages in acquiring and retaining clients and strengthening client relationships, especially with high-net-worth individuals and institutional investors.
- ***Nationwide Network and Cross-border Platform.*** Large securities firms usually have broad nationwide networks and overseas branches, which give them the advantage in distributing products and providing value-added services to retail and institutional clients.
- ***Significant Client Base.*** Large securities firms have significant client bases and large amounts of client assets under administration which enable them to fully realize the potential of cross-selling.
- ***Advantages in Brand and Human Resources.*** Large securities firms have well-recognized brands to attract more talents.
- ***Advantages in Capital Base and Financing Channels.*** Large securities firms can leverage their strong capital base and the development of capital-based intermediary and investment

---

## INDUSTRY OVERVIEW

---

products and services. Further, the access of large securities firms to low-cost financing is crucial for increasing the leverage ratio.

- ***Relatively High and Stable Profitability.*** The profitability of large securities firms is usually more stable than that of smaller competitors given their advantages in scale and more diversified and stable sources of revenue. Therefore, large securities firms are able to gain market share in difficult market environments.