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## INDUSTRY OVERVIEW

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### HISTORY OF THE HONG KONG SECURITIES MARKET

Records of securities trading in Hong Kong can be traced back to 1866, while the first formal stock market was established in 1891. The current Stock Exchange, which commenced operation in 1986, was formed from the unification of four stock exchanges in the same year. The stock market crash in 1987 signified the need for a reform of the securities industry in Hong Kong, and the SFC was subsequently set up in May 1989 as the single statutory securities market regulator to regulate the securities and futures markets in Hong Kong. The introduction of CCASS in 1992 and the automatic order matching and execution system (“AMS”) in 1993 brought further improvement to the securities market infrastructure. In November 1999, the Stock Exchange set up the GEM in order to provide platform of fund raising for companies with all sizes from all industries with growth potentials. On 6 March 2000, the Stock Exchange, the Futures Exchange and HKSCC were merged under a single holding company, HKEx. HKEx listed its shares by introduction on the Main Board on 27 June 2000.

Since the first PRC incorporated enterprise was listed in Hong Kong in July 1993, there were increasing number of PRC related enterprises listed on the Main Board and the GEM. On 26 November 2009, China Minsheng Banking Corporation Limited became listed on the Main Board, with gross proceeds of approximately HK\$31.23 billion raised, and was held the biggest public share sales in Hong Kong in 2009. Another mainland financial company, China Pacific Insurance (Group) Company Limited, listed on the Main Board on 23 December 2009, raised gross proceeds of approximately HK\$24.12 billion to rank second. As at 31 March 2010, there were 253 PRC related enterprises (comprising H-share and red chip companies) listed on the Main Board and the GEM. This number is expected to increase in future as more and more PRC related enterprises seek to raise foreign funds for their continued growth.

In addition, following the listings of the Germany-based manufacturer and supplier of coatings, Schramm Holding AG, and the Russia-based aluminum producer, United Company Rusal Limited on the Main Board in December 2009 and January 2010 respectively, it is expected in general that more overseas companies with business located overseas will seek to list in Hong Kong in the future.

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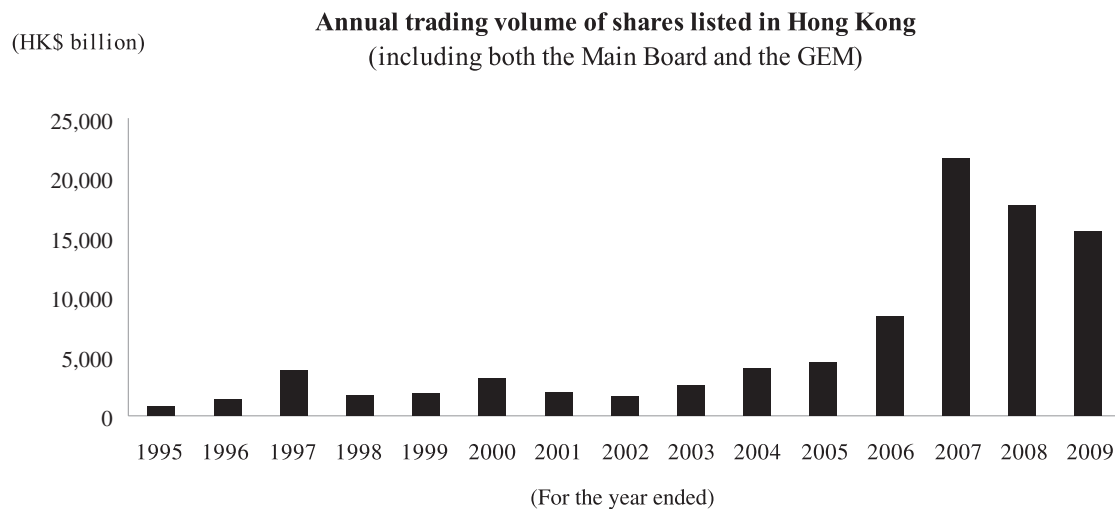
## INDUSTRY OVERVIEW

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In 2009, total capital raised from the Hong Kong securities market through IPOs amounted to HK\$243.9 billion, which represented an increase of 270% when compared with the HK\$66 billion raised in 2008. Average daily turnover of the Hong Kong securities market amounted to HK\$62.3 billion (including both the Main Board and the GEM) for the year ended 31 December 2009. As at 31 March 2010, a total number of 1,332 companies were listed on the Stock Exchange (including both the Main Board and the GEM).

### SECURITIES TRADING IN HONG KONG

The Main Board and the GEM are the two markets operated by the Stock Exchange for securities trading, with the Main Board as a platform for larger and more established companies with a trading record of at least three financial years, and the GEM as another platform of fund raising for companies with all sizes from all industries with growth potentials.



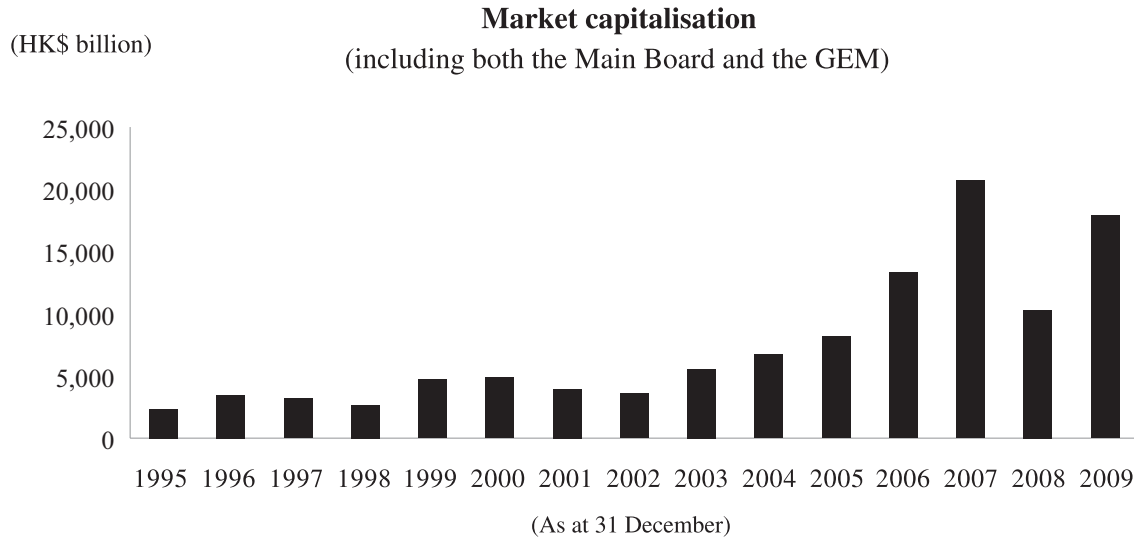
Source: HKEx

The annual trading volume of shares in terms of monetary amount contracted in 1998 following the 1998 Asian financial crisis, but gradually recovered in the following two years. After experiencing a downward trend between 2000 and 2002, the annual turnover of the Stock Exchange in monetary terms enjoyed a prolonged period of growth since 2003 and reached a high level in 2007. The breakout of the financial tsunami in 2008 dragged on the trading volume (in HK dollars) of the Stock Exchange of that year as well as the subsequent year.

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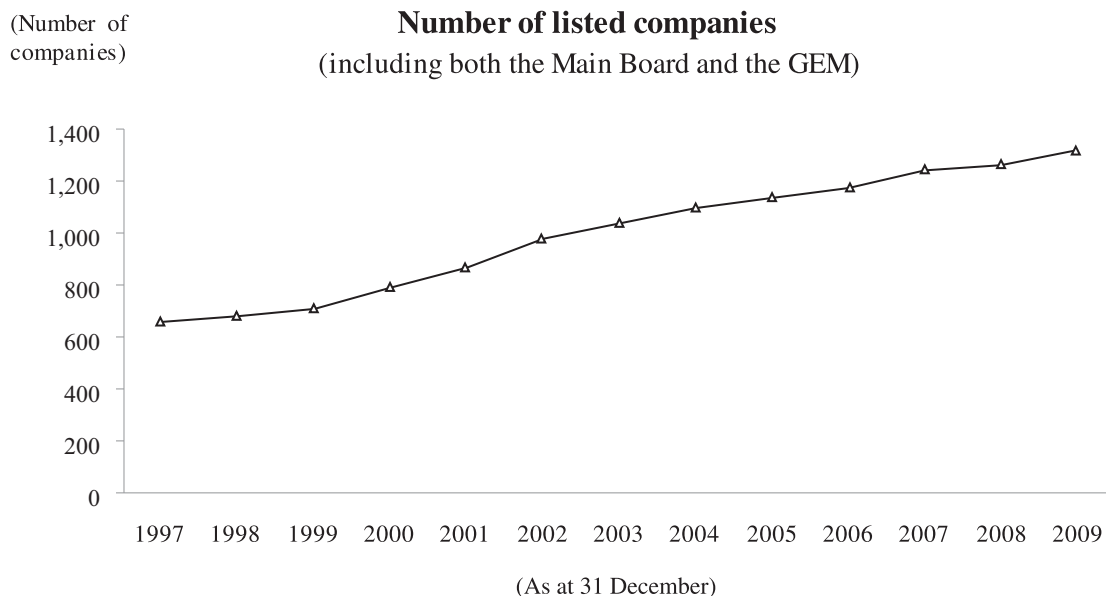
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Source: HKEx

As at 31 March 2010, there were 1,158 companies listed on the Main Board, 116 of which were H-share companies and 92 were red chip companies. The market capitalisation of the Main Board as at 31 March 2010 was approximately HK\$17,920.9 billion. As at 31 March 2010, 174 companies were listed on the GEM and among them 40 were H-share companies and 5 were red chip companies. The GEM's market capitalisation as at 31 March 2010 amounted to approximately HK\$134.7 billion.



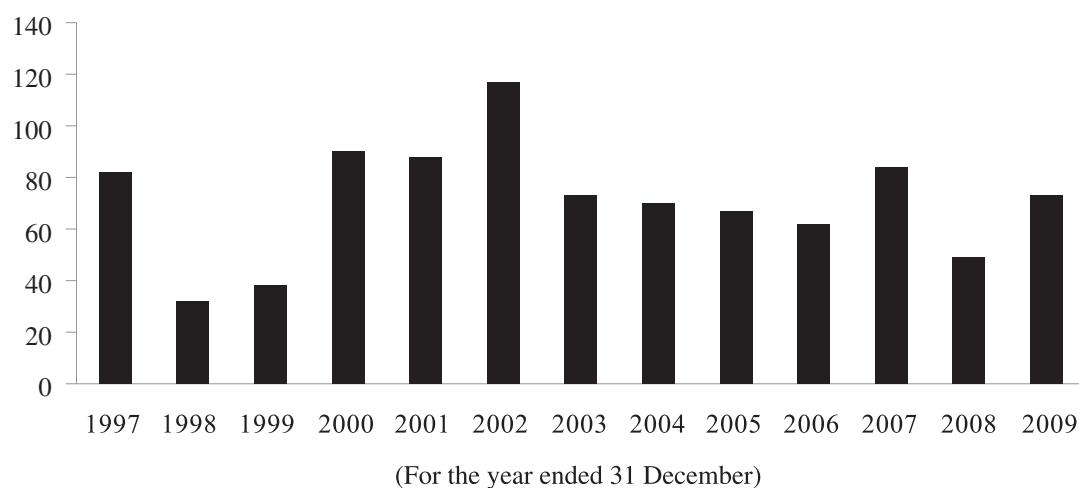
Source: HKEx

Between 1997 and 2009, the number of companies having shares listed on the Main Board has increased from 658 as at 31 December 1997 to 1,158 as at 31 March 2010, while the total market capitalisation on the Main Board has increased by more than quadruple to approximately HK\$17,920.9 billion as at 31 March 2010. Since the establishment of the GEM in 1999, the number of companies having shares listed has increased from 7 as at 31 December 1999 to 174 as at 31 March 2010.

## INDUSTRY OVERVIEW

(Number of companies)

**New Listing**  
(including both the Main Board and the GEM)



Source: HKEx

At the end of December 2009, the Stock Exchange was among the leading stock exchanges in the world and ranked the seventh largest territorial stock market in the world in terms of market capitalisation of the companies listed on both the Main Board and the GEM and the third largest stock market in Asia.

<u>Exchange</u>	<u>Market Capitalisation</u>		
	<u>As at</u> <u>31 December 2009</u> US\$ billion	<u>As at</u> <u>31 December 2008</u> US\$ billion	
1	NYSE Euronext (United States)	11,838	9,209
2	Tokyo Stock Exchange Group	3,306	3,116
3	NASDAQ OMX (United States)	3,239	2,249
4	NYSE Euronext (Europe)	2,869	2,102
5	London Stock Exchange	2,796	1,868
6	Shanghai Stock Exchange	2,705	1,425
7	The Stock Exchange	2,305	1,329
8	TMX Group	1,608	1,033
9	BM&FBOVESPA	1,337	592
10	Bombay Stock Exchange	1,306	647

Source: The World Federation of Exchanges

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### **Securities products on the Stock Exchange**

Securities listed on the Main Board include equity securities, warrants, debt securities, unit trusts and mutual funds. To meet its stakeholders' demands, the Stock Exchange has sought to expand its business through broadening its range of products and services. The first derivative warrant was admitted for listing in Hong Kong in February 1988. Regulated short selling and stock options were introduced in January 1994 and September 1995 respectively to enable more flexible portfolio investment by investors.

### **Stock Exchange Participants**

A Stock Exchange Participant, who is also a holder of Stock exchange Trading Right, is entitled to trade in securities through the trading facilities of the Stock Exchange. A Stock Exchange Participant must be a company limited by shares incorporated in Hong Kong and be a licensed corporation under the SFO to carry on Type 1 (dealing in securities) regulated activity under the SFO. A minimum capital requirement must be met in order to be registered as a Stock Exchange Participant. Generally speaking, Stock Exchange Participants must have a minimum paid-up share capital of HK\$5 million (with a minimum liquid capital of HK\$3 million). If the Stock Exchange Participants also provide securities margin financing, the minimum paid-up share capital will increase to HK\$10 million (with a minimum liquid capital of HK\$3 million). For Stock Exchange Participants carrying on Type 4 (advising on securities) regulated activities, the minimum paid-up share capital is HK\$5 million. In some circumstances, providers of financing services may also require licenses under the Money Lenders Ordinance (Chapter 163 of the Laws of Hong Kong). In addition, Stock Exchange Participants are required to comply with the financial resources requirements specified in the FRR made by the SFC under the SFO and where applicable, the financial resources requirements made under the rules of the Stock Exchange.

As at 31 March 2010, there were a total of 521 Stock Exchange Trading Right holders, of which 468 were Trading Participants, 31 were Non-trading Participants and 22 were non-Stock Exchange Participants.

In order to conduct options trading on the Stock Exchange, a Stock Exchange Participant must become admitted and registered by the Stock Exchange as an options exchange participant as either an Options Trading Exchange Participant or an Options Broker Exchange Participant.

### **Trading and settlement**

Trading on the Stock Exchange is conducted through terminals in the trading hall of the Stock Exchange or through the off-floor trading devices at Stock Exchange Participants' offices. The third generation of the AMS ("AMS/3") is a trading system developed by the Stock Exchange and was launched on 23 October 2000. The AMS/3 enables investors to place trading requests electronically such as the Internet and mobile phones using the network of operators who participate in AMS/3.

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The trading capacity of a Stock Exchange Participant, which is called the throttle rate, determines the rate at which orders can be sent through an open gateway to the AMS/3 by the Stock Exchange Participant. The standard throttle rate is one order per second. The scheme that enables Stock Exchange Participants to increase their throttle rates in integral multiples of one order per second by payment of additional fee was launched in December 2002, which helps brokers to operate more efficiently.

Trades matched in AMS/3 are automatically transmitted to CCASS. These trades are then novated by HKSCC, a wholly-owned subsidiary of HKEx, which acts as the central counterparty to both the buyers and sellers, and guarantees the final settlement of these trades. Clearing positions are created and settled on a continuous net settlement basis two days after the trade date (i.e. T+2). CCASS, a computerised book-entry clearing and settlement system, reduces scrip circulation in the market by the immobilisation of share certificates delivered by clearing participants in HKSCC's central securities depository. Settlement is electronically recorded as debits or credits to clearing participants' stock accounts, without the physical movement of share certificates. Settlement is electronically recorded as increases or decreases in participant's stock account balances, without the physical transfer of share certificates. Under CCASS, HKSCC becomes the central risk taker by substituting itself as the universal counter-party to Stock Exchange trades to be settled under continuous net settlement system ("CNS System"). This effectively guarantees settlement of Stock Exchange trades by broker participants.

Under HKSCC, there are seven categories of participants, namely Direct Clearing Participant, General Clearing Participant, Custodian Participant, Stock Ledger Participant, Stock Pledgee Participant, Clearing Agency Participant and Investor Participant.

### **HISTORY OF THE HONG KONG FUTURES MARKET**

In 1976, the Futures Exchange was established, and introduced its first financial futures product, the HSI futures, in May 1986. On 6 March 2000, the Stock Exchange, the Futures Exchange and HKSCC merged under a single holding company, HKEx.

For the year ended 31 December 2009, derivatives market contributed 11.0% of HKEx's income from external clients. Derivatives currently offered by the Futures Exchange include the following types, namely, (a) equity index derivatives such as HSI futures and options, and mini-HSI futures and options; (b) equity derivatives such as stock futures and options; (c) interest rate and fixed income derivatives such as one-month HIBOR futures, three-month HIBOR futures and three-year exchange fund note futures; and (d) gold futures. Among these, stock options are the most important derivatives at the Futures Exchange today. Over 86% of the option contracts traded in 2009 on the Stock Exchange were stock options.

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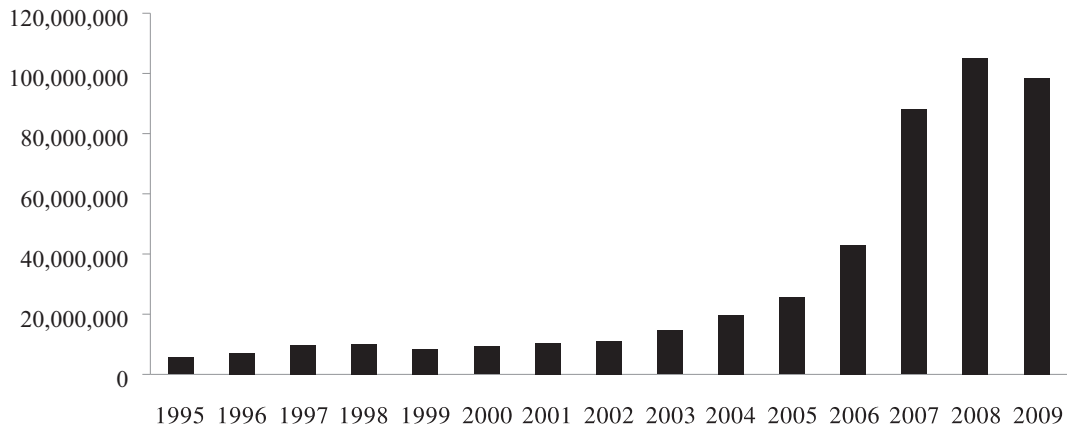
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The total annual number of futures and option contracts traded in Hong Kong has grown from approximately 5.6 million in 1995 to approximately 98.5 million in 2009.

(No. of contracts traded)

### Total futures and option contracts traded on the Futures Exchange between 1995-2009



(For the year ended 31 December)

Source: HKEx

## FUTURES TRADING IN HONG KONG

### Futures Exchange Participants

A Futures Exchange Participant, who is also a holder of Futures Exchange Trading Right, is entitled to trade in futures contracts and/or options contracts on its own account through the trading facilities of the Futures Exchange. A Futures Exchange Participant must be a company limited by shares incorporated in Hong Kong and be a licensed corporation under the SFO to carry on Type 2 (dealing in futures contracts) regulated activity under the SFO. Like Stock Exchange Participants, a minimum capital requirement must be met in order to be registered as a Futures Exchange Participant. In addition, Futures Exchange Participants are required to comply with the financial resources requirements specified in the FRR made by the SFC under the SFO and where applicable, the financial resources requirements made under the rules of the Stock Exchange. As at 31 March 2010, there were a total of 214 Futures Exchange Trading Right holders, of which 171 were trading Futures Exchange Participants and 43 were non-Futures Exchange Participants.

### Trading and settlement

Trading on the Futures Exchange is conducted through an electronic trading system, namely the HKATS. Following the migration of HSI futures and options trading to the new electronic platform HKATS in June 2000, the derivatives market became fully electronic. Since then, HKATS has been the trading platform of all Futures Exchange's products and stock options. With HKATS, users can view real-time price information on a computer screen, click on a bid or ask price and execute an order.

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Trading of derivatives products executed on the HKATS are settled through the Derivatives Clearing and Settlement System (“DCASS”), an electronic and automated clearing and settlement system capable of supporting different types of derivatives products.

### INDICES

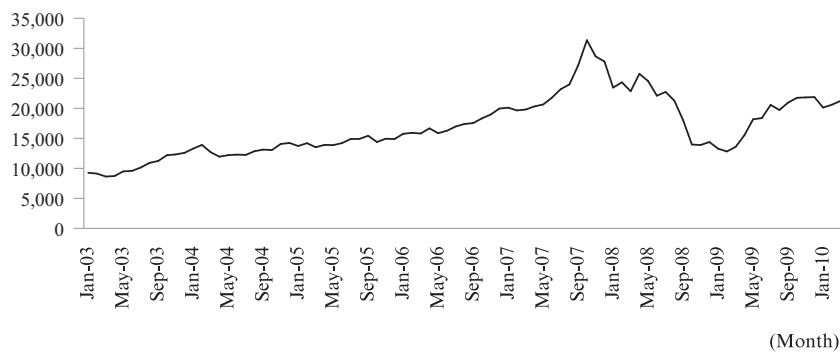
Major indices are set out below.

#### The HSI

A number of indices have been launched to track the performance of different industry groupings of companies whose securities are listed on the Stock Exchange. Of these the most frequently cited is the HSI. The HSI is compiled and managed by Hang Seng Indexes Company Limited (formerly known as HSI Services Limited), which is a wholly-owned subsidiary of Hang Seng Bank. Since its inception in November 1969, HSI has become the most widely quoted indicator of the performance of the Hong Kong stock market, both locally and internationally. Also known as the Hong Kong Blue Chip Index, the HSI measures the performance of largest and most liquid companies listed in Hong Kong. It adopts freefloat-adjusted market capitalisation weighted methodology with a 15% cap on each constituent weighting.

As at 31 March 2010, HSI comprised 43 constituent stocks and such stocks covered approximately 58.9% of the market capitalisation of all eligible stocks listed on the Main Board. Only companies with a primary listing on the Main Board are eligible for selection to become constituents of the HSI. The list of the stock composition is reviewed on a quarterly basis by Hang Seng Indexes Company Limited (formerly known as HSI Services Limited). In 1985, four sub-indices of the HSI were introduced to better reflect the price movements of the major sectors of the market. These four indices were divided into finance, utilities, properties and commerce and industry. The HSI index was set at 100 with the base day at 31 July 1964. As at 31 March 2010, the HSI was valued at approximately 21,239.4 points.

**HSI (January 2003 to March 2010)**



Source: Bloomberg



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### Hang Seng Composite Index

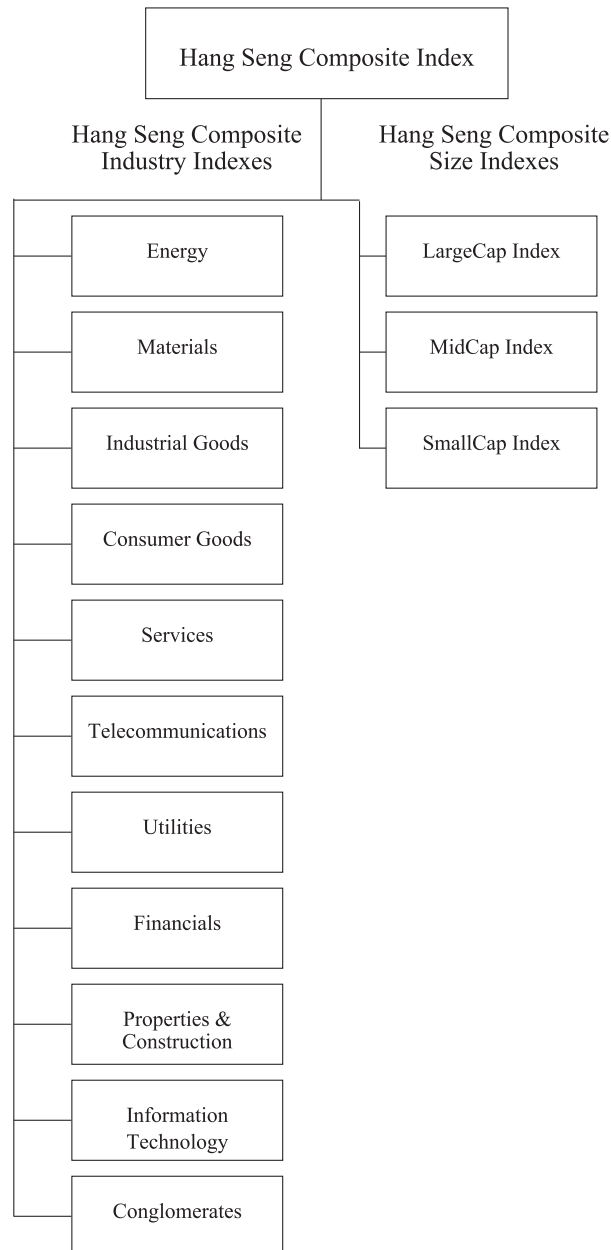
Launched on 3 October 2001, the Hang Seng Composite Index Series comprises the top 200 listed companies on the Hong Kong stock market and aims to provide a comprehensive benchmark of the performance of stocks listed on the Stock Exchange. This series covers approximately 95% of the total market capitalisation of the stocks listed on the Main Board. Eleven sub-indices according to different industries have been created which include:

- Energy
- Materials
- Industrial Goods
- Consumer Goods
- Services
- Telecommunications
- Utilities
- Financials
- Properties & Construction
- Information Technology
- Conglomerates

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Source: Hang Seng Indexes Company Limited

Only companies with a primary listing on the Main Board are regarded as eligible constituents of the Hang Seng Composite Index. The list of the constituents is reviewed on a half-yearly basis. The index was set at 2,000 with the base day at 3 January 2000. As at 31 March 2010, the Hang Seng Composite Index was approximately 3,013.7.

### Standard & Poor's Indices

In March 2003, Standard & Poor's and HKEx together created the S&P/HKEx LargeCap Index and the S&P/HKEx GEM Index to reflect the real-time performance of the Main Board and the GEM respectively. The S&P/HKEx Indices are maintained by an index committee which consists of five

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members, three representatives from Standard & Poor's and two from HKEx. Index additions are selected from a pool of eligible securities continuously monitored by the committee. When adding new constituents, the committee strives to include companies with proven track records.

The S&P/HKEx LargeCap Index is a float-adjusted index, covering approximately 75% of the Main Board by market capitalisation and comprising of 25 constituents. The index is market-capitalisation weighted, with each company's weight reflective of shares publicly available for trading, and is balanced across 10 Global Industry Classification Standard sectors. S&P/HKEx LargeCap Index constituents are selected for inclusion using Standard & Poor's guidelines for evaluating company capitalisation, liquidity and fundamentals. The S&P/HKEx LargeCap Index will serve as the base for relative derivative products such as exchange traded funds, and index options and futures. To prevent the index being dominated by only a few companies, stocks with a relative weight in excess of 15% will be capped on a quarterly basis. The index is based at 23 February 2003 with a base value of 10,000. As at 31 March 2010, the S&P/HKEx LargeCap Index was approximately 24,850.4.

The S&P/HKEx GEM Index is float-adjusted for market capitalisation, to reflect share available for trading to the public, and does not have a fixed number of index constituents. At its inception on 3 March 2003, the index included 46 companies. A quarterly rebalancing process will be used to remove companies that comprise less than 0.25% of the weight of the index, and add companies whose weight, once included, are greater than 0.5% of the index. Companies must also meet minimum liquidity requirements to be eligible for inclusion. Companies removed during each quarter through regular corporate actions, will not be replaced at the time of the deletion. The index is based at 28 February 2003 with a base value of 1,000. As at 31 March 2010, the S&P/HKEx GEM Index was approximately 832.3.

### **THE ONLINE BROKERAGE INDUSTRY IN HONG KONG**

According to the "Cash Market Transaction Survey 2008/09" conducted by the HKEx for Hong Kong cash market, the share of retail online trading value has risen from around 1.9% of total retail investor trading during the period from October 1999 to September 2000 to around 21.5% of total retail investor trading during the period from October 2008 to September 2009. According to the same survey, the number of brokers that offer online trading service to retail investors increased from 97 (or 25.7% of all surveyed brokers in the 2004/05 survey) to 173 (or approximately 42.2% of all surveyed brokers in the 2008/09 survey). Retail investors in this survey represented investors who trade on their personal accounts.

As indicated in the "Guidance Note on Internet Regulation" released by the SFC in March 1999, in general, the SFC will not seek to regulate securities dealing conducted over the Internet that originate outside Hong Kong, provided that such activities are not detrimental to the interests of the investing public in Hong Kong. Since then, there were no additional registration and licensing requirements for a company to conduct securities and commodities dealing through the Internet. The SFC would expect registered persons to put in place additional operational measures if they intend to conduct securities dealing, commodity and futures trading and leveraged foreign exchange trading activities over the Internet. These measures cover aspects of suitability and general conduct, order handling and execution, system integrity, responsible personnel, written procedures, client agreements, record keeping and reporting.

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### FUTURES MARKET IN U.S. AND SINGAPORE

#### The futures market in the U.S.

The U.S. is considered a major futures market in the world, with an annual turnover of approximately 3,229 million and 3,372 million futures and futures options contracts in 2007 and 2008 respectively. Major futures exchanges in the US include the Chicago Board of Trade, Chicago Mercantile Exchange, New York Mercantile Exchange and ICE Futures U.S.

#### Chicago Board of Trade (“CBOT”)

On 3 April 1848, the Chicago Board of Trade was officially founded and the earliest corn forward contract was recorded in 1851. The modern form of futures contract that requires performance bonds, i.e. margin, was not formalised until 1865. In 1977, CBOT launched the US Treasury Bond futures contract.

In 1998, the board of directors of CBOT established side-by-side trading of financial contracts. On 26 April 2006, CBOT announced that it would increase global access to its benchmark agricultural products by offering trading of CBOT full-sized, physically delivered agricultural futures contracts on its electronic trading platform during daytime trading hours. Trading began on 1 August 2006.

On 12 July 2007, the CBOT merged with the CME to form CME Group Inc..

The trading volume of CBOT, in terms of the number of contracts traded, amounted to approximately 961 million and 681 million for 2008 and 2009 respectively.

#### Chicago Mercantile Exchange (“CME”)

Founded in 1898, the Chicago Mercantile Exchange was called the Chicago Butter and Egg Board until 1919. In November 2000, CME became the first US financial exchange to demutualise and become a shareholder-owned corporation. Its products include futures on interest rates, currency, stock indices and agricultural products, Euro dollars and mini S&P futures.

The exchange went public in December 2002, and merged with CBOT in July 2007 to become CME Group Inc. On 17 March 2008, it announced its acquisition of NYMEX Holdings Inc., the parent company of NYMEX (as defined below), which was formally completed on 22 August 2008.

The trading volume of CME, in terms of the number of contracts traded, amounted to approximately 1,893 million and 1,476 million for 2008 and 2009 respectively.

#### New York Mercantile Exchange (“NYMEX”)

The New York Mercantile Exchange was founded in 1872. NYMEX merged with New York Commodities Exchange (“COMEX”) in 1994 and converted into a for-profit organisation in 2000. Trading is conducted through two divisions: the NYMEX Division, which is the home of energy, platinum and palladium markets, and the COMEX Division, where metals like gold, silver and copper are traded. The parent company of NYMEX, NYMEX Holdings Inc. became listed on the New York Stock Exchange on 17 November 2006.

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The trading volume of NYMEX and COMEX, in terms of the number of contracts traded, amounted to approximately 433 million for 2009.

### **ICE Futures U.S. (“ICEF”)**

The New York Board of Trade, renamed ICE Futures U.S. in 2007, was formed from the merger of the New York Cotton Exchange (“NYCE”) and the Coffee, Sugar and Cocoa Exchange in 2004. Its history began with the founding of the NYCE in 1870. ICEF is one of the largest derivatives exchange in the United States, offering futures and options on agricultural commodities, foreign exchange and equity indexes.

The trading volume of ICEF, in terms of the number of contracts traded, amounted to approximately 81 million and 93 million for 2008 and 2009 respectively.

### **The futures market in Singapore**

The Singapore International Monetary Exchange (“SIMEX”), established in 1984, was Asia’s first financial futures market. Developed out of the former Gold Exchange of Singapore, SIMEX provided commodity futures contracts in gold and energy products as well as other futures and options products. Following the merger between SIMEX and the Stock Exchange of Singapore (“SES”), Singapore Exchange Limited (“SGX”) was inaugurated on 1 December 1999. On 23 November 2000, SGX became listed via a public offer and a private placement. Listed on its own bourse, the SGX stock is a component of benchmark indices such as the MSCI Singapore Free Index and the Straits Times Index.

Derivatives traded on SGX include the followings:

- Equity Index Futures and Options on Futures
- Short-Term Interest Rate Futures and Options on Futures
- Long-Term Interest Rate Futures and Options on Futures
- Extended Settlement (ES) Contracts
- Commodity Futures
- Structured Warrants
- Certificates
- OTC clearing of energy, freight and bulk commodity derivatives

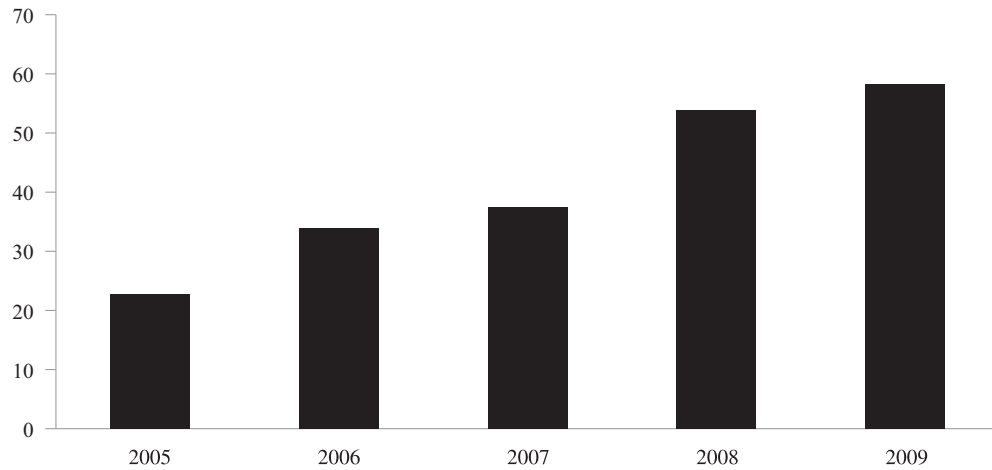
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### Futures & Options Volume Traded in SGX

(million contracts traded)

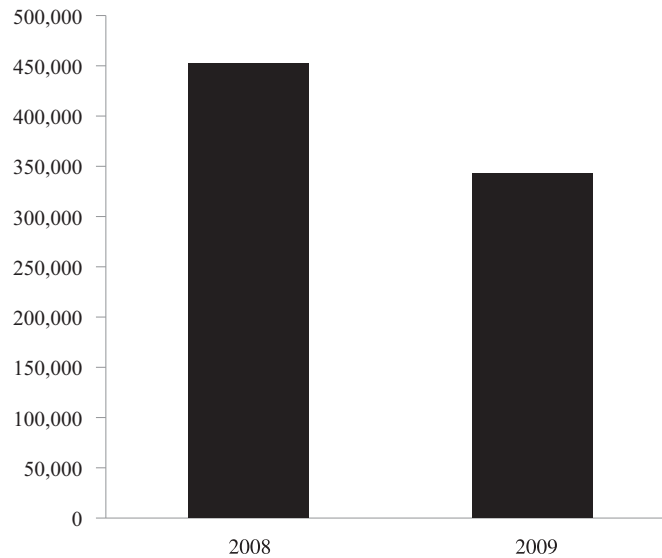


(For the year ended 30 June)

Source: 2009 Annual Report of SGX

### Volume traded in SICOM

(No of contracts)



(For the year ended 30 June)

Source: 2009 Annual Report of SGX