
INDUSTRY OVERVIEW

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OVERVIEW OF THE PRC ECONOMY

The PRC economy has grown significantly over the past three decades and will continue to grow rapidly and steadily in the foreseeable future

The PRC economy has grown rapidly since 1978 when the PRC began its economic reform. From 2001 to 2010, the average annual growth rate of real GDP in the PRC reached 10.5%, compared to the average growth rate of 3.6% for the world during the same period. The nominal GDP of the PRC in 2010 amounted to RMB39.8 trillion, and the PRC economy has become the world's second largest economy since the fourth quarter of 2010. The following table sets out the real GDP growth rates of the PRC and the world for the periods indicated:

Real GDP												
growth rate	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012E
PRC	8.3%	9.1%	10.0%	10.1%	11.3%	12.7%	14.2%	9.6%	9.2%	10.4%	9.5%	9.0%
World Average. . . .	2.3%	2.9%	3.6%	4.9%	4.6%	5.3%	5.4%	2.8%	-0.7%	5.1%	4.0%	4.0%

Sources: International Monetary Fund and NBSC. The 2011 and 2012 estimates were announced by the International Monetary Fund in September 2011

We believe the PRC economy will continue to experience rapid and steady growth in the foreseeable future and that such growth will be driven by the following four major factors:

The less developed central, western and northeastern regions of the PRC have significant potential for future growth

Certain regions in central, western and northeastern PRC have experienced faster economic development than the southeastern coastal regions in recent years due to rapid industrialization in those regions. According to the NBSC, from 2006 to 2010, the GDP of the central, western and northeastern regions of the PRC grew at a CAGR of 18.3%, while the GDP

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of the southeastern coastal regions grew at a CAGR of 15.7% during the same period. The uneven development of different regions in the PRC and the government's continued focus on the development of the central, western and northeastern regions will drive strong economic growth in these regions in the foreseeable future. We believe growth in these regions will contribute to the rapid growth of the PRC economy in the long-term.

Industrial structure transformation stimulates further economic growth

The PRC economy has maintained its rapid growth in recent years while undergoing a structural transformation of its economy. According to the Twelfth Five-Year Plan, improving the structure of economic sectors will be the primary focus of the economic development of the PRC in these five years. The government will focus on transforming lower-value and labor-intensive industries to higher value-added and technology-focused industries. Another goal set out in the Twelfth Five-Year Plan is to transform the PRC economy from being export-oriented to being consumption-driven and service-oriented. Among the measures outlined in the Twelfth Five-Year Plan, the expansion of the financial services industry and the orderly introduction of new businesses are the key drivers for future economic development and industrial transformation in the PRC. We believe transforming the structure of the industrial sector will drive economic growth in the PRC in the foreseeable future and provide new business opportunities for the various industries that undergo transformation and transitions pursuant to the Twelfth Five-Year Plan.

The growth of SMEs drives steady and rapid economic development

SMEs have also experienced a period of rapid development in recent years. On January 1, 2003, Law of the People's Republic of China on the Promotion of Small and Medium-sized Enterprises (中華人民共和國中小企業促進法) was promulgated, providing government legislative support and creating a favorable policy environment for the development of SMEs. According to the PRC Ministry of Industry and Information Technology, there were over ten million SMEs as of December 31, 2010. SMEs accounted for approximately 60% of the country's GDP, 65% of the total number of patents and over 80% of the total number of product innovations. In recent years, the increase in the number and scale of SMEs has significantly contributed to the growth of the PRC economy. This has led to SMEs playing a more balanced role relative to large enterprises in the economic development of the PRC.

Further urbanization drives the continuous growth of the PRC economy

Since the economic reform of the PRC in 1978, the PRC government has promoted urbanization, which created strong momentum for economic development. According to the China Population and Development Research Center, the urbanization rate in the PRC increased by 29.6% from 1978 to 2010. The pace of urbanization further accelerated in the last decade, with the urbanization rate increasing by 11.3% (or an average increase of 1.1% per year). As a result, the PRC urban population increased from 460 million to 630 million (an average increase of 17 million per year) during the same period.

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Despite the large-scale, rapid urbanization over the past 30 years, the overall urbanization rate in the PRC is lower than that of several developed countries. The following table sets forth the urbanization rates of the PRC, Japan, the U.K. and the U.S. in 2010:

	PRC	Japan	U.K.	U.S.
2010 Urbanization Rate ⁽¹⁾	47.0%	67.0%	80.0%	82.0%

(1) Urbanization rate represents the ratio of urban population to total population.

Source: CIA – The World Factbook

As outlined in the Twelfth Five-Year Plan, the urbanization rate of the PRC is set to exceed 50% by 2015. Based on the estimated urbanization rate for the PRC and its population of approximately 1.3 billion, we believe the urban population in the PRC is expected to grow by approximately ten million per year until 2015.

OVERVIEW OF THE PRC CAPITAL MARKET

The PRC capital market is among the largest and the fastest-growing in the world

The PRC capital market has grown substantially over the past 20 years, largely driven by the significant economic development of the PRC, rapid growth in corporate earnings and steady increase in financing demand and per capita income.

The total market capitalization of companies listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached US\$3.8 trillion as of October 31, 2011, and their total trading volume was US\$5.6 trillion during the first ten months of 2011. The total market capitalization and total trading volume of listed companies in the PRC ranked second in the world behind the U.S. The following table sets forth the total market capitalization as of October 31, 2011, and the total trading volume of listed companies in the U.S., the PRC, Japan and the U.K. during the first ten months of 2011:

	U.S.	PRC	Japan	U.K.
		(US\$ in trillions)		
Total market capitalization	15.8	3.8	3.6	3.4
Total trading volume	26.5	5.6	3.6	2.5

Source: WFE

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Over the past several years, the PRC stock market has experienced significant growth in terms of market capitalization and trading volume. According to WFE, the respective rankings of the Shanghai Stock Exchange and the Shenzhen Stock Exchange have improved rapidly among the world's major stock exchanges, as measured by total market capitalization and trading volume. The following table sets forth the respective global rankings of the Shanghai Stock Exchange and the Shenzhen Stock Exchange as of December 31, 2005 and 2010:

	2005	2010	2005-2010 CAGR	2005 Global Ranking ⁽¹⁾	2010 Global Ranking ⁽¹⁾
	(RMB in billions)				
Market capitalization					
Shanghai Stock Exchange	2,309.6	17,900.7	50.6%	21	6
Shenzhen Stock Exchange	933.4	8,641.5	56.1%	32	14
Total.	3,243.0	26,542.2	52.3%		
Trading volume					
Shanghai Stock Exchange	1,951.6	30,326.5	73.1%	18	3
Shenzhen Stock Exchange	1,262.1	24,089.5	80.4%	25	5
Total.	3,213.7	54,416.0	76.1%		

(1) The global ranking encompasses all stock exchanges in the world.

Source: WFE

In 2010, total proceeds raised from IPOs on the Shanghai Stock Exchange and the Shenzhen Stock Exchange reached US\$73.5 billion, representing 18.1% of total IPO proceeds (US\$403.3 billion) raised in global capital markets in the same year and making the PRC the largest IPO market in the world. The following table sets forth the respective rankings of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in terms of total proceeds raised from equity offerings in 2005 and 2010:

	Total proceeds raised from equity offerings				
	2005	2010	2005-2010 CAGR	2005 Global Ranking ⁽¹⁾	2010 Global Ranking ⁽¹⁾
	(RMB in billions)				
The Shanghai Stock Exchange	30.0	564.6	79.9%	24	5
The Shenzhen Stock Exchange	3.0	407.5	167.1%	43	7
Total	33.0	972.1	96.6%		

(1) The global ranking encompasses all stock exchanges in the world.

Source: WFE

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There has been an increased in the number of PRC companies that are listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange. The following table sets forth the number of listed companies in the PRC from 2006 to 2010, which increased from 1,434 in 2006 to 2,063 in 2010, representing a CAGR of 9.5%:

	2006	2007	2008	2009	2010	2006-2010 CAGR
Number of listed companies in the PRC	1,434	1,550	1,625	1,718	2,063	9.5%

Sources: CSRC, Shanghai Stock Exchange, Shenzhen Stock Exchange

In addition to the PRC stock market, the PRC bonds, funds and futures markets have also developed rapidly. According to Wind Info, between 2006 and 2010, the total amount of funds raised through bond offerings (excluding treasury bonds, municipal bonds and central bank instruments) in the PRC increased from RMB1.4 trillion to RMB3.1 trillion, representing a CAGR of 22.7%. The net asset value of PRC mutual funds increased from RMB856.5 billion in 2006 to RMB2,497.3 billion in 2010, representing a CAGR of 30.7%. Furthermore, the PRC futures market is one of the largest in the world in terms of total trading volume, which, according to the CSRC, increased from RMB21 trillion in 2006 to RMB309 trillion in 2010, representing a CAGR of 95.9%.

Despite the rise in its global ranking, the PRC capital market is still in its early stage of development and has enormous growth potential

Despite the rapid growth over the past two decades and the rise in its global ranking, the following aspects of the capital market in the PRC are still in an early stage of development compared with other mature capital markets in the following aspects:

The ratio of stock market capitalization relative to nominal GDP is relatively low

The ratio of the total market capitalization of the PRC stock market to its nominal GDP is much lower than the ratios of major developed countries. As of December 31, 2010, the total market capitalization of the PRC stock market accounted for 66.7% of the nation's nominal GDP, which was lower than that of major developed countries, including the U.S. This suggests that the PRC stock market has further growth potential. The following table sets forth the stock market capitalization of the U.S., Japan, the U.K. and the PRC relative to their nominal GDP as of December 31, 2010:

	U.S.	Japan	U.K.	PRC
Ratio of stock market capitalization relative to nominal GDP (%)	119.0%	69.4%	158.6%	66.7%

Sources: WFE, International Monetary Fund, CSRC, NBSC

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The development of the corporate finance market is unbalanced

Currently, indirect financing such as bank lending remains a major source of external financing for PRC companies. According to the CSRC and the PBOC, bank lending amounted to approximately 67.5% of the total external financing of PRC companies by way of equity offerings, bond offerings and bank lending during 2010. Direct financing, such as the issuance of equity and debt securities, is not as prevalent in the PRC as in certain developed countries such as the U.S. The following table sets forth the total value of equity offerings, bond offerings and bank lending in the PRC and the U.S. in 2010:

	Equity offerings	Bond offerings ⁽¹⁾	Bank lending ⁽²⁾
	(US\$ in billions)		
PRC	136	475	1,269
U.S.	201	1,788	100

(1) In the above table, bond offerings refer to those related to corporate financing, which include corporate bonds, enterprise bonds, financial bonds, short-term commercial papers, medium-term notes, asset-backed securities, convertible bonds and bonds with warrants but exclude treasury bonds, municipal bonds and central bank instruments. The exchange rate of U.S. dollar and RMB used in the above table are the exchange rates as of December 31, 2010.

(2) Difference in commercial bank lending outstandings between 2009 and 2010.

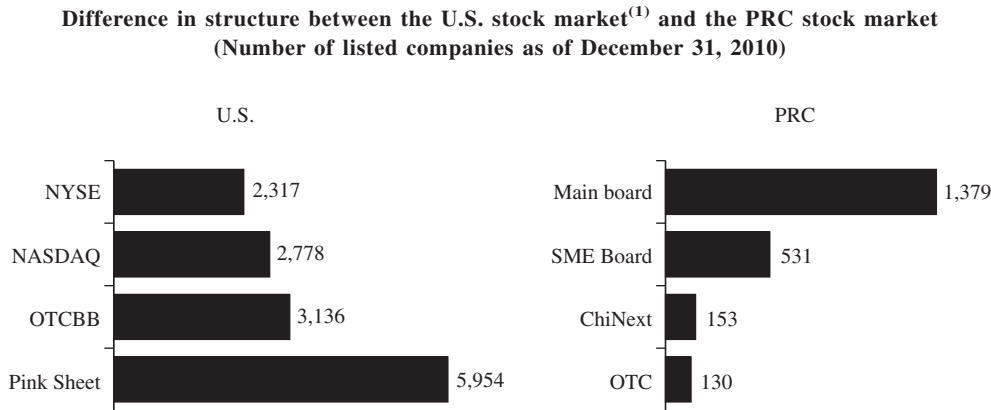
Sources: CSRC, PBOC, Bloomberg, China Banking Regulatory Commission, U.S. Federal Reserve Board

The PRC multi-tiered capital market is still developing

The PRC stock market has quickly developed over the past 20 years. In 2010, the PRC stock market became the world's second largest stock market in terms of total market capitalization. However, there are significant structural differences between the PRC stock market and the stock markets of developed countries such as the U.S. For example, the U.S. stock market, comprised of the New York Stock Exchange and NASDAQ, is more mature and diversified in terms of market capitalization, which are supplemented by other stock exchanges and OTC markets, such as OTCBB and Pink Sheets. The number of companies that trade their shares on the OTCBB and Pink Sheets is greater than the number of companies that are listed on the NYSE and Nasdaq. Conversely, the number of listed companies on the main boards of the Shanghai Stock Exchange and the Shenzhen Stock Exchange still accounts for the majority of the PRC stock markets. In comparison to the stock markets in the U.S., the SME

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Board, ChiNext Board and OTC market in the PRC are still developing. The following table sets forth the structure of the stock markets of the U.S. and the PRC:



(1) The data of OTCBB is the average number for 2010.

Sources: Shanghai Stock Exchange, Shenzhen Stock Exchange, CSRC, Wind Info, WFE, OTC Bulletin Board, OTC Markets

We believe that as the PRC stock market continues to develop, the size of the SME Board and the ChiNext Board will continue to expand. Given the expected expansion of the OTC market, particularly the New OTC Board, the structure of the PRC stock market will become increasingly more mature across multiple capital raising platforms.

The establishment of the SME Board and the ChiNext Board in 2005 and 2009, respectively, has transformed the PRC stock market into a multi-tiered market, increasing the market's ability to accommodate the various financing needs of companies and diverse risk profiles of investors. As shown in the table below, there has been significant growth in 2010 in terms of the number of listed companies on the SME Board and the ChiNext Board, total market capitalization, total proceeds raised in equity offerings and total trading value.

	2009	2010	2010 vs. 2009
Number of listed companies			
SME Board	327	531	62.4%
ChiNext Board.	36	153	325.0%
Market capitalization (RMB in billions)			
SME Board	1,687	3,536	109.6%
ChiNext Board.	161	737	357.4%
Funds raised in equity offerings (RMB in billions)			
SME Board	58	235	307.2%
ChiNext Board.	20	96	372.0%
Value of share trading (RMB in billions)			
SME Board	4,827	8,583	77.8%
ChiNext Board.	183	1,572	759.8%

Source: Shenzhen Stock Exchange

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In addition, the PRC has announced plans to introduce the International Board and the New OTC Board. Recognizing the potential investment power of PRC investors, a number of overseas companies have expressed interest in participating in the fast-growing PRC capital market. Consequently, the CSRC and the Shanghai Stock Exchange have commenced plans to introduce an International Board that will target listings of large global enterprises on the Shanghai Stock Exchange. In addition, the PRC government also intends to establish and expand a New OTC Board, which will create a highly regulated OTC market in the PRC and offer a trading platform for the pre-IPO financing of selected SMEs. The OTC market will focus on SMEs that have been established in science and technology parks in various regions of the PRC, particularly those engaged in high-growth businesses involving new and advanced technologies. Furthermore, the New OTC Board will offer a trading platform for companies that have been delisted from the main board, the SME Board and the ChiNext Board.

The availability of financial products and services in the PRC capital market is limited

With the growth of the PRC economy, the investment needs of increasingly sophisticated investors and the financing demands of companies in various sectors evolved towards more sophisticated financial products and services. However, currently, there are limited types of financial products and services in the PRC capital market. A number of prevalent financial services and products in the capital markets of the U.S. and other developed countries, such as margin and securities refinancing, market maker services for shares or share-linked products and certain other derivatives and structured products, are either restricted or not popular among retail and professional institutional investors in the PRC.

In addition, there are substantial differences between the product mix of the stock exchanges in the PRC and the U.S. The PRC equity spot market is still dominated by stocks. ETFs comprise only 0.9% of the PRC equity spot market compared with 20.5% in the U.S. With respect to the derivatives market, most of the derivatives in the PRC capital market are limited to commodity derivatives. Products such as equity derivatives and fixed-income derivatives are less developed than those in certain mature markets. The range of financial products has limited the investment options, strategies and investment portfolios of PRC investors. The following tables set forth the composition of the equity spot market in terms of turnover (as of June 30, 2011) and the derivatives market in terms of the number of transactions (as of December 31, 2010) in the PRC and the U.S.:

Equity spot market (in terms of turnover)

	PRC		U.S.	
	(US\$ in billions)	(%)	(US\$ in billions)	(%)
Stocks	3,770.1	98.6	14,738.5	79.1
Funds	18.1	0.5	70.8	0.4
ETFs.	33.3	0.9	3,807.7	20.5
Total.	3,821.5	100.0	18,616.9	100.0

Source: WFE

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Derivatives market (in terms of the number of transactions)

	PRC		U.S.	
	(Number of transactions in billions)	(%)	(Number of transactions in billions)	(%)
Equity derivatives	0.1	2.9%	2.2	46.9%
Fixed-income derivatives	–	–	1.6	34.1%
Commodity derivatives	3.0	97.1%	0.9	19.0%
Total	3.1	100.0%	4.7	100.0%

Sources: WFE, CSRC

In recent years, the PRC regulatory authorities have relaxed restrictions and introduced, on a trial basis, certain new businesses, such as stock index futures trading and margin financing and securities lending businesses. The Securities Finance Company has been established and the Trial Supervision and Management Measures on Margin and Securities Refinancing Business (轉融通業務監督管理試行辦法) was promulgated by the CSRC in October 2011, pursuant to which a pilot program for margin and securities refinancing activities for selected securities firms is expected to be launched in the PRC. We believe this initiative will further support the development of margin financing and securities lending business activities. We expect this trend will continue, and the introduction of additional new businesses in the near future will stimulate further growth of the PRC capital market.

A majority of investors in the PRC stock market are individuals

According to the Shanghai Stock Exchange, the average percentage of trading volume attributed to natural person investors was 84.9% from 2007 to 2009. The following table sets forth the trading volume of the Shanghai Stock Exchange by investor type between 2007 and 2009:

	2007	2008	2009	Average
Natural person investors	86.0%	83.2%	85.4%	84.9%
General legal persons ⁽¹⁾	3.6%	4.0%	3.8%	3.8%
Professional institutions	10.4%	12.8%	10.8%	11.3%
– Investment funds	8.3%	9.9%	8.0%	8.7%

(1) General legal persons refer to legal persons other than professional institutions.

Sources: Shanghai Stock Exchange

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In terms of the number of investors, according to the CSDCC, as of December 31, 2010, there were 152.0 million A share accounts in the PRC, of which approximately 151.5 million were held by individuals, representing 99.62% of all accounts. The following table sets forth the total number of A share accounts held by individuals in the PRC at the end of the periods indicated:

As of year end	2006	2007	2008	2009	2010	2006-2010 CAGR
	(in millions, except percentages)					
A share accounts	72.8	110.1	120.8	137.3	151.5	20.1%

Source: CSDCC

We believe the PRC stock market has significant opportunities for optimization and growth in the future. In addition, the robust economic growth and the substantial increase in assets available for investment continue to drive the growth of the PRC capital market.

Personal wealth accumulated rapidly and assets available for investment increased

Per capita disposable income has been increasing rapidly in the PRC and has further growth potential

The rapid economic development in the PRC has accelerated the accumulation of personal wealth of its residents. According to the NBSC, the per capita disposable income of urban residents in the PRC nearly doubled during the period between 2006 and 2010 with a CAGR of 18.5%, which is significantly higher than the growth rate in Japan and the U.S. during the same period. However, the PRC per capita disposable income of US\$1,810 in 2010 is still much lower than US\$36,697 in the U.S. The following table sets forth per capita disposable income growth rate in the PRC, Japan and the U.S. for the period between 2006 and 2010:

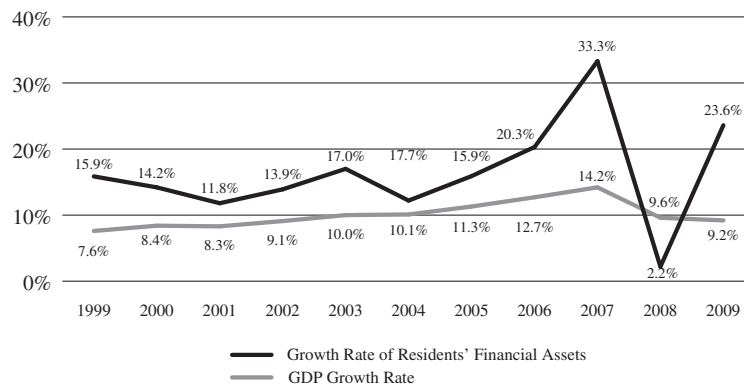
PRC	Japan	U.S.
18.5%	-0.7%	2.6%

Sources: NBSC, Japan Statistics Bureau, U.S. Census Bureau

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Financial assets held by PRC residents grew rapidly

Apart from the growth in personal disposable income levels, the total amount of financial assets held by PRC residents also grew at a fast pace. These assets are held mainly in the forms of cash, bank savings, securities, securities investment funds, personal guarantee deposits and insurance policies. The growth rate of the total amount of financial assets held by PRC residents exceeded the nation's GDP growth rate in nine of the ten years from 1999 to 2009. The following chart illustrates the growth rates of the financial assets held by PRC residents relative to the GDP of the PRC for the periods indicated:



Sources: International Monetary Fund and National Bureau of Statistics of China, Annual Report of Chinese Residents' Income Distribution of the National Development and Reform Commission of the PRC

As of December 31, 2004, and December 31, 2009, the total cash and bank savings of PRC residents increased from RMB1.8 trillion and RMB13.0 trillion to RMB3.2 trillion and RMB26.9 trillion, respectively, representing a CAGR of 12.4% and 15.7%, respectively. The amount of equity assets held by PRC residents grew at a fast pace from RMB0.8 trillion as of December 31, 2004 to RMB4.8 trillion as of December 31, 2009, representing a CAGR of

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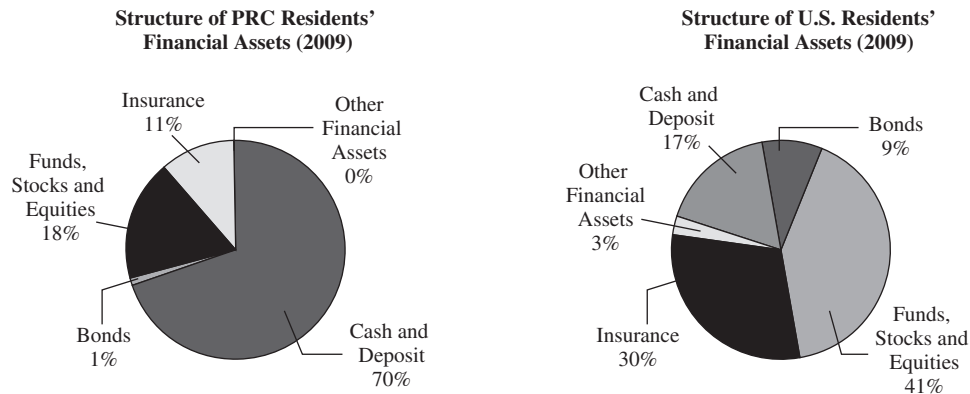
39.9%. The following table sets forth the breakdown of the types of financial assets held by PRC residents from 2004 to 2009:

	2004	2005	2006	2007	2008	2009	2004-2009 CAGR
(RMB in 100 millions, except percentages)							
Cash (local currencies)	17,820	19,945	22,469	25,210	28,622	31,982	12.4%
Bank deposits	129,575	150,551	171,737	181,876	228,478	268,650	15.7%
Listed securities	15,190	14,399	23,945	58,311	25,139	50,371	27.1%
Bonds	6,293	6,534	6,944	6,707	4,981	2,623	(16.1%)
Equity	8,897	7,865	17,001	71,604	20,157	47,748	39.9%
Securities investment funds	1,905	2,449	5,618	29,716	17,011	21,052	61.7%
Personal guarantee deposits	1,339	1,566	3,128	9,904	4,760	5,666	33.4%
Insurance policy benefits	14,113	18,315	22,680	27,000	37,831	46,226	26.8%
Settlement funds	(77)	23	17	-	-	-	-
Other financial assets (net)	504	1,835	2,005	97	1,030	(64)	-
Total financial assets	<u>180,369</u>	<u>209,083</u>	<u>251,600</u>	<u>332,114</u>	<u>342,870</u>	<u>423,883</u>	18.6%

Source: Annual Report of Chinese Residents' Income Distribution of the National Development and Reform Commission of the PRC

Participation by PRC residents in the PRC capital market is limited

Unlike investors in developed markets, a substantial proportion of the financial assets held by PRC residents is in the form of cash and bank savings. The proportion of other types of financial assets, especially securities, is much lower than that of developed markets such as the U.S. The following charts illustrate the breakdown of financial assets held by PRC residents and U.S. residents by asset type as of December 31, 2009:



Sources: Annual Report of Chinese Residents' Income Distribution of the National Development and Reform Commission of the PRC, Account for the Balance of Capital of the PBOC. To be comparable, the PRC stocks include securities investment funds and margins paid by securities customers while U.S. stocks include mutual investment funds.

The uneven holding structure of financial assets provides the opportunity for PRC residents to improve their allocation of financial assets by participating more actively in the capital market.

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Rapid growth in the number of high net worth individuals will drive the development and innovation of financial products and services in the PRC capital market

In recent years, there has been a rapid increase in the number of PRC high net worth individuals. According to the “2011 China Private Wealth Report” (2011中國私人財富報告) jointly published by China Merchants Bank and Bain & Company in 2010, assets available for investment held by PRC high net worth individuals amounted to RMB15.0 trillion in the aggregate, while assets available for investment held by all PRC individuals amounted to RMB62.0 trillion in the aggregate. In 2010, there were over 503,000 high net worth individuals in the PRC, an increase of 92,000 compared to 2009, or 22%.

With the growth in the number of high net worth individuals in the PRC and their increasing participation in capital markets, the demand for customized financial services will continue to grow, and new businesses in the PRC capital market are expected to develop.

Enterprise annuities and other institutional investors have great potential to participate in the PRC capital market in the future

PRC enterprises have experienced rapid growth in corporate earnings and enterprise wealth

With the continued development of the PRC economy, PRC enterprises have experienced substantial growth in corporate earnings and enterprise wealth. The following table sets forth the increase in both earnings and wealth for selected PRC enterprises for the periods indicated:

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2001-2009 CAGR
	(RMB in 100 millions, except percentages)									
Total profits before tax of PRC enterprises ⁽¹⁾ . . .	4,733	5,784	8,337	11,342	14,803	19,504	27,155	30,562	34,542	28.2%
Enterprise savings . . .	51,547	60,029	72,487	84,671	96,144	113,216	138,674	157,632	217,110	19.7%

(1) PRC enterprises are limited to those with annual revenues of RMB5.0 million or more.

Sources: NBSC, PBOC

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Enterprise annuities have high growth potential

Despite the rapid development and expansion of the PRC capital market over the past decade, the overall participation by institutional investors, which mainly comprises mutual funds, remains insignificant compared with the participation by individual investors. As enterprise wealth has accumulated rapidly in recent years and the PRC government continues to promulgate policies to encourage the participation of institutional investors, enterprise annuities are expected to play a more important role in the PRC capital market. This is expected to stimulate the long-term development of the PRC capital market. The following table sets forth the size of enterprise annuities relative to GDP for the PRC and other developed countries as indicated:

	PRC	U.S.	Australia	Switzerland	Average in OECD countries
Percentage of the size of enterprise annuities to GDP (%)	1%	68%	82%	101%	68%

Source: Wind Info

OVERVIEW OF THE PRC SECURITIES INDUSTRY

Development history of the securities industry

Period of Exploration and Development (Before 1999): The PRC stock market developed quickly as PRC stock exchanges were established and securities firms emerged. The structure was segregated and the operation and regulation of different financial sectors emerged.

Following its introduction, the expanded joint stock ownership pilot program involving PRC state-owned enterprises resulted in (i) a rapid increase in the number of stock issuances; (ii) the emergence of a liquid nationwide secondary stock market; and (iii) an increase in stock trading activities. These results contributed to the establishment of the Shanghai Stock Exchange and the Shenzhen Stock Exchange. Subsequently, the number of listed companies, total market capitalization, the amount of proceeds raised from stock equity issuances, the number of investor accounts and securities trading volume all experienced substantial growth.

Early forms of securities firms emerged along with the establishment of primary and secondary securities market in the PRC. In the late 1980s and early 1990s, securities firms, such as Haitong Securities, former Shenzhen Special Economic Zone Securities, former Wanguo Securities Co., Ltd., former Junan Securities Limited Liability Company, former China Southern Securities Co., Ltd. and former China Securities Co., Ltd., were established. In 1996, the number of PRC securities firms reached a record of 553.

In 1997, the PRC adopted a segregated operating structure under which securities, banking, trust and insurance businesses began to operate independently from each other. In 1998, the CSRC became the sole regulatory authority of the PRC securities and futures markets, resulting in the effective segregation of the operation and regulation of the PRC securities industry from other financial sectors.

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Period of Regulated Development (1999 to 2004): As the regulatory regime of the PRC securities market gradually evolved, many regulatory non-compliance incidents and deficiencies in internal controls among securities firms were exposed.

The promulgation of the Securities Law in 1999 and the amendments of the Securities Law and the Company Law in 2005 marked important steps towards the “rule of law” by the PRC securities market. The CSRC implemented a series of measures to reform the procedures governing securities issuances in the PRC. It replaced the “examination and approval system” with the “verification system” in 2001 and subsequently with the “sponsorship system” in 2004. These reforms focused on the quality of the issuers and laid a solid foundation for a stable capital market. In addition, in 2002, the CSRC introduced a floating-rate commission mechanism, resulting in a more market and customer oriented business model for PRC securities firms. All these developments indicated the gradual evolution of the PRC securities industry.

For the period between 1999 to 2001, earnings of PRC securities firms soared during the market boom. However, the subsequent decline of the stock market in 2001 unveiled the inherent risks of the industry as a whole, such as operational non-compliances and misappropriation of customers’ funds by securities firms.

Period of Rectification and Regulation (2004 to 2008): Industry-wide rectification and increased regulatory measures were introduced in the PRC securities industry. The lifting of restrictions on the trading of certain state-owned and non-tradable shares allowed a large number of non-tradable shares to be gradually converted into freely tradable shares, which resulted in the expansion of the size of the PRC stock market.

In August 2004, the CSRC launched comprehensive legislative and enforcement measures governing the operations of PRC securities firms, pursuant to which securities firms that violated relevant regulations and had high-risk exposure were restructured or nationalized through capital injections. During this period, the CSRC implemented a risk management and compliance system that used Net Capital as the key metric to assess the risk exposure of the securities firms. It also promulgated ratings-based regulations to govern PRC securities firms and encouraged those with effective risk management to expand their businesses. As a result of the implementation of risk control measures and the stringent regulation of securities firms, the PRC securities industry successfully navigated through the global financial crisis in 2008.

In April 2005, the CSRC promulgated the Notice on Issues Regarding the Pilot Reform of Non-tradable Shares of Listed Companies (關於上市公司股權分置改革試點有關問題的通知) and implemented the Measures for the Administration of the Reform of Non-tradable Shares of Listed Companies (上市公司股權分置改革管理辦法) in September, which officially launched the reform of non-tradable shares. Such reform enabled holders of non-tradable shares to realize the value of their shares in an open market.

Period of Innovation (2009 and beyond): Encouraging a “market-oriented” regulatory concept and product innovation.

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In 2009, the CSRC began to shift its stringent regulatory approach to a market-oriented approach. Certain securities firms were designated to participate in pilot programs to develop new businesses, resulting in the gradual expansion of the business scope of the PRC securities industry:

- in 2009, the CSRC introduced new guidelines for securities firms to engage in direct investment;
- in March 2010, the CSRC issued guidelines on a pilot program for margin financing and securities lending and stipulated the qualification requirements for securities firms to participate in the pilot program. The pilot program was officially converted to a regular business available to all PRC securities firms that meet certain requirements in October 2011. Please see “Regulatory Environment – Regulation on the PRC Securities Industry – Regulation on Operations” for details on such requirements;
- in April 2010, the China Financial Futures Exchange launched the first stock index futures and the CSRC issued guidelines for trading in these futures by securities firms;
- in April 2011, the CSRC introduced the Regulations on Investment Scopes of the Proprietary Trading Business of Securities Companies and the Relevant Matters (關於證券公司證券自營業務投資範圍及有關事項的規定) to further expand the investment scope of the proprietary trading business of securities firms. These measures granted the proprietary trading divisions of PRC securities firms access to the OTC market and allowed securities firms to invest in more financial products through subsidiaries specifically established to conduct such business;
- in July 2011, the CSRC promulgated the Guidelines on the Direct Investment Business of Securities Companies (證券公司直接投資業務監管指引). Pursuant to such guidelines, subsidiaries of securities firms that engage in direct investment business may raise funds by way of private placements and utilize such proceeds, together with their proprietary funds, to make direct investments; and
- in October 2011, the CSRC promulgated the Trial Supervision and Management Measures on Margin and Securities Refinancing Business (轉融通業務監督管理試行辦法) pursuant to which the Securities Finance Company will be responsible for, among others, providing funding and securities refinancing services to support the margin financing and securities lending business of PRC securities firms, supervising the margin financing and securities lending activities, monitoring and analyzing margin financing and securities lending activities in the PRC securities market, and utilizing market tools to prevent and control risks.

Major business activities conducted by the PRC securities firms

The PRC securities firms engage in one or more of the following businesses:

- Securities and futures brokerage – Securities and futures brokerage business mainly refers to the execution of trades of stocks, bonds, funds, warrants, futures and other securities on behalf of customers;

INDUSTRY OVERVIEW

- Investment banking – Investment banking services primarily include equity and debt underwriting, M&A and financial advisory services;
- Asset management – Asset management services primarily include mutual fund management, collective and targeted asset management schemes, alternative asset management (in particular, private equity asset management) and investment advisory services;
- Direct investment – Direct investment business involves the use of proprietary funds by securities firms to make direct equity investments in private companies either directly or through private equity funds;
- Proprietary trading – Proprietary trading business relates to the investments in, and trading of, authorized financial products by securities firms using their own funds in accordance with the guidelines issued by the CSRC. These authorized financial products can be divided into three major categories, namely, securities listed on the domestic stock exchanges, securities traded in the domestic inter-bank market (including government bonds, RMB-denominated bonds issued by international development agencies, instruments of central banks, financial bonds, short-term financing bonds, corporate bonds, medium-term notes and enterprise bonds) and the securities approved by or filed with the CSRC that are traded over the counter at domestic financial institutions. In addition, securities firms can also set up subsidiaries to engage in a broader range of investment activities. The investment scope of these subsidiaries includes the three major investment categories mentioned above, as well as other types of investment products, such as financial products including derivative investment products, trust products and inter-bank wealth management products;
- Overseas and cross-border business – Overseas and cross-border business primarily includes QFII asset management, QFII brokerage, domestic and overseas acquisitions, as well as other businesses that may arise in the future such as RQFII and listings on the International Board.

REGULATORY REGIME AND TRENDS

Segregated operations and regulations of various PRC financial industries

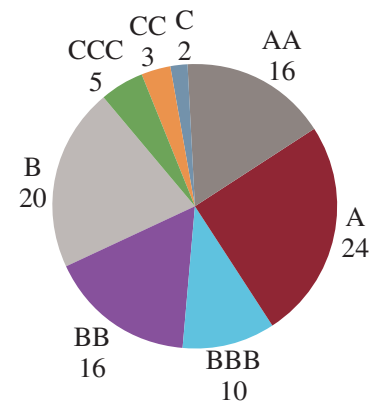
The operations of various PRC financial industries, such as securities, banking, insurance and trust industries, are segregated from one another, and are regulated by different regulatory authorities. The restrictions imposed on the business scope of the financial services industry create a favorable and independent environment for the development of the PRC securities industry, and limited financial institutions to engage in cross-industry business activities. We believe that this segregated structure will continue in the future.

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Major regulatory characteristics of the PRC securities industry

The PRC securities industry has experienced a significant transformation over the past 20 years as the industry evolved from being operated in a disorderly manner to being well-regulated. The main regulatory characteristics of the PRC securities industry are:

- A strict market entry system has been established. The PRC securities industry is an industry subject to stringent license control and many business activities are subject to the approval and filing requirements of the relevant regulatory authorities (Please see “Regulatory Environment – Regulation on the PRC Securities Industry – Entry Requirements”);
- The PRC securities industry is subject to a risk management and compliance regulatory regime that uses Net Capital as the key metric to assess risk. As required by the PRC regulatory authority, many business activities and the scale of such activities are subject to specified Net Capital requirements; and
- The CSRC imposes different regulatory measures on securities firms based on their regulatory rating, which is determined according to their respective risk management capabilities, competitiveness and compliance record. The CSRC gives securities firms with higher ratings priority to participate in pilot programs of new financial products. The following chart illustrates the number of PRC securities firms under each rating category as determined by the CSRC as of September 30, 2011:



Source: CSRC, as of September 30, 2011

Please see “Industry Overview – The Competitive Landscape in the PRC Securities Market” for an explanation of the rating categories.

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Regulatory trends in the PRC securities industry

Currently, the regulatory focus of the PRC securities industry is moving towards a more market-oriented regime. We believe that this trend will foster the development of the PRC securities industry, promote industry consolidation and strengthen the overall competitiveness of securities firms. We believe the regulatory outlook will include: (i) the relaxation of restrictions on the business scope of securities firms; (ii) the encouragement of product innovation and diversification of product mix; and (iii) the introduction of leverage to increase the capital efficiency of securities firms. This trend has also allowed PRC securities firms to gradually transform from a traditional business model to a capital-based and value-added business model.

We believe large securities firms will benefit more from these regulatory developments as they enjoy economies of scale, have effective corporate governance and possess the skills and resources to develop new businesses.

THE EMERGING SECURITIES INDUSTRY IN THE PRC

The PRC securities industry has experienced rapid growth in terms of asset size, revenue and net profit and has maintained a relatively high profit margin. The following table sets forth the total assets, net assets, revenue, net profit and net profit margin of the PRC securities firms for the periods indicated:

	2006	2007	2008	2009	2010	2006-2010 CAGR
	(RMB in 100 million, except percentages)					
Total assets	6,187	17,337	11,909	20,287	19,686	33.6%
Net assets	1,060	3,443	3,594	4,840	5,674	52.1%
Revenue	626	2,836	1,231	2,053	1,927	32.5%
Net profit	256	1,307	494	934	784	32.3%
Net profit margin of the industry (%)	40.9%	46.1%	40.2%	45.5%	40.7%	

Source: SAC

- Asset size: Between 2006 and 2010, total assets of the PRC securities firms increased from RMB618.7 billion to RMB1,968.6 billion, representing a CAGR of 33.6%, and net assets of the PRC securities firms increased from RMB106.0 billion to RMB567.4 billion, representing a CAGR of 52.1%.
- Revenue: Total revenue of PRC securities firms increased from RMB62.6 billion in 2006 to RMB192.7 billion in 2010, representing a CAGR of 32.5%, which is substantially higher than the CAGR of -12.6% for U.S. securities firms during the same period, according to SIFMA. In addition, total net profit increased from RMB25.6 billion in 2006 to RMB78.4 billion in 2010, representing a CAGR of 32.3%, which was also higher than the CAGR of -2.3% for U.S. securities firms during the same period, according to SIFMA.

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- **Profitability:** According to the SAC, the net profit margins of PRC securities firms were maintained at over 40% in the past five years. In 2010, the return on assets of PRC securities firms was 3.98%, which was higher than the 0.53% return on assets of U.S. securities firms during the same period.

Additionally, the primary business segments in the PRC securities industry experienced high growth, which has driven the PRC securities industry's rapid growth.

Brokerage business

As the PRC securities market is still in its early stages of development, brokerage business remains the core business of PRC securities firms. Driven by economic development, urbanization and wealth accumulation, the total trading volume of securities brokerage businesses of securities firms increased substantially. According to the CSRC, the stock trading volume in the PRC securities market increased from RMB9,046.9 billion in 2006 to RMB54,563.4 billion in 2010, representing a CAGR of 56.7%. According to the CSDCC, the number of stock brokerage accounts, including A shares and B shares, in the PRC increased from approximately 79 million at the end of 2006 to approximately 155 million at the end of 2010, representing a CAGR of 18.4%. The following table sets forth the stock trading volume and the number of stock brokerage accounts in the PRC from 2006 to 2010:

	2006	2007	2008	2009	2010	2006-2010 CAGR
Stock trading volume (RMB in 100 million)	90,469	460,556	267,113	535,987	545,634	56.7%
Number of stock brokerage accounts (in ten thousand)	7,854	11,287	12,364	14,028	15,454	18.4%

Sources: CSRC, SAC, CSDCC

Investment banking business

The total proceeds raised from equity offerings on the Shanghai Stock Exchange and Shenzhen Stock Exchange increased from RMB269.7 billion in 2006 to RMB1,012.1 billion in 2010, representing a CAGR of 39.2%.

	2006	2007	2008	2009	2010	2006-2010 CAGR
(RMB in 100 million, except percentages)						
Proceeds raised from equity offerings	2,697	8,043	3,464	5,150	10,121	39.2%

Source: Wind Info

According to Wind Info, non-government bond and note offerings in the PRC increased from RMB1,381.6 billion in 2006 to RMB3,129.3 billion in 2010, representing a CAGR of 22.7%.

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The following table shows the information on bonds and notes issued from 2006 to 2010:

	2006	2007	2008	2009	2010	2006-2010 CAGR
(RMB in 100 million, except percentages)						
Proceeds raised from bond and note offerings ⁽¹⁾	13,816	17,562	21,528	30,347	31,293	22.7%

(1) Issuances of bonds and notes refer to those related to corporate financing, including corporate bonds, financial bonds, short-term commercial papers, medium-term notes, asset-backed securities, convertible bonds and warrant bonds but exclude treasury bonds, municipal bonds and central bank instruments.

Source: Wind Info

Corporate M&A activities increased between 2006 and 2010. According to Dealogic Ltd., the total value of domestic and overseas M&A transactions involving PRC enterprises increased from US\$129.2 billion in 2006 to US\$238.2 billion in 2010, representing a CAGR of 16.5%.

The rapid growth of investment banking business contributed to the revenue growth of PRC securities firms. According to the SAC, net revenue of securities firms from securities underwriting increased from RMB10.1 billion in 2007 to RMB27.2 billion in 2010, representing a CAGR of 39.1%. During the same period, revenue from the investment banking business as a proportion of the total revenue of the securities industry increased from 3.6% to 14.1%. The following table sets forth the net revenue of securities firms from securities underwriting for the periods indicated:

	2007	2008	2009	2010	2007-2010 CAGR
(RMB in 100 million, except percentages)					
Net revenue from securities underwriting and sponsors business	101	77	152	272	39.1%

Source: SAC

Asset management business

According to the SAC, the asset management industry achieved tremendous growth between 2006 and 2009 as total AUM managed by mutual fund management companies and securities firms increased from RMB857.1 billion in 2006 to RMB2,676.1 billion in 2009 (including securities investment funds), representing a CAGR of 46.2%.

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	December 31,				2006-2009
	2006	2007	2008	2009	CAGR
(RMB in 100 million, except percentages)					
Net AUM managed by mutual fund management companies and securities firms	8,571	32,766	19,381	26,761	46.2%

Source: 2006-2009 China Securities Investment Fund Annual Report

The PRC securities industry is still in its early stages of development and we believe there is significant potential for further development

Despite its high growth rate, the PRC securities industry is still in its early stages of development compared to the securities industries in developed overseas markets. The following table sets forth a comparison of certain information about the PRC and U.S. securities industries as of December 31, 2010:

	Total assets of securities firms	Total assets of securities firms as a percentage of the total assets of the financial industry	Total revenue of securities firms	Total revenue of securities firms as a non-brokerage business as a percentage of total revenue of securities firms
	(RMB in 100 million)	(%)	(RMB in 100 million)	(%)
PRC	19,686	1.9%	1,927	44.0%
U.S.	305,640	20.0%	16,787	82.0%

Sources: CSDCC, NBSC, CSRC, SAC, SIFMA, U.S. Census Bureau

As of December 31, 2010, the assets of PRC securities firms accounted for 1.9% of the total assets of the PRC financial industry compared with 20.0% for U.S. securities firms. As of December 31, 2010, the total assets and total revenue of the PRC securities firms were RMB1,968.6 billion and RMB192.7 billion, respectively, compared to RMB30,564 billion and RMB1,678.7 billion, respectively, for the U.S. securities firms.

Currently, the brokerage business constitutes a major part of the PRC securities industry, with revenue from non-brokerage businesses accounting for 44% of the total revenue, compared with 84% for the U.S. The structural disparity between the PRC securities market and developed securities markets suggests that there is great potential for growth in various businesses in the PRC securities industry.

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The PRC securities industry has a lower penetration rate and a higher return on assets than other financial sectors

The penetration rate of the PRC securities industry is substantially lower than that of banking and insurance industries. According to the 2010 China Payment System Development Report published by the PBOC in June 2011, as of December 31, 2010, the PRC banking industry had approximately 3.38 billion settlement accounts in the PRC whereas the PRC securities industry had only approximately 155 million accounts (including A-share and B-share accounts), which was approximately 4.6% of that of the banking industry. This indicates that many potential clients are yet to be tapped by the securities firms. With further urbanization and wealth accumulation, the PRC securities industry is likely to have greater growth potential than other financial sectors as a result of its currently lower penetration rate. In addition, the PRC securities industry has higher returns on assets than other financial industries. In 2010, a return on assets was approximately 4.0%, compared with approximately 1.0% and approximately 1.3% for the PRC banking and insurance industries, respectively.

Significant growth potential in various business segments

Brokerage business: Significant development potential

Despite its substantial development in recent years, the PRC brokerage business still has significant potential and will likely maintain its rapid growth. For example, we believe:

- Urbanization in the PRC and the growth of the PRC economy are expected to lead to the increase in the number of brokerage accounts opened. Furthermore, the personal disposable income level in the PRC and the amount of tradable financial assets are expected to stimulate investment needs and increase the trading volume of PRC securities firms;
- The brokerage branches of PRC securities firms are concentrated in more developed coastal areas of the PRC. According to the Shanghai Stock Exchange, as of June 30, 2011, 61.5% of the brokerage branches of PRC securities firms were located in the Pearl River Delta, the Yangtze River Delta and the Bohai Rim, which accounted for only 39.3% of the PRC population. Conversely, as of June 30, 2011, 38.5% of the brokerage branches of PRC securities firms were located in less developed central, western and northeastern regions of the PRC, which accounted for 60.7% of the nation's population. With the continued economic growth of the underdeveloped regions in the PRC, it is expected that there will be further growth of the PRC brokerage business;

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- There is high growth potential due to the age and geographic distribution of brokerage customers. According to CSDCC, as of December 31, 2010, accounts held by individuals aged between 20 and 40 years totaled 65.7 million, accounting for 50.2% of brokerage accounts. This age group represents a major portion of the working population in the PRC, the growth of which, we believe, will continue to propel the increase in brokerage trading volume. In addition, the geographic distribution of accounts among PRC securities firms is highly uneven. As of December 31, 2010, the number of securities accounts in economically developed areas such as Beijing and Shanghai exceeded their population. In contrast, in the less developed areas such as central, western China, the number of securities accounts per capita was 0.08 and 0.07, respectively. With the faster economic growth in less developed regions in the PRC, the number of individual investors is likely to increase. The following table sets forth the number of accounts per capita in various regions of the PRC as of December 31, 2010:

	Beijing	Shanghai	Eastern China ⁽¹⁾	Central China ⁽¹⁾	Western China ⁽¹⁾	Entire PRC
Number of accounts ⁽²⁾ opened per capita as of						
December 31, 2010	1.37	1.34	0.23	0.08	0.07	0.15

(1) Central China covers provinces that include Anhui, Henan, Heilongjiang, Hubei, Hunan, Jilin, Jiangxi, Inner Mongolia and Shanxi; Western China covers provinces that include Gansu, Guizhou, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang, Yunnan and Chongqing; Eastern China covers provinces that include Beijing, Fujian, Guangdong, Guangxi, Hainan, Hebei, Jiangsu, Liaoning, Shandong, Tianjin and Zhejiang.

(2) Including accounts opened by institutions.

Sources: CSDCC, NBSC

- As a result of the continuing economic development of the PRC and the expansion of financial services targeting institutions and high net worth individuals, institutions and high net worth individuals are expected to boost the trading volume of securities; and
- In the foreseeable future, margin financing and securities lending, margin and securities refinancing, stock index futures trading and futures IB brokerage, among other things, will stimulate interest in brokerage services and will create momentum for the development of the securities industry.

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We expect that commission rates for stocks and funds will stabilize in the future. Since 2002, commission rates for stocks and funds have been driven by market demand. In particular, the CSRC allowed service outlets to offer securities brokerage services when the number of securities branches surged rapidly, which led to intense price competition. According to the China Securities Sector Report published by BOCOM International dated July 14, 2011, the intense market competition caused industry average commission rates for stocks and funds to fall from 0.160% in 2007 to 0.099% in 2010. However, we believe that commission rates for stocks and funds are gradually stabilizing for the following reasons:

- the commission rate level is close to that in developed markets, such as the U.S. securities market. According to data from SIFMA, the commission rate for stocks and funds in the U.S. was 0.08% in 2009. This suggests that the commission rates for stocks and funds in the PRC brokerage business do not have much room for further reduction;
- a number of PRC securities firms, in particular large securities firms, have offered a variety of specialized products and services, such as investment advisory services, personalized wealth management and margin financing and securities lending. By providing differentiated services, these securities firms aim to distinguish their brokerage businesses from those of other securities firms that continue to offer standard brokerage products and services. We believe such differentiation in products and services can help stabilize or even raise commission rates for stocks and funds in the foreseeable future;
- the establishment of new securities branches will still be subject to stringent regulation with respect to the number of securities branches that can be opened and the areas where they may operate. The CSRC's previous policy that allowed service outlets to be upgraded to securities branches has resulted in intensified price competition and significant reductions in commission rates for stocks and funds over the last several years. The CSRC has subsequently instituted strict controls over the opening of new securities brokerage branches, especially in certain major economically developed regions of the PRC where the brokerage market is deemed saturated and the opening of the new securities branches is basically prohibited. Therefore, this restriction is favorable to large securities firms that have already established their nationwide branch network in economically developed areas; and
- to curb price competition and to prevent further declines in commission rates for stocks and funds, the CSRC has published its updated opinion stipulating that commission rates for stocks and funds must not be lower than the cost of the brokerage operations of PRC securities firms. In addition, a number of CSRC local representative offices in various provinces have successively announced minimum commission rates for stocks and funds in these regions.

INDUSTRY OVERVIEW

Investment banking business: Numerous potential growth drivers

- *Equity financing:*

In 2010, the ratio of stock market capitalization in the PRC to its GDP was 67%, significantly less than the ratio of 119% for the U.S. We believe a lower ratio implies greater growth potential for equity financing. In addition, the ratios of the number of listed companies to the total number of large and medium-sized PRC enterprises and to the total number of enterprises with annual revenue of RMB5 million or more are still relatively low, which implies a large number of companies still have the potential to seek a listing in the future. The following tables set forth the ratio of the number of listed companies to the total number of large and medium-sized PRC enterprises and to the total number of enterprises with annual revenue of RMB5 million or more for the periods indicated:

	2006	2007	2008	2009
Ratio of listed companies to the total number of large and medium-sized enterprises	4.97%	4.82%	4.59%	4.47%

Sources: NBSC, Shanghai Stock Exchange, Shenzhen Stock Exchange. Classification of enterprises into large, medium or small ones is made according to the criteria stipulated in the “Measures of Classifying Large, Medium and Small-Sized Companies for Statistical Purpose (Provisional)” announced by the NBSC in 2003. Data in the above table are figures as of December 31 of each relevant year.

	2006	2007	2008	2009
Ratio of listed companies to the total number of enterprises with revenue of RMB5 million or more.	0.47%	0.46%	0.38%	0.40%

Sources: NBSC, Shanghai Stock Exchange, Shenzhen Stock Exchange

- *Bond offerings:*

While bond offerings have experienced rapid growth in the PRC in the past, the penetration rate is still substantially lower than that of developed countries and there is still enormous potential for development.

According to Wind Info, SIFMA and Bloomberg, total corporate debt outstanding in the PRC accounted for 7.3% of its GDP in 2010 compared to a 51.6% in the U.S. This implies that the PRC bond market still has enormous growth potential. Driven by the transformation towards direct financing channels, the amount of debt financing will further expand and we believe its penetration will eventually reach a level comparable to that of developed markets.

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- *Mergers and acquisitions/restructuring:*

We believe that domestic and cross-border M&A activities will grow significantly. Economic transformation in the PRC is prompting various industries to consolidate, which is likely drive domestic M&A transaction volume. In addition, as liquidity has increased remarkably as a result of the launch of several rounds of quantitative easing by a number of developed countries to deal with the recent financial crisis, we believe that many large multinational enterprises with significant cash reserves are eager to conduct M&A activities in the PRC. Furthermore, encouraged by PRC government policy, a number of PRC enterprises have expedited their accumulation of capital reserves and increased their pace of internationalization. As a result, the number of overseas M&A transactions entered into by PRC enterprises has risen considerably during the past several years.

In August 2011, the CSRC promulgated the “Decision to Revise Relevant Regulations on the Restructuring of Major Assets and Obtaining of Related Financing by Listed Companies” (關於修改上市公司重大資產重組與配套融資相關規定的決定) to support PRC enterprises to conduct M&A by taking advantage of the resources in PRC capital market, which further promotes industrial consolidation and upgrading. We expect that under a favorable business and regulatory environment, M&A activities will generate more revenue particularly for leading securities firms with strong research capabilities and a strong international network.

Asset management: Strong demand, expanding product types and low penetration rate to drive strong growth

As of December 31, 2010, the ratio of AUM of mutual funds to GDP in the PRC was 6.3%, far below the ratio of 79.9% for the U.S. We believe that the following factors will become the main drivers of the PRC asset management business:

Strong increase in demand:

- The accumulation in per capita wealth in the PRC drives the demand for wealth management products: The rapid accumulation of family wealth in the PRC has laid a solid foundation for the development of asset management services. According to the NBSC, household deposits in the PRC increased from RMB16,159 billion in 2006 to RMB30,330 billion in 2010, representing a CAGR of 17.0%. We believe future growth in family wealth will continue to foster the development of the asset management industry in the PRC;
- The increase in high net worth population: The growth of high net worth individuals will likely boost the demand for high-end financial products; and
- Demand of institutional or corporate clients for asset management services: The demand for asset management services will boost the innovation of products and services, including enterprise annuities and QFII asset management products.

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Comparatively small scale basis:

Currently, banks in the PRC manage far more assets than securities firms. According to the PBOC, as of June 30, 2011, the outstanding balance of wealth management products of the PRC banks totaled RMB3.57 trillion. As of the same date, according to the SAC, the AUM of PRC securities firms totaled RMB248.7 billion. As securities firms have a competitive advantage in product design and innovation, there is great potential for further development of the asset management business of PRC securities firms.

Expanding product types:

Expanded asset types, including real estate funds and alternative investment funds, will likely propel the expansion of the asset management market.

Proprietary trading: More mature business model to drive growth, increased revenue contribution to the industry and numerous advantages for large securities firms

In an emerging stock market that offers few choices of investment products, proprietary trading business is limited to stocks, bonds and derivatives. In the past, as there were limited financial instruments (including risk management and trading instruments), regulation was more stringent. We believe that the proprietary trading business will likely account for a higher percentage of the revenue generated by the industry because:

- Business models and risk management systems continue to improve. As the industry continues to develop, and risk management models, trading strategies and hedging methods continue to improve, proprietary trading risks can be effectively monitored and controlled. With the proprietary trading business model taking shape, securities firms can use their capital more efficiently to improve their profitability; and
- Regulation has gradually eased. While the CSRC imposed relatively more stringent regulations on proprietary trading in the past, with the increase and improvement of financial instruments, regulatory authorities have gradually eased the restrictions on proprietary investments. Pursuant to the new requirements for permitted proprietary trading business of securities firms promulgated in April 2011, permitted proprietary investment products can be divided into three major categories, which include securities listed on the domestic stock exchanges, securities traded in the domestic inter-bank market (including government bonds, RMB-denominated bonds issued by international development agencies, central bank notes, financial bonds, short-term financing bonds, corporate bonds, medium-term notes and enterprise bonds), and securities approved by or filed with the CSRC that are traded over the counter at domestic financial institutions. In addition, PRC securities firms can also set up subsidiaries to engage in a broader range of investment activities. The investment scope of these subsidiaries includes the three major investment categories mentioned above, as well as other types of investment products, such as financial products including derivative investment products, trust products and inter-bank

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wealth management products. Such subsidiaries can invest in a wide range of financial products with more flexible investment strategies. The regulations impose certain limitations on the proprietary trading business of securities firms, including, among other things: (i) the total value of equity securities and security derivatives held for proprietary trading shall not exceed 100% of the Net Capital of the securities firms; (ii) the total value of fixed income securities held for proprietary trading shall not exceed 500% of the Net Capital of the securities firms; (iii) the cost of one kind of equity securities held by the securities firms shall not exceed 30% of their Net Capital; and (iv) the market value of one kind of equity securities held by the securities firms shall not exceed 5% of such securities' market value, except circumstances that result from full commitment securities underwriting and otherwise required by the CSRC. Currently, the proprietary trading regulations do not have any specific requirements with respect to the investment scale of securities firms' investment subsidiaries. According to the latest regulatory requirements, securities firms cannot provide financing or guarantees to their respective investment subsidiaries and therefore, the risk exposure of securities firms in respect of their investment subsidiaries is limited to the capital contributed to the latter. By establishing investment subsidiaries, securities firms can expand the scope and range of their proprietary trading business. With the gradual easing of regulation and the inclusion of more tradable financial products, the sources of proprietary trading revenue will become increasingly diversified.

With respect to the proprietary trading business, large securities firms have advantages over smaller ones. The major advantages include:

- Possession of abundant capital helps to fully capture business opportunities. As funds used in proprietary trading businesses often come from the securities firms' own capital, securities firms with strong capital bases can usually allocate more funds to their proprietary trading business and, therefore, can better capture market opportunities. In addition, a large securities firm with greater capital can expand the revenue model for its proprietary trading business by setting up and making use of special purpose subsidiaries dedicated to investments in alternative financial products; and
- Proprietary trading and other securities businesses provide strong support for one another. For example, a large securities firm with a strong proprietary trading business often has a large stock portfolio that can be used to support its securities lending business. A large securities firm also possesses strong research capabilities to assist the development of its proprietary trading business. A securities firm in possession of sufficient assets can utilize its financial strength to develop various products and services.

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Direct investment: Fast growth, significant potential and unique advantages enjoyed by PRC securities firms

Since the launch of pilot programs for direct investment by the CSRC in 2007, registered capital of direct investment subsidiaries of the PRC securities firms increased from RMB3.1 billion in 2007 to RMB17.6 billion in 2010, representing a CAGR of 78.2%.

As of December 31, 2010, the ratio of stock market capitalization to GDP in the PRC was only 67% and most of the PRC enterprises are not able to raise funds from the public market. In addition, the increased use of direct financing for enterprises also encouraged the growth of the direct investment business of securities firms. As such, the market for direct investment has significant growth potential.

When competing with domestic and foreign private equity funds, PRC securities firms have certain advantages over their competitors, which are mainly reflected in:

- Extensive domestic knowledge on valuation, industry dynamics, due diligence practice and exit mechanisms; and
- Early access to direct investment opportunities through a branch network across the PRC.

In addition, securities firms with strong capital position generally can have a larger scale of investment. According to the existing regulatory requirements, registered capital of the direct investment subsidiary of a PRC securities firm cannot exceed 15% of the Net Capital of such securities firm.

THE TRANSFORMATION OF THE PRC SECURITIES INDUSTRY

Momentum of transformation

After over 20 years of development, the PRC securities industry has established a considerable scale. However, we believe various factors are driving the transformation of the industry:

- Driver of customer demand. With economic development and wealth accumulation in the PRC, the demand of individual and institutional investors for financial products and services has continued to evolve. Clients have generally looked beyond standard services and demanded customized and value-added services. At the same time, as a result of the economic reform and development of the PRC over the past three decades, RMB has gradually become internationalized. With growing capabilities and globalization, PRC enterprises have increasing desire to expand overseas. We believe that such aspirations have led PRC securities firms to strengthen their international business and overseas financial services.

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- Diversification of revenue composition. Historically, the PRC securities industry has relied extensively on traditional channel-based brokerage services. According to the SAC, in 2010, brokerage commissions generated approximately 56% of total revenue of the PRC securities firms. PRC securities firms are inherently required to diversify their businesses and to gradually reduce their reliance on the traditional channel-based brokerage business to achieve sustainable growth.
- Trend of regulation. The gradual relaxation of regulatory restrictions and increasing emphasis on innovation, such as the introduction of margin financing and securities lending (including margin and securities refinancing), stock index futures trading and direct investment in the industry.

Through this transformation, the PRC securities industry will have a more diversified revenue composition, reducing its reliance on the traditional channel-based brokerage business and allowing it to meet evolving customer demands.

Key areas of transformation

The PRC securities industry is adopting a business model that features integrated and value-added products and services and an optimized customer base.

Customer service and product offering approach: From homogenous, channel-based brokerage services to comprehensive and diversified product suite

The traditional channel-based brokerage business has been the backbone of the PRC securities industry. However, as intense competition arises from homogenous brokerage services, securities regulations gradually move towards a market-oriented regulatory regime with an emphasis on innovation, and customer demands for differentiated products and services increase, securities firms with a large capital base and strong operating capabilities have begun to offer more integrated and comprehensive products and services. We believe this transformation will enhance the competitiveness of these securities firms and help attract and retain their customers, leading to more stable and diversified revenue streams. Currently, many large PRC securities firms provide customers with integrated services, including investment banking, asset management and private equity, to reduce their reliance on the traditional channel-based brokerage business and aim to achieve a more diversified revenue composition. Furthermore, in order to satisfy the demands of their customers and to maintain steady growth of the revenue, many securities firms are expected to design and offer more diversified products, such as private equity fund management, collective and targeted asset management schemes, margin financing and securities lending (including margin and securities refinancing), investment advisory services, stock index futures trading and futures IB brokerage.

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Customer base: From a predominantly retail customer base to a balanced client base with higher proportion of institutional and high net worth customers

In the past, the PRC securities industry was primarily comprised of retail customers who provided a steady stream of revenue. With the rapid growth of the PRC economy and the resulting increase in corporate wealth, the total number and assets of institutional clients increased. A broader array of products and services that securities firms could offer also serve to meet the diverse needs of institutional clients. We expect that institutional clients will contribute a greater portion of revenue to the PRC securities industry. In comparison to individual investors, institutional investors have a higher demand for value-added securities services, such as research, prime brokerage and market-making services. They are also less price sensitive and are more likely to choose new businesses. As such, leading full-service securities firms can leverage their first-mover advantage to capture business opportunities by providing those value-added securities products and services, which generally command higher margin.

In addition, with the rapid growth of individual wealth, we expect the demands of high net worth individuals in the PRC for asset management services and value-added services to increase. According to the “2011 China Private Wealth Report” jointly published by China Merchants Bank and Bain & Company, in 2011, total assets available for investment held by PRC high net worth individuals are expected to be RMB17.7 trillion in aggregate, representing an increase of approximately 18% compared to 2010. In addition, the number of high net worth individuals in the PRC is expected to reach 585,000, representing an increase of 16% compared to 2010. In the future, demands from institutional and high net worth individual customers and their contribution to the PRC securities industry are likely to increase. As a result of the accumulation of personal wealth and urbanization in the PRC, we also expect the number of retail customers to increase, leading to a more balanced industry customer base.

Business model: From a capital-light business model to a capital based and value-added business model

The PRC securities industry is transforming from a capital-light and low-leverage operating model into a more capital-based and value-added model. Many new businesses, such as margin financing and securities lending and direct investment, may require large amounts of proprietary capital. This creates a competitive advantage for securities firms with larger capital bases to differentiate themselves from their competitors and attract new and retain existing clients. For example:

- Brokerage business – Large capital base can strengthen a securities firm’s ability to engage in the margin financing and securities lending business and to optimize its product mix;
- Underwriting business – Capital can be used to strengthen a securities firm’s commitment in underwriting and securities offerings to enhance the competitiveness of securities firms and in obtaining higher commissions and fees;

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- M&A financial advisory service – A higher capital base can assist a securities firm in receiving higher financial advisory fees, interest income and investment returns through M&A financing, bridge financing and partnership investment;
- Asset management and direct investment businesses – Seed Capital can be deployed to establish funds with other limited partners to obtain higher management fees and investment returns from more AUM while achieving risk sharing; and
- Proprietary trading business – As the PRC regulatory authorities began to permit securities firms to establish subsidiaries specifically for making alternative investments, large securities firms with strong capital base will be in a better position to capture market opportunities, to expand product mix, to enhance the scale of investments, to optimize the revenue model of the proprietary trading business and to eventually improve their ability to realize investment returns.

With the gradual transformation of the business model in the PRC securities firms to a capital-based and value-added model, we believe that the financial and operating leverage ratios will be enhanced accordingly, thus increasing the profitability of the industry.

Scope of operations: Expansion into international businesses

As the RMB is gradually internationalized and foreign investments continue to flow into the PRC, cross-border business is expected to become a fast-growing area of the PRC securities industry. Overseas business, cross-border M&A, cross-border financing and cross-border asset management are expected to become catalysts for future growth and the PRC securities industry will become more internationalized:

- Overseas business: An increasing number of PRC securities firms, including Haitong Securities, have established overseas branch networks to satisfy the cross-border investment needs of their domestic clients. At the same time, these firms have benefited from the growth in overseas securities markets;
- Cross-border M&A: With the growth of PRC enterprises and the increasing demands for cross-border M&A transactions, according to Dealogic Ltd., the transaction value of cross-border M&A conducted by the PRC enterprises increased from US\$13.0 billion in 2000 to US\$100.7 billion in 2010;
- Cross-border financing: An increasing number of PRC enterprises are seeking overseas listing of their shares. According to Dealogic Ltd., 63 Chinese enterprises raised an aggregate amount of US\$38.1 billion (including full deal value for dual-listed deals) through their IPOs on the Hong Kong Stock Exchange in 2010, accounting for 60.1% of the total amount of proceeds raised through IPOs in Hong Kong in that year; and

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- Cross-border asset management: The establishment of the QFII system in 2002 marked an important step for the PRC capital markets to open up and to attract foreign investment. By the end of December 2010, the amount of the QFII quota was US\$19.7 billion. With the relaxation of stringent regulatory policies, QFII business is expected to further expand. Meanwhile, the CSRC is discussing with the SFC in connection with certain policies on RQFII, which will provide a mechanism for the return of overseas RMB to the PRC through PRC securities firms and fund management companies in Hong Kong.

Business transformation by segments

Transformation of the brokerage business: The growth of margin transactions, diversified and customized products and a balanced customer base

As a result of the industry transformation and the development of margin financing and securities lending business, the contribution of margin transactions in the brokerage business has gradually increased, but it is significantly lower than that in the U.S. As of June 30, 2011, the margin financing balance of the PRC accounted for 0.1% of its domestic market capitalization, compared to 1.7% for the U.S. for the same period. The PRC securities lending balance accounted for 0.001% of its domestic market capitalization, compared to 0.82% for the U.S. for the same period. The PRC margin transactions have substantial development potential, and are expected to be growth drivers of the brokerage business.

In addition to traditional channel-based brokerage services, the brokerage business will offer diversified and value-added services such as investment advisory, stock index futures trading, margin financing and securities lending (including margin and securities refinancing), equity market research, QFII brokerage and futures IB brokerage, which will enable the stabilization of or increase in brokerage commission rates for stocks and funds. For example, currently, the commission charged by discount brokers in the U.S., which do not provide value-added services is between US\$4.99 and US\$9.99 per transaction, while that of full-service securities firms is between US\$16.00 and \$20.00 per transaction. We believe diversified, customized and value-added services will further increase the revenue of the industry.

With the rapid increase in the number of institutions and high net worth individuals and their growing importance in the PRC economy, we believe that they will form a substantial customer base of the PRC brokerage business in the future. Therefore, the development of customized products and the provision of better services to these customers will be a key strategy for the PRC brokerage business in the future.

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Transformation of the investment banking business: The development of bonds and other financing channels, increase in the M&A business and the rise of small and medium-sized clients

The investment banking business is expected to experience rapid growth with the transformation from indirect financing to direct financing. According to Wind Info, SIFMA and Bloomberg, total corporate debt outstanding in the PRC accounted for 7.3% of its GDP in 2010 compared to 51.6% in the U.S. In addition, the emergence of new listing venues, such as the SME Board, the ChiNext Board and the upcoming International Board and the New OTC Board will continue to contribute to the development of the investment banking business.

In terms of M&A transactions, the economic transformation in the PRC has led to a trend of consolidation in a variety of industries. With increasing corporate restructuring, mergers and overseas expansion, M&A activities are expected to grow rapidly. It is expected that leading securities firms with strong research capabilities and international branch networks will benefit from this trend.

In terms of customer base, investment banks have begun to switch their focus to SME clients whose participation in capital markets are growing rapidly. In 2010, according to Wind Info, the total amount of the funds raised from IPOs on the SME Board and the ChiNext Board were US\$45 billion compared to US\$28 billion on the main board.

Transformation of the asset management business: Transformation to diversified asset management structure and optimization of customer base

Of the AUM in the PRC securities industry, 95.7% is in traditional mutual funds and 4.3% is in collective asset management schemes. Transformation to a more mature asset management structure in the PRC offers an opportunity for the PRC asset management business, especially in the area of hedge funds, private equity funds and collective asset management schemes.

With the accumulation of wealth in the PRC and the increase in the number of high net worth individuals, we believe high net worth customers will become increasingly important, and asset management services for high net worth individuals will experience strong growth. The increase in the number of high net worth customers will further optimize the customer base of asset management business.

As additional investment products appear in the PRC capital market, including real estate funds, hedge funds, commodity funds, the PRC asset management business will attract more individual and institutional investors.

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New businesses are driving growth for PRC securities firms

We believe new businesses are key for PRC securities firms to achieve:

Customer-oriented, differentiated product offerings. Pursuant to the traditional channel-based brokerage business model where customer demand analysis is limited, PRC securities firms primarily provide homogeneous products and services despite differences in customer characteristics. Securities firms will continue to enhance customer demand analysis with the development of new businesses such as investment advisory and wealth management services. PRC securities firms are expected to eventually transform into a customer-oriented model and promote differentiated solutions through a combination of traditional and new products and services.

Diversification in revenue composition. New businesses will serve as new growth areas for PRC securities firms and lessen their reliance on traditional channel-based brokerage business and homogeneous products and services. We believe the revenue composition of PRC securities firms will become more diversified through the development of new businesses.

Optimization of customer base. New businesses are key to attracting and retaining high net worth individual and institutional clients. Increasing the revenue contribution from such customers is an important element of customer base optimization.

Capital-based and value-added business model. As sufficient capital base is necessary for conducting value-added new businesses, such as margin financing and securities lending and direct investment, as well as new businesses to be introduced, such as alternative financial products investments. New businesses will reinforce the transformation of PRC securities firms into a capital-based and value-added business model.

The following are some examples of the impact of new businesses on the transformation:

Margin financing and securities lending

The CSRC launched the pilot program for margin financing and securities lending in March 2010, which was converted to a regular business available to all PRC securities firms that meet certain requirements in October 2011. Margin financing refers to the service by which securities firms lend money to investors to buy securities. Securities lending refers to the service by which securities firms lend securities to their clients to enable them to short sell the underlying securities. According to relevant guidelines issued by the CSRC, the interest rate for margin financing is generally 3% higher than the PBOC benchmark interest rate for six-month RMB loan to financial institutions. The interest rate for securities lending is set at the same level or even higher. Margin financing and securities lending not only enable securities firms to charge interest income and facilitate more transactions to generate additional commission, but also earn more commission fees through stimulating of trading activities. Margin financing and securities lending business can facilitate the securities firms to improve revenue composition and

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transform their business models to capital-based and value-added models. In addition, margin financing and securities lending as an additional value-added service allows customers to broaden their investment and trading strategies, which in turn improve customer loyalty of PRC securities firms.

Margin financing and securities lending business is highly regulated in the PRC. For instance, there are currently only 90 stocks eligible for margin financing and securities lending and a securities firm can only use its own securities for securities lending. With the expansion of the scope of eligible stocks and the launch of margin and securities refinancing business, we believe that the margin financing and securities lending business has significant growth potential.

In October 2011, the Trial Supervision and Management Measures on Margin and Securities Refinancing Business (轉融通業務監督管理試行辦法) was promulgated by the CSRC and the Securities Finance Company was established, which will be responsible for, among others, providing funding and securities refinancing services to support the margin financing and securities lending business of PRC securities firms. We believe the margin and securities refinancing business will enhance the development of the margin financing and securities lending business and increase the leverage ratio of PRC securities firms.

Stock index futures

Stock index futures were launched in April 2010. They are standard futures contracts based on a specific stock price index (such as CSI 300 Index). Investors can trade stock index futures contracts on the futures exchange and use stock index futures for hedging, arbitrage, calendar spread arbitrage and other activities. Their trading volume of stock index futures is close to the stock trading volume since its introduction. During the third quarter of 2011, the trading volume of stock index futures was RMB11,143.3 billion, which was equivalent to 55.1% of stock trading volume during the same quarter. We expect the participation of more institutional investors in the trading of stock index futures will create further business opportunities and diversify revenue streams for the PRC securities firms. In addition, securities firms can leverage stock index futures to lower the risks associated with proprietary trading and increase the types of assets under management.

Private equity investment

PRC private equity investments have experienced rapid growth in recent years. We believe there are synergies between PRC private equity investment and IPO underwriting businesses. A successful IPO will provide an effective exit opportunity for private equity investors. In the PRC, leading securities firms with integrated platforms for private equity investment and IPO underwriting businesses will gain more competitive advantages. Private equity business will not only help diversify revenue stream for securities firms, but also enhance the utilization of capital.

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Large securities firms have more advantages in securities industry transformations

Large securities firms possess the following advantages in the transformation of the PRC securities industry:

- *Advantage of business innovation.* Large securities firms are generally rated higher by the CSRC and have larger capital bases. These advantages also meet the key criteria for the grant of regulatory approvals for conducting new businesses on a trial basis. In addition, with large customer bases, solid traditional businesses, large capital bases and strong brand, large securities firms are better positioned to develop new businesses;
- *Economy of scale and low commission rate sensitivity.* Fierce competition and declining in commission rates for stocks and funds creates substantial market pressure on the brokerage business. However, with the benefits of economies of scale and diversified income sources, large securities firms are more resilient to declines in commission rates for stocks and funds and thus, maintaining steady levels of total income;
- *Large customer base and cross-selling ability.* Large customer base and established business platforms will enable large securities firms to take advantage of cross-selling opportunities, provide customers with a one-stop solution and allow them to attract new customers and improve customer relationships;
- *Superior nationwide network.* Large securities firms generally have well-established nationwide networks, which are crucial for their effective product distribution and provision of localized services to retail and institutional clients;
- *Branding and human resources.* Large securities firms generally have better brand recognition, which not only gives them an advantage in attracting new customers, but also helps them attract and retain highly proficient professionals to ensure long-term business development; and
- *High and stable profitability.* For example, the weighted average profit margin in 2010 of the top 20 PRC securities firms was 44.7% compared to 21.8% for the bottom 20 PRC securities firms. From 2008 to 2010, weighted average profit margin of the top 20 PRC securities firms in terms of revenue was consistently above 40%, whereas that of the bottom 20 PRC securities firms was very volatile ranging from -4.4% to 41.4%. The table below sets forth the change of average profit margin of the top 20 securities firms and the bottom 20 securities firms from 2008 to 2010:

	2008	2009	2010	2008-2010 Weighted average
Weighted average profit margin of the top 20 PRC securities firms in terms of business revenue	44.9%	48.2%	44.7%	45.9%
Weighted average profit margin of the bottom 20 PRC securities firms in terms of business revenue	-4.4%	41.4%	21.8%	19.6%

Source: SAC

INDUSTRY OVERVIEW

THE COMPETITIVE LANDSCAPE IN THE PRC SECURITIES MARKET

According to the SAC, as of June 30, 2011, there were 109 registered securities firms in the PRC securities industry.

The current market landscape reflects the PRC government's effort to regulate the securities industry. Between 2004 and 2005, a significant number of companies dissolved, merged or restructured during the rectification process. In 2007, the CSRC introduced a rating mechanism, pursuant to which securities firms were rated based on their risk controls, corporate governance, capital base, profitability and market position.

The rectification and the rating mechanism accelerated the consolidation of the securities industry, which benefited large securities firms. During the past five years, there has been a significant increase in market concentration, in terms of net assets, among the large securities firms. According to the SAC, as of December 31, 2010, the top ten securities firms (based on net assets) accounted for 47.6% of net assets, 39.5% of the total assets, 44.6% of Net Capital and 48.7% of net profit of the PRC securities industry.

The following table sets forth the key information relating to net assets, total assets, Net Capital, net profit, brokerage market share and underwriting market share of the top ten PRC securities firms (based on net assets) as of December 31, 2010:

Top 10 Securities Firms (Based on Net Assets)	Net		Total		Net		Net		Brokerage	
	Assets	%	Assets	%	Capital	%	Profit	%	Share	Underwriting
									Share	Market
									% ⁽¹⁾	Share % ⁽²⁾
(RMB in million, except percentages)										
CITIC	61,523	10.8%	109,371	5.6%	41,050	9.5%	11,814	15.1%	2.5%	11.1%
Haitong	43,852	7.7%	100,718	5.1%	32,460	7.5%	3,417	4.4%	4.4%	5.7%
Huatai	29,998	5.3%	86,479	4.4%	21,658	5.0%	2,369	3.0%	4.2%	3.2%
Guotai Junan . .	23,711	4.2%	93,572	4.8%	17,347	4.0%	3,738	4.8%	5.1%	5.5%
CMS	23,443	4.1%	89,584	4.6%	14,063	3.3%	3,012	3.8%	4.4%	3.2%
Everbright . . .	22,344	3.9%	56,418	2.9%	17,646	4.1%	2,102	2.7%	2.7%	1.2%
Guangfa	19,006	3.3%	91,036	4.6%	11,963	2.8%	4,887	6.2%	5.3%	2.4%
Guosen	17,306	3.1%	63,726	3.2%	12,490	2.9%	3,115	4.0%	3.2%	4.6%
Guoyuan	14,867	2.6%	23,902	1.2%	11,771	2.7%	875	1.1%	0.7%	0.7%
Shenyin										
Wanguo	14,806	2.6%	60,215	3.1%	12,084	2.8%	2,835	3.6%	3.5%	1.2%
Total	270,856	47.6%	775,021	39.5%	192,532	44.6%	38,164	48.7%	36.0%	38.8%

(1) Based on the total value of customers' brokerage transaction.

(2) Based on the value of securities underwritten by a securities firm acting as the lead underwriter.

Source: SAC

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The CSRC rates every securities firm in the PRC annually. The CSRC rating is divided into 11 categories, the highest of which is an “AAA” rating, and the lowest of which is a “E” rating. Highly rated securities firms generally become the designated securities firms for new pilot products and services approved by the CSRC and will then benefit from first-mover advantages. As of September 30, 2011, only 16 securities firms (representing 16.7% of the total number of securities firms) were “AA” rated by the CSRC. To date, no securities firms has obtained an “AAA” rating from the CSRC.

The PRC securities industry also faces fierce competition from international investment banks. In recent years, foreign securities firms have been actively looking for chances to access the PRC securities market through joint ventures. However, the business scope of Sino-foreign joint venture securities firms is relatively limited and primarily focuses on equity and debt financing and M&A advisory services. Most of the Sino-foreign joint venture securities firms were not permitted to operate retail brokerage businesses. We believe, currently, the competition posed by Sino-foreign joint venture securities firms against PRC securities firms is insignificant.

In addition to competition from domestic and foreign securities firms, the PRC securities industry also faces competition in certain businesses, including but not limited to, asset management, direct investment and bond underwriting, from domestic financial institutions, such as banks, asset management firms, trust companies and private equity firms. For example, banks are the largest bond underwriter in the PRC. We believe that PRC securities firms still have some competitive advantages over other financial institutions in terms of personnel, product mix and customer service.

HONG KONG SECURITIES MARKET

History of the stock market in Hong Kong

The Stock Exchange of Hong Kong Limited, previously named the Stockbrokers' Association of Hong Kong at the time of its establishment in the late 19th century, was the first formal securities trading market established in Hong Kong and has been the main exchange in Hong Kong. In 1986, The Stock Exchange of Hong Kong Limited merged with the other exchanges in Hong Kong and retained its name. It also established GEM in 1999 to provide a fund-raising platform for growth companies from different industries and to promote the development of the technology industry in the region. In 2000, The Stock Exchange of Hong Kong Limited, Hong Kong Futures Exchange Limited and Hong Kong Securities Clearing Company Limited merged into the Hong Kong Stock Exchange and Clearing Limited, which was subsequently listed on the Main Board by way of introduction.

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Overview of the stock market in Hong Kong

International financial center

After years of continuous efforts, the Hong Kong Stock Exchange has become a key capital market in Asia for overseas investors. The rapid development of the PRC economy and expansion of PRC enterprises overseas have steadily strengthened the importance of Hong Kong in global financial markets over the years. According to WFE, in 2010, the Hong Kong Stock Exchange ranked tenth in terms of annual and daily average trading volume and ranked second in terms of the amount of proceeds raised from equity offerings (including primary market and secondary market). In addition, as of September 30, 2011, total market capitalization of the listed companies on the Main Board and GEM ranked third in Asia and seventh in the global market.

From 2001 to 2010, the total market capitalization of listed companies on the Hong Kong Stock Exchange (including Main Board and GEM) increased from approximately HKD3.95 trillion to approximately HKD21.08 trillion at a CAGR of 20.5%. The annual trading volume increased from approximately HKD1.99 trillion to approximately HKD17.21 trillion at a CAGR of 27.1%. The number of listed companies on the Main Board increased from 756 to 1,244 while the number of companies listed on the GEM has increased from 111 to 169.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Market capitalization (HKD in billions). . .	3,946.31	3,611.32	5,547.85	6,695.89	8,179.94	13,337.71	20,697.54	10,298.75	17,874.31	21,076.96
Number of Main Board listed companies . . .	756	812	852	892	934	975	1,048	1,087	1,145	1,244
Number of GEM listed companies	111	166	185	204	201	198	193	174	174	169
Annual trading volume (HKD in billions). . .	1,989.50	1,643.05	2,583.83	3,974.11	4,520.43	8,376.31	21,665.53	17,652.80	15,515.25	17,210.08
Daily trading volume (HKD in billions). . .	8.19	6.65	10.42	15.96	18.3	33.91	88.07	72.05	62.31	69.12

Source: Hong Kong Stock Exchange

Diversified and well-organized Hong Kong Stock Exchange participants

The Hong Kong stock market is characterized by (i) its globalization; (ii) high level of participation of institutional investors; and (iii) increasing participation by PRC investors. According to the Cash Market Transaction Survey 2009/10 issued by the Hong Kong Stock Exchange, from October 2009 to September 2010, the stock trading volume by overseas investors and institutional investors accounted for approximately 46.3% and 64.3% of the total trading volume, respectively. In addition, the proportion of PRC retail investors in the stock trading volume also increased from 3.0% for the period from October 2000 to September 2001, to 10.6% during October 2009 to September 2010, reflecting increasing participation by PRC investors.

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To deal in listed securities through the Hong Kong Stock Exchange, a person must be an Exchange Participant holding an Exchange Trading Right. An Exchange Participant must be a permanent resident of Hong Kong or a limited liability company incorporated in Hong Kong and registered with the SFC as a licensed corporation authorized to conduct Type 1 (dealing in securities) regulated activity under the SFO. An Exchange Participant must maintain sound financial condition and comply with the Securities and Futures (Financial Resources) Rules and the rules of the Hong Kong Stock Exchange. As of September 30, 2011, there were a total of 549 of Exchange Participants, including 494 trading participants, 34 non-trading participants and 21 non-Exchange Participants. Exchange Participants are classified into three categories:

- Group A – top 14 largest firms in terms of trading volume, which mainly comprise large international institutional investors;
- Group B – firms ranked 15-65 in terms of trading volume, who are engaged in a mixture of overseas and local institutional trading and retail trading; and
- Group C – other Exchange Participants.

For the nine months ended September 30, 2011, the market share of Exchange Participants (based on the total trading volume) from Group A, Group B, and Group C accounted for 56.83%, 33.63%, and 9.54%, respectively. The market share of Exchange Participants from Group C decreased from 36.8% in 1999, representing the most significant change among the three. This decline in market share during recent years is primarily attributed to the absence of economies of scale and the inability to provide a comprehensive and sophisticated platform.

Attractive listing venue

As an international financial hub, Hong Kong has become one of the preferred listing venues for overseas and domestic companies. One of the core strategies in the Strategic Plan 2010-2012 of Hong Kong Stock Exchange is to attract different types of companies to list in Hong Kong, including companies in the Greater China area, companies engaged in PRC-related business and companies from other strategically important international markets. Since 2007, to help more foreign companies getting listed in Hong Kong, Hong Kong Stock Exchange actively increased the number of admitted jurisdictions in which the issuer may be incorporated from three in 2007 to 21 as of Latest Practicable Date. In addition, Hong Kong Stock Exchange also launched a variety of facilities for foreign companies to become listed such as IPOs, secondary listings and Hong Kong depositary receipts. As a result, a number of world renowned companies, including AIA Group Limited, Glencore International plc, L'Occitane International S.A., Samsonite International S.A., Prada S.p.A. and United Company Rusal Limited, have listed in Hong Kong, making Hong Kong a popular listing venue for international companies. In 2010, Hong Kong became the second largest globally in terms of fund raising.

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In the past ten years, the amount of funds raised in Hong Kong (including primary and secondary market) increased significantly from HKD64.4 billion to HKD858.72 billion. Due to the global financial crisis, the IPO market was slow in the first half of 2009, but recovered in the second half due to improved market conditions. This secured Hong Kong's position in 2009 as the world's largest IPO market with HKD248.2 billion in total funds raised. Hong Kong maintained its leading position in 2010, with HKD449.5 billion raised through 101 IPOs that year, representing an increase of 81% compared to the preceding year.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	(HKD in billions)									
Amount of funds raised										
Primary market	25.71	51.98	59.14	97.16	165.65	333.85	292.44	65.98	248.23	449.48
Secondary market. . .	38.71	58.53	154.62	184.64	136.06	190.69	298.41	361.27	393.89	409.24
Total funds raised . . .	64.42	110.51	213.76	281.8	301.71	524.54	590.85	427.25	642.12	858.72

Source: Hong Kong Stock Exchange

The interaction between Hong Kong and the PRC capital markets

Cross-border activities between Hong Kong and the PRC has increased rapidly due to their close economic ties and frequent capital flows. In addition, the influence of PRC companies in the Hong Kong stock market gradually increased and PRC companies has become a vital part of Hong Kong capital market.

Cross-border activities driven by the internationalization of RMB

The internationalization of RMB is a highlight of Hong Kong capital market and is a catalyst to further enhance the business interaction between Hong Kong and PRC capital markets. This has enabled Hong Kong to become a key overseas platform for the development of RMB financial products. RMB derived from trade settlement is the main source of Hong Kong's offshore RMB settlement center. As of June 30, 2011, the total amount of RMB trade settlement by Hong Kong banks amounted to approximately RMB800 billion. This figure more than doubled compared to 2010 when the total amount of RMB trade settlement was RMB370 billion. In addition, RMB trade settlement by Hong Kong banks as a percentage of that of the PRC increased from 73% in 2010 to 80% in the first half of 2011, demonstrating that Hong Kong remained the most important platform for RMB cross-border trade settlement. According to Hong Kong Monetary Authority, RMB deposits in Hong Kong increased substantially by 317% from RMB1,493 billion as of September 30, 2010 to RMB6,222 billion as of September 30, 2011. Hong Kong as an offshore RMB center soon develops. We believe that, with the on-going internationalization of RMB and its increasing demand, an increasing amount of offshore RMB trade settlement will be carried out in Hong Kong.

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	As of December 31,						As of September 30,	
	2004	2005	2006	2007	2008	2009	2010	2011
	(RMB in millions)							
Balance of RMB deposits in								
Hong Kong	12,127	22,586	23,403	33,400	56,060	62,718	314,938	149,326 622,236

Source: Hong Kong Monetary Authority

As the RMB liquidity pool in Hong Kong continues to expand, RMB financial intermediary activities have become more active, especially the development of RMB dim sum bonds. In the first six months of 2011, 38 entities issued RMB bonds amounting to RMB42.7 billion in Hong Kong, already breaking the record of RMB35.8 billion of RMB bonds issued by 16 issuers for the entire year of 2010. In addition, the internationalization of RMB also offers significant RMB business opportunities in Hong Kong. It is expected that more RMB-linked products and services will be launched in Hong Kong, such as RMB funds, RMB denominated IPOs and QFII, which will support the sustained growth of the RMB business in Hong Kong.

Strengthening Hong Kong's capital market under favorable policies

In August 2011, in order to strengthen Hong Kong as an international financial hub and facilitate its growth as the offshore RMB center, the PRC government promulgated six policies to promote further development of Hong Kong and deepen the cooperation between the PRC and Hong Kong in trade and financial sectors. These policies include the launch of Hong Kong Stock ETFs in the PRC, the continued encouragement of PRC enterprises to list in Hong Kong and the involvement of PRC licensed Hong Kong banks in the distribution of mutual funds. The PRC government will also give full support to the development of the RMB market in Hong Kong, encourage direct investments in RMB by Hong Kong investors in the PRC and allocate an initial aggregate amount of RMB20 billion to RQFIs to invest in the domestic securities market. In addition, the PRC government will permit more PRC financial institutions and enterprises to issue dim sum bonds in Hong Kong and increase the approved size of dim sum bond issuances. The PRC government intends to institutionalize RMB sovereign bonds and gradually increase their size. In light of Hong Kong's favorable environment and policies, Hong Kong is set to further expand its capital market activities by leveraging its relationship with the PRC.

Active participation of PRC companies in the Hong Kong stock market

Since the first H share company listed in Hong Kong in 1993, more PRC companies followed and the frequency of fund-raising activities has also increased. In the past ten years, the number of PRC companies listed on the Main Board and GEM increased from 128 to 265 and the aggregate amount of proceeds raised by PRC companies by equity offerings increased from HKD25.9 billion to HKD346.9 billion at a CAGR of 33.4%, representing 40% of the total amount of proceeds raised. As of September 30, 2011, there were 164 H-share listed

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companies, 103 red-chip listed companies and 353 non-H-share PRC private enterprises listed on the Hong Kong Stock Exchange, with a total market capitalization of HKD8.91 trillion, representing 54.9% of the total market capitalization. After the recent announcement by the PRC government of its continued support for the listing of PRC enterprises in Hong Kong, it is expected that more PRC enterprises will seek listings in Hong Kong. The continued entry of PRC companies and the related fund-raising activities will further stimulate growth of the Hong Kong stock market. This will in turn be one of the driving forces for shaping the competitive landscape of the Hong Kong securities industry and the growth in the investment banking business.

The following table sets forth the changes of the total market capitalization of listed companies and PRC companies and their respective numbers on the Hong Kong Stock Exchange (including Main Board and GEM) for the periods indicated:

	As of December 31,									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total Market										
Capitalization										
(HKD in billions)										
All listed companies . . .	3,946.3	3,611.3	5,547.9	6,695.9	8,179.9	13,337.7	20,697.5	10,298.8	17,874.3	21,077.0
PRC companies	1,011.6	938.9	1,606.0	1,871.6	2,997.7	6,331.1	10,604.0	5,607.6	8,582.2	9,616.5
Number of listed										
companies										
All listed companies . . .	1,189	1,586	1,785	2,176	2,649	3,383	6,092	5,831	6,616	7,900
PRC companies	128	143	164	184	200	222	238	245	253	265

Source: Hong Kong Stock Exchange

In light of the above developments, investment banking businesses in Hong Kong have also changed in the past ten years, from a market dominated by international investment banks to a market shared by international investment banks and investment banks with Chinese background. Revenues generated from the investment banking business is becoming the main source of income of PRC securities firms in Hong Kong. In 2010, Investment banks with Chinese background had participated as sponsors (or one of the sponsors) in 28 Hong Kong IPOs, the fund raising amount of which represented approximately 34% of the total fund raised. This percentage has increased from approximately 16% in 2001. Accordingly, the proceeds from the equity offerings sponsored by such investment banks on the main board of the Hong Kong Stock Exchange increased from approximately HKD16.8 billion in 2001 to approximately HKD153.8 billion in 2010, representing a CAGR of 27.9%. These factors demonstrate the rising prominence of investment banks with Chinese background in the Hong Kong stock market.

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SOURCE OF INFORMATION

In addition to statistics, market share information and industry data from publicly available government sources, some information and data contained in this section are derived from Wind Info. As a leading integrated service provider of financial data, information and software in the PRC domestic market. Wind Info serves financial enterprises, including securities firms, fund management firms, insurance companies, banks and investment companies. The financial database of Wind Info contains comprehensive information on stocks, bonds, futures, foreign exchange, insurance, derivatives and the macro-economy. Historic data and market estimates provided by Wind Info are collected by Wind Info independently from various public information sources, including the SAC, the Shanghai Stock Exchange and the Shenzhen Stock Exchange.