
BUSINESS

OVERVIEW

We are a leading integrated financial services provider in the PRC securities industry. We provide comprehensive securities services, including brokerage, sales and trading as well as investment banking and investment management.

Our principal business lines include:

<u>Brokerage, Sales and Trading</u>	<u>Investment Banking</u>	<u>Investment Management</u>	<u>Overseas Business</u>
<ul style="list-style-type: none">• Brokerage and wealth management• Institutional sales and investment research• Margin financing and securities lending• Proprietary trading and other securities trading services	<ul style="list-style-type: none">• Equity financing• Debt financing• Financial advisory	<ul style="list-style-type: none">• Asset management• Private equity investment	<ul style="list-style-type: none">• Brokerage and sales• Investment banking• Asset management

We are one of the largest brokerage service providers in the PRC securities industry. Our net revenue from securities brokerage business ranked first in the industry in each year from 2008 to 2012 among SAC members. Galaxy Futures, our futures business subsidiary, ranked second among all futures subsidiaries of PRC securities firms and fifth among all PRC futures firms in terms of commission and fee income in 2011, according to the CFA.

We have a leading market position in terms of aggregate market value of securities in our client accounts, which amounted to approximately RMB1.8 trillion and represented a market share of 7.50%, as at December 31, 2012. We also ranked first in the industry in terms of total client account balance, which amounted to approximately RMB33.2 billion and represented a market share of 5.53% as at December 31, 2012.

We have the most extensive securities brokerage network coverage with the largest number of branches in the PRC securities industry. As at December 31, 2012, we had 229 securities brokerage branches strategically located in 30 provinces in the PRC, and one of the largest client bases in the industry with approximately 5,573,000 brokerage clients in the PRC. Leveraging our securities brokerage network and client base, we have been rapidly transforming our traditional brokerage branches into wealth management centers that provide a comprehensive suite of brokerage and wealth management services.

Our sales and trading business has been growing rapidly. As at December 31, 2012, the outstanding balance of our margin financing and securities lending business reached approximately RMB5,377 million, representing a 6.01% market share, and increased to approximately RMB9,651 million as at March 31, 2013. We provide securities sales, trading and other value-added services to approximately 500 institutional investor clients, including management companies of publicly-raised funds, management companies of private investment funds, QFIIs, the NSSF, insurance companies, trust companies, asset management companies, finance companies and commercial banks. As at December 31, 2012, our stock research services covered over 400 public companies in 24 industries in the PRC. In 2012, *New Fortune* ranked us the fourth “Most Influential Research Firm.”

BUSINESS

Our fund research center is widely recognized in the industry and our research classification system has become one of the major benchmarks for fund classification in the PRC. For 2012, we ranked third in the industry in terms of commissions from management companies of publicly-raised funds with a 4.65% market share. We endeavor to continuously develop new securities services and products in the PRC, such as our securities-based lending product which provides short-term financing to clients, our dealer-quoted bond and fund repurchase products which serve as a type of cash management and short-term investment instrument for our clients, our market-making service which improves market liquidity, and our capital-based intermediary bulk trade service which provides liquidity for clients.

As of December 31, 2012, we had participated in all of the ten largest IPOs in the PRC in terms of offering amount, including transactions that Galaxy Limited participated in. As of December 31, 2012, including transactions underwritten by Galaxy Limited, we had acted as a lead underwriter in 68 equity financing transactions with an aggregate offering amount of approximately RMB203.0 billion, including approximately RMB54.6 billion in the coal mining industry, RMB70.9 billion in the financial services and insurance industry, and RMB14.2 billion in the transportation and warehousing industry, according to Wind info.

We have been a leading debt underwriter in the PRC securities industry in terms of amount underwritten and underwriting fees. We ranked first in the industry in terms of the aggregate amount of enterprise bonds underwritten for three consecutive years from 2009 to 2011, and ranked second for 2012. As of December 31, 2012, we had acted as a lead underwriter in 178 debt financing transactions with an aggregate offering amount of approximately RMB308.5 billion, including transactions underwritten by Galaxy Limited, according to Wind Info.

In addition, our investment management business grew rapidly in 2012. The total amount of AUM of our collective asset management plans increased from approximately RMB1.8 billion as at December 31, 2011 to approximately RMB3.0 billion as at December 31, 2012. As of December 31, 2012, we had also entered into 22 targeted asset management plan contracts, 10 of which were outstanding with a total amount of AUM of approximately RMB13.0 billion.

We currently operate our overseas business through Galaxy International Holdings, our Hong Kong subsidiary. Galaxy International Holdings has the requisite business licenses to provide a wide range of securities and financial services in Hong Kong, and has achieved rapid growth in client base and revenue. Using Galaxy International Holdings as our first platform to develop overseas business, we plan to further explore other overseas growth opportunities as they arise.

Since 2007, we have established sound corporate governance as well as effective risk management and internal control systems to manage our risk exposure in the securities market. Recognizing our sound capital base as well as our effective risk management and internal control systems, the CSRC assigned us an “AA” regulatory rating, which is currently the highest rating issued to PRC securities firms, in 2010, 2011 and 2012.

BUSINESS

We have received the following awards in recognition of our outstanding performance:

Year Granted	Issuer of Award	Award
2012	<i>China Securities Journal</i>	“Superior Securities Firm in the Golden Bull Investment Advisory Contest” “Golden Bull Award for Best Bond Financing Investment Bank”
	<i>CNstock.com</i>	“Best Mobile Phone Securities Business of 2012”
	<i>Futures & Options World</i>	“2012 PRC Derivatives Firm of the Year”
	<i>Securities Times</i>	“2012 Best Enterprise Bond Underwriting Team”
2011	<i>New Fortune</i>	Third place for the “Most Capable Investment Bank for Blockbuster Deals” “Best Main Board IPO of the Year”
	<i>Shanghai Securities News</i>	“Best Securities Brokerage Firm” “Best Brand in the PRC Futures Market”
	<i>Financial Times</i>	“Securities Firm with Excellent Brand Value”
	<i>Securities Times</i>	“Innovative Financial Services Firm of the Year” “Best Securities Firm for Investment Advisory Services” “Best Wealth Management Center”
	<i>Award Committee for Science and Technology of the Securities and Futures Industry</i>	“Science and Technology Award in the Securities and Futures Industry for 2011”
	<i>21st Century Business Herald</i>	“Best PRC Securities Brokerage Firm of 2010”
2010	<i>China Enterprise Confederation</i>	“Most Influential Enterprise of 2010”
	<i>Hexun.com</i>	“Best Securities Firm for Investor Satisfaction”
	<i>Securities Times</i>	“Top Ten IT Innovation by Financial Institutions of 2010”

As at December 31, 2010, 2011 and 2012, we had total assets of RMB94,264.6 million, RMB59,214.7 million and RMB64,295.5 million, respectively, and we had total equity of RMB14,544.7 million, RMB16,126.8 million and RMB17,558.8 million, respectively. In 2010, 2011 and 2012, our total revenue and other income was RMB8,460.2 million, RMB6,431.1 million and RMB5,961.6 million, respectively, and our profit was RMB2,790.5 million, RMB1,584.8 million and RMB1,432.5 million, respectively.

COMPETITIVE STRENGTHS

As a leading integrated financial services provider in the PRC securities industry, we believe the following strengths distinguish us from our competitors. We believe that the PRC securities markets have significant growth potential in areas such as wealth management, margin financing and securities lending, securities trading, debt financing, SME financing, M&A and investment management, and that our strengths will enable us to capture these opportunities.

One of the largest brokerage service providers in the PRC with significant scale advantages

We have leading market positions in our brokerage business. Our net revenue from securities brokerage business ranked first in the PRC securities industry in each year from 2008 to 2012 among

BUSINESS

SAC members. For 2012, our trading turnover of stocks and funds on a combined basis had a 5.14% market share and ranked second in the industry among members of the Shanghai Stock Exchange and the Shenzhen Stock Exchange. For 2012, our commissions from management companies of publicly-raised funds had a 4.65% market share and ranked third in the industry. According to the CFA, Galaxy Futures held a 2.68% market share in terms of commission and fee income in 2011, ranking second among all futures subsidiaries of PRC securities firms and fifth among all PRC futures firms.

According to the CSDCC, as at December 31, 2012, we ranked first in the industry in terms of aggregate market value of securities in our client accounts, which amounted to approximately RMB1.8 trillion and represented a market share of 7.50%. As of the same date, we also ranked first in terms of total client account balance, which amounted to approximately RMB33.2 billion and represented a market share of 5.53%, according to the SAC. The CSRC has begun to gradually relax policies, allowing PRC securities firms to capture business opportunities arising from the securities and funds in client accounts. For example, our “Daily Profit” (天天利) product was one of the first cash management products approved by the CSRC. As the CSRC continues to encourage innovation, we believe that the scale of our client base and client assets provide significant growth potential for our businesses, and will become a powerful driver for development and innovation of our businesses such as margin financing and securities lending, capital-based intermediary bulk trades, institutional sales and cash management.

Given our significant scale advantages and the relatively stable fixed costs of our brokerage business, we believe that the performance of our brokerage business could improve considerably when the overall PRC securities market improves.

Largest network of strategically located branches with leading financial product distribution capabilities

We have the most extensive securities brokerage network coverage in the PRC securities industry with the largest number of branches. As at December 31, 2012, we had 229 securities brokerage branches and 22 futures brokerage branches in 30 provinces in the PRC.

Our branches are strategically located and cover both developed and developing regions. As at December 31, 2012, approximately two thirds of our securities brokerage branches were located in the developed regions in eastern China, including the Yangtze River Delta, the Pearl River Delta and the Bohai Rim, while the remaining branches were located in regions with strong growth potential such as central, western and northeastern regions of the PRC. We have also established Galaxy International Holdings in Hong Kong to develop our overseas business. The strategic locations of our branches enable us to acquire high-end clients in the developed regions, benefit from the rapid economic growth and urbanization of the developing regions, and capture overseas business opportunities.

We have been rapidly transforming our conventional brokerage business into a multi-tiered wealth management business, focusing on providing wealth management products and asset allocation advisory services tailored to meet our clients’ needs. As at December 31, 2012, we had a team of 1,137 registered investment advisors, ranking second in the PRC securities industry. We have obtained the license to engage in agency sales of financial products after the relevant regulation was issued in November 2012. We have established wealth management centers in Beijing, Shanghai, Chengdu and Guangzhou. In addition to providing our own financial products, we offer over 1,000 third-party fund

BUSINESS

products, and we are in the process of expanding our product portfolio to include more financial products offered by other financial institutions such as banks, trusts and insurance companies.

We believe that the strategic coverage of our branch network enables us to provide clients with convenient, locally accessible services, which further enhances our brand recognition, increases our client loyalty, and increases our cross-selling opportunities.

To supplement our branch network's financial product distribution capabilities, we also utilize various information technologies such as Internet, e-mails, text messages, mobile devices, and call centers to further improve our multi-channel distribution and trading system.

One of the largest client bases in the PRC securities industry, providing a solid foundation for cross-selling and new businesses development

We have a large, stable and growing client base. As at December 31, 2012, we had approximately 5,573,000 brokerage clients in the PRC, including over 16,000 institutional clients. We also have approximately 500 institutional investor clients, including management companies of publicly-raised funds, management companies of private investment funds, QFIIs, the NSSF, insurance companies, trust companies, asset management companies, finance companies and commercial banks. As at December 31, 2012, we had approximately 190,000 high-end clients.

As at December 31, 2012, approximately 63.7% of our securities brokerage clients were active clients. As at the same date, approximately 82.0% and 45.5% of our brokerage clients, including both securities and futures brokerage clients, had maintained accounts with us for over three and ten years, respectively. Our client base grew from approximately 5.01 million as at December 31, 2010 to approximately 5.39 million as at December 31, 2011, and to approximately 5.57 million as at December 31, 2012.

Our investment banking clients primarily include large state-owned enterprises and governmental entities in traditional pillar industries such as financial services, energy, mining and metallurgy, transportation and national defense. Our investment banking clients also include SMEs with strong potential in the biopharmaceutical, culture and media, communications and electronics and franchising industries. Our investment banking business has served over 350 corporate clients, including the clients of Galaxy Limited. We have maintained long-term strategic relationships with a number of large corporations.

We believe that our large client base affords us significant potential for cross-selling among our business lines, which enables us to capture opportunities and rapidly grow new businesses. For instance, some of our new businesses such as margin financing and securities lending have achieved rapid growth by leveraging our brokerage client base and our cross-selling capability. The outstanding balance of our margin financing and securities lending business grew 380.0% from December 31, 2010 to December 31, 2011, 110.2% from December 31, 2011 to December 31, 2012, and 79.5% from December 31, 2012 to March 31, 2013.

Leading investment banking expertise, providing strong support for expansion in growing segments of the investment banking business

We are committed to providing our clients with a full range of high-quality investment banking services. Our industry-leading expertise in growing segments of the investment banking business

BUSINESS

enables us to take advantage of opportunities arising from the growth of the debt market and the SME financing market in the PRC.

We have maintained an industry-leading position in the debt financing market. We ranked first in the industry in terms of the aggregate amount of enterprise bonds underwritten for three consecutive years from 2009 to 2011, and second for 2012. As of December 31, 2012, we had acted as a lead underwriter in 178 debt financing transactions, including transactions underwritten by Galaxy Limited, with an aggregate offering amount of approximately RMB308.5 billion, according to Wind Info. Based on our experience in the relevant industries and products as well as our understanding of investor needs, we have developed outstanding pricing capability to help our clients obtain optimal offering prices. Our consistent, high-quality and distinctive services have earned the trust and recognition of our clients. We have received awards such as the “Golden Bull Award for Best Bond Financing Investment Bank” in 2011 from *China Securities Journal* and the “Best Enterprise Bond Underwriting Team” award in 2012 from *Securities Times*, among others. We have maintained close communication with relevant regulatory authorities and have actively contributed to the rule making for the PRC bond market. In November 2012, we obtained the qualification to act as lead underwriter for debt instruments including medium-term notes and short-term notes traded on the interbank bond market. Currently, the interbank bond market is the primary bond financing market in the PRC for non-financial companies. The total amount of medium-term notes and short-term notes issued in 2012 amounted to RMB2.7 trillion, representing a CAGR of 32.9% from 2009 to 2012. We believe that our expertise and large client base in the enterprise bond market will help us to rapidly expand our market share in this important market segment.

As of December 31, 2012, we had participated in all of the ten largest IPOs in the PRC in terms of offering amount, including transactions that Galaxy Limited participated in. As of December 31, 2012, including transactions underwritten by Galaxy Limited, we had acted as a lead underwriter in 68 equity financing transactions with an aggregate offering amount of approximately RMB203.0 billion, ranking fifth in the PRC securities industry, according to Wind Info. Recognizing the growth potential of the SME financing market and the multi-tiered capital markets, we have established regional equity financing teams dedicated to providing convenient and locally accessible services to SME clients. Leveraging the expertise and extensive experience of our investment banking team, we believe we are well-positioned to capture the opportunities from growth of SME financing and development of multi-tiered capital markets.

First-mover advantages in new businesses and outstanding product innovation capabilities, enabling us to stay at the forefront of industry transformation

We have been tracking closely new policies issued by the CSRC in recent years as it has gradually relaxed regulatory restrictions and promoted structural transformations of the PRC securities industry. We also maintain continuous communication with regulatory authorities and make recommendations for new policies from time to time. Leveraging our market leadership and competitive strengths, we have been among the first securities firms to obtain qualifications for several important new businesses, which provided us with first-mover advantages in these businesses. We were:

- the first securities firm qualified to conduct futures IB business;
- one of the first securities firms qualified to conduct margin financing and securities lending business on a pilot basis, and one of the first securities firms to engage in margin and securities refinancing business;

BUSINESS

- one of the first securities firms qualified to offer cash management products on a pilot basis after the investment scope of securities firms' cash management products was expanded;
- one of the first securities firms qualified to offer dealer-quoted bond repurchase products as part of the expanded pilot program, and one of the first securities firms to enjoy reduced regulatory requirements with respect to the scale, variety and minimum purchase amount for such products;
- one of the first securities firms qualified to offer dealer-quoted fund repurchase products;
- one of the first three securities firms to offer securities-based lending products on a pilot basis;
- one of the first ten fund rating agencies to join the Asset Management Association of China and the first fund evaluation institution to receive the fund XBRL data authorization from the CSRC;

In addition, we have designed and developed a variety of new products and participated in several pioneering transactions including the following:

- our “Galaxy Mercury I” collective asset management plan was one of the first cash management products in the PRC securities industry, and helps our clients improve the returns on the funds in their accounts;
- we were a pioneer in the industry for ETF market-making and have created a new model to provide liquidity for ETFs;
- our “Galaxy 99 Index” collective asset management plan was the first index-based asset management product developed by a securities firm in the PRC;
- our “CCTV Balanced 50” collective asset management plan was the first hybrid wealth management product that benchmarks against a media index and focuses on balanced portfolio allocation between debt and equity;
- the lead underwriter for the first non-performing asset securitization product in the PRC;
- the first securities firm to act as a lead underwriter for subordinated bonds issued by commercial banks; and
- the lead underwriter for the first municipal construction project bond.

We believe that our first-mover advantage in new businesses and our innovation capabilities will enable us to capture the opportunities from reforms in the PRC securities market in the future.

Unique advantages from our history, brand and shareholder background, underpinning our business strategies and operations

The history of our securities brokerage and investment banking businesses can be traced back to the formative stage of the PRC securities market in early 1990s from the former securities divisions of major financial institutions in the PRC, namely Industrial and Commercial Bank of China, China Construction Bank, Bank of China, Agricultural Bank of China, China Life Insurance and China Economic Development Co., which were subsequently consolidated into Galaxy Limited. Following the establishment of Galaxy Limited, “China Galaxy Securities” became a well-known brand in the PRC securities industry, and has achieved considerable recognition and influence in the PRC capital markets. China Galaxy was established in 2007 and acquired the securities brokerage and investment

BUSINESS

banking businesses as well as the related assets from Galaxy Limited. Our controlling shareholder is Galaxy Financial Holdings, and our ultimate controlling shareholder is Huijin, a wholly state-owned company authorized by the State Council to make equity investments in major state-owned financial institutions. We believe that our history, brand and shareholder background have enhanced our clients' confidence in us, and enabled us to strengthen and expand our client base, capture new business opportunities, strengthen our government relations, and take lead in future industry consolidation.

Advanced IT infrastructure as well as prudent and effective risk management and internal control

We have an advanced IT infrastructure. In 2010, we completed implementation of one of the largest centralized online trading systems in the PRC securities industry, which centralizes all of our trades and settlements. Our centralized client management system and client relationship management system provide solid support for our product promotion and sales. We have an advanced mobile trading platform which serves over 1.5 million mobile-trading clients as at December 31, 2012. Under our effective risk management, our IT system efficiently supports the growth of our business. We have an in-house team dedicated to IT research and development, which enables us to maintain our competitive strengths in IT systems.

We believe risk management creates value, and we have established a comprehensive risk management system to manage our market risk, credit risk and operational risk. Our multi-level risk management structure encompasses the Supervisory Committee, the Board, senior management, business departments and branches, with each level reporting to the one above. We have also established a three-level risk quota authorization mechanism whereby authorizations are granted from the Shareholders' General Meeting to the Board, from the Board to the President, and from the President to the business departments. We have also strengthened the management of our overall liquidity risk by conducting rigorous stress testing and dynamic monitoring of our Net Capital risk control indicators.

We have been focusing on improving our internal control. We are committed to improving our corporate governance, formulating a robust internal control system and cultivating a corporate culture of compliance. We strive to promptly identify and rectify internal control deficiencies and continuously improve our internal control system through quantitative risk management and operational risk control in order to safeguard the healthy and stable growth of our business. Considering our robust back-office infrastructure as well as effective risk management and internal control systems, among other criteria, the CSRC assigned us an "AA" regulatory rating, which is currently the highest rating issued to PRC securities firms, in 2010, 2011 and 2012.

Experienced management with global vision leading a team of high-quality professionals

Our senior executives have on average over 20 years of management experience in the securities and financial industries. Their great vision and entrepreneurial spirit enable us to timely adjust our business strategies and tactics based on client needs and market conditions. Our mid-level management team, including the executives at department- and branch-level, have strong execution capabilities. A majority of them have on average over ten years of experience in the securities industry. A significant portion of our workforce were from the former securities divisions of major financial institutions in the PRC such as Industrial and Commercial Bank of China, China Construction Bank, Bank of China, Agricultural Bank of China, China Life Insurance and China Economic Development

BUSINESS

Co., and governmental agencies such as the MOF. We are one of the first few state-owned securities firms in the PRC to start recruiting senior executives globally, which we believe will help further enhance the professional capabilities and global visions of our senior management team.

We are focused on cultivating our employees' professional competence internally and recruiting talents externally, and have built a team of high-quality professionals. As at December 31, 2012, 5,817, or 67.6%, of our employees held bachelor's or higher degrees.

OUR STRATEGIES

We aim to become a large, globally competitive, integrated financial services provider that leads the development trends in the PRC securities industry. Our brokerage, sales and trading business, or BS&T business, is the core of our business model while our investment banking and investment management businesses are the "two wings." We seek to capture growth opportunities in the PRC securities market and increase our profits through executing client-centric, innovation-driven strategies that are focused on balanced and synergistic growth among our business lines. Specifically, our business strategies include the following:

Build the most competitive BS&T business in the PRC securities industry

Our BS&T business discovers and creates value through transactions in the securities market and provides a wide variety of brokerage, sales and trading services. BS&T business is at the core of our strategies, which is based on our most important competitive strengths in scale, network coverage and client base. We intend to build the most competitive BS&T platform in the industry by providing differentiated services tailored for various client groups. Our plans include:

Further strengthen the leadership position of our brokerage business, and enhance our business scale through consolidation and organic growth

We intend to further strengthen the leadership position of our brokerage business in the PRC securities industry through organic growth as well as acquisitions:

- We believe that the continuous decline in brokerage commission rates in the past few years will lead to further consolidation in the PRC securities industry. We intend to increase the market share of our brokerage business through acquisitions by leveraging our leading market position, sound capital base and shareholder support.
- Our plan for organic growth includes further expansion of the geographic coverage of our branch network by establishing new branches and "light branches" to the extent permitted by applicable regulations.
- We intend to further enhance our scale advantages in operational cost by streamlining and integrating the operations of our middle- and back-offices.

Continue to upgrade our retail platform to multi-level, full-range wealth management services, and focus on improving our distribution capabilities and share of wallet with high-end clients

The increase in personal wealth in the PRC in recent years has led to increasing demand for wealth management services. In the meantime, wealth management products have emerged and grown

BUSINESS

rapidly to meet this increased demand. We intend to continue to improve our wealth management services for our brokerage clients, particularly our approximately 190,000 high-end clients, through the following measures:

- Refining the management of and services for individual clients, including implementing differentiated strategies aimed at improving client experience based on the transaction and investment needs of different types of individual clients.
- Analyzing and categorizing high-end clients, and targeting groups with considerable disposable assets and large purchase potential.
- Adjusting our organizational structure according to client needs to establish a tiered network of physical branches with branch offices and regional headquarters branches as local centers, and widely distributed satellite securities branches as additional contact points with clients.
- Constantly improving our robust training system for front-line managers and sales personnel to continuously improve our client serving capabilities, and further enhancing our client manager and brokerage agents team to increase the competitiveness of our sales force.
- Further expanding our portfolio of financial products, which currently includes securities, publicly-raised funds, private investments funds, trust products, asset management plans and securities trading products, to include insurance products, wealth management products offered by commercial banks, alternative investment products, private equity funds and other products authorized by regulatory authorities, as well as offering customized product portfolios based on client needs.

Strengthen our sales and service capabilities for institutional investor clients and increase our market share in this growth segment

We believe that institutional investors are an increasingly important investor group in the PRC securities market. Compared to individual clients, institutional investors are less price-sensitive, more sophisticated and more consistent in terms of trading activities, and have greater demand for value-added services such as investment research and bulk trading. Institutional investors in the PRC have significant growth potential in number, trading frequency and transaction type. We plan to further enhance our sales and service capabilities for institutional investors through the following measures:

- Enhancing our capabilities to provide specialized services to various types of institutional investors by integrating and segmenting our sales teams and providing customized sales strategies.
- Enhancing our research capabilities and research focus to build an influential investment research institute in the PRC securities market and to provide value-added research services to our institutional investor clients.
- Expanding our offerings to institutional investor clients to include high value-added services such as margin financing and securities lending, high-frequency trading, bulk trade, market-making, cross-border trading and cross-market trading.
- Creating a professional service chain for fund custody services, further consolidating our leading position in the area of fund rating, and actively expanding the scale of our fund custody business.

BUSINESS

Expand our securities trading services through product innovation and internal collaboration to further drive growth

We design and implement standard and customized securities trading solutions to meet clients' investment, financing, risk management and liquidity needs. This type of business typically has relatively low risk, high value-added and significant growth potential. We intend to realize its full potential through the following measures:

- Mandating a dedicated team to innovate and develop products in a systematic manner through coordination of internal resources, and continuing to actively seek regulatory approvals for our new trading products.
- Closely following the progress of regulatory reform, developing products with differentiated focus and priority. For instance, as the New OTC Board and the New Regional OTC Board continue to develop and as the OTC market has officially commenced operation with continually diversifying OTC products, we plan to provide related liquidity services.
- Prioritizing the allocation of our funding resources to this type of business and enhancing the sales support of our distribution network for corresponding products to improve client awareness of these products and increase the scale of these businesses rapidly.

Develop our investment banking business through synergistic collaboration with our BS&T platform, solidify our leadership in traditional segments and expand into emerging growth segments

As one of the “two wings” of our business model, our investment banking business is our platform to serve corporate, financial institution and government issuers. Our investment banking business plays a unique role in strengthening our client base and enhancing our cross-selling. Our investment banking projects typically involve large-scale capital transactions of our clients, offering us opportunities to identify and understand client needs holistically. We believe that the synergistic collaboration between our investment banking business and our BS&T platform creates significant business opportunities. For instance, in addition to access to a large number of high-quality corporate clients, our BS&T business can develop close client relationships and understand clients' financing needs through our branch network, and therefore can introduce a significant amount of business opportunities to our investment banking business. Conversely, our investment banking business can introduce more business opportunities and high-quality clients to our BS&T business and enhance the overall competitiveness of our BS&T platform.

We believe that the structural transformation of the investment banking industry in the PRC will create significant growth opportunities. As compared to developed countries, the PRC's direct financing market, including both equity and debt, is disproportionately small compared to the overall PRC economy and has significant growth potential. As at December 31, 2012, the total market capitalization of the PRC stock markets and the total outstanding amount of bonds issued by PRC enterprises accounted for 46.6% and 9.2%, respectively, of the PRC's nominal GDP, both of which were considerably lower than those of the U.S. Domestic M&A in the PRC is less active than that of developed countries, and there is significant potential for further industry consolidation.

We plan to implement the following measures to develop our investment banking business:

- *Equity financing:* We have established an operational matrix for our investment banking business based on the three dimensions of industry, region and product. Our strategy is to

BUSINESS

focus on both large corporations and emerging SMEs. For large corporate clients, we plan to further enhance our service quality and increase our market share in industries in which we have market leadership. We also plan to explore business opportunities from SMEs with significant growth potential and expand our market share in the SME equity financing market through regional and local teams dedicated to SME client coverage and project execution.

- *Debt financing:* We believe the debt financing market has considerable growth potential and will continue to be a major component of the PRC direct financing market. We intend to leverage our advantages in bond underwriting to further strengthen our leading position in the enterprise bond financing market. At the same time, we intend to leverage our leading market position and rich experience in the enterprise bond market, our access to investors and client base, as well as our execution capability and shareholder support, to actively expand our business to include all available forms of debt financing. We have obtained the qualification to underwrite bond products traded in the interbank markets such as medium-term notes and short-term notes. There is considerable overlap between issuers and investors in the enterprise bond market and those in the medium-term notes and short-term notes market. The potential launch of the asset securitization business and private placement of our debt instruments are expected to fully release the synergies between our investment banking, investment management, and BS&T platform, and we plan to actively pursue opportunities arising from debt underwriting, offering, pricing, sales and subsequent transactions.
- *Financial advisory on M&A and corporate restructuring:* We believe that M&A and corporate restructuring activities in China are likely to increase rapidly and we expect our M&A and corporate restructuring advisory services to become one of our core businesses. As the PRC economy experiences structural transformation, industry consolidation through domestic M&A is likely for PRC enterprises in certain industry sectors to improve operational efficiency. In addition, a significant number of PRC enterprises need to expand overseas through cross-border M&A to maintain growth. We plan to explore the growth area of investment banking business by focusing on industries with ample opportunities in M&A and corporate restructuring, strengthening our research on industry sectors, and leveraging our distribution network and client base to capitalize on the opportunities arising from industry consolidation and cross-border M&A.
- *Financial advisory services on investments in OTC markets and private equity investment:* As the multi-tiered capital markets and private equity investments continue to grow in the PRC, we plan to strengthen our services in the OTC markets through our nationwide branch network and expand the client base and service scope of our investment banking business. We also plan to strengthen our services for private equity fund clients and generate commission income from providing intermediary services to link them with corporations seeking private equity investment.

Develop our investment management business through synergistic collaboration with our BS&T platform, and build multi-tiered and diverse product offerings

Our investment management business is the other wing of our business model. Leveraging our strong distribution network and client base, we intend to further expand the cross-selling between our investment management business and other businesses. In addition, we plan to increase distribution of

BUSINESS

our products by third parties through expanding our external sales channels and deepening our partnerships with major banks in areas including custodian services and sales. To meet the diversifying needs of our clients, we plan to establish and improve our multi-tiered investment management product portfolio by implementing the following measures:

- *Enriching the product portfolio and increasing the scale of targeted asset management plans and collective asset management plans:* Supplement our offerings of low-risk, counter-cyclical products with fixed-income products, develop asset management plans focusing on cash management and bond investment, and leverage our advantage in government relations, client base and branch network to expand our offerings of financing asset management products.
- *Developing alternative asset management products:* Capitalizing on less restrictive regulations governing the scope of investment options for asset management products, we intend to expand our asset management product portfolio to include alternative investment products that invest in alternative financial products including commodities and art, in order to develop asset appreciation instruments suitable for the PRC market.
- *Developing private equity fund products:* Through our subsidiary Galaxy Capital, we intend to establish multiple industrial funds and other private equity funds with diverse investment styles that are open to third-party investors.

Steadily expand our international business and build an integrated overseas platform

We currently conduct our overseas business through Galaxy International Holdings, our wholly-owned subsidiary incorporated in Hong Kong. Galaxy International Holdings aims to become an investment bank offering a comprehensive suite of services including brokerage and sales, investment banking, investment research, asset management and financing. Since its establishment in 2011, Galaxy International Holdings has, through its wholly-owned subsidiaries, obtained the requisite business licenses to provide a wide range of financial and securities services in Hong Kong, including the Type 1 license for dealing in securities, Type 2 license for dealing in futures contracts, Type 4 license for advising on securities, Type 6 license for sponsoring IPOs and providing financial advisory services, a Type 9 license for asset management, and the license for acting as a qualified lender. As the first platform for developing our overseas securities business, Galaxy International Holdings serves as a bridge for domestic clients to expand overseas and for overseas clients to enter into the PRC, and it has laid a solid foundation for further overseas expansion of our business. We intend to further expand our overseas business as opportunities arise.

The diversified business platform and overseas client base of Galaxy International Holdings enable us to capture the growing opportunities for cross-border business in the Greater China region. Our business strategies include the following:

- Launch new businesses involving cross-border ETFs, QDIIIs and RQFIIIs, off-shore RMB bonds as well as underwriting offerings on the International Board and H-share offerings.
- Capitalize on cross-selling opportunities, leveraging our domestic and overseas client bases as well as Hong Kong's leadership role in RMB internationalization.
- Provide overseas financing, overseas investment, and cross-border M&A advisory services to PRC domestic companies, leveraging our large corporate client base in the PRC, to capture the opportunities from their international expansion.

BUSINESS

- Strategically conduct cross-border M&A and establish representative offices or subsidiaries in economies and regions with more developed capital markets to explore overseas growth opportunities and gradually increase the revenue contribution from our overseas businesses.

Improve our return on equity by better deploying assets and utilizing leverage

Due to strict regulatory restrictions, relatively nascent product development and other reasons, there is considerable potential for PRC securities firms to utilize their capital and assets more efficiently. For instance, as of December 31, 2012 the ratio of total assets to net assets of the PRC securities industry is approximately 2.5, which is considerably lower than that of major securities firms in the U.S. and Europe. In addition, the funds and securities in the client accounts of PRC securities firms are underutilized. As the applicable regulatory restrictions continue to be relaxed, we plan to take the following measures to utilize our capital and client assets more efficiently and increase our return on equity:

- *Increase leverage ratio:* Improve our return on equity by using leverage through repurchase transactions in our bond investments and other securities trading services (such as dealer-quoted repurchase products), improve our capital structure, increase the ratio of financial liabilities to net assets, and reduce overall cost of funds by issuing debt financing instruments (including corporate bonds, subordinated debt, and asset-linked notes).
- In November 2012, our Shareholders authorized us to issue short-term notes in the aggregate principal amount of up to RMB7.0 billion. On April 1, 2013, the PBOC approved our application for issuing short-term notes. Pursuant to PBOC's approval, we may at our discretion issue short-term notes in an aggregate principal amount of up to RMB7.0 billion within a one-year period. We issued the first tranche of fixed interest rate short-term notes in the aggregate principal amount of RMB3.5 billion on April 12, 2013 in the national interbank bond market through a bidding process. This tranche of notes has a term of 90 days, an interest rate of 3.58%, an issuer rating of AAA and an issuance rating of A-1. The proceeds raised from this first tranche of short-term notes will be used to replenish our working capital. We intend to issue additional short-term notes, subject to regulatory approvals and market conditions.
- In addition, at a Shareholders' meeting on April 24, 2013, our Shareholders authorized us to issue corporate debt financing instruments, which may take the form of short-term notes (up to 60% of our Net Capital), financial bonds, short-term and long-term subordinated bonds and other debt instrument, in the aggregate outstanding principal amount of up to RMB20 billion over a three-year period based on our liquidity needs, subject to regulatory approvals.
- *Mobilize our own funds:* Based on our target return on risk-based capital, significantly improve the yield of our own funds by allocating funds to high-return and high-growth businesses, in particular margin financing and securities lending and capital-based intermediary securities trading services.
- *Mobilize client assets:* Subject to our risk control targets, direct client assets to cash management and investment products with relatively high returns (such as index fund, money market fund, hybrid fund and fund of funds) to increase both clients' return on funds and our management fee income.

BUSINESS

Enhance risk management capabilities throughout our entire business operation, and strengthen capital management, internal control and IT capabilities to improve overall operational efficiency

As we develop new businesses, we intend to continue upgrading our middle- and back-office support by taking the following measures:

- Establish a risk management model that supports the development of new businesses through risk selection, risk allocation, risk-based performance evaluation and risk hedging.
- Integrate risk management mechanisms and building a unified risk management infrastructure to prevent risks before they occur, manage and control risks when they occur, and audit and review risks after they occur, which ensure that risk management is integrated into our entire business operation.
- Strengthen our compliance and audit capabilities as well as the firewalls between various business lines.
- Improve the efficiency of capital allocation among business lines by strengthening the monitoring of core risk control indicators including Net Capital and risk-based capital.
- Strengthen the research, promotion and implementation of our core business systems, innovative business systems, mobile and Internet technologies, as well as system customization to meet clients' personalized needs and to support the development and innovation of our businesses; and recruit additional technology personnel with extensive experience and skills to enhance our research and development capabilities as well as execution capabilities.

Further improve our human resources management through a performance-based system that effectively attracts, incentivizes and retains talent

Our success depends to a great extent on our ability to attract, incentivize and retain professional and experienced personnel. In order to maintain and improve our competitive advantages in the market, we intend to implement the following human resources initiatives:

- Adopt a market-oriented human resources management mechanism and recruit senior management globally.
- Promote young and outstanding professional personnel with strong leadership skills and international perspectives, and continuously improve our personnel composition.
- Provide our staff with professional training as well as clear and diversified career development plans.
- Improve and strengthen our performance evaluation system and pursue a market-oriented and performance-based remuneration system across our business lines.
- Further incentivize and increase the loyalty of our employees through equity incentive programs, including employee stock ownership programs, subject to applicable regulations.

BUSINESS

OUR BUSINESS

We provide a wide range of financial products and services to corporations, financial institutions, government entities and individuals. Our principal business lines include:

Brokerage, Sales and Trading	Investment Banking	Investment Management	Overseas Business
• Brokerage and wealth management	• Equity financing	• Asset management	• Brokerage and sales
• Institutional sales and investment research	• Debt financing	• Private equity investment	• Investment banking
• Margin financing and securities lending	• Financial advisory		• Asset management
• Proprietary trading and other securities trading services			

The following table sets forth the revenue and other income from each of our principal business lines and their respective percentages of our total revenue and other income for the periods indicated:

	2010		2011		2012	
	Revenue and other income	%	Revenue and other income	%	Revenue and other income	%
(RMB in millions, except percentages)						
Brokerage, sales and trading ⁽¹⁾	7,490.5	88.5%	5,418.5	84.2%	4,997.1	83.7%
Investment banking	740.1	8.8%	682.5	10.6%	684.9	11.5%
Investment management ⁽²⁾	88.2	1.0%	58.8	0.9%	70.0	1.2%
Overseas business	—	—	4.3	0.1%	33.5	0.6%
Others ⁽³⁾	141.4	1.7%	267.0	4.2%	176.1	3.0%
Total	8,460.2	100.0%	6,431.1	100.0%	5,961.6	100.0%

(1) Includes revenue and other income from securities brokerage, futures brokerage, proprietary trading and other securities trading services segments after inter-segment eliminations as set forth in the Accountants' Report in Appendix I to this prospectus.

(2) Includes revenue and other income from the segments of asset management and private equity investment as set forth in the Accountants' Report in Appendix I to this prospectus.

(3) Mainly includes interest income from our bank deposits and our treasury management activities.

Brokerage, Sales and Trading

We derive revenue primarily from our brokerage, sales and trading business, which includes:

- *Brokerage and wealth management:* We execute trades on behalf of clients in stocks, funds, bonds, derivatives and futures, and provide comprehensive wealth management services to our clients;
- *Institutional sales and investment research:* We market and sell securities products and services to institutional investor clients and provide professional research services to facilitate their investment decisions;
- *Margin financing and securities lending:* We provide collateralized margin financing and securities lending services, which provides financial leverage for our clients and enables our clients to engage in short selling; and

BUSINESS

- *Proprietary trading and other securities trading services:* We engage in proprietary trading and provide other securities trading services to enhance liquidity for clients and accommodate our clients' investment and financing needs.

Brokerage and Wealth Management

Overview

We provide securities and futures brokerage services to individual and institutional clients for the trading of listed stocks, funds, bonds, futures, financial derivatives and other financial products. We receive commissions primarily for executing and settling securities trades for our clients. In 2010, 2011 and 2012, the commission and fee income from our securities and futures brokerage business amounted to RMB6,066.9 million, RMB3,940.2 million and RMB3,070.0 million, respectively, representing 71.7%, 61.3% and 51.5% of our total revenue and other income, respectively. While the commission and fee income from our brokerage business decreased considerably in the above periods due to market conditions, our revenue decreased at a slower rate than that of the industry. Our net revenue from securities brokerage business ranked first among SAC member securities firms for five consecutive years beginning 2008. Our average securities brokerage commission rate in the PRC in 2010, 2011 and 2012 was 0.103%, 0.083% and 0.083%, respectively.

Our annual trading turnover and market share of stocks and funds on a combined basis ranked first in each year from 2007 to 2010 and ranked second in 2011 and 2012 in the PRC securities industry among members of the Shanghai Stock Exchange and the Shenzhen Stock Exchange. The following table sets forth our brokerage trading turnover and market share of stocks, warrants, funds, bonds and futures for the periods indicated:

	2010		2011		2012	
	Trading turnover	Market share	Trading turnover	Market share	Trading turnover	Market share
(RMB in billions, except percentages)						
Stocks	5,576.3	5.1%	4,368.6	5.2%	3,229.5	5.2%
Warrants*	197.7	6.6%	81.2	11.7%	—	—
Funds	64.7	3.8%	51.5	4.3%	59.2	3.8%
Bonds	738.0	6.1%	1,701.4	4.7%	4,053.2	5.7%
Futures**	8,645.6	—	7,590.8	—	9,610.1	—
<i>Commodities</i>	4,910.1	2.2%	3,925.6	2.1%	4,987.8	2.6%
<i>Stock index</i>	3,735.5	4.6%	3,665.2	4.2%	4,622.3	3.1%
Total	15,222.3	—	13,811.5	—	17,052.0	—

* All exchange-traded warrants in the A share market reached their maturity in 2011.

** Prior to 2011, the CFA included the transaction amounts for both sides of a trade in its calculation of futures trading volume in the PRC futures market, and included only the transaction amount of a trade since 2011. Our futures trading volume in 2011 and 2012 has been adjusted to include both sides of a trade for consistent presentation.

We have received numerous awards in recent years for our brokerage and wealth management services, including the following:

- “Superior Securities Firm in the Golden Bull Investment Advisory Contest” award by *China Securities Journal* in 2012;
- “Best Securities Brokerage Firm” award by *Shanghai Securities News* in 2011;

BUSINESS

- “Innovative Financial Services Firm of the Year” award, “Best Securities Firm for Mobile Business” award, “Best Securities Firm for Investment Advisory Services” award and “Best Wealth Management Center” award by *Securities Times* in 2011;
- “Best Chinese Securities Brokerage Firm” award by *Securities Times* in 2010; and
- “Best Wealth Management Brand” award, “Best Financial Marketing” award and “Innovative Financial Marketing” award by *Financial Analyst Team League*, a prominent industry publication in the PRC, for 2010-2011.

Clients

We believe our large and stable brokerage client base is the foundation of our business. As at December 31, 2012, we had approximately 5,573,000 brokerage clients, which included approximately 5,514,000 securities brokerage clients and approximately 59,000 futures brokerage clients. As at the same date, our brokerage clients consisted of approximately 5,556,000 individual clients and over 16,000 institutional clients.

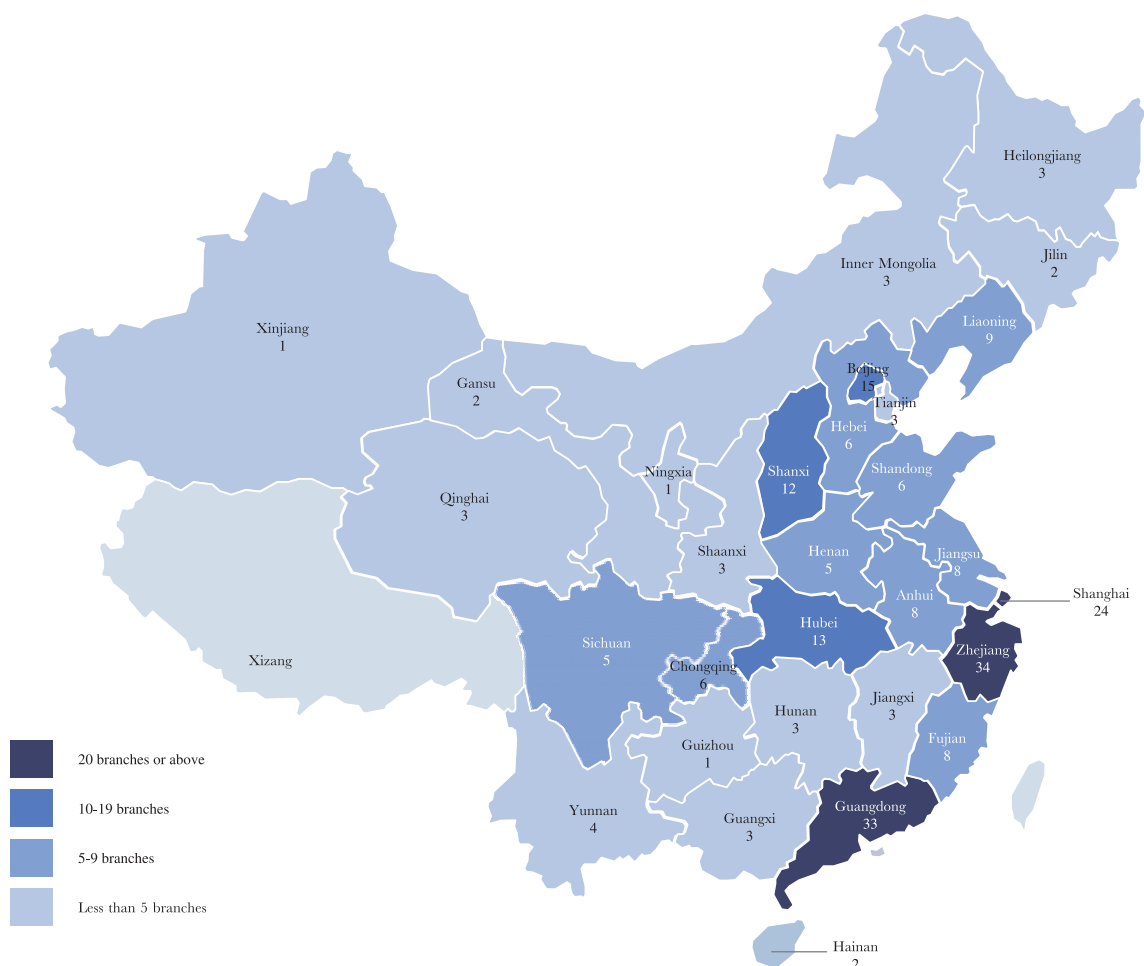
As at December 31, 2012, 82.0% of our brokerage clients had maintained accounts with us for over three years and 45.5% for over ten years. The number of our brokerage clients who closed their accounts decreased from 75,562 in 2010 to 55,711 in 2011, and further decreased to 28,792 in 2012. We believe that the high percentage of our long-term clients and the decreasing number of clients who closed their accounts reflected our high client loyalty. As at December 31, 2012, approximately 63.7% of our securities brokerage clients were active clients. Our client base grew from approximately 5.01 million as at December 31, 2010 to approximately 5.39 million as at December 31, 2011, and to approximately 5.57 million as at December 31, 2012.

We provide differentiated services to our brokerage clients based on their risk appetite and wealth management needs. We offer service contracts of different levels and scope of services to suit our clients’ individual needs. As at December 31, 2012, we had approximately 190,000 high-end clients, and we expect our high-end client base to expand as the PRC economy continues to grow. We have started to provide comprehensive wealth management services to our high-end clients, and plan to further enhance our wealth management services by increasing the range of our products and services and increasing cross-selling among our business lines.

BUSINESS

Branch Network and Trading System

We have the largest number of securities brokerage branches and the most extensive network coverage among all PRC securities firms, according to the SAC. As at December 31, 2012, we had 229 securities brokerage branches and 22 futures brokerage branches in 30 provinces in the PRC. As at the same date, 104 of our brokerage branches were qualified to conduct futures IB business. For more information about our futures brokerage and futures IB businesses, please see “—Futures Brokerage and Other Services.” We have extensive coverage in more developed regions of the PRC such as the Yangtze River Delta, the Pearl River Delta and the Bohai Rim. We have also established branches in regions that we consider to have significant growth potential, such as the central, western and northeastern regions of the PRC. We believe that the large number, extensive coverage and strategic location of our brokerage branches are key competitive strengths of our brokerage business as well as a significant advantage for our branding and business development. The following diagram sets forth the PRC provinces covered by our securities brokerage branch network and the number of branches in each province as at December 31, 2012.



In March 2013, the CSRC issued the Supervisory Provisions on Branches of Securities Companies (《證券公司分支機構監管規定》), which relaxes the regulatory requirements for setting up new branches of securities firms and allows accounts to be opened remotely. We believe such relaxation of regulatory requirements will facilitate the development and consolidation of the securities industry and provide competitive securities firms with more flexibility to deploy their resources. We have begun to build a tiered network of physical branches with branch offices and regional headquarters branches as

BUSINESS

local centers and widely distributed satellite securities branches as additional contact points with clients. We intend to improve the capability of our corporate subsidiaries and regional headquarters branches in terms of local sales, client service and cross-selling. In addition, we have been rapidly transforming our branches from conventional brokerage branches to wealth management centers that provide comprehensive brokerage and wealth management services and improve our overall client service capabilities. For more information about our wealth management services, please see “—Wealth Management Services.”

PRC regulatory authorities have relaxed the requirements for securities brokerage branches in terms of scale, region and on-site trading facilities. Compared to conventional brokerage branches, “light branches” have fewer employees incur lower capital expenditures and lower operational expenses, and focus more on client communication. We plan to set up more “light branches” to facilitate the transition of traditional brokerage branches to wealth management centers. We believe the “light branches” will help lower our operating costs and expand our network coverage and client base.

We provide clients with a variety of trading methods. Our clients can trade at our branches trading counters or trading terminals, or trade remotely via telephone, Internet, or mobile devices (including mobile phones and tablets). Online trading has become the primary trading method for our securities brokerage clients. In 2012, our online trading turnover accounted for close to 90% of our total securities brokerage trading turnover.

Our scalable IT infrastructure includes a wide-area network connecting PRC securities and futures exchanges and all of our branches as well as high-speed online and mobile trading platforms. We operate over 20 mirror websites nationwide that can support over one million online users simultaneously. Our three mobile trading centers in Beijing, Hangzhou and Guangzhou support over 1.5 million mobile-trading clients as at December 31, 2012. We believe that our policies and procedures on system development, operations and maintenance as well as security management have enabled our trading information system to consistently operate in a secure and stable manner. We have built two disaster recovery centers in Beijing and Shanghai, and strive to continuously enhance our ability to respond to IT failures. We also plan to further enhance our various off-site trading platforms to better accommodate our clients’ evolving needs.

Marketing and Client Service

Our sales and marketing team consists primarily of securities brokerage agents who are third-party contractors and client-managers who are our employees. Both the securities brokerage agents and the client managers receive performance-based remuneration. As at December 31, 2012, we had 333 securities brokerage agents and 2,941 client managers. In addition to client development through phone calls, in-person meetings, referrals and investor education events, we strive to capture cross-selling opportunities among our business lines and between our domestic and overseas operations. For example, our investment banking business refers institutional clients to our brokerage business, while our brokerage business also refers clients to our investment banking and asset management businesses.

We strive to ensure client satisfaction through high-quality client services. We have one of the largest centralized client service centers in the PRC securities industry. Except on PRC public holidays, we provide 24-hour real-time assistance through our client hotlines and online client support, including answering inquiries about trading rules, account status and trading software. In addition, we provide brokerage clients with our proprietary analyses and recommendations of stocks, funds and

BUSINESS

other financial products via text messages and emails. Our dedicated client service quality inspectors are able to timely identify and resolve service quality issues in our client service centers through random checks of service records.

Wealth Management Services

As at December 31, 2012, we had approximately 190,000 high-end clients. We believe that our high-end clients have significant needs for investment and financing solutions, personalized wealth management products and risk management instruments, areas that represent an important source of potential revenue for us.

To meet the wealth management needs of our clients, we are rapidly transforming our conventional brokerage branches into wealth management centers that provide a comprehensive suite of brokerage and wealth management services. In addition to brokerage services, we also sell self-developed and third-party financial products through our brokerage branch network. The sale of our self-developed financial products grew rapidly. The market value of the self-developed financial products we sold grew from RMB1.99 billion as at December 31, 2010 to RMB1.80 billion as at December 31, 2011, and to RMB6.44 billion as at December 31, 2012. The amount of third-party financial products we sold increased from RMB6.09 billion in 2010 to RMB9.61 billion in 2011, and to RMB14.07 billion in 2012. Since the new regulation on agency sales of financial products was issued in November 2012, we have become qualified to engage in agency sales of financial products and are now able to offer a greater variety of third-party financial products. We intend to significantly expand the scale and diversity of third-party financial products we sell. We believe that our client base and branch network advantage, as well as our continuously diversified product portfolio, will provide strong support for the development of our wealth management services and help turn it into a new growth area of our business in the future. In 2010, 2011 and 2012, the respective percentages of the market value of our self-developed financial products and third-party financial products were as follows:

	<u>2010</u>	<u>2011</u>	<u>2012</u>
Self-developed financial products	11.1%	11.3%	28.9%
Third-party financial products*	88.9%	88.7%	71.1%

* Not including trust products as there is no market value data for trust products.

We also aim to answer to client needs and upgrade our brokerage services to include wealth management planning, investment and financing solutions as well as risk management. For example, we have begun to offer differentiated service packages to provide value-added services and investment information of various scope and professional levels based on client needs. In addition, our continuous innovation has enabled us to provide a comprehensive suite of financial services, including trading, financing and investment services on and outside of exchanges, for our clients.

Our investment advisory team is critical to the success of our wealth management services. Deployed across our entire branch network, our investment advisors possess relevant financial knowledge and have obtained requisite Securities Investment Advisory Business (Investment Advisor) qualification granted by the SAC. As at December 31, 2012, we had a team of 1,137 registered investment advisors, ranking second in the PRC securities industry, according to the SAC. Over two-thirds of our registered investment advisors have more than ten years of experience in the securities industry, and a majority of our registered investment advisors have been a registered investment

BUSINESS

advisor for over two years. We enhance the service quality and professional skills of our investment advisors through conducting regular training and performance reviews and providing appropriate incentives. Our investment advisors engage in in-depth communication with clients and provide one-on-one personalized investment advisory services, including introducing and recommending our contract service plans to clients.

Our investment advisory research team consists of over 30 members. As of December 31, 2012, over two-thirds of the members of our investment advisory research team have received the Securities Investment Advisory Business (Investment Advisor) qualification granted by the SAC, while the remaining team members possess qualification to provide general securities services. As of the same date, a majority of the members of our investment advisory research team have more than ten years of experience in the securities industry, and more than 80% of our investment research team have been a registered investment advisor for over two years. Our investment advisory research team provides the knowledge foundation for our wealth management services through providing analyses and making recommendations on stocks, funds and financial product portfolios. Our investment advisory research team also screens and evaluates the financial products we offer as well as provides asset allocation advice based on our clients' financial sophistication, risk appetite and investment philosophy. We also provide our wealth management clients with detailed investment analyses and recommendations based on their specific needs.

Futures Brokerage and Other Services

We conduct futures brokerage business through our subsidiary, Galaxy Futures. As at December 31, 2012, we and RBS Asia Futures Limited held 83.32% and 16.68% of the equity interest in Galaxy Futures, respectively.

Galaxy Futures is a member of the Shanghai Futures Exchange, the Dalian Commodity Exchange and the Zhengzhou Commodity Exchange, as well as a trading and clearing member of the China Financial Futures Exchange. Galaxy Futures holds qualifications to provide comprehensive services, including futures brokerage, futures investment advisory and asset management services. The futures brokerage services provided by Galaxy Futures cover all futures products in the PRC, including commodities futures such as copper, rebar, soybean, corn, wheat, cotton, sugar, rubber and gold, as well as financial futures such as stock index futures. The futures investment advisory services currently offered by Galaxy Futures include risk management advisory, research and analyses, and formulation of futures trading strategies.

In 2010, 2011 and 2012, the revenue and other income of Galaxy Futures amounted to RMB304.3 million, RMB387.7 million and RMB521.2 million, respectively, representing 3.6%, 6.0% and 8.7% of our total revenue and other income, respectively. The commission and fee income of Galaxy Futures was RMB253.3 million, RMB267.5 million and RMB337.7 million, respectively, in the same periods.

BUSINESS

The following table sets forth the breakdown of Galaxy Futures' trading turnover, trading volume, and market share by futures product for the periods indicated:

	2010	2011	2012
	(RMB in billions, except percentages)		
Trading turnover	8,645.6	7,590.8	9,610.1
<i>Turnover of commodity futures</i>	4,910.1	3,925.6	4,987.8
<i>Market share of commodity futures</i>	2.16%	2.09%	2.62%
<i>Turnover of stock index futures</i>	3,735.5	3,665.2	4,622.3
<i>Market share of stock index futures</i>	4.55%	4.19%	3.05%
	(transaction number in millions, except percentages)		
Trading volume*	72.4	47.4	76.1
<i>Trading volume of commodity futures</i>	68.2	43.2	69.7
<i>Market share of commodity futures</i>	2.24%	2.15%	2.59%
<i>Trading volume of stock index futures</i>	4.2	4.2	6.4
<i>Market share of stock index futures</i>	4.56%	4.14%	3.04%

* Prior to 2011, the CFA included the transaction amounts for both sides of a trade in its calculation of futures trading volume in the PRC futures market, and included only the transaction amount of a trade since 2011. Our futures trading volume in 2011 and 2012 has been adjusted to include both sides of a trade for consistent presentation.

We expect that the regulatory authorities are likely to approve new futures products in the near future, such as crude oil futures and MOF bond futures, which we believe would further increase Galaxy Futures' trading volume.

Galaxy Futures' client base has grown rapidly in recent years. As at December 31, 2010, 2011 and 2012, Galaxy Futures had approximately 35,000, 48,000 and 59,000 clients, respectively. As at the same dates, Galaxy Futures' total client margin balance amounted to RMB3,970 million, RMB3,989 million and RMB5,655 million, respectively.

According to the CFA, in terms of commission and fee income in 2011, Galaxy Futures had a market share of 2.68%, ranking second among all futures subsidiaries of PRC securities firms and fifth among all PRC futures firms. Galaxy Futures has received numerous awards, including:

- “PRC Derivatives Firm of the Year” award by *Futures & Options World* in 2012;
- “Best Brand in the PRC Futures Market” award by *Shanghai Securities News* in 2011; and
- “PRC Futures Firm with the Best Growth” award by *Securities Times* in 2011.

As at December 31, 2012, Galaxy Futures had 22 branches in 21 cities across 16 provinces in the PRC. The branch network of Galaxy Futures has gradually covered more developed areas in central and eastern China in synchronization with the branch network of our futures IB business.

Our futures IB business refers to our securities brokerage business introducing potential clients to Galaxy Futures. In December 2007, we became the first PRC securities firm to receive a license from the CSRC to conduct futures IB business. As at December 31, 2012, 104 of our securities brokerage branches in 29 provinces in the PRC had been licensed to conduct futures IB business, representing approximately 45% of all of our securities brokerage branches. We are in the process of applying for futures IB business licenses for our other securities brokerage branches.

BUSINESS

As at December 31, 2012, approximately 15,000, or 25.5%, of Galaxy Futures' clients were introduced to Galaxy Futures through our futures IB business, and the total assets in the accounts of these clients amounted to approximately RMB1,712 million.

Institutional Sales and Investment Research

Institutional Sales

We market and sell various securities trading services and financial products, including stocks, bonds and funds, to institutional investor clients, which primarily include mutual fund management companies of publicly-raised funds, management companies of private investment funds, QFIIs, the NSSF, insurance companies, trust companies, asset management companies, finance companies and commercial banks. We had approximately 500 institutional investor clients as at December 31, 2012.

As at December 31, 2012, we had 65 management companies of publicly-raised funds as our clients which included the vast majority of the fund management companies in the PRC. According to Wind Info, commission income from management companies of publicly-raised funds in 2010, 2011 and 2012 amounted to RMB138.6 million, RMB156.5 million and RMB188.4 million, respectively, representing market shares of 2.14%, 3.20% and 4.65%, respectively. In 2012, we ranked third in the PRC securities industry in terms of commission income from management companies of publicly-raised funds, which we believe reflects our clients' recognition of the quality of our research and services.

The CSRC issued the Tentative Provisions on the Launch of Securities Investment Fund Custody Business by Non-bank Financial Institutions (非銀行金融機構開展證券投資基金託管業務暫行規定) and the Asset Custody Business of Securities Companies (Draft for Commentary) (證券公司資產託管業務 (徵求意見稿)) in March 2013. Given our strength in client base and branch network and our leading position in fund rating service, we believe that our fund custody business will become a new growth area for us, and provide additional income diversification opportunities for our brokerage business.

Our QFII clients include large overseas investment banks and asset management companies. Leveraging our sophisticated trading system and experienced traders, we provide our QFII clients with specialized trading services such as executing complex trading strategies and conducting basket trades of stocks.

Our institutional investor clients have diverse investment and financing needs, large trading turnover and high expectations for quality of information. In addition to specialized investment research, we provide numerous value-added services, such as capital-based intermediary bulk trades, off-exchange financing, margin financing and securities lending, financing advisory, securities custody, market value management, and fund research and valuation. We also offer integrated solutions to satisfy client needs and enhance client loyalty.

Investment Research

We provide our institutional investor clients with research services that cover macroeconomic analysis, investment strategies, fixed-income product research, industry sectors and public companies research, and fund research. As at December 31, 2012, our stock research covered over 400 public companies in 24 industries. Our research team serves the vast majority of the management companies

of publicly-raised funds and major insurance companies in the PRC, and also provides support to our brokerage, investment banking and other business lines. As of December 31, 2012, our research team consisted of 93 members, of which 23% held doctor's degrees, 65% held master's degrees, and 12% held bachelor's degrees.

In 2010, we established the China Galaxy Post-doctoral Research Center in collaboration with renowned domestic universities, such as the Chinese Academy of Social Science, Renmin University of China, and University of International Business and Economics, to jointly cultivate post-doctoral research analysts and to conduct research on the PRC economy, capital markets and the securities industry. We believe that the research center improves our research capabilities and develops research talent for us. The research center has admitted eight post-doctoral candidates since its establishment.

Our Fund Research Center conducts fund research and evaluation which includes analysis of fund performance, analysis of a fund portfolio's investment style, analysis of fund stock allocation, analysis of fund investment value, comprehensive evaluation of fund management companies' investment capabilities, and growth strategies of the fund management industry and fund management companies. We provide customized products to fund management companies, commercial banks, insurance companies and other institutions to accommodate their different needs. We were the first securities firm in the PRC to establish a professional fund evaluation and rating agency, and were also the first in the industry to classify securities investment funds based on the components and compositions of their portfolios. Our classification system has become one of the major benchmarks for fund classification in the PRC.

We have received awards from numerous institutions in the industry for our research excellence. In January 2008, we received the "National Prize for Best Science and Technology Innovation of Securities and Futures Institutions (全國證券期貨系統科學技術最佳創新獎)" jointly awarded by the CSRC and the SAC for our "Fund Research and Evaluation Information System (基金研究評價資訊系統)." In 2012, *New Fortune* ranked us the fourth "Most Influential Research Firm (最具影響力研究機構)," first for our research on the petrochemical industry, first for our research on the machinery industry, and second for our research on the automobile and automobile parts industry.

Margin Financing and Securities Lending

We obtained the requisite qualification for margin financing and securities lending business from the CSRC in June 2010 and started to conduct such business in July 2010. We offer collateralized financing through our margin financing services to brokerage clients who wish to finance their securities purchases, thereby enabling them to improve investment returns through financial leverage. We lend securities held in our own accounts to our brokerage clients through our securities lending services, enabling our clients to take advantage of potential short-selling opportunities in the market.

BUSINESS

Our margin financing and securities lending clients may offer securities identified on the websites of the Shenzhen Stock Exchange and the Shanghai Stock Exchange as collaterals. Different discount rates apply when determining the value of the securities as collaterals. The following chart sets forth the applicable discount rates for various types of securities in our margin financing and securities lending business as of December 31, 2012:

<u>Type of securities</u>	<u>Discount rate</u>
MOF bonds	95%
ETFs	90%
Non-ETF listed securities investment funds and non-MOF bonds	80%
SSE 180 Index and SZSE 100 Index constituent stocks	70%
Non-ST stocks (excluding SSE 180 Index and SZSE 100 Index constituent stocks)	65%
ST stocks	0%

We expect the types and quantity of securities eligible for margin financing and securities lending in the PRC to further expand due to regulatory changes. We also expect that the eligibility requirements for brokerage clients to engage in margin financing and securities lending is likely to be lowered, and that institutional investors, such as fund management companies and insurance companies, are likely to be permitted to utilize our margin financing and securities lending services.

Revenue from our margin financing and securities lending business consists primarily of interest income from margin financing and securities lending and brokerage commission income from margin trades by our clients. We specify in our agreements with margin financing and securities lending clients the maximum amount, maturity, and interest rate for the funds and securities that we lend to clients. The annualized interest rates we currently charge for our margin financing services and securities lending services are 3% and 5%, respectively, above the PBOC benchmark interest rate of six-month loans for financial institutions, and therefore may fluctuate due to fluctuations in the base PBOC benchmark rate. As at December 31, 2012, the annualized interest rates for our margin financing and securities lending services were 8.6% and 10.6%, respectively. The following table sets forth the interest income and commission income from our margin financing and securities lending business for the periods indicated:

	<u>2010</u>		<u>2011</u>		<u>2012</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
(RMB in millions, except percentages)						
Interest income*	6.7	51.1%	162.2	69.5%	347.5	67.8%
Commission income*	6.4	48.9%	71.2	30.5%	165.1	32.2%
Total	<u>13.1</u>	<u>100.0%</u>	<u>233.4</u>	<u>100.0%</u>	<u>512.6</u>	<u>100.0%</u>

* Not including that of the margin financing and securities lending business of China Galaxy International.

In 2010, 2011 and 2012, interest and commission income from our margin financing and securities lending business represented 0.15%, 3.63% and 8.60% of our total revenue and other income in the same periods, respectively. We believe that our margin financing and securities lending business has become an important driver for the future growth of our brokerage business and is gradually becoming an increasingly important source of our overall revenue and profit. Revenue from our margin financing and securities lending business has been included in the revenue and other income of our brokerage business in our financial report. Please see “Financial Information—Summary Segment Results—Securities brokerage.”

BUSINESS

As at December 31, 2010, 2011 and 2012, the market value of the collaterals from our margin financing and securities lending clients amounted to RMB2,010 million, RMB8,790 million and RMB16,520 million, respectively. The following table sets forth our balance of margin financing and securities lent, trading turnover of margin trades by our clients and respective market share of our margin financing and securities lending business for the periods indicated:

	2010		2011		2012	
	Amount	Market share	Amount	Market share	Amount	Market share
(RMB in millions, except percentages)						
Closing balance of margin financing and securities lent*	533	4.17%	2,558	6.70%	5,377	6.01%
Trading turnover of margin trades by clients*	4,356	N.A.**	40,919	6.99%	108,450	6.57%

* Not including that of the margin financing and securities lending business of China Galaxy International.

** No industry data available.

Our margin financing and securities lending balance grew rapidly in the first three months of 2013. As at March 31, 2013, total margin financing and securities lending balance reached RMB9,651 million, an increase of 79.5% since the end of 2012.

The clients of our margin financing and securities lending business include high-end individual clients and institutional clients. As at December 31, 2012, approximately 116,500 of our brokerage clients met the regulatory eligibility requirements of having maintained a brokerage account with us for at least six months and holding assets with a market value of at least RMB500,000, and represented an industry-leading 9.03% share of all brokerage clients having assets with a market value of RMB500,000. As at the same date, approximately 26,200 of our brokerage clients had opened margin financing and securities lending accounts with us, representing 22.5% of all of our eligible clients. We believe that our margin financing and securities lending business has significant growth potential.

As at December 31, 2012, we offered margin financing and securities lending services at 211 of our brokerage branches in 29 provinces in the PRC. We are one of the largest providers of margin financing and securities lending services in terms of market share and network coverage. As at December 31, 2012, 278 stocks and ten ETFs were eligible for margin financing and securities lending in the PRC, and we offered margin financing services for all of the eligible stocks and ETFs, and offered securities lending services for 267 eligible stocks. Our brokerage team collaborates with our investment research team to provide our margin financing and securities lending clients with real-time service and professional investment analyses and research reports to assist them with product selection and risk management. For institutional investor clients who already utilize our margin financing and securities lending services, we intend to broaden our services to include comprehensive trading services such as trading strategies consulting, algorithmic trading and program trading services.

We became one of the first PRC securities firms to obtain qualifications for margin refinancing business in August 2012 and securities refinancing business in February 2013, both of which were permitted through a pilot program overseen by the CSRC. Margin and securities refinancing enables us to lend funds and securities owned by third parties to our clients, thereby increasing the amount of funds and securities available to our margin financing and securities lending business and enhancing the effectiveness of hedging strategies available to our clients. In addition, we believe that our margin and securities refinancing business will help increase the leverage ratio of our margin financing and

BUSINESS

securities lending business and consequently improve our return on equity. As at March 31, 2013, the balance of our margin and securities refinancing totaled RMB3,423 million.

Proprietary Trading and Other Securities Trading Services

In 2010, 2011 and 2012, revenue and other income from our proprietary trading and other securities trading services accounted for approximately 3.8%, 1.8% and 6.7% of our total revenue and other income, respectively. The following table sets forth the daily average investment amount, net revenue and realized return for our proprietary trading and other securities trading services by asset class for the periods indicated⁽¹⁾:

		2010	2011	2012
		(RMB in millions, except percentages)		
Stocks and fund products	Investment Amount	289.1	729.1	423.5
	Net Revenue	38.2	-125.5	-5.9
	Realized Return (%)	13.2%	-17.2%	-1.4%
Bonds	Investment Amount ⁽²⁾	4,083.4	4,022.3	4,346.4
	Net Revenue	229.0	174.3	294.4
	Realized Return (%)	5.6%	4.3%	6.8%
Others⁽³⁾	Investment Amount	50.5	452.8	915.2
	Net Revenue	-3.6	21.9	36.2
	Realized Return (%)	-7.1%	4.8%	4.0%
Total	Investment Amount	4,423.0	5,204.1	5,685.2
	Net Revenue	263.5	70.7	324.8
	Realized Return (%)	6.0%	1.4%	5.7%

(1) Calculated as follows: (i) investment amount = aggregate of daily funds used by our proprietary trading and other securities trading activities during the period / number of days during the period; (ii) net revenue = income associated with proprietary and other securities trading activities (including but not limited to investment income and interest income)—cost associated with proprietary trading and other securities trading activities (including but not limited to cost of funding and interest cost) and (iii) realized return = net revenue / investment amount.

(2) Net of bonds sold under repurchase agreements, and includes investments made for liquidity management purposes.

(3) Includes primarily net revenue from stock index futures hedging, Alpha trading, securities-based lending and liquidity services.

Proprietary Trading

Our proprietary trading business emphasizes prudent operation and value investing, and aims to achieve stable returns while managing risk rigorously. We formulate our annual investment strategy that controls the investment scale and risk quota for our proprietary trading, taking into account our financial condition and performance. Our comprehensive and timely research on the markets, industry sectors and individual securities underpins the decision-making for our proprietary trading.

We use our own funds to engage in proprietary trading of equity securities and seek to achieve stable returns by utilizing hedging instruments such as stock index futures and implementing a variety of trading strategies. Our proprietary trading of debt securities prudently uses leverage through repurchase agreements and seeks to increase our bond holdings and enhance the investment return on our principal.

Other Securities Trading Services

We utilize our own funds to provide various other securities trading services and products to meet client needs in primarily three aspects: (1) liquidity and risk management—we offer market-

BUSINESS

making service, capital-based intermediary bulk trade service, equity swap service, hedging service and provision of securities for the securities lending business; (2) financing—we offer securities-based lending product; and (3) investment—we offer “Daily Profit” (天天利), a dealer-quoted bond repurchase product and we have received qualifications to offer dealer-quoted fund repurchase products.

We engage in the market-making of ETF, LOF and MOF bonds. Market-making enhances market liquidity, facilitates price discovery and promotes market equilibrium. Our market-making service may generate profits for us from the bid/ask spreads, and may generate higher commission income for our brokerage business by increasing trading turnover. We believe that the skills and experience we have accumulated from our current market-making service can benefit us in providing market-making service in the OTC markets.

We also provide capital-based intermediary bulk trade service to clients who wish to trade a large amount of securities. Pursuant to our bulk trade service agreements with clients, we purchase their securities through the block trading platform and sell them in the market through program trading, or purchase securities specified by clients from the market through program trading and sell them through the block trading platform. We charge a fee for our service, while the client assumes the risk of price fluctuations of the securities. Our bulk trade service helps mitigate the impact of a large transaction on the market price of the securities and lowers our client’s cost associated with the bulk trade, which in turn benefits market stability and maximizes our client’s interest.

We designed our securities-based lending product and became one of the first securities firms in the PRC to receive the qualification to offer it. We purchase securities from clients under a repurchase agreement which provides that our clients shall buy back the securities at pre-determined prices and within a specified period of time. The securities-based lending product helps our clients obtain desired liquidity without a fire-sale of their securities and also offers them opportunities to mobilize their idle assets. The interest rate we charge for the securities-based lending product is generally comparable to that of our margin financing and securities lending services. Subject to regulatory requirements and restrictions, we plan to gradually expand the variety of our securities-based lending product to better meet clients’ financing needs. As at December 31, 2012, the aggregate outstanding balance of securities-based lending product was RMB648 million compared to RMB6 million as at December 31, 2011.

Daily Profit is a dealer-quoted bond repurchase product which serves as a cash management and short-term investment instrument for our clients. We pledge bonds to our clients to obtain short-term funds and offer interest rates typically higher than interest rates of bank deposits of similar tenors. Daily Profit enables us to leverage our bond holdings as we are able to borrow up to 90% of the value of the pledged bonds. In addition, we benefit from the interest rate spread between our borrowing rates and the bond yields. Daily Profit improves our client’s return on short-term funds while ensuring the liquidity of the investment. In 2011, the Shanghai Stock Exchange started to promote innovative products similar to Daily Profit. We started offering Daily Profit in November 2011 as one of the first PRC securities firms in the pilot program. In January 2013, we were authorized to offer dealer-quoted bond repurchase products on an enlarged scale, with broadened product maturities and reduced minimum purchase requirement. More specifically, the maximum amount of dealer-quoted bond repurchase products we may offer has been increased from RMB5 billion to RMB20 billion, and we have been approved for offering three new product maturities, namely, 42 days, 63 days and 182 days, in addition to the existing maturities of one day, 7 days, 14 days, 28 days and 91 days. We now offer eight products covering all of the key maturity points in a year, effectively meeting our clients’ needs

BUSINESS

for products with different maturities. In addition, the minimum purchase requirement for our dealer-quoted bond repurchase products has been reduced from RMB50,000 to RMB1,000, which significantly reduces the threshold for our Daily Profit product and helps to further expand our target client base for this product. As at December 31, 2012, the number of our Daily Profit clients reached approximately 32,000 with an aggregate outstanding balance of approximately RMB3,524 million, compared to RMB3 million as at December 31, 2011.

We have received the qualification for offering equity swap service and intend to launch the service in the near future. Clients of our equity swap service would receive returns from a long or short position in the underlying securities for a given period with fixed interest costs. Applicable regulations permitting, we also intend to launch asset-linked notes to meet investors' wealth management needs while diversifying our fund sources to effectively support the growth of our new businesses and improve our leverage ratio.

In February 2013, we obtained qualification to conduct OTC trading on a pilot basis, which enabled us to further leverage our BS&T platform and our strength in product innovation. We intend to continue to enhance our innovative capabilities and continue to develop new securities trading products and services.

BUSINESS

Investment Banking

Our investment banking business consists primarily of equity financing, debt financing and financial advisory services.

The following table sets forth the client type, securities market, financial product or service and regulatory authority of our equity financing, debt financing and financial advisory businesses:

	<u>Client Type</u>	<u>Securities Market</u>	<u>Financial Product or Service</u>	<u>Regulatory Authority</u>
Equity financing	Public and private companies	the Shanghai Stock Exchange the Shenzhen Stock Exchange New OTC Board	Stock (including convertible corporate bonds)	CSRC
Debt financing	Public companies in non-financial sectors	the Shanghai Stock Exchange the Shenzhen Stock Exchange	Corporate bonds	CSRC
	Private micro-, small- and medium-sized enterprises	the Shanghai Stock Exchange the Shenzhen Stock Exchange	Privately placed SMEs bonds	CSRC
	Private companies in non-financial sectors	Interbank bond market the Shanghai Stock Exchange the Shenzhen Stock Exchange	Enterprise bonds	NDRC
	Financial institutions (including insurance companies and commercial banks)	Interbank bond market	Financial bonds	CBRC, CIRC and/or PBOC
	Public or private companies in non-financial sectors	Interbank bond market	Medium-term notes Short-term notes Collective notes Privately placed notes and asset-backed notes	NAFMII
		Not applicable	Debt investment plans of insurance companies	CIRC
Financial advisory	Public and private companies	Stock exchanges, OTC and other markets	Financial advisory with respect to M&A and corporate restructuring, as well as other transaction brokering	CSRC and other relevant regulatory authorities

BUSINESS

Our investment banking business focuses on large corporations and government entities, as well as on SMEs that demonstrate significant growth potential. In addition, our investment banking business collaborates closely with our other businesses, such as brokerage and asset management, to promote cross-selling and further expand our investment banking client base.

As of December 31, 2012, we had acted as a lead underwriter in 246 financing transactions, including transactions underwritten by Galaxy Limited, with an aggregate offering amount of approximately RMB511.5 billion, ranking third in the PRC securities industry, according to Wind Info. The total amount we underwrote as a lead underwriter was approximately RMB72.9 billion, RMB45.1 billion and RMB77.4 billion, in 2010, 2011 and 2012, respectively.

In 2010, 2011 and 2012, all of our top five clients were investment banking clients, as set forth in the chart below:

2010	2011	2012
Agricultural Bank of China Limited	Zhejiang Semir Garment Co., Ltd.	Elec-Tech International Co., Ltd.
Hangzhou Songcheng Tourism Development Co., Ltd.	Shanxi Coal International Energy Group Co., Ltd.	China National Petroleum Corp.
Guangzhou Haige Communications Group Incorporated Company	Dalian Port (PDA) Company Limited	Beijing Philisense Technology Co., Ltd.
Chongqing Water Group Co., Ltd.	Zhongshan Broad-Ocean Motor Co., Ltd.	Jinhe Biotechnology Co., Ltd.
State Grid Corp. of China	Changzhou Urban Construction Co., Ltd.	Ganzhou City Development Investment Group Co., Ltd.

Equity Financing

We underwrite IPOs, follow-on offerings, issuance of convertible corporate bonds, rights issues, and private placements. We had 43 PRC sponsor representatives as at December 31, 2012. We receive underwriting fees based on a certain percentage of the amount of securities we underwrite.

Our underwriting fees from our equity financing business amounted to RMB381.6 million, RMB281.6 million and RMB125.3 million in 2010, 2011 and 2012, respectively, representing 51.6%, 41.3% and 18.3% of the total revenue and other income of our investment banking business in the same periods, respectively.

As of December 31, 2012, including transactions underwritten by Galaxy Limited, we had acted as a lead underwriter in 68 equity financing transactions with an aggregate offering amount of approximately RMB203.0 billion, ranking fifth in the PRC securities industry, and such aggregate offering amount included approximately RMB54.6 billion in the coal mining industry, RMB70.9 billion in the financial services and insurance industry, and RMB14.2 billion in the transportation and warehousing industry, according to Wind Info.

BUSINESS

The following table sets forth certain details of the equity financing transactions in which we acted as a lead underwriter, co-lead underwriter and sub-underwriter, respectively, during the periods indicated:

As a lead underwriter:

		2010	2011	2012
(RMB in millions, except for the number of transactions)				
IPO	Number of transactions	4	1	2
	Amount underwritten	22,595.30	4,221.00	805.14
	Underwriting fees	331.92	150.08	52.90
	Average commission rate*	1.47%**	3.56%**	6.57%**
Follow-on offerings	Number of transactions	—	1	—
	Amount underwritten	—	1,059.32	—
	Underwriting fees	—	33.00	—
	Average commission rate	—	3.12%	—
Rights issues	Number of transactions	1	—	—
	Amount underwritten	746.03	—	—
	Underwriting fees	0.91	—	—
	Average commission rate	0.12%	—	—
Private placements	Number of transactions	1	2	4
	Amount underwritten	3,000.00	6,315.22	8,379.00
	Underwriting fees	47.16	97.06	72.11
	Average commission rate	1.57%	1.54%	0.86%

As a co-lead underwriter:

		2010	2011	2012
(RMB in million, except for the number of transactions)				
IPO	Number of transactions	—	2	—
	Amount underwritten	—	296.48	—
	Underwriting fees	—	0.45	—
	Average commission rate	—	0.15%	—

As a sub-underwriter:

		2010	2011	2012
(RMB in million, except for the number of transactions)				
IPO	Number of transactions	10	13	5
	Amount underwritten	1,803.63	438.99	139.33
	Underwriting fees	0.73	0.70	0.29
	Average commission rate	0.04%	0.16%	0.21%
Rights issues	Number of transactions	1	3	—
	Amount underwritten	50.00	—	—
	Underwriting fees	0.12	0.25	—
	Average commission rate	0.24%	—	—
Convertible bonds	Number of transactions	1	1	—
	Amount underwritten	250.00	10.00	—
	Underwriting fees	0.10	0.05	—
	Average commission rate	0.04%	0.50%	—

BUSINESS

* Average commission rate = aggregate underwriting fees / aggregate amount underwritten of the period indicated.

** The increases of average commission rates from 2010 through 2012 were primarily due to the different sizes and listing venues of the equity financing transactions in which we acted as a lead underwriter. Our commission rates for main-board listings with a larger offering size are usually lower than those for ChiNext Board or SME Board listings with a smaller offering size. The IPO of the Agricultural Bank of China, which was a very large main-board listing, accounted for a significant portion of our underwriting fee income from equity financing transactions in 2010, while the equity financing transactions we underwrote in 2011 and 2012 were all smaller offerings listed on the ChiNext Board or the SME Board, which generated less underwriting fees for us but carried higher commission rates.

In 2011, we acted as a co-lead underwriter in two equity financing transactions with an aggregate amount underwritten of RMB296 million. In 2010, 2011 and 2012, we acted as a sub-underwriter in 12, 17 and 5 equity financing transactions, respectively, with an aggregate amount underwritten of RMB2,104 million, RMB449 million, and RMB139 million, respectively.

We provide investment banking services for share transfers and private placements of securities of private companies, and also provide OTC brokerage services to help private limited liability companies enter into the New OTC Board system for share quotation and transfer. We have been the chief agency broker for the listing of a company in the energy industry on the New OTC Board.

Including transactions Galaxy Limited participated in, we participated in all of the ten largest IPOs in the PRC securities market in terms of offering amount as listed below:

Ranking	Issuer	Offering amount (RMB in billions)	Industry
1.	Agricultural Bank of China	68.5	Banking
2.	China National Petroleum	66.8	Oil and Gas
3.	China Shenhua	66.6	Coal
4.	China Construction Bank	58.1	Banking
5.	China State Construction	50.2	Construction
6.	Industrial and Commercial Bank of China	46.6	Banking
7.	Ping An Insurance	38.9	Insurance
8.	China Pacific Insurance	30.0	Insurance
9.	China Life	28.3	Insurance
10.	China Coal	25.7	Coal

Source: Wind Info

In recent years, we have gradually expanded our equity financing services for SMEs with significant growth potential, and have facilitated the equity financing of SMEs in a variety of industries, including high-tech, national defence, consumer goods, telecommunications, biotech and franchising industries.

Our equity financing transactions have received numerous awards including:

Project	Award
IPO of Agricultural Bank of China	Best Main Board IPO Project of the Year
Follow-on offering of China Construction Bank	Best Rights Issue Project of the Year
IPO of Ping An Insurance	Most Influential Project of the Year
	Top 10 Investment Banking Project of the Year
IPO of China Shenhua	Most Influential Project of the Year
IPO of CHINALCO	Most Innovative Project of the Year
	Top 10 Investment Banking Project of the Year
IPO of China Coal	Most Influential Project of the Year
IPO of China Life	Top 10 Investment Banking Project of the Year
IPO of Air China	Top 10 Investment Banking Project of the Year

BUSINESS

Our strategy for the equity financing business is to focus on both large corporations and promising SMEs. While we continue to develop and serve our large corporate clients, we have also established a team dedicated to SME clients to capture the opportunities for their financing needs. Our investment banking business also collaborates closely with our other businesses, such as brokerage and asset management, to promote cross-selling and further expand our equity financing client base. Moreover, we have established regional equity financing divisions to provide services in close proximity to clients in economically more developed regions.

Considering the current market environment, we strive to add high-quality projects to our deal pipeline and improve the scale and variety of our projects while focusing on completing our active projects.

Debt Financing

We have consistently held a leading position in the PRC securities industry in terms of the amount of debt underwritten and underwriting fees. We underwrite primarily enterprise bonds and corporate bonds and also underwrite other debt securities such as subordinated bonds of commercial banks, debt investment plans and asset securitization products. The aggregate amount of enterprise bonds that we underwrote ranked first in the PRC securities industry in each year from 2009 to 2011, and ranked second for 2012. In November 2012, we obtained the qualification to act as a lead underwriter in offerings of debt financing instruments for non-financial companies on the interbank bond market. We plan to commence underwriting medium-term notes and short-term notes in the near future. Such qualification is conditioned upon our maintaining an “AA” regulatory rating from the CSRC.

We had anticipated the rapid development of the bond underwriting market in the past few years and had accordingly increased the size of our bond underwriting team in advance. Our revenue from bond underwriting was among the highest in the PRC securities industry from 2010 to 2012. In 2010, 2011 and 2012, underwriting fees from our debt financing business amounted to RMB321.7 million, RMB304.9 million and RMB532.7 million, respectively, representing 43.5%, 44.7% and 77.8% of the total revenue and other income of our investment banking business in the same periods, respectively. As of December 31, 2012, we had acted as a lead underwriter in 178 debt financing transactions with an aggregate offering amount of approximately RMB308.5 billion, including transactions underwritten by Galaxy Limited, according to Wind Info. The underwriting of enterprise bonds has been one of our long-standing strengths. As of December 31, 2012, including transactions underwritten by Galaxy Limited, we had acted as a lead underwriter for enterprise bonds with an aggregate offering amount of approximately RMB210.6 billion, ranking first in the PRC securities industry, according to Wind Info.

BUSINESS

The following table sets forth the amount underwritten and the underwriting fees of our debt financing business for the periods indicated:

		2010	2011	2012
		(RMB in millions, except for the number of transactions)		
Lead underwriter	Number of transactions	16	20	36
	Amount underwritten	46,561.0	33,469.0	68,229.0
	Underwriting fees	296.4	295.1	501.3
Co-lead underwriter	Number of transactions	4	3	7
	Amount underwritten	537.0	1,471.0	1,982.0
	Underwriting fees	0.6	1.5	1.5

In addition, in 2010, 2011 and 2012, we acted as a sub-underwriter in three, three, and four debt financing transactions, respectively, with an amount underwritten of RMB2,550 million, RMB308 million and RMB926 million, respectively.

Our long-term enterprise bond financing clients include primarily large prominent institutions such as the Ministry of Railways, State Grid Corp. of China, China Southern Power Grid Co., Ltd., China National Petroleum Corp., China Petroleum & Chemical Corp., Beijing Capital International Airport, China Guodian Corp., China Huadian Corp., China Power Investment Corp., Sinohydro Group Ltd., China Poly Group Corp., Legend Holdings Ltd., Tsinghua Holdings Co., Ltd., Beijing Infrastructure Investment Co., Ltd., Hebei Construction & Investment Group Co., Ltd., Shanghai Guosheng Group Co., Ltd. and Dalian Port (PDA) Company Ltd.

We have underwritten corporate bonds for leading public companies such as PetroChina Company Ltd., Dalian Port (PDA) Company Ltd., China Suntien Green Energy Corp. Ltd. and Hebei Jointo Energy Investment Co., Ltd. In particular, we underwrote two offerings of corporate bonds by Dalian Port (PDA) Company Ltd. in 2011.

We acted as the sole lead underwriter for the RMB25.0 billion offering of subordinated bonds by Bank of Communications in February 2007, becoming the first securities firm to act as a lead underwriter for subordinated bonds of a commercial bank. Since then, we have underwritten subordinated bonds for a number of commercial banks such as Bank of Communications, Bank of Jinzhou, Bank of Liaoyang and Baoshang Bank. In 2010, we acted as a lead underwriter for the RMB54 billion bonds offering by Huijin.

The leading position of our debt financing business is also reflected in our ability to consistently offer popular products and to innovate our offerings. Galaxy Limited first underwrote municipal construction project bonds in 2002, and we have been a market leader in this relatively profitable product segment. With respect to innovation of our offerings, our debt financing business introduced the first nonperforming asset securitization product in the PRC in 2006; we were the first securities firm to underwrite subordinated bonds of a commercial bank when we underwrote the RMB25 billion subordinated bonds of Bank of Communications in 2007; and we introduced the first municipal construction project bond in the PRC in 2010.

BUSINESS

We have received numerous awards and honors recognizing our leading position in the debt financing business, including:

<u>Year</u>	<u>Award</u>	<u>Awarded By</u>
2012	Best Underwriting Team of Enterprise Bonds	<i>Securities Times</i>
2011	Golden Bull Award for Best Bond Financing Investment Bank	<i>China Securities Journal</i>
2007	Best Bond Underwriting Firm in the PRC	<i>FinanceAsia</i>
2007	Best Bond Underwriter in China	<i>Asiamoney</i>

In addition, we believe that PRC regulatory authorities are considering allowing private placements of corporate bonds, which would provide issuers more flexibility compared to the public offering of corporate bonds in terms of regulatory requirements, offering process and secondary market trading. We believe such change will drive the rapid growth of private placement of debt in the PRC, and create new growth opportunities for the PRC securities industry. Given our strong BS&T platform, and the professional capabilities of our investment management business, we believe that we will significantly benefit from this new business opportunity.

Financial Advisory

We provide financial advisory services for M&A, corporate restructuring, and advising SMEs on obtaining financing from private equity funds. We charge advisory fees based on the type and size of the transactions as well as specific terms of each assignment.

Our financial advisory clients include public and private companies such as China National Petroleum Corp., China Petroleum & Chemical Corp., Minmetals Development Co., Ltd., Sinochem International Corp., GD Power Development Co., Ltd., China Southern Airlines Co., Ltd., China National Building Materials Group Corp., Mittal Steel Company N.V., Unisplendour Corp. Ltd. and Shanxi Coal Import & Export Group Co., Ltd.

We have extensive experience in formulating M&A proposals, capturing market opportunities, creating new transaction structures, conducting valuation and pricing as well as managing project risks. We have served as a financial advisor in over 70 transactions since our establishment. Our financial advisory services have been widely recognized in the PRC securities industry, and some of our awards include:

- “M&A Financial Advisory Services Award” at the Annual Convention of M&A of China (中國併購年會) in 2012 for the acquisition of coal assets of Shanxi Coal Import & Export Group Co., Ltd. by Shanxi Coal International Energy Group Co., Ltd.;
- “Award for Best M&A Proposal Design” at the Annual Convention of M&A of the PRC in 2010 for the major assets restructuring of Wuhu Port;
- “Model M&A and Restructuring Deal” at the Forum of Corporate Governance for Public Companies in China in 2009 for the acquisition of Lanzhou Aluminum Co., Ltd. and Shandong Aluminum Industry Co., Ltd. by Aluminum Corp. of China;
- “Award for Best M&A Proposal Design” at the Annual Convention of M&A of China in 2009 for the listing of AVIC Xi’an Aero-engine (Group) Ltd. through China Resources (Jilin) Bio-chemical Co., Ltd.; and
- “Best M&A Financial Advisory Services” at the Annual Convention of M&A of China in 2008 for the listings of four securities firms, namely Changjiang Securities, Guo Yuan Securities, Northeast Securities and Southwest Securities.

BUSINESS

As the PRC economy experiences structural changes, industry consolidation through domestic M&A is likely for PRC enterprises in certain industry sectors to improve operational efficiency. Meanwhile, a significant number of PRC enterprises need to expand overseas through cross-border M&A to maintain growth. In addition, private equity funds continue to grow and have been playing an increasingly important role in the PRC M&A market. Leveraging our strong branch network and client base, we intend to develop our financial advisory services for domestic industry consolidation, cross-border M&A, and private equity investment to improve our profitability while creating value for our clients.

Investment Management

Our investment management business includes asset management and private equity investment. We commenced the investment management business in 2008 and our AUM has grown rapidly.

Asset Management

Our asset management products and services primarily include:

- *Collective asset management plans*: we manage client assets for a group of clients while keeping client assets in designated accounts pursuant to applicable laws and in accordance with collective asset management contracts; and
- *Targeted asset management plans*: with each plan, we manage assets for a single client pursuant to the specific terms of the bilateral contract between the client and us through a designated account.

In addition to our existing asset management plans, we also intend to develop specialized asset management plans. We have also obtained the requisite qualification to offer QDII asset management fund products and entrusted insurance fund management services, and are in the process of designing and preparing for the launch of such products and services.

As of December 31, 2012, we had served approximately 29,000 asset management clients. Our asset management plans are primarily sold through our nationwide branch network with close collaboration between our asset management business and our brokerage business. We also sell our asset management plans through third-party institutions.

In 2010, 2011 and 2012, the revenue and other income from our asset management business amounted to RMB61.1 million, RMB31.1 million and RMB44.8 million, respectively, representing 0.7%, 0.5% and 0.8% of our total revenue and other income in the same periods, respectively.

As of December 31, 2012, we had 11 outstanding collective asset management plans, including equity-linked plans, index-based plans, money market plans, funds of funds and hybrid plans. We currently charge management fees in the range between 0.6% and 1.5% of the amount of AUM of such plans. Since 2012, we have developed multiple innovative collective asset management plans such as money market plans, “CCTV Balanced 50” plans and quantitative asset management plans. As at December 31, 2010, 2011 and 2012, the total amount of AUM of our collective asset management plans was RMB1,993 million, RMB1,802 million and RMB2,912 million, respectively. As of

BUSINESS

December 31, 2012, we had entered into 22 targeted asset management plan contracts, ten of which were outstanding with a total amount of AUM of RMB13,148 million.

Our asset management business continued its strong growth in the first three months of 2013, during which we introduced three new collective asset management plans and 11 new targeted asset management plans. As at March 31, 2013, total AUM of our collective asset management plans and targeted asset management plans reached RMB6,696 million and RMB24,701 million, respectively, an increase of 130% and 88% since the end of 2012, respectively. In March 2013, 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) which further promotes and supports the development of the asset securitization business. We believe such regulatory developments will help us take advantage of our strength in product design, sales and marketing to diversify our asset management portfolios and expand our asset management business.

Private Equity Investment

The strategy for our private equity investment business is to focus on managing client investments, as supplemented by investments with our own funds, and to become an investment manager for third-party funds. We operate our private equity investment business through Galaxy Capital, which was established in October 2009. Galaxy Capital makes direct equity investments with our own funds in private companies that we believe have potential for capital appreciation. In its capacity as an investment manager, Galaxy Capital also makes private equity investments with funds raised from third-party investors.

As of December 31, 2012, we had invested a total of approximately RMB442 million in eight private companies in the manufacturing, consumer goods, telecommunications, culture, and mining industries. Galaxy Capital generally makes direct equity investments as a financial investor and seeks to exit from its investments and capture capital appreciation through share transfers or IPOs.

Overseas Business

Leveraging our leading position in the PRC securities industry as an integrated financial services provider, we expanded our business overseas and established Galaxy International Holdings in February 2011. Galaxy International Holdings has the requisite business licenses through its wholly-owned subsidiaries to provide a wide range of financial and securities services in Hong Kong, including brokerage and sales, investment banking, asset management, and research services. Galaxy International Holdings and its subsidiaries have obtained a Type 1 license for dealing in securities, a Type 2 license for dealing in futures contracts, a Type 4 license for advising on securities, a Type 6 license for sponsoring IPOs and providing financial advisory services, a Type 9 license for asset management, and the requisite license to act as a qualified lender. The businesses of Galaxy International Holdings primarily include:

- *Brokerage and Sales*: Galaxy International Holdings provides brokerage and sales services with respect to various securities and futures products in multiple international capital markets, including stocks, bonds, convertible bonds and ETFs, and intends to further broaden its product offerings. Galaxy International Holdings also provides margin financing services for securities covered by its brokerage business, and provides flexible

BUSINESS

securities trading and investment services to international institutional clients, corporate clients and retail clients.

- *Investment Banking:* The investment banking team of Galaxy International Holdings provides corporate finance and financial advisory services to companies listed on the Hong Kong Stock Exchange as well as private companies. Its investment banking services include IPO sponsorship, equity underwriting and pre-IPO financing, securities underwriting in the secondary markets, compliance advisory and financial advisory services for M&A transactions of listed companies.
- *Asset Management:* Galaxy International Holdings has obtained a Type 9 license for asset management business from the SFC and has officially started its asset management business in early 2013. Galaxy International Holdings plans to provide investment portfolios relating to securities and futures and fund management services for institutional clients, high-net-worth clients and retail clients, and leverage Hong Kong's position as the first offshore Renminbi center to develop various types of Renminbi asset management products.

The research team of Galaxy International Holdings is critical to the growth of its overall business. The research team provides research reports and analyses on macro-economy, industry sectors, public companies and stock markets, and prepares pre-IPO reports to support other business departments such as investment banking, securities and futures brokerage, and institutional sales. The research team is key to enhancing the competitiveness of Galaxy International Holdings.

Since commencing operations in October 2011, Galaxy International Holdings has experienced rapid growth in the number of securities brokerage clients and their trading turnover, and the number of futures brokerage clients and their trading volume. We obtained the Type 6 license in July 2012, and as of December 31, 2012, we had acted as a financial advisor in five transactions and had underwritten two IPOs. We plan to further expand our overseas business and offer services such as asset management, insurance brokerage, and personal wealth management service for high-end clients. We also plan to take advantage of Hong Kong's position at the frontline of Renminbi internationalization to promote cross-selling opportunities from our domestic and overseas client base and offer more Renminbi products and services. We also intend to increase synergies between our domestic and overseas businesses by sharing client and research resources among our investment banking, asset management and securities brokerage and research businesses. As at December 31, 2012, Galaxy International Holdings had approximately 2,100 securities and futures brokerage clients. For 2012, the total trading turnover of its securities brokerage business amounted to HK\$21,728 million.

Through recruiting experienced bankers and analysts, Galaxy International Holdings has developed the talent infrastructure of a full-service securities firm, and it has established an internal management system and trading platforms that conform with international standards. Galaxy International Holdings intends to continuously optimize and expand its talent pool through external recruiting and internal training to meet its talent needs and further grow its business.

We intend to leverage our strengths and brand recognition in the PRC to build Galaxy International Holdings into a first-class securities firm in Hong Kong that connects the PRC domestic capital markets with the overseas capital markets and serves as a bridge for domestic clients to expand overseas and for overseas clients to enter into the PRC.

BUSINESS

We also plan to strategically expand our overseas business through various means, including conducting overseas acquisitions and establishing representative offices or subsidiaries in economies and regions with more developed capital markets. In addition, we intend to explore overseas growth opportunities and gradually increase the revenue contribution of our international business.

MAJOR CLIENTS

We provide services for various types of individual and institutional clients. Our clients primarily include non-corporate institutions, large-, medium- and small-sized enterprises, institutional investors, and high-end and general clients. Our clients are primarily located in the PRC. We expect the number of our overseas clients to increase as we expand our overseas business.

In 2010, 2011 and 2012, the revenue derived from our five largest clients accounted for less than 30% of our total revenue.

To the knowledge of our Directors, none of our Directors, Supervisors, their respective associates or any Shareholders holding more than 5% of our issued share capital have any interests in any of our five largest clients as at the Latest Practicable Date.

We have no major suppliers due to the nature of our business.

MANAGEMENT OF LIQUIDITY AND LEVERAGE RATIO

The management of liquidity and leverage ratio is essential to the success of our business. Our liquidity management focuses on ensuring sufficiency of liquidity and safety of capital, while actively capturing opportunities to increase return on short-term funds. Through leverage ratio management, we seek to improve our return on equity by reducing our total costs of funds.

To manage liquidity while ensuring return on short-term funds, we invest in bank deposits and interbank borrowings, as well as low-risk and highly liquid financial instruments such as fixed-income securities and financial assets held for resale. We manage the credit risk of resale transactions by requiring counterparties to pledge high-quality collaterals. The collaterals we accept are typically highly liquid securities traded in the interbank market, including treasuries, PBOC bills, financial institution debt, and shall have a credit rating of AAA or above. The resale amount is determined by discounting the net value of the collaterals as appraised by China Central Depository & Clearing Co., Ltd. (the "CCDC"). In addition, the term of resale shall be no more than 14 days and the loans extended to any single counterparty shall be no more than RMB1 billion. We generally adopt a delivery-versus-payment method for the settlement of resale transactions. We deploy funds in the money market and bond market so as to improve the return on short-term funds as part of our liquidity management.

We use a comprehensive budget system to forecast our cash flows and estimate our funding requirements for business expansion and other investments. To meet our short-term cash flow needs, we conduct repurchase transactions in both the exchange market and interbank market. To meet our Net Capital requirements, we have also adopted strict liquidity management measures, which require us to conduct stress tests on our overall liquidity and other financial indicators before making any capital investments.

BUSINESS

In addition to liquidity management, we also actively manage our capital structure and financing channels. To increase our financial leverage ratio, we intend to actively broaden our debt financing channels. We plan to improve our capital structure through margin and securities refinancing, issuances of corporate bonds and short-term notes, as well as other financing channels.

In November 2012, our Shareholders authorized us to issue short-term notes in the aggregate principal amount of up to RMB7.0 billion. On April 1, 2013, the PBOC approved our application for issuing short-term notes. Pursuant to PBOC's approval, we may at our discretion issue short-term notes in an aggregate principal amount of up to RMB7.0 billion within a one-year period. We issued the first tranche of short-term notes in a principal amount of RMB3.5 billion on April 12, 2013, with a term of 90 days and an interest rate of 3.58%, in the national interbank bond market through a bidding process. The proceeds raised from this first tranche of short-term notes will be used to replenish our working capital. We intend to issue additional short-term notes, subject to regulatory approvals and market conditions.

In addition, at a Shareholders' meeting on April 24, 2013, our Shareholders authorized us to issue corporate debt financing instruments, which may take the form of short-term notes (up to 60% of our Net Capital), financial bonds, short-term and long-term subordinated bonds and other debt instrument, in the aggregate outstanding principal amount of up to RMB20 billion over a three-year period based on our liquidity needs, subject to regulatory approvals. The debt instruments we intend to issue will increase our indebtedness and interest expense, yet we expect them to improve our return on equity by increasing our leverage ratio.

We have formulated a series of internal control policies regarding the principles, structure and duties of managing our own funds, the budgeting, financing, usage, and risk management of our own funds as well as the provision of guarantees and mortgages for third parties using such funds. We have established a multi-level authorization mechanism and formulated policies regarding management, approval and appropriation procedures for the use of our own funds. We have also set out the pricing principles, management structure and duties, internal financing procedures and pricing method in respect of our own funds. These policies are established to enhance our funds management, improve our funds allocation and operation efficiency, control our liquidity risk and form a comprehensive fund management system.

RISK MANAGEMENT

Overview

We are committed to the philosophy that risk management creates value. Our risk management aims to allocate risk-based capital reasonably, limit risks to a tolerable level, maximize our enterprise value, and solidify the foundation for our sustainable, steady and healthy development. Since our incorporation in 2007, we have established sound corporate governance, as well as effective risk management and internal control systems, in order to manage our risk exposure in the securities market. Considering our sound capital base, effective risk management and internal control systems as well as other criteria, the CSRC assigned us an "AA" regulatory rating, which is currently the highest rating achieved by PRC securities firms, in 2010, 2011 and 2012. Prior to this, the CSRC assigned us an "A" regulatory rating in 2008 (the year in which CSRC started to assign regulatory ratings to PRC securities firms) and 2009.

Our risk management has the following characteristics:

- *Three-level authorization system as the core of our risk quota management.* To strengthen the core competitiveness of our risk management, we applied advanced risk management concepts in implementing our risk quota management, which features a three-level authorization system, including the first level of authorization from the Shareholders' General Meeting to the Board, the second level from the Board to the President, and the third level from the President to different business departments. Our three-level authorization system has established risk quota management focusing on scale of investment, trading position exposures and stop-loss limits by setting various risk quota indicators to cover such businesses as stock investment, bond investment, asset management and derivatives, as well as margin financing and securities lending. We have a clear stop-loss mechanism that matches the earnings target of our financial budget with the stop-loss limit for risk management so as to limit the potential aggregate loss of various businesses and provide reasonable assurance for achieving our business goals.
- *Continuously improve our risk management IT system for real-time monitoring of different types of risks.* We are committed to building and improving our risk management IT system, which includes a performance evaluation and risk management system, as well as a risk monitoring system. We use the performance evaluation and risk management system to conduct risk analysis and evaluation for our investment and financing businesses. We also monitor and report the VaR, duration and other indicators through the performance evaluation and risk management system. Through our risk monitoring system, we monitor marketing personnel's behavior, client information and client trading behavior, among other things, on a real-time basis. We have designated specialized personnel to monitor specific business operational risks on a real-time basis, so as to identify and rectify deficiencies promptly. These personnel make timely reports to senior management, the Board and the Supervisory Committee, and supervise the relevant departments to rectify the problems.
- *Cultivate a risk management culture.* We are committed to cultivating a risk management culture embodying the core philosophy that risk management creates value. The Board and senior executives are responsible for promoting risk management while the Chief Risk Officer is in charge of implementation and the business departments are responsible for carrying out their risk management duties and making recommendations to the senior executives. The Risk Management Department, Legal and Compliance Department and Audit Department are responsible for continuously monitoring risks for each of the business departments and assisting them in enhancing their risk management in order to drive our business growth, and to integrate risk management culture into our corporate culture.

Risk Management Principles

Our risk management principles are as follows:

- *Matching risk and return:* In formulating risk management strategies and making risk management decisions, we should control our risk exposure within our risk quota limit. The expected return should be proportionate to the expected risks in order to match risk and return;

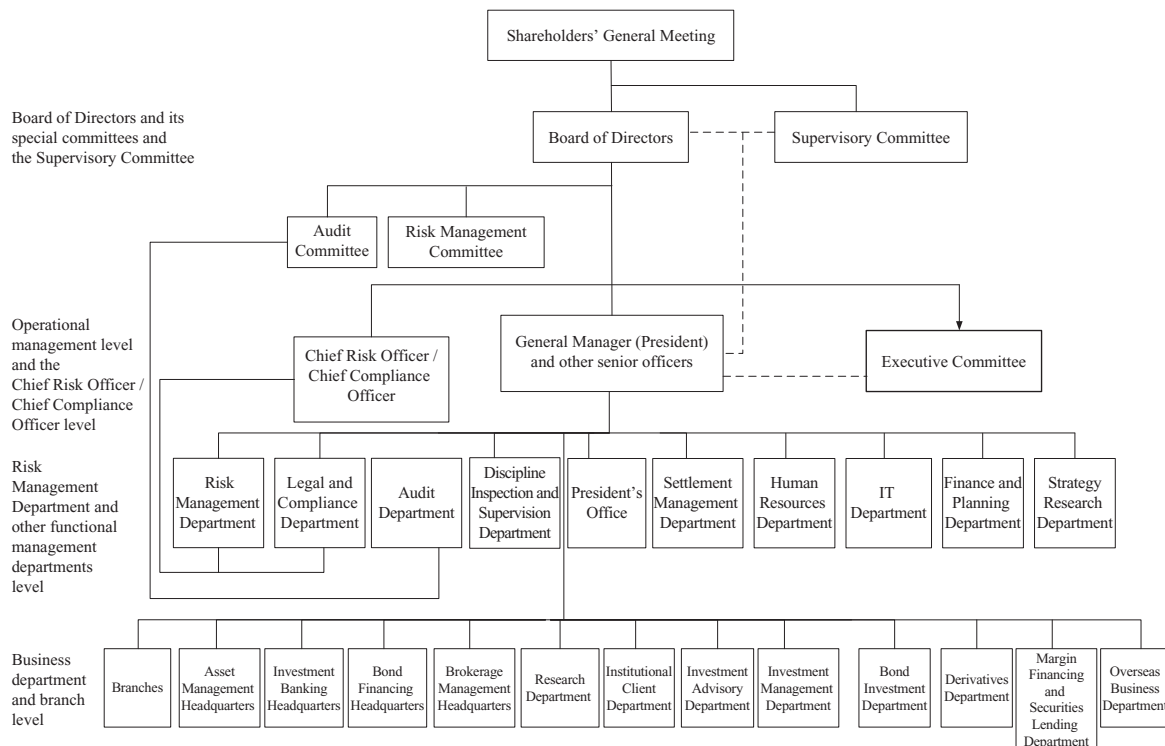
BUSINESS

- *Emphasizing efficiency:* Each of our various departments, branches and employees should communicate and coordinate effectively among each other while streamlining the management process to enhance efficiency;
- *Combining qualitative and quantitative risk management methodologies:* We should develop risk measurement techniques that are suitable for the characteristics, scale and complexity of our business so as to enhance our risk measurement capability;
- *Dynamic adjustment of adaptability:* We should continuously inspect and assess the changes in the internal and external operating environments, the competitive landscape and the actual or potential impacts on our risk management. We should continuously and timely adjust our policies, rules and procedures on risk management;
- *Independence:* Risk management should be performed by an autonomous department to maintain a high degree of independence and authority; and
- *Accountability:* We should assign clear responsibilities to each of our risk management personnel and hold accountable those who violate our risk management policies and their senior supervisors accountable.

Risk Management System

The organizational structure of our risk management includes the Supervisory Committee, the Board and its special committees, the General Manager (President) and other senior executives, the Chief Risk Officer / Chief Compliance Officer, the Risk Management Department and other departments performing risk management functions, the risk management personnel in the business departments, and the risk management personnel at the branch level.

The organizational structure of our risk management is illustrated below:



Supervisory Committee

The Supervisory Committee supervises the performance of risk management duties by the Board, the General Manager (President) and other senior executives pursuant to relevant laws and regulations and our Articles of Association.

Board and Special Committees

The Board is our highest risk management decision-maker within the scope authorized by the Shareholders' General Meeting, and performs its risk management duties through the Risk Management Committee and the Audit Committee.

The Risk Management Committee is primarily responsible for assisting the Board in formulating risk management strategies, policies and the basic risk management and internal control system. The Risk Management Committee proposes our overall risk quota, evaluates events with significant risks and assesses the implementation of risk management measures and the performance of the relevant senior executives. It recommends risk management improvements to the Board periodically and supervises the senior executives to implement the risk management policies.

The Audit Committee (i) supervises the disclosure of the Company's accounting information and other major issues, reviews the critical accounting policies and their implementation, and monitors the implementation of the Company's major financial decisions and annual budget; (ii) reviews and evaluates the Company's internal control system; (iii) formulates the Company's internal audit development plans and approves the annual audit plans; (iv) controls and manages connected transactions under the leadership of the Board; (v) oversees the implementation of the rectifying measures by the management in response to the audit opinion; (vi) reviews, monitors and evaluates the Company's internal audit; (vii) makes recommendations to the Board on the appointment and removal of the external auditors, approves the remuneration and the terms of appointment of the external auditors and deals with any relevant issues regarding the resignation or removal of external auditors; (viii) reviews and monitors the independence and objectivity of the external auditors and the effectiveness of the audit procedure; (ix) develops and implements the policy on engaging external auditors to provide non-audit services and (x) carries out other matters as authorized by the Board.

For details of the functions of our Board, the Risk Management Committee and the Audit Committee, see "Directors, Supervisors and Senior Management—Special Committees of the Board" and "Appendix V—Summary of the Articles of Association" in this prospectus.

General Manager (President) and Other Senior Executives

The General Manager (President) and other senior executives are the executive body of our risk management system. Their primary risk management duties include the following:

- implementing risk management strategies, goals and policies of the Board;
- implementing the risk quota goals set by the Board and allocating the quota to the business departments;
- implementing the identification and assessment of various types of risks;
- establishing effective risk management mechanisms and risk management systems, as well as timely rectifying defects and problems in our risk management; and
- establishing contingency plans for managing significant risks.

Chief Risk Officer / Chief Compliance Officer

The Chief Risk Officer / Chief Compliance Officer is appointed by the Board to be in charge of our risk management and compliance. He is responsible for supervising the implementation of our risk management policies and procedures, organizing risk management activities, and establishing internal control systems, as well as examining, supervising and inspecting the legality and compliance of our business operations. The Chief Risk Officer / Chief Compliance Officer reports potential illegal activities or non-compliance to the Supervisory Committee, the Board, the President, the regulatory authorities and the self-disciplinary organizations.

Mr. Shuhua Li is our Chief Risk Officer and Chief Compliance Officer. For details about Mr. Li's background, please see "Directors, Supervisors and Senior Management."

Risk Management Department and Functional Management Departments at Headquarters***Risk Management Department***

The Risk Management Department is responsible for reviewing and evaluating the risks of various businesses, as well as supervising the daily risk management activities of the business departments. Its primary duties include the following:

- drafting the scheme of risk management authorization by the Board to the President;
- establishing and improving the risk quota management system, allocating risk quotas to business departments through the President's authorization, and supervising and inspecting the implementation of risk quotas by the business departments;
- identifying, analyzing, evaluating and examining the market risks, credit risks and operational risks of the business departments, and providing support for decision-making;
- monitoring risks of the business departments and timely addressing the issues discovered; and
- reporting the risks identified during risk management on a timely basis, making risk management recommendations and evaluating the risk management performance of the business departments.

As at December 31, 2012, the Risk Management Department had eight staff. They had on average ten years of experience in the securities industry and were all qualified to engage in general securities business. Six, or 75%, of the eight employees held master's or higher degrees.

Legal and Compliance Department

The Legal and Compliance Department is responsible for identifying, assessing, supervising, inspecting and reporting our legal and compliance risks, as well as providing professional legal support and services to various departments to ensure the compliance of our business operations. Its specific responsibilities include the following:

- monitoring and timely interpreting the changes in laws and regulations, assessing the impact of such changes on our compliance management, and providing recommendations to relevant departments for revising and improving their management system and business procedures;

BUSINESS

- conducting compliance reviews on our internal management systems, significant decision-making, new products and new business plans;
- providing legal support and services as well as compliance advice to various departments, branches and subsidiaries;
- supervising and inspecting the compliance of our business operations and management, as well as the business practices of our employees;
- establishing and improving the legal compliance mechanisms for the Chinese Wall, anti-money-laundering measures, anti-corruption measures and related sanctions, and supervising the implementation thereof; and
- reviewing contracts, managing internal authorization, litigation and arbitration.

As at December 31, 2012, the Legal and Compliance Department had 18 staff. They had on average over ten years of experience in the securities industry and 17 of them had passed the compliance competency examination organized by the SAC or the PRC National Judicial Examination. 11, or 61%, of the 18 employees, held master's or higher degrees.

Discipline Inspection and Supervision Department

Our Discipline Inspection and Supervision Department is responsible for reviewing whistleblower reports from our departments and employees, supervising the business practices of employees, investigating and disciplining illegal activities or misconduct and penalizing the perpetrators, and maintaining the discipline of our business management.

Audit Department

The Audit Department is responsible for conducting independent audit supervision and evaluation of our business operations, financial condition, corporate governance and internal controls, implementation of our annual budget, and the economic accountability of key managers during their tenure and key managers departing from us, as arranged by the senior executives. It is also responsible for organizing self-assessment of our internal control system. The Audit Department submits timely proposals timely to the Audit Committee and senior executives with respect to issues identified during the auditing process.

Other Departments Performing Risk Management Functions

Our other departments performing risk management functions at the headquarters include the Finance and Planning Department, the Settlement Management Department, the Human Resources Department, the IT Department and the Strategy and Research Department. In addition to providing back-office support to our various businesses, they also identify, evaluate, monitor and report such risks as liquidity risk, human resources attrition risk, IT risk, securities settlement risk and external investment risk.

Risk Management at Branch Level

Branch Executives

The general manager of each branch is responsible for the branch's risk management, and is primarily responsible for the branch's operational safety, risk management and compliance management.

BUSINESS

Compliance Managers and Regional Compliance Officers

We have a compliance manager at each branch who is responsible for compliance management of the branch. We have 23 compliance officers in 21 regions reporting directly to headquarters, who are responsible for conducting inspections and training. As of December 31, 2012, the compliance officers had on average 18 years of experience in the securities industry, 19, or 83% of which had passed the compliance competence examination organized by the SAC.

Formulation of Risk Management Systems and Procedures

We have a three-level risk management system comprising the fundamental corporate governance system, the core business management system and the specific business management rules, which include (1) the authorization from the Shareholders' General Meeting to the Board for investments, acquisition and disposal of assets, providing asset collateral and guarantees as well as connected transactions, (2) the authorization from the Board to the senior executives, and (3) the specific risk management measures of the business departments with respect to their businesses or products.

In addition, we have established a comprehensive risk management process for identifying, assessing, monitoring and reporting risks:

- *Identifying risk:* Our business departments issue risk self-assessment reports, either periodically or on an as-needed basis, to identify potential risks, determine their nature, classify them, and identify their cause.
- *Assessing risk:* Our risk management departments are responsible for reviewing the risk self-assessment reports issued by business departments and issuing independent risk evaluation opinions.
- *Managing risk:* We prepare specific strategies to manage various risks based on the identification and assessment of the risks.
- *Inspecting and monitoring risks:* We have established a risk monitoring indicator system and monitoring procedures. Our risk monitoring system enables the risk management departments and the risk management personnel at the business departments to conduct daily risk monitoring and manage irregular situations.
- *Communicating risk:* We have established an information reporting mechanism for risk control, which enables us to use risk control information to guide our business growth.

Monitoring and Management of Major Risks

We focus on monitoring and managing the market risk, credit risk, operational risk and liquidity risk in our various businesses.

Market risk

Market risk refers to the risk resulting from the changes in stock prices, foreign exchange rates, interest rates and other changes in the market that may affect the products sensitive to the market risk.

- We use VaR to evaluate risk exposure and combine with other methods such as scenario analysis and stress testing to assess the relative and absolute risks of portfolios and monitor their risk quotas.

BUSINESS

- We increase bond portfolio duration when market interest rates are expected to decrease, and decrease bond portfolio duration when market interest rates are expected to increase. When we keep our bond portfolio duration unchanged, we prefer securities with larger convexity.
- We implement capital limits at various levels in the firm (including product and business) to govern risk appetite by controlling our exposures to market risk. Our capital limits are reviewed and amended annually to reflect changing market conditions, business conditions or tolerance for risk.

Credit risk

Credit risk refers to the risk resulting from the failure of a counterparty to timely perform its contractual obligations. To manage credit risk, we mainly adopt measures such as credit risk assessment and quota control.

- We have established models for counterparty credit-rating and credit-limit management to assess counterparty credit risks. Counterparties with low credit ratings are not accepted as our clients. Our business departments cooperate with the Risk Management Department to establish a system analyzing the credit of our clients and counterparties. We determine trading limits and other monitoring indicators based on credit ratings or credit models, and monitor a counterparty's credit exposure to prevent the risk of counterparty default. For our investment in credit products, we have established multi-level authorization to manage the investment quota based on the products' credit ratings. We periodically assess and monitor the credit risk of these products in order to prevent excessive risk concentration.
- We use both qualitative and quantitative methodologies for measuring credit risk. We review and revise credit limits either periodically or based on changes in the market. The qualitative method includes reviewing internal and external research reports and assessing macroeconomic fundamentals. The quantitative method includes assessing credit ratings.

Operational risk

Operational risk refers to the risk resulting from the inadequacy or defect of internal process, personnel or systems, or from external events.

- We monitor, calculate and evaluate the losses resulting from operational errors and system errors.
- We calculate and analyze the frequency and amount of losses resulting from the operational risk incidents of our products, activities, processes and systems.

Liquidity risk

Liquidity risk refers to the risk resulting from the failure to effectively meet expected and unexpected needs for current or future cash flows or collateral without affecting daily operations or financial condition.

- We strengthen the real-time monitoring and management of the usage of large amounts of funds in order to achieve centralized fund allocation and coordinated liquidity risk management.
- We adjust and configure the scale and maturity structure of assets in order to build a multi-level liquidity reserve system, in order to timely achieve the target of our liquidity portfolio through accessing the money market, capital markets and bank credit.
- We have set up an RMB1 billion emergency funding facility at China Construction Bank, which provides us with an additional source of funding in the event of emergencies.

BUSINESS

INTERNAL CONTROL MEASURES

We have implemented a series of risk management and internal control measures to manage the specific risks relating to our business activities.

Securities Brokerage Business

We have formulated comprehensive internal rules and guidelines for our securities brokerage business to ensure that our securities brokerage business and branch operations are in compliance with the relevant laws and regulations and to standardize the operations of our securities brokerage business. During the Track Record Period, we did not experience any unauthorized trades or serious trade errors committed by our employees or other misconduct committed by our representatives, agents and clients that had a material adverse effect on our business, financial condition or results of operations.

The key risks we monitor for our brokerage business include credit risk, operational risk and compliance risk. We manage these risks primarily through the following measures:

<i>Standardizing management of service counters</i>	We have strict rules for verifying client identity, preserving information, as well as opening and re-examining client accounts, among others, and have established supervision and inspection mechanisms for opening and re-examining client accounts.
<i>Understanding the risk profile of our clients</i>	We evaluate the risk profile of our clients based on a combination of factors, such as their financial condition, investment experience and investment preferences. In addition, we use our proprietary risk tolerance assessment system and our proprietary risk tolerance questionnaire to assess the risk tolerance of our clients, in order to match the needs of our clients with the financial products.
<i>Third-party custody of client funds</i>	In accordance with the relevant laws and regulations regarding the custody of client funds, we require brokerage branches to maintain accounts with qualified commercial banks to hold client deposits.
<i>Real-time monitoring system</i>	Through our IT system, we are able to monitor client transactions on a real-time basis and detect unusual and irregular trading patterns. Our dedicated personnel conduct real-time monitoring of our branches with respect to account openings, security deposits, authority limits of tellers and irregularities in client trading.
<i>Centralized management</i>	To prevent misappropriation of client funds, we have centralized client transactions and client data backup, and have centralized the management of the securities brokerage trading systems of our branches with respect to authority limits and parameters. In order to enhance the security of clients' funds, we settle and clear client funds centrally through our headquarters.
<i>Segregation of front and back offices</i>	We supervise and manage the front office and the back office of our branches separately. We have a dedicated internal control team to manage the authority limits and duty assignment for our employees. The auditing, settlement and risk management personnel of our back office are prohibited from participating in sales and marketing, managing client accounts, or handling client deposits.
<i>Regular and special audits</i>	Our Audit Department, Legal and Compliance Department and Risk Management Department conduct regular and special audits on our brokerage business department and branches with respect to their internal controls, daily operations, financial and accounting management and business performance.

BUSINESS

<i>Highlighting risks to investors</i>	We continue to strengthen investor education and improve the risk highlight functions of our trading system in order to improve investors' risk awareness and risk management capabilities.
<i>Mechanisms for follow-up calls and handling client complaints</i>	We have established a coordinated client service platform to make follow-up calls for important clients. We also conduct sample checks on our branch's follow-up with clients. Meanwhile, we prominently display information about the hotlines, e-mail addresses and mailing addresses that handle client complaints at our headquarters, securities brokerage branches and local securities regulatory authorities, in order to ensure that the concerns of our clients are handled properly and timely.

Futures Brokerage Business

We conduct our futures brokerage business primarily through our subsidiary, Galaxy Futures. Galaxy Futures has established its own risk management system, and has established a compliance and inspection department and an audit department to be responsible for risk management. It also manages risks related to the futures brokerage business through the following measures:

<i>Management of account opening</i>	During the process of account opening, Galaxy Futures requires strict review of a client's creditworthiness, identity and other relevant documents, as well as brokerage contracts.
<i>Management of client margin deposit</i>	Galaxy Futures requires client margin deposits to be segregated from its own funds and managed in separate accounts. Galaxy Futures adjusts the required security deposit ratio in a timely manner based on market fluctuations and market conditions. If a client fails to maintain the required deposit ratio, that client will be required to deposit additional amounts or close out the position.
<i>Trading</i>	Galaxy Futures has established various policies to regulate futures trading. For example, it prohibits employees from making non-compliant entrustment arrangements, promising profits, or participating in futures trading. It is required to maintain multiple backups of clients' trading order records and in multiple forms of media.
<i>Real-time monitoring</i>	Galaxy Futures conducts real-time risk monitoring during the trading process, focusing on risky accounts, opposite positions in a sharply volatile market, and positions close to an adjustment period.

Margin Financing and Securities Lending Business

The key risks we monitor for our margin financing and securities lending business include credit risk, interest rate risk, operational risk and compliance risk. We also manage the market risk and liquidity risk related to this business. We have established a monitoring system based on Net Capital requirements to monitor and control on a daily basis the scale of our margin financing and securities lending business based on predetermined parameters. We seek to prevent our business from excessively concentrating on any single client or stock. We conduct our margin financing and securities lending business in accordance with the following pre-determined parameters to ensure compliance with the relevant PRC laws and regulations:

- the scale of business from any single client of margin financing may not exceed 5% of our Net Capital;
- the scale of business from any single client of securities lending may not exceed 5% of our Net Capital;

BUSINESS

- the market value of any single stock collateral we hold may not exceed 20% of such stock's market capitalization.

We have established a client selection and credit assessment system for our margin financing and securities lending business. To manage client credit, we have established a multi-level review system that involves both branches and the relevant management department of our headquarters. Branches are responsible for the preliminary review of credit information submitted by clients in order to understand clients' identities, properties owned and income, investment experience and risk appetite. The credit information of eligible clients will then be reviewed by the margin financing and securities lending department. We will not accept applications for margin financing and securities lending from clients who fail to satisfy the following criteria: (i) providing relevant personal information as required; (ii) maintaining an account in our Company for more than half a year; (iii) depositing transaction settlement funds under a third-party custody; (iv) meeting the minimum account assets requirement; (v) possessing adequate experience in securities investment; (vi) having the appropriate level of risk tolerance and having no material default record; and (vii) not being our Shareholders and affiliated persons. We determine clients' credit ratings and credit limits based on their credit information provided. The credit ratings of clients are divided into five levels, ranging from 1A to 5A, pursuant to which, we determine the credit lines of the clients. We reject any applications for margin financing and securities lending from clients who fail to obtain the lowest credit rating. We track and assess the credit condition of clients engaging in margin financing and securities lending business on an ongoing basis. In case of any material change in client credit condition, we will re-evaluate his or her credit rating and decide whether to continue granting credit or adjust the credit limit for the client. Our above criteria for accepting applications for margin financing and securities lending services comply with the requirements under applicable PRC laws and regulations. During the Track Record Period and as of the Latest Practicable Date, we have not experienced any material defaults in this respect.

We monitor the collateral ratio of clients engaging in margin financing and securities lending business on a real-time basis and close out the client's position if necessary. The collateral ratio is calculated as the ratio of the client's total account balance, which includes cash and securities held, to the client's margin balance, which is the sum of margin loans extended, the market value of securities sold short, and any accrued interests and fees. We categorize clients' credit accounts into three classes, namely, safe class, alert class and liquidation class according to their different collateral ratios to conduct differentiated management. We send margin calls to clients whose accounts are under the alert class (i.e. client accounts with collateral ratio below 150% but not lower than 130% upon day-end clearing) requesting them to increase their collateral ratio to 150% or above within a business day, failure of which will result in restrictions on purchase of collaterals, margin financing and securities lending. We send notices of liquidation to clients whose accounts are under the liquidation class (i.e. client accounts with collateral ratio lower than 130% upon day-end clearing) requesting them to increase their collateral ratio to 150% or above within a business day, failure of which will result in mandatory liquidation.

We have established a centralized system to manage the risks related to our margin and securities refinancing business. We conduct real-time monitoring of our margin and securities refinancing transactions to ensure compliance with the pre-determined requirements such as:

- the balance of our margin and securities refinancing business may not exceed 50% of our Net Capital or the maximum amount determined by CSFC,
- the amount of refinancing for any single stock may not exceed 10% of the market value of the stock's public float, and

BUSINESS

- the market value of any single stock collateral we hold may not exceed 15% of the issuer's market capitalization.

We borrow securities from CSFC for our margin and securities refinancing business, and we are obligated to return the borrowed securities to CSFC in accordance with the terms and conditions of our refinancing agreement with CSFC. To avoid failure to meet our obligations under such refinancing agreement in the event of our clients defaulting, we would either repay CSFC with securities from our proprietary trading books or purchased from the open market.

We have established a comprehensive risk monitoring and control system for our margin financing and securities lending business. Our risk control system consists of the following departments:

<i>The Board</i>	The Board is responsible for determining the overall scale of our margin financing and securities lending business based on the budget of our total funds and Net Capital, as well as the relevant PRC laws and regulations.
<i>Decision-making team of our margin financing and securities lending business</i>	The decision-making team of our margin financing and securities lending business is responsible for reviewing and determining the risk control indicators, collectively reviewing and making decisions on significant issues of risk control, and making recommendations for rectifying problems and weaknesses in the risk control of our margin financing and securities lending business.
<i>Risk Management Department, Audit Department as well as Legal and Compliance Department</i>	<p>The following three departments perform internal control functions independently from other departments and business activities:</p> <ul style="list-style-type: none">● The Risk Management Department is responsible for setting the risk quota and risk indicator system for the margin financing and securities lending business, and is responsible for monitoring the authorization indicators and the risk quota of our margin financing and securities lending business through our central monitoring system and the risk monitoring modules of our business system.● The Audit Department is responsible for conducting regular audits of our internal controls.● The Legal and Compliance Department is responsible for appointing dedicated personnel to conduct daily monitoring of our margin financing and securities lending business through our central monitoring system, and is responsible for generating daily reports on such monitoring activities.
<i>Margin Financing and Securities Lending Department</i>	<p>As the primary business department, this department:</p> <ul style="list-style-type: none">● grants credit limits to our margin financing and securities lending clients based on their credit rating;● conducts real-time monitoring of client transactions, sets threshold at 80% of the monitoring indicator and automatically issues alert if the threshold is crossed. When the upper limit of trading control is reached, the system will be immediately restricted from granting additional credit for margin financing and securities lending, posting any single stock as collateral, or executing margin financing and securities lending business;● sets different discount ratios for various collateral securities, and sets different deposit ratios for various target securities. If any client fails to maintain the required collateral level, the client is required to deposit additional funds or close out a position. We will close out the client's position if necessary.

BUSINESS

Proprietary Trading Business

The key risks we monitor for our proprietary trading business include market risk, credit risk, liquidity risk, operational risk and compliance risk. We also manage the interest rate risk and potential off-balance sheet risk related to this business.

Proprietary trading department

Within the scope authorized by the Board, the proprietary trading department, in cooperation with the Legal and Compliance Department and the Risk Management Department:

- establishes and maintains an equity securities pool for proprietary trading business to ensure that we make equity investments within this pool;
- establishes a sound system that separates restricted and unrestricted securities to prevent insider trading;
- requires the credit rating of issuers of debt instruments to be A or above or, if no such rating is available, the issuance rating to be AA or above. In addition, our proprietary trading department conducts strict internal assessment for the debt instruments to be invested;
- limits the leverage ratio by limiting the authorized amount of repurchase of debt investment;
- manages and controls risk exposure of derivatives to be within the permitted range;
- establishes a system monitoring counterparty risks of derivatives business which traces, monitors and reports the contractual performance of counterparties;
- establishes a stop-profit and stop-loss mechanism that sets pre-determined stop-profit and stop-loss points to monitor our proprietary trading; and

In order to control market risk, we engage in hedging activities through using stock index futures.

- As required by PRC regulation, the goal of our hedging strategy is to neutralize market risk of our long positions. The main positions that we hedge are the long positions that we take when we act as a counterparty to our clients in our securities lending business and market making business for ETF and LOF. We also hedge positions taken in capital based intermediary trade and stock investments as appropriate. By holding and adjusting stock index futures positions in opposite direction to the positions of securities held or to be held, we can effectively reduce volatility of our securities portfolio, and enhance the stability and reliability of our proprietary trading model. In 2011 and 2012, the effectiveness of our hedging activities have generally been between 80% to 120%.

BUSINESS

Investment Banking Business

The key risks we monitor for our investment banking business include operational and compliance risk. We also manage the market risk related to our equity and debt financing business, as well as the credit risk and interest rate risk related to our debt financing business. We control and manage these risks through our internal review team, Quality Control Department, Legal and Compliance Department and Risk Management Department, involving project approval, on-site inspection, documentary review, internal review meetings and continuous supervision.

<i>Project approval</i>	We implement strict procedures for approving investment banking projects. The report for project approval must undergo the requisite quality control procedures. The project approval needs to go through experts' review and collective decision-making process. After the approval becomes effective, the business department may officially form a team to execute the project.
<i>On-site inspections</i>	Before submitting the project for internal review, the Quality Control Department is responsible for organizing on-site inspections for the project, which primarily include the following: <ul style="list-style-type: none">● reviewing due diligence documents as well as collecting and analyzing relevant materials;● visiting operational venues; and● attending meetings and interviewing the issuer's senior executives and employees.
<i>Documentary review</i>	The internal review team and the project's sponsor representatives conduct thorough reviews of the issuer's business, legal and financial matters to ensure that the disclosure documents are accurate and complete, have no material misstatements or omissions, and comply with the relevant listing rules.
<i>Management of project quality</i>	The project team reports issues timely and proposes solutions through the weekly reporting systems and significant events reporting systems. The project is also subject to reviews by sponsor representatives, relevant investment banking business team leaders, the Quality Control Department and the internal audit team in order to ensure project quality.
<i>Management of project agreements</i>	We delineate different signatory authorities for various types of agreements. The Legal and Compliance Department is responsible for reviewing agreements relating to the investment banking business.
<i>Management of underwriting risk quota</i>	We separate the pricing and sales functions from project execution. The capital markets department is responsible for the pricing and sales, and effectively controls underwriting risk by establishing a mechanism to assess and manage such risk. The Risk Management Department and the Finance and Planning Department set and monitor the underwriting risk quota based on the relevant regulatory requirements and our operating conditions.
<i>Management of sponsor representatives and other key employees</i>	We regulate our sponsor representatives and other key employees with respect to their qualification registration, workflow procedures, powers and remuneration, as well as responsibilities and penalties.

Asset Management Business

Our Legal and Compliance Department, Risk Management Department and Audit Department supervise and assess our exposure to the potential regulatory risk, market risk, credit risk, interest rate

BUSINESS

risk, liquidity risk, operational risk and compliance risk arising from our asset management business. These departments cooperate with the risk management personnel of our asset management business to monitor these risks in order to ensure the effective performance of our entrusted duties, the accurate disclosure of risk-related data, prudent business growth and the protection of our investors' interests.

The internal control and risk management measures of our asset management business primarily include the following:

- Investment decision-making procedures*
- The asset management investment committee is responsible for determining significant matters such as investment philosophy, investment principles, investment restrictions and appointment of investment managers.
- Management of trading procedures*
- We assign different personnel to issue investment orders and execute trades. Investment managers issue electronic trading orders through the trading system in accordance with the authorization by the asset management investment committee and the scope of investment specified in asset management contracts. Traders strictly follows such orders in executing trades, and the trading system will automatically reject trades that do not comply with the orders, and also reject the operations without orders. Both the issuance and the execution of trading orders are recorded in the system.
 - The asset management business implements stop-profit and stop-loss programs in accordance with contracts, product schemes and relevant regulatory rules.
 - The asset management business establishes a securities pool and makes investments within the scope of the securities pool. The establishment and maintenance of the securities pool is required to be conducted in accordance with pre-determined criteria and analysis mechanisms.
- Product design*
- When designing asset management products, the asset management business department is required to consult with the relevant legal, compliance and risk management personnel with respect to each product's compliance and risk-return profile, among other aspects.
- Segregation of businesses*
- We require the asset management business to be segregated from our proprietary trading and other securities businesses in order to prevent insider trading and avoid conflicts of interest.
- A senior executive is prohibited from managing both the asset management business and proprietary trading business simultaneously. These two business departments may not be led by the same individual. An investment sponsor may not be involved in both the asset management business and proprietary trading business simultaneously. The investment manager of a targeted asset management plan may not act as the investment manager of any other asset management business. The accounts of our targeted asset management plans may not trade with our proprietary trading accounts, and our various asset management accounts may not trade with each other.
- We require the asset management business to segregate the duty of positions that may generate conflicts of interest, such as investment operations, fund transfer and allocation, account management, settlement and clearing, and accounting, among others.
- Opening independent accounts*
- We entrust client assets with qualified commercial banks, the CSDCC, securities firms approved by the CSRC or other asset custodian institutions. We provide asset management services to our clients through designated accounts. The asset management business is managed through designated fund accounts, securities accounts and trading accounts.

BUSINESS

<i>Due diligence on client identity</i>	We conduct due diligence on client identity to understand the client's assets, income, securities investment experience, investment preferences, risk awareness and risk tolerance level. We also timely examine whether the source and usage of the assets being managed is legitimate so that we can recommend products or services that suit the client's risk tolerance level.
<i>Risk disclosure</i>	We require our client development personnel to disclose our business qualifications to our clients, explain the asset characteristics, investment scope, investment restrictions, risk-return characteristics and other aspects of the asset management contracts, and disclose risks to our clients proactively.
<i>Fair trading and tunneling</i>	<p>We have developed a fair-trading verification module in our asset management trading system in order to examine the fairness of trades. The Risk Management Department promptly monitors the trading and the Legal and Compliance Department promptly monitors the communication of trading personnel, issuing warnings and alerts for potential non-compliance.</p> <p>We have established mechanisms to ensure fair trading between clients, prevent tunneling between clients and protect the interests of our clients.</p>
<i>Emergency response mechanism</i>	We have established a response mechanism to effectively handle emergency situations relating to our asset management business so as to avoid or mitigate any impact of such emergency on our asset management business.
<i>Real-time risk monitoring</i>	Our risk management personnel have established risk-monitoring thresholds within our trading system in accordance with the relevant legal and regulatory requirements, in order to supervise, monitor, identify and report the irregularities and non-compliance incidents in trade execution, shareholding ratio, stop-loss and stop-profit as well as risk quota.
<i>Employee management</i>	We require our asset management employees to sign letters of commitment and declare their accounts. We organize compliance and risk control training periodically for these employees.

We centralize the management of our clients' assets and prohibit any department, subsidiary or branch from conducting asset management business without our consent.

Private Equity Investment Business

We engage in the private equity investment business primarily through Galaxy Capital, which has established its investment committee that can make decisions on any investment not exceeding the RMB100 million limit as authorized by the Board. The investment committee of Galaxy Capital manages the risks associated with our private equity investment activities, primarily operational risk and compliance risk, by limiting the scale of our investment within the limit authorized by the Board. The investment committee is responsible for reviewing and determining the mid- to long-term equity asset management plans and strategies as well as approving equity asset management plans of less than RMB100 million. For any equity investment over RMB100 million, the investment committee will recommend such investment to the Board for approval.

Our private equity investment targets companies with fast growth, listing potential or significant value for merger and acquisition. We focus on investing in companies having independent intellectual property rights, sophisticated scientific technology and advanced profit model. We do not intend to obtain controlling stakes of, or control, our target companies. Our shareholdings in target

BUSINESS

companies usually do not exceed 40%. Unless otherwise approved by our Shareholders, a single investment by our Company usually does not exceed 20% of Galaxy Capital's registered capital.

Galaxy Capital has established strict risk management and internal control systems based on relevant PRC laws and regulations and our general internal control policies, covering project approval, due diligence, transaction negotiation, investment decision-making, investment transaction, post-investment management and exit of investment. Galaxy Capital has established three lines of defense, namely, the investment committee, the compliance and risk management team and the business operation team, to control business risk from the decision-making, supervision and execution aspects.

Overseas Business

Galaxy International Holdings is an independent legal entity, and its business operations are strictly separated from China Galaxy. Galaxy International Holdings has an independent senior executive team, operational personnel, assets, financial management and IT system.

Through an effective segregation of duties among the front, middle and back offices as well as checks and balances among various positions, Galaxy International Holdings has established clear procedures for operations, management and control. It has established effective mechanisms for reporting, handling as well as supervisory feedback through implementation of risk control measures encompassing the entire business management and operation process in order to enhance its risk management.

The key risks we monitor for our overseas business include credit risk, operational risk and compliance risk. We also manage the interest rate risk and liquidity risk related to our overseas operations. Galaxy International Holdings has established a credit management committee at the senior executive level to formulate and supervise the implementation of credit policies as well as to manage asset quality. The credit management committee comprises of senior executives, directors and other key members of relevant departments of Galaxy International Holdings and its subsidiaries. The Finance and Planning Department and the relevant business departments are responsible for monitoring and tracking credit risk on a daily basis.

Galaxy International Holdings has issued operating manuals for various business departments to standardize risk monitoring and risk management procedures. It strengthens the supervision of its employees' business practice through various IT measures such as system screening, real-time monitoring and tape-recording of phone calls.

Galaxy International Holdings has established constitutive control mechanisms such as business, physical, personnel, fund and account segregation to prevent tunneling between various businesses and inappropriate flow and usage of sensitive information. It has established and has continuously maintained an updated watch list and restriction list, through which it monitors business activities and employee transactions to ensure compliance with relevant laws and regulations.

Innovative Business

Full-process participation by Risk Management Department and Legal and Compliance Department Our Risk Management Department and Legal and Compliance Department participate in the entire process of development and analysis for innovative businesses and conduct comprehensive risk assessment and feasibility studies on various types of risks in relation to new products and new businesses, including legal risk, compliance risk, credit risk, market risk, operational risk and reputational risk. They identify the potential risks of these new products and businesses, establish risk control measures and assign the responsibilities of implementing these measures to the relevant business departments. In addition, our Risk Management Department and Legal and Compliance Department conduct risk monitoring and compliance inspections on innovative businesses in order to rectify problems timely and improve the risk management of innovative businesses.

Restrictions on scale of business and management of risk quota Based on the regulatory requirements for the relevant risk control indicators and our operation conditions, we determine the annual risk-based capital reserve budget, the scale of business and the risk quota for the new businesses and new products, and integrate the limit of scale and risk quota of innovative business into our overall risk authorization system.

Controlled Subsidiaries

In order to strengthen our support and management of our controlled subsidiaries, promote standard operating procedures for these subsidiaries, protect our interests and enhance return on investment, we manage and control these primarily as follows:

- We appoint directors and supervisors to the controlled subsidiaries and require the articles of association of these subsidiaries to comply with the relevant laws and regulations. We require these subsidiaries to adopt sound corporate governance structures and to use legal means to appoint chief financial officers, chief risk officers or chief compliance officers to supervise and manage the operations of such subsidiaries;
- We supervise the controlled subsidiaries to improve their internal control mechanisms and require them to develop internal control policies that comply with regulatory requirements; and
- We have developed policies requiring the controlled subsidiaries to report significant matters to our headquarters, and our Audit Department conducts regular audits on these subsidiaries.

Chinese Wall

As a securities firm with a diversified range of businesses, we inevitably face conflict of interests. We recognize the importance of managing such conflict of interests to protect the interests of our clients and employees. Thus, we have established Chinese Walls between businesses with conflicting interests to prevent and reduce the potential conflict of interests by controlling the flow of material non-public information, thereby ensuring compliance with relevant rules and regulations.

A Chinese Wall is a barrier to ensure that material non-public information held by any of our departments regarding listed companies would not be inappropriately released to any other departments. A Chinese Wall aims to segregate the personnel making investment decisions from the personnel who are privy to material non-public information which may influence the investment decision-making.

We have developed and implemented effective policies and procedures to safeguard insider information and prevent improper trading. To enforce the Chinese Wall policy, we have implemented

BUSINESS

segregation among various departments, including investment banking, proprietary trading, asset management as well as research advisory services. We have adopted the following specific measures:

- Our online trading system has adopted measures to safeguard network security such as implementing firewalls and intrusion detection and applying sophisticated encryption and other technical measures in order to prevent the misappropriation and tampering of client data;
- Our investment banking, proprietary trading, private equity investment and asset management as well as research departments operate in physically segregated offices and use computers, facsimile machines, printers and other office equipment separately;
- Investment research reports for equity underwriting projects are required to be prepared independently and signed by research advisory personnel, and should not be circulated to any client during the offering process without authorization; and
- Personnel of the supervision and inspection department are obligated to maintain the confidentiality of the information acquired during the supervision and inspection process and should not disclose such information to other business departments or third parties.

Segregation of Duties

To minimize the opportunity for collusion and improper trading, duties and functions within our various business departments are assigned to different teams of employees. The business operation and decision-making of our business departments, including the brokerage, investment banking, proprietary trading, asset management as well as research advisory departments, operate independently from one another, and no employee may work for two or more departments simultaneously.

No employees in our IT Department, Finance and Planning Department as well as supervision and inspection department may work in any of the above-mentioned business departments simultaneously. The personnel responsible for the settlement and clearing of funds may not work in our IT Department or trading department simultaneously. Without approval by the relevant authorization management department, securities brokerage tellers without authorization may not set authorization limit of the trading system and may not lend their system operation authorization to personnel of the IT Department or the Settlement Management Department. Our proprietary trading business and asset management business operate independently from each other and use separate trading desks and accounts. Personnel engaging in providing securities investment advisory services to the general public are required to work solely for the research advisory department and may not simultaneously work in the proprietary trading, investment banking or asset management departments.

Conflicts of Interest

Conflicts of interest may arise between (i) our various operating units; (ii) our clients and us; (iii) our various clients; (iv) our employees and us; or (v) our clients and our employees.

In order to prevent conflicts of interest, we have adopted the following specific measures:

- Research personnel should not provide false information that misleads clients;
- Investment analyses, forecasts or recommendations provided to different clients for the same issue and at the same time may not contain contradicting views; and
- Research results and information may not be disclosed to other personnel or institutions without authorization.

BUSINESS

When forecasting the trends of securities prices or making recommendations on the feasibility of securities investment, research and advisory personnel are required to explicitly indicate, to their knowledge, whether their employer, themselves or any other stakeholders hold any interest in the securities evaluated or recommended, and if there is any potential conflict of interest, the research and advisory personnel should avoid making forecast or recommendation.

One of the fundamental objectives of Chinese Walls is to manage conflicts of interest. We have adopted a series of measures and methods to manage conflicts of interest based on the principles of prudent management, prioritizing client interests and treating clients fairly. We first adopt measures of information segregation to avoid conflicts of interest. If it becomes difficult to avoid conflicts of interest even with Chinese Walls, such conflicts of interest must be disclosed. If such conflicts of interest cannot be managed effectively through disclosure, we may adopt measures such as imposing restrictions on business activities. When we or our employees have a conflict of interest with any client, the client's interests prevail. When a conflict of interest arises between clients, we are required to treat our clients fairly.

In addition, we have issued a series of manuals requiring employees to learn and comply with internal policies, such as prioritizing client interests, treating clients fairly, guarding against insider trading, preserving confidentiality, complying with Chinese Walls as well as complying with the restrictions on employees' securities investments. We also require employees to timely disclose any conflict of interest to the manager of the relevant department. During the Track Record Period, we did not experience any material failure to protect confidential information of our clients.

Anti-Money Laundering

We are committed to establishing and enforcing appropriate policies and procedures to prevent money laundering and terrorist financing and to ensure compliance with all relevant legal and regulatory requirements. Money laundering activities refer to various activities intended to hide or alter the illegal source of money. Our employees are required to conduct stringent identification verification for clients applying to open new accounts, and to review and archive their identification documents and transaction records. Our account management system categorizes the money laundering risk of each client as "prohibited," "high," "medium" or "low" so that we can manage clients at various levels of money laundering risk differently. Furthermore, we may restrict, suspend or terminate our business relationship with clients based on the extent of the money laundering risk.

We have also established reporting systems for large-size transactions as well as suspicious transactions and suspicious information. Our Chief Risk Officer /Chief Compliance Officer is responsible for reporting to our senior executives periodically and from time to time the status of our money-laundering risk and anti-money laundering activities. We have also formulated specific rules and operating procedures for the confidentiality, training and promotion of anti-money laundering activities as well as reporting suspicious activities and assisting with the investigation of money laundering activities. We submit reports about our anti-money laundering information and activities in accordance with the relevant regulatory requirements, conduct money laundering risk assessment for new businesses and products, and establish performance review system for anti-money laundering activities.

Based on the materials that we have provided and through the appropriate verification procedures, our PRC legal advisors believe that, except for the incident of non-compliance of Galaxy Futures as disclosed in "Business—Laws and Regulations" of this prospectus, during the Track Record Period and as at the Latest Practicable Date, we have not received any administrative penalties from

BUSINESS

regulatory authorities because of violations of PRC laws and regulations related to anti-money laundering.

We have never engaged in or knowingly assisted with any money laundering activities. For risks associated with money laundering activities, please see “Risk Factors—Risks Relating to Our Business and Industry—We may not be able to fully detect money laundering and other illegal or improper activities in our business operations on a timely basis.”

LAWS AND REGULATIONS

Licensing requirements

We conduct our securities business in the PRC and Hong Kong and are subject to the regulatory requirements of the PRC and Hong Kong. Our Directors and PRC legal advisors confirm that, during the Track Record Period and as at the Latest Practicable Date, we have complied with the relevant PRC regulatory requirements and guidelines in all material respects and have obtained all material consents and licenses required for our operations in accordance with the PRC laws and regulations. To the best knowledge of our Directors after due inquiry, our Directors confirm that, as of the Latest Practicable Date, all of our employees and brokers have obtained the relevant licenses required for their business activities.

Our certain Hong Kong subsidiaries are required to obtain necessary licenses to conduct their businesses in Hong Kong under the licensing regime regulated by the SFC. Such subsidiaries have obtained the relevant licenses and have been in compliance with the relevant regulatory requirements.

Galaxy International Securities holds a Type 1 license for dealing in securities, a Type 4 license for advising on securities and a Type 6 license for sponsoring IPOs and providing financial advisory services. Galaxy International Futures holds a Type 2 license for dealing in futures contracts. Galaxy International Finance holds a money lenders license. Galaxy International Asset Management holds a Type 4 license for advising on securities and a Type 9 license for asset management.

Our Directors confirm that, during the Track Record Period and as of the Latest Practicable Date, we have complied with the relevant Hong Kong regulatory requirements and guidelines in all material respects and have obtained the permits and licenses necessary for our operations in accordance with the laws and regulations of Hong Kong.

Legal Proceedings

We are involved in a number of legal proceedings arising in the ordinary course of our business. As at the Latest Practicable Date, we were involved in three pending legal proceedings in which the potential claim amount was more than RMB8.5 million in each case. As far as our Directors are aware, the aggregate potential maximum amount of claims for these three proceedings was approximately RMB69.8 million. The three pending proceedings are summarized as follows:

(i) Asset management contract dispute arising from account statements falsified by Weitong Bai

Hualin Cai and Jinglin Cai, two brothers who were clients of our Xiaolan branch in Zhongshan, privately entrusted Weitong Bai, a former employee of that branch, to manage their accounts. Weitong Bai incurred losses in managing these accounts and subsequently used falsified account statements to hide the losses from 2008 to August 2010. Weitong Bai surrendered herself to the police. After receiving notification from the police of Weitong Bai’s surrender, the branch immediately reported to

BUSINESS

our headquarters. In September 2011, the court sentenced her to two-year imprisonment with three-year probation for forging company seals.

Each of Hualin Cai and Jinglin Cai filed a lawsuit with the Second People's Court of Zhongshan of Guangdong Province on March 19, 2012, and February 6, 2012, respectively, against the Xiaolan branch and Weitong Bai, claiming for the amounts on the falsified account statements. The aggregate amount of these two claims is approximately RMB11.0 million, including approximately RMB2.3 million claimed by Hualin Cai and approximately RMB8.7 million claimed by Jinglin Cai. Currently the cases are pending for decision.

As the proceeding relates to an isolated case of a former employee's violation of the law and our internal policies, it pertains to an individual's criminal activities and therefore will not have a material effect on our business. Nonetheless, we consider it reflected areas for improvement in our measures to monitor our employees' operation of client accounts and manage the seals of our securities branches. We have taken the following rectification measures, including: (i) upgrading the risk monitoring system for our brokerage business, with an emphasis on improving our capability to monitor unusual transactions that may involve employees operating accounts and managing assets on behalf of clients; (ii) strengthening the monitoring system for orders placed through equipment such as employee computers, blocking employee office computers' function to place orders; (iii) improving our business processes, strengthening our monitoring of information from client account openings and standardizing the management of business seals; and (iv) reminding clients during follow-up calls of the risks of financial fraud and the risks of non-compliant activities performed on clients' behalf.

(ii) Civil dispute arising from the fraud by Jianwei Liang

From February 2006 to January 2011, Jianwei Liang, a former employee of the Xiaolan branch in Zhongshan, committed fraud by forging asset management agreements and affixing forged seals on these agreements. We discovered the fraudulent activities and reported to the police, who arrested Jianwei Liang. On August 23, 2012, the Intermediate People's Court of Zhongshan convicted Jianwei Liang of defrauding 15 people for an aggregate amount of approximately RMB49.1 million, sentenced him to life imprisonment and deprived him of political rights for life. Jianwei Liang has not appealed.

In May 2012, the fraud's victims filed 13 civil proceedings against the Company and the Xiaolan branch with the Second People's Court of Zhongshan, claiming that the Xiaolan branch and the Company were vicariously liable for Jianwei Liang's fraud. The aggregate damages of their claims is approximately RMB50.2 million. Subsequently, each of the plaintiffs added Jianwei Liang as a co-defendant. As of January 17, 2013, the court reached its decisions for the first trial, ruling that Jianwei Liang shall compensate the plaintiffs for their losses and that we and the Xiaolan branch in Zhongshan shall jointly compensate 40% of the loss (the principal amount) that Jianwei Liang is unable to pay back. We and the Xiaolan branch in Zhongshan have appealed the decision. Currently, the case is pending for decision.

As this proceeding pertains to an isolated case of an individual's criminal conducts and is not related to our day-to-day business activities, it will not have a material effect on our business. However, we consider it reflected the need to further improve internal control areas such as supervision over employee activities, investor education, risk warnings for financial fraud and client follow-up calls. We have taken rectification measures including: (i) adopting rectification measures for the Xiaolan branch in Zhongshan including adjusting management personnel of Xiaolan branch and strengthening the supervision over its employee activities; (ii) improving account opening procedures,

BUSINESS

strengthening our monitoring over information from account openings, enhancing risk monitoring system for our brokerage business to monitor non-compliant account openings by employees; (iii) revising questions to be asked during client follow-up calls, so as to improve clients' ability to prevent financial fraud, and strengthening the workflow for investor education pertaining to account opening. For this proceeding, we have made a provision in the financial statements for 2012 in the amount of RMB18.9 million. Our Directors believe that this provision is sufficient.

(iii) Civil dispute involving Latou Tang, the Company and Lei Li

On March 17, 2013, Lei Li, a client manager of our Jiangdongzhong Road branch in Nanjing, reported to us that (i) on March 14, 2013, Latou Tang, a client of our Jiangdongzhong Road branch, through the introduction and facilitation of Lei Li, invested RMB9 million in bank acceptance bills business through Xiaolei Yu, a client manager of another securities firm; (ii) under the bank acceptance bills business, Xiaolei Yu promised to pay high interest on the funds invested by the participants; (iii) Lei Li and another employee of our Jiangdongzhong Road branch also invested in such bank acceptance bills business; and subsequently, Xiaolei Yu became subject to criminal detention for suspected illegal fund collection.

Latou Tang could not recover his above investment and filed a lawsuit on April 15, 2013 with the Jianye District People's Court of Nanjing against the Company and our Jiangdongzhong Road branch in Nanjing, as co-defendants, claiming a payment of RMB8,614,000 plus interest. The court hearing for the case will be held on June 7, 2013.

Upon being notified of the incident, on March 18, 2013, our Legal and Compliance Department, Brokerage Management Headquarters and regional compliance officers jointly conducted onsite investigations on this incident. Concurrently, we have checked our internal control measures of the Jiangdongzhong Road branch in Nanjing, including employee trainings, investor education, management of client account opening information as well as management of business seals. We have also made follow-up calls with our clients that are served by Lei Li, conducted interviews with the sales and marketing employees of the branch and provided compliance and risk control educations to the branch's employees. Our investigation results supported that the required account opening information and investor education materials of the clients involved in this case were complete and Lei Li attended our required employee trainings and signed the compliance commitment letter. Also, according to our client follow-up calls and interviews, none of our other clients that are served by Lei Li has been involved or invested in such bank acceptance bill business.

Our Directors and our PRC legal advisors confirmed that the legal proceedings mentioned above would not have a material adverse effect on our business.

As at the Latest Practicable Date, the aggregate amount of outstanding claims and judgments of the three pending legal proceedings mentioned above amounted to approximately RMB69.8 million. Our Directors and PRC legal advisors confirm that, as at the Latest Practical Date, none of the legal proceedings to which we were a party, individually or in the aggregate, would have a material effect on our business, financial condition or results of operations.

Regulatory Non-compliance

We are subject to a number of regulatory requirements and guidelines issued by the regulatory authorities in the PRC and Hong Kong, including but not limited to the CSRC, the Shanghai Stock Exchange, the Shenzhen Stock Exchange, the Hong Kong Stock Exchange, the SFC and their respective local branches and offices (if applicable).

BUSINESS

We or our employees have, from time to time, been involved in regulatory non-compliance incidents and received related notices or warnings from the relevant regulatory authorities. We set out below the details of our non-compliance incidents (i) that led to regulatory measures and the deduction of regulatory points by the CSRC or fines imposed by the PBOC, or (ii) in which our employee was prosecuted or convicted, during the Track Record Period and up to the Latest Practicable Date, and the primary remedial measures we adopted in response to these incidents:

Non-compliance incidents

Internal control deficiencies

Brief explanation and our primary remedial measures

Headquarters

In July 2011, our research department issued a research report on PanGang Steel that contained calculation errors, which led to a big gap between the valuation in the research report and the correct valuation. There was unusual fluctuation in PanGang Steel's share price after some media reports quoted the research report without authorization, which adversely affected our reputation. We immediately investigated in this matter, published a clarification announcement and reported to the CSRC Beijing Bureau. The CSRC Beijing Bureau then conducted an investigation in this matter in July 2011 and issued a regulatory notice to us in September 2011. Such regulatory notice required us to improve our qualification management of research personnel, research report quality control, compliance checks, management of working papers, and the performance evaluation of research personnel as well as to penalize the relevant employees. We submitted two rectification reports to the CSRC Beijing Bureau on July 22, 2011 and September 8, 2011, respectively.

Apart from our research report evaluation mechanism, we did not establish a control mechanism for unusual research report results, and our research department did not conduct sufficient verification of the valuation results during its evaluation of the research report.

Since July 2011, we have taken the following rectification measures: (i) withdrawing the research report and apologizing publicly; (ii) conducting comprehensive internal investigation on the publication and verification process for research reports, enacting policies relating to the evaluation and format requirement of research reports, establishing a control mechanism for unusual research report conclusions, increasing the requirements for reviewing the reasonableness of research report conclusions; (iii) establishing a mechanism of working papers for research reports, through which securities analysts must upload to the system any information collection, data calculation tables, investigation information and meeting transcripts, company earnings forecasts and summaries of valuation model research relating to the preparation of research reports, which will serve as a necessary basis for our internal assessment and various inspections; (iv) defining quality standards for research reports, requiring that quality control for research reports shall cover fundamental aspects such as information processing, logic of analyses and research conclusions; (v) conducting compliance training for research personnel and clarifying their compliance duty; and (vi) imposing penalties on the relevant supervisor and research team, including demotions and bonus deductions.

BUSINESS

From July 2010 to March 2011, we acted as a sponsor in relation to the IPO of Jinhe Biotechnology Co., Ltd., during which two of our sponsor representatives failed to conduct adequate due diligence and did not timely obtain materials related to a patent used by Jinhe Biotechnology, as a result of which they had not discovered that the patent had expired. After discovering that such patent had expired, the project team did not report such matter to the CSRC. The CSRC made an inquiry into the incident and required us to investigate. The CSRC then conducted regulatory interviews with the two sponsor representatives in May 2012. Except for such regulatory interviews, the two sponsor representatives had not been subject to any other regulatory disciplinary actions for their inadequate due diligence.

Supervision and control over due diligence on sponsor representatives need to be improved.

In July 2012, we demoted and fined the two sponsor representatives. Our Discipline Inspection and Supervision Department, Legal and Compliance Department and Investment Banking Headquarters jointly conducted special investigations on this incident and looked for internal control deficiencies, and on the basis of such investigations specifically drafted and published relevant policies requiring investment banking personnel to stringently fulfill due diligence obligations according to regulatory requirements, as well as adopted measures to improve the quality of due diligence work in the following areas: (i) improving project teams' issuer education work to ensure it covers information such as basic securities laws and regulations, information disclosure during securities offering, securities offering and sponsorship, securities listing and supervision, securities market risks, and cases of violation of rules in the securities market, taking into account the CSRC and its local counterparts' requirements regarding issuer education; (ii) further raising the quality requirements for sponsorship working papers, making the authenticity, accuracy and completeness of working papers one of the important evaluation criteria of project team members; and (iii) adopting a methodology of "quality control department's onsite inspection + documents review" to improve our independent verification capabilities.

BUSINESS

In April 2007, one of our former employees engaged in insider trading as well as holding and trading of the stock of FangDa Carbon New Material Co., Ltd. In May 2012, the CSRC conducted an investigation and trial and imposed administrative penalties and securities market access injunction on this employee. Such former employee was a deputy general manager at our investment banking headquarters from January 2007 to April 2008 and then a team leader at our investment banking headquarters from April 2008 to July 2012. Such former employee obtained the insider information while he was working as a sponsor's representative in connection with the non-public stock offering of FangDa Carbon New Material Co., Ltd.

The incident occurred during the early stage of our establishment, and mechanisms for preventing and monitoring insider trading were in need of improvement.

Since September 2011, we have also strengthened compliance training and education to the employees. Meanwhile, in order to effectively guard against illegal or non-compliant activities such as insider trading, transfer of benefits and the use of non-public information, we have developed and implemented a number of internal control processes, policies and notices to regulate and manage employees' professional conducts (including information segregation and employees' securities investment activities). We require employees to report information of their securities accounts and contact information such as mobile phone numbers, and require employees in key positions to report information of the securities accounts of their immediate family. We have put in place technical restrictions regarding the use of online trading software and the access to online order-placing webpages via our internal network. Meanwhile, we have independently developed a real-time system of monitoring employees' securities investment activities. During such monitoring, if we find that certain employees that may be involved in non-compliant securities investment activities, we will initiate investigations and verification procedures regarding such employees. Additionally, following the ruling of the CSRC, in July 2012, this employee's employment contract with us was terminated, his illegal proceeds were confiscated, and he was imposed a fine.

Branches

From February 2006 to January 2011, Jianwei Liang, a former employee of our Xiaolan branch in Zhongshan, forged company seals and falsified agreements to defraud clients. We discovered the fraudulent activities and reported to the police. In August 2012, Jianwei Liang was convicted of fraud and was sentenced to life imprisonment.

Internal control areas such as the supervision over employee activities, investor education, and risk warnings for financial fraud need to be improved.

Since 2011, we have taken the following rectification measures: (i) adopting rectification measures for the Xiaolan branch in Zhongshan including adjusting management personnel of Xiaolan branch and adding a function to the brokerage business risk monitoring system to supervise employee activities such as account opening by employees and orders placing through employees' telephones and office equipment; (ii) improving account opening procedures, adding a function to the brokerage business risk monitoring system to monitor unusual client account opening information and non-compliant account opening by employees; the settlement management department strengthening its verification of imaging information about client account openings uploaded by the branches; (iii) revising questions to be asked during client follow-up calls to enhance their fraud-avoidance capability and strengthening investor education during account opening.

During an investigation in May 2010, the CSRC Jiangsu Bureau discovered that: (i) certain sales personnel in our Hanzhong Road branch in Nanjing had no requisite qualifications or employment relationship with us but had engaged in sales and marketing for securities brokerage business, (ii) from January 2009 to May 2010, certain sales personnel conducted sales and marketing outside of the geographical areas permitted, and (iii) from January 2009 to May 2010, certain sales personnel opened accounts for clients outside the geographical areas permitted through "notarization" means. On January 26, 2011, we submitted a rectification report to the CSRC Jiangsu Bureau. In April 2011, the CSRC Jiangsu Bureau issued a warning letter to us.

Internal control areas such as the account opening procedures of the branches and the management of sales and marketing activities need to be improved.

We adopted the following rectification measures from July 2010 to January 2011: (i) assisting the clients who had improperly opened their accounts outside our Hanzhong Road branch's permitted geographical area to open new accounts through the proper procedures; and (ii) terminating the employment of the perpetrating client managers, terminating the non-compliant brokerage relationships, and imposing various penalties on the relevant supervisors, including demotions and bonus deductions.

BUSINESS

In addition, we have continued to adopt and implement related company-wide management measures, including: (i) organizing periodic training for sales and marketing personnel; (ii) carrying out compliance checks annually at the headquarter level and semi-annually at the branch level, regional compliance officers conducting routine and random compliance checks on important business operations, branch compliance managers conducting regular checks and sampling inspections, conducting real-time monitoring over the professional conducts of employees in key positions and issuing weekly monitoring reports. (iii) improving our monitoring system for employee activities and strengthening service counter checks; (iv) upgrading our sales and marketing system so that the system can prohibit employees without proper qualification from signing up clients or taking on clients; and (v) strictly limiting the geographic areas for sales and marketing according to regulatory requirements.

From February 2008 to August 2009, one of our employees used funds of the branch through reimbursements in order to make up for losses incurred in unauthorized transactions she conducted on behalf of clients, and later put back such funds in a safety box of the branch. In November 2012, such employee was prosecuted by the Tianjin Procuratorate. In December 2012, the court of first trial convicted this employee for misappropriation. However, taking into consideration her confession and the minor impact of her criminal offense, the court waived her criminal punishment.

Branch level financial management and expense reimbursement approval, timely entry of petty cash transactions and controls over employees privately being entrusted to carry out transactions on behalf of clients need to be improved.

The relevant employee was demoted in October 2009. In addition, we have taken the following rectification measures: (i) implementing strict expense budget management, specifying the criteria, scope of use, management authority and approval procedures for various types of expenses; (ii) formulating unified accounting measures to be strictly followed by the headquarters and branches when conducting confirmation, computation and reporting of various types of transactions or activities within a unified financial system; and (iii) blocking the order-placing functions of office facilities, optimizing the risk monitoring system for the brokerage business, monitoring the placement of orders by employees via mobile devices, as well as imposing penalties and issuing warnings regarding non-compliant order-placing activities.

Subsidiary: Galaxy Futures

During its on-site inspection, the PBOC discovered that from January 2008 to February 2009, Galaxy Futures failed to obtain sufficient understanding of the actual beneficiaries who controlled a number of accounts opened by natural persons and the transactions made by such accounts, some natural persons holding accounts failed to register their required identification information, and Galaxy Futures failed to register information about some institutional clients' business licenses and their controlling persons, which showed that Galaxy Futures failed to fulfill the required client identification obligations. In June 2010, Galaxy Futures was fined RMB200,000 by the PBOC. On May 26, 2009, we submitted a report to the PBOC summarizing our rectification measures.

Galaxy Futures' individual client identification process needs to be improved.

Since May 2009, we have adopted the following rectification measures: (i) improving the internal control, business systems and procedures of our anti-money laundering activities; (ii) strengthening the classification of clients' money-laundering risks and our identification of suspicious transactions; (iii) conducting internal inspection and audit on anti-money laundering activities; (iv) strengthening the training of our employees on anti-money laundering knowledge and skills; and (v) strengthening investor education on anti-money laundering. At the same time, when we establish new policies or make changes to our existing policies, we focus on integrating requirements of various anti-money laundering policies into our day-to-day business operations rules, so as to improve our anti-money laundering work standard. Furthermore, we launched a tiered anti-money laundering categorization system, formulated related operational guidelines and enhanced the effectiveness of our anti-money laundering efforts.

In response to the above non-compliance incidents, we have carefully investigated each incident, implemented a series of remedial measures, supervision mechanisms and policies to strengthen our risk management and internal control. At the same time, to address the non-compliance incidents and internal control deficiencies discovered during regulatory inspections, we have submitted the corresponding rectification reports to the relevant regulatory agencies pursuant to their requests, and have not received any objections to our rectification reports from such regulatory agencies. Our Directors confirm that we have implemented measures to rectify the non-compliance immediately upon becoming aware of the incidents as disclosed above, all such non-compliance incidents have been rectified up to the Latest Practicable Date, and our remedial measures, internal control measures and risk management procedures are sufficient and effective in detecting and preventing similar non-compliances. Our Directors and our PRC legal advisors confirm we have not received any objections from the regulatory authorities to whom we had submitted rectification reports in connection with the non-compliance instances disclosed above up to the Latest Practicable Date, the instances of regulatory non-compliance disclosed in this prospectus were not significant to our business operations and have not had any material adverse effect on our business, financial condition and results of operations. Our Directors also confirm that none of our existing Directors or senior executives has been involved in any regulatory non-compliance incidents.

Regulatory inspections

The CSRC and other regulatory agencies conduct periodic or random inspections, examinations and inquiries in respect of our compliance with the laws, regulations, guidelines and regulatory requirements applicable to us and our business. During the Track Record Period and as at the Latest Practicable Date, the periodic and random inspections conducted on us by the CSRC and its local counterparts covered our risk management, internal control, corporate governance and various business areas that we are engaged in, and the scope of which included our headquarters, subsidiaries, branch offices, representative offices and various securities branches. Although the aforementioned inspections have not revealed any material risks or non-compliance incidents and have not resulted in any fines or other administrative penalties, they revealed certain deficiencies with respect to our business operations, risk management and internal control. We immediately took rectification measures and improved our risk management and internal control systems based on the CSRC's recommendations. The following sets out examples of recent inspections:

- On October 24, 2012, the CSRC Fujian Bureau conducted an on-site inspection of the compliance and risks of our Zhangzhou Shuixian Avenue securities branch and made the following oral recommendations regarding: (i) improving management of seals: the keeping, time of commencement of use and time of use of the seals shall be clearly recorded; (ii) establishing regular inventory-checking records for important blank certificates; (iii) the need for improvement of the investor bulletin: approval documents for financial products and resume of the general manager were not posted; (iv) timely updating client information; and (v) for transactions handled by service counter employees, to impose prohibitions on parties involved in a transaction from being the person processing the transaction or the reviewer thereof. According to these recommendations, the branch immediately took the following rectification measures: (i) improving the process for the commencement of the use of seals and the use of the registry book; (ii) conducting inventory check on important blank certificates on a regular basis; (iii) adding approval documentation for financial products and the resume of the general manager to the investor bulletin; (iv) sending registered letters to notify those clients unreachable by telephone to remind them to update their contact information; and (v) if the service counter employee who is handling the transaction is involved in the transaction, having transaction department managers conduct reviews. Because this inspection was a routine inspection, and as the improvement recommendations were issued to us verbally and we have not received any comment letter in writing, we are neither required to nor have we submitted any report explaining our rectification measures to the CSRC Fujian Bureau, and we have not received any follow-up comments from them.
- On October 16, 2012, the CSRC Zhejiang Bureau conducted a special on-site inspection of our Zhejiang Lishui securities branch, and provided a number of oral recommendations for improvement, including (i) to optimize the contents of the public information bulletin to include investor education materials about combating illegal securities transactions and complaint channels of local securities regulatory bureau and securities industry association; (ii) the lack of sufficient information on the application forms for account opening and cancellation; (iii) the lack of segregated area in the branch for Futures IB business; and (iv) the lack of written record of compliance manager's daily entry. In response to these recommendations, we immediately took the following rectification measures: (i) supplementing the content of publicly available information, adding

BUSINESS

complaints channels, such as complaint hotlines, email addresses and addresses of local securities regulatory bureau and securities industry association, and adding investor education materials about combating illegal securities transactions; (ii) optimizing the client information form, instructing relevant personnel to strengthen on day-to-day inspection and reviews of relevant forms to ensure the completeness of client data; (iii) establishing a segregated area in the branch for Futures IB business; (iv) establishing and improving a compliance management platform to ensure that historical data is backed up electronically through compliance manager's daily online reports. On October 25, 2012, we submitted a rectification report to the CSRC Zhejiang Bureau, and have not received any objections from the regulatory authorities toward our rectification report or rectification measures.

- On July 6, 2012, the CSRC's issuance supervision department conducted an on-site inspection of the sponsorship business of our investment banking headquarters and issued a comment letter. The letter expressed its confidence in our ability to carry out a variety of sponsorship work according to the relevant requirements of the sponsorship system, but also pointed out the need to strengthen our efforts in verifying relevant circumstances of the issuer during the due diligence process, adjusting the focus of our issuer education and further improving the preparation of sponsorship working papers. In response to the aforementioned recommendations, we took the following measures to further standardize the operation of our sponsorship business: (i) reconstructing the organizational structure of our investment banking headquarters, establishing a new model comprising of matrix business interaction structure and step-by-step process support structure, and enhancing the professionalism of our due diligence work; (ii) adopting a due diligence methodology of "quality control department's onsite inspection + documents review," and increasing our independent verification capabilities; (iii) summarizing the CSRC's local counterparts' requirements regarding issuer education, adjusting the focus of issuer education of the project teams, ensuring the issuers have comprehensive and detailed understanding of important information such as the basic securities laws and regulations, information disclosure during securities issuance, securities issuance and sponsorship, securities listing and supervision, securities market risks, and cases of violation of rules in the securities market; and (iv) further raising the quality requirements for sponsorship working paper, and making the completeness of working papers one of the important evaluation criteria of project team members. On August 27, 2012, we submitted to the CSRC's issuance supervision department a response to the aforementioned comment letter, and have not received any follow-up comments to this response.

INFORMATION TECHNOLOGY

Our IT system is essential to the effective operation and performance of our businesses and is critical to our success and future business growth. We focus on developing our IT capabilities and possess a sound IT management infrastructure. The IT Department comprises the IT operation center, the IT research and development center, the online trading center, and the technology management team.

IT System

We have established seven principal IT systems and platforms for our business operations, risk control and management:

- *Centralized trading system:* Our centralized trading system is our core business system. In 2010, we launched the centralized trading system for our securities brokerage business online and have subsequently integrated the functions of sales of publicly-raised funds and third-party custodian services into this system. Our centralized trading system covers all of our branches within the PRC and approximately 5.57 million clients and has enabled us to process and share data and information across our entire company, providing timely and accurate data for our business management, risk monitoring and support for decision-making;
- *Centralized account management system:* Our centralized account management system standardizes the procedures for client's account opening, consolidates client information, and enhances our client management;
- *Comprehensive maintenance platform:* We have established a comprehensive maintenance platform based on our IT infrastructure, in order to monitor the operations of our IT hardware and software, such as our networks, servers, databases and applications systems;
- *Online trading system:* Our online trading system is a business platform that provides online trading and market information services to our clients through the Internet and the mobile Internet. Our mobile securities trading system supports multiple types of mobile platforms, and focuses on improving client experience, access speed, security controls and unique features;
- *Centralized monitoring system, risk management system and off-site audit system:* Our central monitoring system monitors the trading activities of our branches and issues real-time risk warnings. Our risk management system monitors the trading activities of our headquarters and issues risk warnings timely. Our off-site audit system provides support to our auditing activities;
- *Data center:* Our data center collects and processes the business data of our entire company in order to meet the data requests for various management and reporting purposes that support our decision-making and business operations; and
- *Client relationship management system:* Our client relationship management system provides support for our client services, product promotion as well as sales and marketing efforts.

In addition to systems and platforms above, we have also built customized IT systems for innovative businesses such as margin financing and securities lending, futures IB, margin and securities refinancing, dealer-quoted bond and fund repurchase products and securities-based lending transactions.

Our IT systems, along with other risk management systems and the audit systems, form a unified risk management infrastructure to prevent risks before they occur, manage and control risks when they occur, and audit and review risks after they occur, which ensures that risk management is integrated into the entire business operation process.

IT Risk Management

We have established IT security management policies and procedures that handle our IT system's physical security, network security, mainframe security, application security and data security, and other relevant matters such as backup recovery, personnel, research and development, operation maintenance, emergency response and outsourcing.

We have established a multi-tiered information security system covering border protection, network access, identity authentication, control of outbound access, intrusion detection, auditing and monitoring, terminal management and anti-virus protection. We have adopted various IT security measures, including firewalls, anti-virus measures, user authentication and authorization, intrusion detection and infiltration tests, in order to improve our information security management capabilities with respect to defense, monitoring, warning, response and recovery, among other aspects.

We have established a research and development system as well as an operation and maintenance center that is suitable for centralized processing of large volume of data. We seek to strengthen the security control in developing new IT systems and establish security management mechanisms for such systems in their development phase, installation phase and online operation phase, in order to timely identify and manage those security issues arising in system development, modification and operation, and achieve effective control over information security risk.

We actively improve our emergency and disaster recovery system and have established two disaster recovery centers in Beijing and Shanghai. Our core operation system is located in a network data center operated by a third party. We seek to strengthen our emergency response management and actively conduct disaster recovery drills in order to enhance our capabilities managing IT crisis.

Research and Development

Our IT Department is responsible for implementing key IT projects and developing IT software. We develop our core business systems and innovative business systems independently or jointly with third parties. We have cooperated with software developers to develop our margin financing and securities lending system and data center system. We have independently developed the securities-based lending transaction system, the mobile securities trading system, the mid- to long-term bond information system, the centralized risk monitoring system, the funds analysis and evaluation system, and the anti-money laundering system, among others.

COMPETITION

The PRC securities industry is highly competitive. We believe that the PRC securities firms primarily compete on the following factors:

- the range of products and services offered;
- pricing;
- client services;
- network coverage;
- marketing and distribution capacities;
- IT system;

BUSINESS

- financial strength; and
- brand recognition.

For our securities brokerage as well as margin financing and securities lending businesses, we compete with other PRC securities firms primarily on pricing and the range of products and services offered. These firms include CITIC Securities Co. Ltd., Haitong Securities Co., Ltd., Guangfa Securities Co., Ltd., Huatai Securities Co., Ltd., Guotai Junan Securities Co., Ltd., China Merchants Securities Co. Ltd., Everbright Securities Co. Ltd., Shenyin & Wanguo Securities Co., Ltd. and Guosen Securities Co., Ltd. Currently, there are more than 100 registered securities firms in the PRC. The intense price competition in recent years has lowered the commission rates of our securities brokerage business.

For our futures brokerage business, we compete with other futures firms primarily on pricing and the range of products and services offered.

For our investment banking business, we compete with other PRC and Sino-foreign joint venture securities firms as well as PRC commercial banks primarily on brand recognition, marketing and distribution capability, quality of services, financial strength and performance, and pricing.

For our asset management business, we compete with fund management companies, banks, insurance companies and other financial institutions in the PRC primarily on range of products and services offered, pricing and quality of services.

For our private equity investment business, we compete primarily with other PRC securities firms qualified to conduct private equity investment business and private equity investment firms.

Please see “Risk Factors—Risks Relating to Our Business and Industry—Intense competition in existing and emerging business could materially and adversely affect our business if we are unable to compete effectively.”

EMPLOYEES

As at December 31, 2010, December 31, 2011 and December 31, 2012, we had 10,746, 12,104 and 8,601 employees, respectively, who had entered into employment contracts with the Company. The decrease in the number of our employees from 2011 to 2012 was predominately due to the reduction of our client manager team. The overall market downturn in 2012 has created a difficult environment for many of our client managers in light of our performance evaluation and incentives system. The number of our client managers decreased by 3,739 in 2012, and 77.6% of those who departed did not renew their contracts with us upon expiration of the contracts or otherwise voluntarily left their positions with us.

We believe that the natural attrition and renewal of our client manager team met our business needs, served our development objectives well and did not have a negative impact on our business operations. The decrease in the number of our client managers also reduced our salary and other compensation expenses for our client manager team.

BUSINESS

The following table sets forth the breakdown of our employees by business function as at December 31, 2012:

	<u>Number of Employees</u>	<u>Percentage</u>
Securities, sales and trading	7,846	91.2%
Investment banking	243	2.8%
Investment management	59	0.7%
Overseas business	74	0.9%
Middle and back offices	<u>379</u>	<u>4.4%</u>
Total	<u>8,601</u>	<u>100.0%</u>

The following table sets forth the breakdown our employees by age as at December 31, 2012:

	<u>Number of Employees</u>	<u>Percentage</u>
30 or below	3,924	45.6%
31 to 40	2,821	32.8%
41 to 50	1,689	19.6%
50 or above	<u>167</u>	<u>1.9%</u>
Total	<u>8,601</u>	<u>100.0%</u>

The following table sets forth the breakdown of our employees by educational background as at December 31, 2012:

	<u>Number of Employees</u>	<u>Percentage</u>
Doctor's degree	69	0.8%
Master's degree	893	10.4%
Bachelor's degree	4,855	56.4%
Junior college graduate and below	<u>2,784</u>	<u>32.4%</u>
Total	<u>8,601</u>	<u>100.0%</u>

We believe the sustainability of our growth depends on the capability and loyalty of our employees. We have adopted an incentive scheme that links employees' remuneration with their performance. Our performance evaluation system provides the basis for making such personnel decisions as remuneration adjustment, bonus grant, career promotion, talent cultivation and employee incentive programs. We have been gradually cultivating a remuneration culture based on our employees' positions, capabilities and performance. In accordance with applicable PRC laws and regulations, we provide our employees with such benefits as basic pension insurance, basic medical insurance, workplace injury insurance, unemployment insurance, maternity insurance and housing provident funds, as well as supplementary medical insurance and optional corporate annuity fund. In addition, we plan to incentivize and increase the loyalty of our employees through employee stock ownership programs, subject to applicable regulations.

We place a long-term focus on recruiting and retaining talents, and expend numerous resources and employ a variety of methods so that our employees can help us achieve our growth strategies. For example, we have started to recruit globally business department managers and senior management personnel; our derivatives department has attracted a group of personnel with rich industry experience and specialized knowledge who are responsible for researching and developing new products; we are building our overseas business talent base by attracting senior bankers and analysts from the market.

BUSINESS

In order to improve the professional skills of our employees, we provide them with various training programs, including orientation for new employees, professional skill training, qualification training and professional specialty training.

To date, we have not experienced any labor strikes or other material labor disputes that affected our operations. We believe that our senior executives, labor union and employees will continue to maintain good relationships with each other.

PROPERTIES

Our headquarters is located at Tower C, 2-6F Corporate Square, 35 Finance Street, Xicheng District, Beijing, PRC. As at December 31, 2012, we owned 41 properties in the PRC with an aggregate gross floor area of 53,219.77 square meters, and leased 302 properties in the PRC and two properties in Hong Kong with an aggregate leased area of 370,966.31 square meters and 2,072.9 square meters, respectively.

Owned Properties

As at December 31, 2012, among our 41 owned properties in the PRC:

- We had obtained the relevant building ownership certificates and land use rights certificates in respect of 32 properties with a gross floor area of approximately 43,643.82 square meters, representing 82.0% of the aggregate gross floor area of our owned properties. We have been advised by our PRC legal advisors that we have the legal ownership of such properties and we have the rights to possess, utilize, generate income from and dispose of such properties;
- We have obtained the building ownership certificates but have not obtained the land use rights certificates in respect of six properties with a total gross floor area of approximately 6,874.34 square meters, representing 12.9% of the aggregate gross floor area of our owned properties. Among those properties:
 1. we have not been able to obtain the land use right certificates for two properties that we purchased from Galaxy Investment due to local administrative practices which prevent us from obtaining such certificate. We may be able to obtain such certificate for one property if the relevant local authorities issue specific guidance. It is difficult for us to obtain the certificate for the other property unless such local administrative practices change; and
 2. we have not been able to obtain the land use right certificates for four properties built by the developers beyond the authorized scope. The relevant developers either became bankrupt or were unable to help obtain the certificate.

We have been advised by our PRC legal advisors that we will be entitled to the complete and valid right to use the land which such properties occupy when we obtain the relevant land use right certificates, and the defective titles have no material adverse effect on our assets and operations because we have obtained the building ownership certificates for those properties.

- We have not obtained the building ownership certificates and land use rights certificates in respect of three properties with a total gross floor area of approximately 2,701.61 square meters, representing 5.1% of the aggregate gross floor area of the properties that we

BUSINESS

owned. The titles to two of the properties have not been transferred from Galaxy Investment to us for historical reasons. We are making commercially reasonable efforts to complete the registration procedures of the ownership change of these two properties. As advised by our PRC legal advisors, we will be entitled to the complete and valid ownership of such properties upon completion of the registration for the ownership change, and the fact that the titles to those two properties have not been transferred will not have any material adverse effects on our assets and operations because of the limited size of these properties as compared with the total size of our owned properties. For another property built by the developer beyond the authorized scope which has a gross floor area of 20 square meters, we have not been able to obtain the building ownership certificate or land use right certificate. However, we have been advised by our PRC legal advisors that it will not have any material adverse effect on our assets and operations because of the limited size of the property as compared with the total size of our owned properties.

Our Directors believe that the nine owned properties with defective titles mentioned above are not crucial to, and will not have a material impact on, our operations because (i) we have obtained the relevant valid building ownership certificates and land use rights certificates for the majority of our owned properties, representing 82.0% of the aggregate gross floor area of our owned properties; (ii) for six of the owned properties with defective titles, we have been advised by our PRC legal advisors that we can legally possess, utilize and/or lease such properties and, therefore, it would not have an impact on our business or financial condition; (iii) with respect to the remaining three owned properties with defective titles, we can substitute such properties with other comparable buildings, if necessary, without any material adverse effect on our operations; and (iv) the majority of our securities and futures brokerage branches are located on leased properties.

Our owned properties are primarily used for business operation and office, with gross floor areas ranging from approximately 63.32 square meters to 4,362.78 square meters.

Leased Properties

As at December 31, 2012, we leased 302 properties in the PRC and two properties in Hong Kong, with aggregate gross floor areas of 370,966.31 square meters and 2,072.9 square meters, respectively. Our leased properties are primarily used for business operation and office purposes, with gross floor areas ranging from approximately 36.31 square meters to 19,552.66 square meters.

The following table sets forth our total rental expenses and average monthly rental expenses for the periods indicated:

	<u>2010</u>	<u>2011</u>	<u>2012</u>
	(RMB in millions)		
Total rental expenses	277.2	335.9	371.9
Average monthly rental expenses	23.1	28.0	31.0

For our leased properties in the PRC, as at the December 31, 2012, our landlords did not provide certificates showing official ownership of or the right to lease 45 buildings with a total gross floor area of approximately 44,673.11 square meters, representing 12.0% of the aggregate gross floor area of our leased properties. Of these 45 buildings, (a) the landlords of 22 buildings, which accounted for 5.2% of the aggregate gross floor area of our leased properties, are in the process of applying for

BUSINESS

building ownership certificates, and (b) for the other 23 buildings, which accounted for 6.8% of the aggregate gross floor area of our leased properties, either (i) the landlords have provided explicit indemnity to us for any potential losses we may incur as a result of our lease of the relevant properties, or (ii) the relevant lease agreements expressly provide for indemnity obligations. However, we have been advised by our PRC legal advisors that we will have the right to seek indemnity from the landlords pursuant to the relevant confirmation letters issued by them or the relevant lease agreements and that the title defects of these leased properties will not have any material adverse impact on our operations because of the limited number and size of these leased properties as compared with the total number and size of our leased properties and the fact that these leased properties can easily be substituted by comparable premises.

As at December 31, 2012, our property interests (including land and buildings) represented approximately 0.24% of our total assets. Our Directors confirm that none of our property interests is individually material to us in terms of revenue contribution or rental expense. The highest carrying amount of our property interest was approximately RMB17.1 million as at December 31, 2012, which accounted for less than 0.03% of our total assets. Accordingly, this prospectus is exempt from the requirements under the Listing Rules and the Companies Ordinance to include a property valuation report. Pursuant to Rule 5.01A, a prospectus is exempt from the requirement if the carrying amounts of a listing applicant's property activities and non-property activities are below 1% and 15%, respectively. A similar exemption applies under section 6 of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice, with respect to the requirement under section 342(1)(b) of the Companies Ordinance and paragraph 34(2) of the Third Schedule to the Companies Ordinance.