## RISKS RELATING TO THE GROUP'S BUSINESS

### If the Group's future expansion is unsuccessful, the business of the Group may be adversely affected

Under the Group's business expansion plan, the Group will increase its total number of leased-and-operated hotels in the near future. The ability of the Group to expand its hotel operation successfully will depend on a number of factors, including the Group's ability to obtain financing on acceptable terms, the availability and selection of suitable locations, the brand management and some of which may be beyond the control of the Group. In addition, the anticipated rapid growth of hotel business may require the Group to have a more integrated and comprehensive operational, information and accounting system, training programme, managerial talent and other resources to manage and operate its expansion of hotel business effectively. In such circumstances, the Group cannot guarantee the returns of its business expansion plan.

The quality of the Group's services and hotels is crucial to the success of the expansion plan. Any significant failure or deterioration of quality control system may seriously damage the Group's brands and have a material adverse effect on the Group's reputation in the market among current or prospective customers, which could be an obstacle to achieving the Group's business expansion plan. There is no assurance that the Group will be able to effectively and efficiently manage the growth of operations or maintain the quality standards. If the Group is unable to do so, the Group's results of operations and financial condition may be materially and adversely affected.

As the Group plans to operate new hotels in new markets in the PRC where its management may have less or no operating experience, the costs incurred relating to the opening, operation and promotion of these new hotels may be substantially greater than the existing markets that the Group currently has presence. These hotels may attract fewer hotel guests than the Group's existing hotels, while the Group may incur substantial additional costs in relation to the operation of these new hotels. Unanticipated expenses may be incurred by the Group's hotels in new market which may also cause certain non-financial key performance indicators to decline, such as the RevPAR and occupancy, as hotels in new markets may have lower ARR and occupancy than markets in which the Group currently operates. Expansion into new markets will cause substantial demand on managerial, operational, financial, information technology and other resources. Inability to anticipate changing demand of new markets could result in lower revenue and increased expenses and otherwise harm the results of operations and financial performance of the Group.

### The Group may not be able to successfully identify, secure or operate additional hotel properties

The Group plans to open more hotels in the PRC to accelerate its business growth. The Group may not be successful in identifying and leasing additional hotel properties at desirable locations and on commercially reasonable terms, or at all. It may be difficult to increase the number of hotels in developed cities as the competition for prime locations may be severe and rental prices may be high in such cities. Competition may reduce the number of suitable investment opportunities available to the Group and consequently increase the bargaining power of property owners seeking to lease their properties. If the Group fails to successfully identify new hotel properties, the Group's ability to execute the growth strategy could be impaired and its business and prospects may be materially and adversely affected.

**The Group's success is dependent on the retention of certain key personnel**

The Group's ability to compete and succeed in its business has been, and will continue to be, heavily dependent upon the continuing services of the key personnel of the Group. The Group relies on the experience of Mr. Fong (the chairman of the Company and an executive Director) and Mr. Wong (the chief executive officer of the Company and an executive Director) to devise the Group's strategic objectives and manage the business. In particular, the Group relies on the architectural experience of Mr. Fong as he is actively involved in designing the hotels (including both the leased-and-operated hotels and hotels under the hotel consultancy agreements). The Directors cannot guarantee that the Group will be able to retain Mr. Fong and Mr. Wong, the loss of their services in the absence of any suitable replacements may have a negative impact on the Group's operation and future profitability. As a result, the Group's financial condition and operating result may be materially and adversely affected.

**The Group has a limited operating history in hotel consultancy business and consultancy fee is paid on a project basis**

The Group commenced the hotel consultancy business in December 2009 and has a limited operating history in this business segment. The consultancy fee received for the year ended 31 December 2010 amounted to approximately HK$9,632,486, which accounted for approximately 25.8% of the total revenue of the Group for the year. However, the Group's hotel consultancy business is at an early stage of development, and the revenue, potential income and cash flow from this new business is unproven. The Group had completed providing the services under four hotel consultancy agreements in 2010. Since 1 January 2011 and up to the Latest Practicable Date, the Group had entered into only one hotel consultancy agreement with an independent hotel investor for the provision of hotel consultancy services for South China Hotel. As the Group's hotel consultancy business has only been launched since December 2009, there can be no assurance that it will generate long term revenue to the Group. Also, the consultancy fee is paid on a project basis. The Directors cannot guarantee that the Group will be able to enter into new hotel consultancy agreements with hotel investors in the future. As such, the revenue generated from the hotel consultancy business may be subject to fluctuation depending on the success of the Group in entering into new hotel consultancy agreements. The success of the Group's hotel consultancy business will also depend on many factors outside its control, including the economic development of the market, which can cause fluctuations to the Group's revenue. Because of the Group's limited operating history in this business segment, its historical financial data may not provide a meaningful basis for investors to evaluate the hotel consultancy business of the Group and its prospects. Accordingly, evaluation of the Group's hotel consultancy business and its prospects is difficult, and there can be no assurance that the Group will succeed in this business.

**The Group may experience an increase in labour costs**

Labour costs in the PRC are increasing and may continue to increase in the future. The Group relies on labour resources for the provision of the Group's services, and therefore a high proportion of the Group's costs are labour costs. During the Track Record Period, the Group's employee benefit expenses accounted for approximately 15.2% and approximately 17.0% of the Group's total operating expenses, respectively. There is no assurance that the Group will not experience an increase in labour costs. Such negative incident may have a significant impact on the Group's business, results of operations and financial condition.

**Majority of the Group's revenue comes from the Shenzhen operations**

The Group currently relies on its Shenzhen operations for the majority of its revenue and profits. During the Track Record Period, most of the revenue were generated from the Group's hotels in Shenzhen. As such, the Group's revenue and results of operations are substantially dependent on conditions in Shenzhen, in general, and demand for hotel rooms in Shenzhen, in particular. The developments in Shenzhen and any neighbouring region, including:

(i) economic and political developments;

(ii) changes in the PRC's regulations, including changes to regulations or other restrictions imposed on tourists by the PRC government; and

(iii) the outbreak of any severe contagious disease or pandemic within Shenzhen, or any neighbouring region,

may have a significant adverse impact on travel to Shenzhen. As a result, the Group's business, results of operations and financial condition may be adversely affected.

**The development of new hotels is subject to a number of risks beyond the Group's control, including insufficient growth in demand for hotel rooms**

If future demand for the Group's hotel rooms does not match the growth of the Group's business, the Group may experience lower occupancy than expected or be required to adopt lower room rates to attract hotel guests, which may cause the Group not being able to achieve a satisfactory return and have a material adverse impact on the Group's financial condition and results of operations.

New project development and property conversions are also subject to a number of additional risks, many of which are outside the Group's control, and those risks include but not limited to:

(i) delay in obtaining necessary licences or approvals from government authorities;

(ii) shortages of labour, materials, equipment, contractors and skilled labour;

(iii) property deterioration after acquisition;

(iv) the possibility of discovering previously undetected defects or problems in a property to be converted;

(v) social disorder and other extraordinary events; and

(vi) political and regulatory risks.

Besides, the Group relies on third party contractors for hotel construction and conversion and is subject to risks relating to the performance of these contractors. There is no assurance that the hotel construction and conversion will be completed on schedule without additional costs or that the services rendered by the third party contractors will fulfill the quality level required by the Group. The occurrence of any of these events could have a material adverse effect on the financial performance of the Group.

**The Group may not be able to obtain sufficient funding for its capital expenditure and other funding requirements in a timely manner or on acceptable terms, which could limit its capacity for future business development**

The Group expects to incur a high level of capital expenditure to implement the growth strategy, remain competitive or expand its hotel network in the foreseeable future. To fund the Group's ongoing operations and future expansion, the Group needs sufficient internal resources and/or access to additional financing from external sources. If adequate funding is not available, the Group's ability to develop and expand its business could be adversely affected. The Group's ability to obtain external financing in the future and the related financing cost on acceptable terms is subject to a variety of uncertainties, including:

(i) the PRC government approvals necessary for obtaining financing in the domestic markets;

(ii) the Group's future results of operations, financial condition and cash flow;

(iii) the condition of the international and domestic financial markets; and

(iv) changes in the monetary policies of the PRC government with respect to bank interest rates and lending practices.

The Group may be unable to obtain additional capital in a timely manner or on acceptable terms, or at all, which could have a material adverse effect on liquidity, financial condition and ability to pursue the expansion plans.

**The Group has recorded net current liabilities**

The Group had a net current liabilities of approximately HK$41.7 million and approximately HK$8.7 million as at 31 December 2009 and 31 December 2010 respectively. The net current liabilities as at 31 December 2009 was primarily due to a debt owed to Mr. Fong and outstanding trade and other payables. The amount due to Mr. Fong was approximately HK$32.2 million as at 31 December 2009. On 31 December 2010, Mr. Fong waived the amounts due to him by the Group at the sum of approximately HK$20.8 million.

The Group maintained a lower rental payables balance as at 31 December 2010 as compared with such balance as at 31 December 2009 due to a rental waiver granted by the landlord of Welcome Inn Nanshan. As a result, the net current liabilities as at 31 December 2010 was substantially reduced compared with that as at 31 December 2009. The net current liability position improved and became net current assets of approximately HK$0.6 million as at 30 April 2011 based on unaudited management accounts. This was mainly attributable to the increase of cash and cash equivalents due to capital injection into Legend Strategy by the then shareholders in proportion to their shareholdings, and decrease in trade and other payable and amount due to a director as a result of settlement of the payables during the period.

Nonetheless, the Directors cannot guarantee that the Group will not experience net current liabilities in the future which may limit the Group's working capital for the purposes of operations or capital for business expansion plan and adversely affect the Group's financial position accordingly.

**The Group experienced significant fluctuation in its net profit during the Track Record Period and the four months ended 30 April 2011**

The Group incurred a net loss of approximately HK$3.5 million for the year ended 31 December 2009 and a net profit of approximately HK$9.5 million for the year ended 31 December 2010. The net loss for the year ended 31 December 2009 was mainly due to under-utilisation of the Group's hotel and the high fixed costs in hotel operations. In 2009, the occupancy of the Group's hotels remained low, ranging from approximately 40.6% to approximately 78.8%, since three out of four of its hotels, namely Welcome Inn Baoan, Welcome Inn Nanshan and Welcome Inn Luohu were established in 2008 and their customer base and goodwill required time to build up. The Group's financial results improved for the year ended 31 December 2010 mainly due to the new source of revenue generated from the hotel consultancy business and increased profit margin from the hotel operations as occupancy improved. Based on the unaudited management accounts of the Group, the Group was in a loss position for the four months ended 30 April 2011 mainly due to the lack of revenue from the hotel consultancy business being recognised and the Group incurring non-recurring expenses in relation to [●] during the period.

With the fluctuation in the Group's profitability during the Track Record Period and the four months ended 30 April 2011, the Company cannot assure that it could generate profit in the future and maintain or increase the profit of the Group. The Group's ability to achieve profitability will depend on its growth of its existing business and the success of the implementation of its business expansion plans. The Group's profitability is affected by a number of factors outside of the Group's control. The Group's operating results may be adversely affected by any of such factors.

**The Group's historical financial condition may not be treated as indication of its future profitability**

The Group's future success depends on its ability to achieve its hotel business expansion plan, including development of leased-and-operated hotels. However, the Group's limited operating history makes it difficult to evaluate the Group's future prospects. As a result, the Group's historical financial condition may not be indicative of its future profitability. Investors should consider the Group's future prospects in light of the risks and challenges encountered by a company with limited operating history. These risks and challenges include, among others:

(i) the uncertainties associated with the Group's ability to continue its growth and maintain profitability;

(ii) improving and preserving the Group's competitive position in the hotel industry in the PRC;

(iii) offering consistent and high-quality accommodations and services to retain and attract guests;

(iv) implementing the Group's strategy and modifying it from time to time to respond effectively to competition and changes in hotel guest preferences;

(v) increasing awareness of brand and continuing to develop hotel guest loyalty; and

(vi) recruiting, training and retaining qualified managerial and other personnel.

If the Group is unsuccessful in addressing any of these risks or challenges, its business may be materially and adversely affected.

**The Group lacks experience in engaging in the hotel management business**

The Group intends to expand its hotel business by offering hotel management services. Since the Group has no experience in engaging in the hotel management business, the Directors cannot guarantee that it will be successful in generating sufficient revenue to make this business profitable. The success of such business depends on a number of factors, both within and outside the control of the Group, including the successful employment of the Group's experience built from managing its leased-and-operated hotels to offer hotel management services. Accordingly, evaluation of the Group's hotel management services business and its prospects is difficult, and there can be no assurance that the Group will succeed in this business.

**The Group's financial position and operating results could be materially and adversely affected by its concentration of suppliers**

The Group has a concentration of suppliers that the Group's five largest suppliers in aggregate accounted for approximately 91.0% and approximately 98.3% of the Group's total purchases for the two years ended 31 December 2010, respectively. The major suppliers of the Group are suppliers of disposable amenities, cleansing products and laundry services. Although suppliers of such products and services are readily replaceable, there is no assurance that the Group can secure adequate supply at commercially viable prices in a timely manner to meet the Group's requirements. In addition, the Group does not have long term supply contracts with these suppliers and therefore the Group cannot guarantee consistent supplies from these suppliers. A shortage of such supplies could result in the Group's inability to operate its hotel business, therefore its financial position and operating results could be materially and adversely affected.

**The Group has an increasing concentration of and reliance on major customers and the loss of any of such customers could materially and adversely affect the Group's business and financial position**

The Group has an increasing concentration of and reliance on major customers that the Group's five largest customers accounted for approximately 3.0% and 29.6% of the Group's revenue for the two years ended 31 December 2010, respectively. This is mainly due to the commencement of the hotel consultancy business in December 2009 which contributed revenue on a project basis. For the year ended 31 December 2010, the Group completed the projects under four hotel consultancy agreements entered into with two hotel investors, which contributed approximately 25.8% of the Group's total revenue for the year. The Directors cannot guarantee that the Group will be able to enter into new hotel consultancy agreements with these or other hotel investors in the future. If any of the hotel investors materially reduces or delays payment, or terminates the hotel consultancy agreements with the Group, the Group's cash flow and profitability may be adversely impacted.

**The financial results of the Group are expected to be affected by the expenses in relation to [●]**

The financial result of the Group for the year ending 31 December 2011 will be affected by the non-recurring expenses in relation to [●]. Such expenses in relation to [●] have not been incurred during the Track Record Period.

Accordingly, the financial results of the Group for the year ending 31 December 2011 are expected to be materially and adversely affected by the estimated expenses in relation to [●].

**The Group intends to refurbish or further develop the existing leased hotel properties which could result in cost overruns or disruptions of the leased-and-operated hotel operations**

In order to improve and maintain the conditions of the leased-and-operated hotels, the Group needs to conduct refurbishments of the hotels. These refurbishments may be more costly than expected and are subject to risk of delay and cost overrun. Moreover, even though the operations of hotels may not need to stop entirely during the refurbishment, there may be situations where refurbishment would disrupt hotel operations and adversely affect the Group's revenue. The disruption and other risks associated with refurbishments or the failure to improve and maintain the conditions of the hotels could have an adverse effect on the Group's business, financial condition and results of operations.

**The Group may not be able to register the existing brand names**

During the Track Record Period, the Group operated the hotels under the brand names of "悅來", "悅來客棧" and "Welcome Inn". The Directors believe that brand names, trade names and trademarks are critical to the Group's success in the long term. The Group has made applications for the registration of word marks and logo marks containing "悅來客棧", "悅來" and "Welcome Inn" as trademarks in the PRC in February and March 2011 which are accepted and currently being processed by 國家工商行政管理總局商標局 (Trademark Department of the State Administration of Industry and Commerce*) as at the Latest Practicable Date. It is expected that the registrations will be completed within two years from the respective date of applications. Before the trademarks are successfully registered in the PRC, the Group is unable to prevent one or more other parties from using the same brand names or word marks or logo marks to promote hotel business. Any use by a third party of the "悅來", "悅來客棧" or "Welcome Inn" brand names or logo marks may impact hotel guests' perception of the Group's hotels. In particular, hotel guests may believe that other hotels using the same brand names are related to the Group, and recognition of and confidence in the Group's brand names may be negatively impacted if the standard of any services or amenities offered in third-party hotels are below that of the Group. If the Group is unable to register any of the said trademarks, it may not be able to effectively promote the hotel business and the Group's hotel occupancy, revenue and profitability may be materially and adversely affected. Further details of the Group's trademarks are set out in the sub-section headed "Intellectual properties" under the section headed "Business" of this document and the sub-paragraph headed "Intellectual property rights of the Group" under the section headed "Further information about the business of the Group" in Appendix V to this document.

**The Group's insurance coverage may be insufficient to protect the Group against potential liabilities arising during the course of the operations**

The Group's operations may be affected by a number of risks, including business interruption or potential damage to the Group's facilities and equipment caused by adverse weather conditions, human error, terrorist attack, war, pollution or labour disputes. Moreover, the Group faces risks relating to provision of services to hotel guests such as causing damage to hotel guests' belongings. Consistent with industry practice, the Group does not maintain insurance against all risks associated with the hotel industry, either because the Directors have deemed it commercially unfeasible to do so, or the risk is minimal, or the premium is not justifiable, or because the insurers have carved certain risks out of their standard policies. These risks include, but are not limited to, events such as the loss of business arising from increased competition, the loss of any business resulting from negative effects on the changing business cycles or supply of rooms. If an incident occurs in relation to which the Group has inadequate insurance coverage, the business, financial position and operating results of the Group could be materially and adversely affected. Further, the Directors cannot guarantee that the Group will be able to renew the existing insurance policies on commercially reasonable terms, or at all.

**Prohibited activities, accidents or injuries in the Group's hotels may adversely affect the Group's reputation and hold the Group liable**

There are inherent risks of prohibited activities (such as illegal drug use, gambling, violence or prostitution by guests), accidents or injuries taking place in the Group's hotels. The occurrence of one or more prohibited activities, accidents or injuries at any of the Group's hotels could adversely affect the Group's safety reputation among hotel guests, harm the Group's brand name, decrease the overall occupancy, and increase the costs of implementing additional safety measures. Moreover, if prohibited activities, accidents or injuries occur at any of the Group's hotels, the Group may be held liable for fines or damages. The Group's current property and liability insurance policies may not provide adequate or any coverage for such losses, and the Group may be unable to renew the insurance policies or obtain new insurance policies without paying higher premium costs. The Group has not experienced any material prohibited activities, accidents or injuries in its hotels during the Track Record Period.

**The Group may not be able to renew the leases with the hotel property owners and the rent for the leased hotel properties may increase**

All the Group's leased-and-operated hotels are operated under leases. The leases of the hotel properties in Nanshan, Caitian, Luohu and Baoan will expire on 31 December 2014, 19 November 2015, 31 January 2018 and 15 August 2017 respectively. The Directors cannot guarantee that the property owners will renew the leases or renew the terms of the leases acceptable to the Group upon their expiration. If any of the property owners is unwilling to renew the lease or the Directors are of the view that the terms of the proposed new lease are not commercially acceptable or reasonable, it would have a material adverse effect on the Group's revenue, profit margin and results of operations.

The Directors also cannot guarantee that the rent for the leased properties will not increase. Rental expense is one of the Group's major costs in its business operations. For the two years ended 31 December 2009 and 2010, total rent for the Group's leased properties amounted to approximately HK$8,420,635 and HK$7,492,727, representing approximately 36.8% and 31.6% of the operating expenses of the Group, respectively. Given that there has been a general rising trend of rent in the PRC, any substantial increase in rental expenses in future may have a material adverse impact on the Group's profitability.

**Certain property owners are not able to produce certain title documents**

As at the Latest Practicable Date, the Group had a total of 12 leased properties in Hong Kong and the PRC for its hotels, staff quarters and office premises. All of such properties are leased from Independent Third Parties. The leased property for Welcome Inn Caitian (the "**Caitian Property**") is located on a parcel of land which the land use rights belong to 中國人民武裝警察部隊 (the People's Armed Police Force of China*) (the "**PAPF**"). The lessor has the right to use the Caitian Property under 中國人民武裝警察部隊房地產租賃許可證 (Real Estate Title Certificate of the People's Armed Police Force of China*) (the "**Lease Permit**") issued by the 中國人民武裝警察部隊後勤部基建營房部 (Logistic Department and Infrastructure and Housing Department of the People's Armed Police Force of China*). However, the Lease Permit had expired on 31 December 2009 and to the best knowledge of the Directors, the application by the lessor for a new Lease Permit is in progress. However, it is not certain when a new Lease Permit will be issued and if a new Lease Permit will be issued at all. As advised by the Company's PRC legal advisers, if the PAPF refuses to issue a new Lease Permit, the lessor may not be entitled to lease the Caitian Property to the Group and the lease agreement may not be enforceable. In such event, the

Group may risk being requested by the PAPF to vacate from the property and hence would have a material adverse effect on the Group's revenue, profit margin and results of operations. In the event that the Group is requested to vacate the Caitian Property, it is expected that the Group will incur a loss of approximately HK$3.6 million, being the carrying amount of Welcome Inn Caitian (including all immovable assets such as leasehold improvements) as at 31 December 2010. Further details of the Caitian Property are set out in the sub-section headed "Properties" under the section headed "Business" of this document.

Further, the landlord of a staff quarter is unable to produce evidence of ownership in the property, and the validity of such lease agreement may be challenged. If the lease agreement is found to be invalid by the competent authorities or if the landlord turn out does not possess valid title, the Group may have to relocate the staff quarter and in such circumstance, the Group would have to incur additional relocation costs.

The Controlling Shareholder has agreed to keep the Group indemnified for any losses that the Group may suffer from any failure of any member of the Group in leasing or obtaining licence or permit to use any property interests owned or leased or otherwise used or occupied by the Group, or to obtain any property certificate in respect of such properties. Please refer to the paragraph "1. Estate duty and tax indemnity" under the section "E. Other Information" in Appendix V to this document for further details.

**A few lease agreements have not been registered according to relevant PRC rules and regulations**

According to the relevant PRC rules and regulations, a lease agreement shall be registered with the relevant authority within 30 days after the lease agreement is entered into, failing which the relevant authority is entitled to request the parties of the lease to rectify the situation within a time limit. The lease agreements of the Caitian Property and Welcome Inn Nanshan have not been registered with the relevant authority. As at the Latest Practicable Date, the lease agreement of Welcome Inn Nanshan was in the process of registration with the relevant authority. In addition, the Company intends to register the lease agreement of the Caitian Property after the issue of a new Lease Permit. However, to the understanding of the Company, the registration of the lease agreement of the Caitian Property may be subject to the validity of the Lease Permit. As such, the Company may or may not successfully register such lease agreement.

Further, none of the lease agreements of the staff quarters have been registered with the relevant PRC authorities as the respective landlords of the properties are unwilling to provide the Group with the original building ownership certificates for registration purpose or are reluctant to complete the required registration, as confirmed by the Directors. Should such staff quarters are required to be relocated, alternative staff quarters be available in close proximity. The Directors believe that the cost of relocation for one staff quarter is estimated to be approximately RMB1,000. The Directors do not anticipate the relocation of staff quarter to have any material potential operational and financial impact on the Group.

As at the Latest Practicable Date, the Group had not received any rectification or penalty order. If the parties still fail to register the lease agreement, they may be subject to a fine in the sum between RMB1,000 and RMB10,000. According to the relevant PRC rules and regulations, the Group may be liable for the fine as mentioned above.

The Controlling Shareholder has agreed to keep the Group indemnified for any losses that the Group may suffer from any failure of any member of the Group in leasing or obtaining licence or permit to use any property interests owned or leased or otherwise used or occupied by the Group, or to obtain any property certificate in respect of such properties. Please refer to the paragraph "1. Estate duty and tax indemnity" under the section "E. Other Information" in Appendix V to this document for further details.

**The Group may be subject to fine due to delay in full payment of registered capital**

The registered capital of Modern Tourists and Yuelai Inn were all fully paid. However, such registered capital were fully paid after the time limit specified by the relevant registration authority due to administrative omission. According to 中華人民共和國公司登記管理條例 (the PRC Company Registration and Management Regulations*), the relevant registration authority is entitled to request a company which has delayed full payment of its registered capital to pay a fine in a sum between 5% to 15% of the amount due. The Group is subject to an aggregate maximum penalty of HK$187,500 for the delay in full payment of the registered capital of Modern Tourists and Yuelai Inn. As advised by the Company's PRC legal advisers, the delay in full payment of registered capital will not affect the valid existence and will not cause any material adverse effect on the legal status of Modern Tourists and Yuelai Inn. 深圳市市場監督管理局 (the Market Supervision and Administration Bureau of Shenzhen*), the competent authority, confirmed that as at 31 December 2010 none of Modern Tourists and Yuelai Inn was in breach of 市場監督管理法律法規 (the Law and Regulation of Market Supervision and Administration*). No provision for the penalty has been made during the Track Record Period since the Directors consider the financial impact of such penalty is insignificant and it is not probable that the Group's subsidiaries will be subject to such penalty since the Group has obtained the confirmation from 深圳市市場監督管理局 (the Market Supervision and Administration Bureau of Shenzhen*) that both Modern Tourists and Yuelai Inn were not in breach of 市場監督管理法律法規 (the Law and Regulation of Market Supervision and Administration*). Although no objections have been raised by the relevant registration authority up to the Latest Practicable Date in relation to the delayed payment of the registered capital of Modern Tourists and Yuelai Inn, if the relevant registration authority decides to enforce the regulations and request any of Modern Tourists or Yuelai Inn to pay fines, it would have a material adverse effect on the Group's results of operations.

The Controlling Shareholder has entered into a deed of indemnity with and in favour of the Company in which the Controlling Shareholder has agreed with each member of the Group that he will indemnify and at all times keep all and each of the members of the Group fully indemnified on demand against all losses, costs (including all legal costs), expenses, penalties or other liabilities which any of the members of the Group may incur in connection with or sustain from the delay in capital contribution to any members of the

Group by the relevant shareholders. Please refer to paragraph headed "1. Estate duty and tax indemnity" under the section headed "E. Other Information" in Appendix V to this document.

**The Group may be required to pay up any outstanding social insurance, or subject to penalties for any irregularities arising from the contribution to the social insurance**

As set out in the sub-section headed "Litigation and legal compliance" under the section headed "Business" of this document, the Group has not fully paid and has not been required by the relevant local authorities to fully pay the social insurance contribution for some of the Group's employees.

Therefore, the Group may be required to pay up any outstanding social insurance, or subject to penalties for any irregularities arising from the contribution to the social insurance. The Controlling Shareholder has entered into a deed of indemnity with and in favour of the Company in which the Controlling Shareholder has agreed with each member of the Group that he will indemnify and at all times keep all and each of the members of the Group fully indemnified on demand against all losses, costs (including all legal costs), expenses, penalties or other liabilities which any of the members of the Group may incur in connection with or sustain from the under-provision of social insurance to any members of the Group by the relevant shareholders.

## RISKS RELATING TO THE HOTEL INDUSTRY

**The hotel industry is subject to intense and growing competition**

The hotel industry is highly competitive in the PRC. The Group's competitors include operators of single guesthouses and hotels located in the vicinity of the Group's hotels, local hotel chains with multiple hotels, established property developers who have entered the hotel industry, and large international hotel chains operating multiple hotels under a variety of brand names. The competition to attract hotel guests is primarily based on the location of the hotel, price, property size, quality of rooms, amenities and facilities, hotel guest brand recognition and loyalty, geographic coverage, quality of services provided, and relationships with travel agents and third party wholesalers. Many of the competitors have operated in the industry for substantially longer periods of time than the Group and have accumulated more operational, managerial, sales and marketing experience, brand recognition, human resources and financial resources. The Directors cannot guarantee that some or many of the competitors will not engage in hotel business in markets in which the Group is operating or plan to operate, which will increase the supply of available hotel rooms in those areas and thereby increase competition and negatively impact the Group's occupancy and room rates. The Directors cannot guarantee that the Group will be able to successfully compete against the current and future competitors. In particular, if more established competitors engage in significant price discount to attract hotel guests, the Group may be forced to substantially reduce the hotel room rates to maintain occupancy, and it would have a material adverse effect on the Group's revenue, profitability and results of operations.

In addition, competition for hotel staff, particularly experienced ones, is intensive in the hotel industry. The Group's hotel staff interacts with the guests and are critical in maintaining consistent and high-quality services, and enhances the brand names and reputation. The Group must recruit and train qualified managerial and other employees on a timely basis to keep pace with the planned future growth. Due to rapid growth of the economy in the PRC, there is a shortage in the supply of labour in the market. The Group needs to compete against other hotel operators which have substantially more established brand names that may potentially be perceived to be more attractive than the Group's brand names, which may offer better compensation, benefits and potential for career advancement and international exposure. The Group also needs to face competition for labour from other industries in the PRC. If the Group fails to recruit, train and retain qualified managers and other employees, the quality of the Group's hotel services may deteriorate and the Group may be unable to implement the expansion plans, which in turn may have a material adverse effect on the Group's brand names, business, financial condition and results of operations.

**The Group's business may be adversely affected by a reduction in travel or discretionary consumer spending as a result of a downturn in the PRC or the global economy**

The Group's business may be adversely affected by a reduction in business travel or discretionary consumer spending as a result of a downturn in the PRC or the global economy. Consumer demand for the hotel accommodation and convention amenities which are provided by the Group are particularly sensitive to downturns in the economy. In particular, the Group is vulnerable to decline in demand from travellers. Changes in consumer preferences, level of travel, or discretionary consumer spending brought about by factors such as deterioration in general economic conditions, decrease in disposable consumer income, fear of recession or decline in consumer confidence in the economy could reduce consumers' demand for the hotel services provided by the Group, thus imposing practical limits on pricing and consequently will have an adverse effect on the Group's business, financial condition and results of operations.

**The Group's financial and operating performance may be adversely affected by adverse weather conditions, epidemics, natural disasters and other catastrophes, wars, the threat of terrorist attacks and the occurrence of international or political crises**

The Group's financial and operating performance may be adversely affected by adverse weather conditions, epidemics, natural disasters and other catastrophes, wars, the threat of terrorist attacks and the occurrence of international and political crises, particularly in the PRC. Losses caused by adverse weather conditions, epidemics, natural disasters and other catastrophes, such as severe acute respiratory syndrome (SARS), avian flu, swine flu, earthquakes, typhoons, wars and terrorist attacks are either uninsurable or too expensive to justify insuring against. In the event an uninsured loss or a loss in excess of insured limits occurs, the Group could lose all or a portion of the capital it has invested in the hotels, as well as the anticipated future revenue from the hotels. Similarly, war (including the potential for war), terrorist attacks (including threats of terrorist attacks), as well as geopolitical uncertainty and international conflict, may affect travelling and may in turn have a material adverse effect on the Group's business and results of operations. In addition, the Group may not be adequately prepared in contingency planning or recovery capability in relation to a major incident or crisis, and as a result, the Group's operational continuity may be adversely affected and reputation may be harmed.

**The seasonality of the hotel industry could have a material adverse effect on the Group's revenue and financial condition**

The hotel industry is seasonal in nature and can cause fluctuations in the Group's revenue and financial conditions. This seasonality can be expected to cause periodic fluctuations in the Group's occupancy, hotel room rates and operating expenses. The results of operations are affected by seasonal fluctuation in demand for hotel services. The corporate customers contribute a significant portion of revenue to the Group. The Group experiences lower revenue in Chinese New Year holidays during which most of the workers in the PRC are on vacation and less business trips are arranged. The revenue earned from the hotel operations segment during January 2009 and February 2010 (the months with Chinese New Year holidays) dropped by approximately 26.5% and approximately 37.0% compared with the average monthly revenue earned from the hotel operations segment for the two years ended 31 December 2010 respectively. The Directors cannot guarantee that the Group's cashflow will be sufficient to offset any shortfalls that occur as a result of these fluctuations, and the Group may have to enter into short-term borrowings in order to enhance the cash flow position at any time during the financial year. As a result, volatility in the financial performance resulting from the seasonality of the hotel industry could have a material adverse effect on the Group's revenue and financial condition.

**The Group's co-operation with third-party websites and other hotel reservation intermediaries may adversely affect the Group's margins and profitability**

The Group has contracted with operators of websites and other hotel reservation intermediaries who are Independent Third Parties to whom the Group pays commission for such services. If these intermediaries continue to develop their hotel guest bases and the percentage of bookings at the Group's hotels made through their systems becomes even more significant, they may be able to negotiate higher commission or other significant concessions from the Group, which could adversely affect the Group's margins and profitability.

**The Group is subject to renewal of various licences and various hotel industry, health and safety, and environmental laws and regulations that may subject the Group to liability**

The Group is required to obtain applicable licences and renew them from time to time for the operation of its hotel business. The Group does not have automatic rights of renewal to the licences. The Directors cannot guarantee that the conditions or requirements the Group may be required to satisfy or meet will not change from time to time. If the Group is unable to renew the licences in a timely manner or if the relevant government authority does not approve the application for a renewal of the licences, the Group may be subject to fines or penalties and may be required to cease the hotel operations, which may have a material adverse effect on the Group's financial condition and results of operations.

The Group's business is also subject to various health, safety and environmental laws and regulations, including fire prevention, public safety, health and sanitary requirements. Therefore, there could be risks of monetary damages, the imposition of fines, or the suspension or disruption of operations, which could materially adversely affect the financial condition and results of operations. Furthermore, the failure to obtain environmental approvals from local environmental protection agencies and non-compliance with applicable health and safety regulations may subject the hotels to fines or suspension of operations, which could materially adversely affect the financial condition and results of operations. New regulations could also require the Group to retrofit or modify the hotels or incur other significant expenses.

**Fluctuations in the price of disposable amenities, cleansing products and laundry services**

The price of disposable amenities, cleansing products and laundry services required by the Group may fluctuate due to changes in the supply and demand of the market. There is no assurance that the disposable amenities, cleansing products and laundry services required by the hotel operation will not be subject to any shortage in supply or upsurge in demand which may lead to an increase in prices. If the Group is unable to pass these increased cost to its hotel guests because of the competitive nature of hotel industry, the Group's profit margin will decrease and the Group's profitability may be materially and adversely affected.

## RISKS RELATING TO THE PRC

**Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of the PRC, which could adversely affect business of the Group**

The Group conducts substantially all of the business operations in the PRC. Since the travel industry is highly sensitive to business and personal discretionary spending levels, it tends to decline during general economic downturns. In view of that, the Group's results of operations, financial condition and prospects are subject to a significant degree to economic developments in the PRC. The PRC's economy is different from the economies of most developed countries in many respects, including the level of government intervention, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past 20 years, growth has been uneven across different regions and among various economic sectors. In addition, the PRC has also experienced a recent reduction on its economic growth as part of the world financial crisis. The PRC government has executed various measures to encourage economic development and guide the allocation of resources. While some of these measures benefit the overall PRC economy, they may also have a negative effect on the Group. For instance, the Group's results of operations and financial condition may be adversely affected by government control over capital investments or changes in environmental, health, labour or tax regulations.

**Governmental control of currency conversion and fluctuations in the value of the RMB may affect the value of investment, the Group's ability to remit the dividend to the shareholders and the ability of the Group's PRC subsidiaries to obtain financing**

Substantially all of the Group's net revenue and operating expenses are currently generated in RMB. In addition, the Group will require foreign currencies for dividend payment (if any) to the Shareholders. As a result, the Group is exposed to foreign currency fluctuations.

In the PRC, since 1994, the conversion of RMB into foreign currencies including Hong Kong and US dollars, has been based on rates set by the People's Bank of China. The PRC government has, with effect from 21 July 2005, reformed the exchange rate regime by permitting RMB to fluctuate within a narrow and managed band based on market supply and demand with reference to a basket of currencies. The PRC government has since made further adjustments to the exchange rate system. Any appreciation of RMB may result in the decrease in the value of the Group's foreign currency-denominated assets, including the net proceeds from [●]. Conversely, any depreciation of RMB may adversely affect the value of any dividends payable on the Shares in foreign currency terms.

Further, any future restrictions on currency exchanges may limit the ability to use net revenue generated in RMB to fund possible business activities outside the PRC or expenditure denominated in foreign currencies. Although the PRC government introduced regulations in 1996 to allow greater convertibility of RMB for current account transactions, including trade and services-related foreign exchange transactions and payment of dividend, significant restrictions still remain, including primarily the restriction that enterprises may only buy, sell and/or remit foreign currencies at those banks authorised to conduct foreign exchange business after providing valid commercial documents. In addition, remittance of foreign currencies abroad and conversion of RMB for capital account items, including direct investment and loans, is subject to government approval in PRC, and companies are required to open and maintain separate foreign exchange accounts for capital account items. Under the current group structure, the Company's income is derived principally from dividend payments from the Company's PRC subsidiaries. Shortage in foreign currencies may restrict the ability of the PRC subsidiaries to remit sufficient foreign currencies to pay dividends or other payments to the Company, or otherwise satisfy their foreign currency-denominated obligations. The Directors cannot guarantee that the Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of RMB, especially with respect to foreign exchange transactions.

**PRC regulations on loans and direct investments by offshore holding companies to PRC entities may delay or prevent the Group from using proceeds received from [●] to make loans or additional capital contributions to the PRC subsidiaries of the Group**

Any loans or capital contributions the Company, as an offshore entity, makes to its PRC subsidiaries, including the proceeds of [●], are subject to PRC regulations. For example, a foreign-invested enterprise may offer loans according to the PRC regulations, provided that the sum of the long-term, mid-term and short-term loans shall not exceed the difference between the approved investment amount and the registered capital, and such loans must be registered with 中華人民共和國國家外匯管理局 (State Administration of

Foreign Exchange of the PRC*) or its authorised organisation. In addition, the Company's capital contributions to its PRC subsidiaries by way of increasing the registered capital of the PRC subsidiaries must be approved by the competent authority of the Ministry of Commerce of the PRC. There is no assurance that the Group will be able to obtain the approvals on a timely basis, or at all. If the Group fails to obtain such approvals, its ability to make equity contribution or provide loans to the PRC subsidiaries, to fund their operations or to utilise the proceeds of [●] may be adversely affected, which could adversely affect the liquidity of the PRC subsidiaries and their ability to fund working capital.

**PRC legal system embodies uncertainties that could limit the legal protection available to Shareholders and the Group**

A majority of operations of the Group is located in the PRC and such operations are governed by the legal system of the PRC. The PRC legal system is based on written statutes. Prior court decisions may be cited for reference only but have limited precedential value. The PRC government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organisation and governance, commerce, taxation and trade since the late 1970s. However, as these laws and regulations are relatively new and are still evolving, interpretation and enforcement of these laws and regulations may involve significant uncertainties and certain degrees of inconsistencies. Many laws, regulations, policies and legal requirements have only been recently adopted by PRC central or local governments, and their enforcement, implementation and interpretation may involve uncertainty due to the lack of established practice available for reference. Some of the laws and regulations are still at a developing stage and are subject to changing policies. The Group cannot predict the effect of future legal developments in the PRC, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the pre-emption of local regulations by national law. As a result, there is substantial uncertainty as to the legal protection available to the Group and investors. Moreover, due to the limited number of published cases and the non-binding nature of prior court decisions, the outcome of dispute resolution may not be as consistent or predictable as in other more developed jurisdictions, which may limit the legal protection available to the Group.

**The Group may be classified as a "resident enterprise" of PRC which could result in unfavourable tax consequences to the Group and non-PRC Shareholders**

The State Council promulgated the Regulation on the Implementation of PRC Enterprise Income Tax Law (the "**EIT Regulation**") on 6 December 2007, effective as at 1 January 2008. The EIT Regulation defines the term "de facto management bodies" as "bodies that substantially carry out comprehensive management and control on the business operation, employees, accounts and assets of enterprises". Under the EIT Regulation, an enterprise incorporated outside China whose "de facto management bodies" are located in China is considered a "resident enterprise" and will be subject to a uniform 25% enterprise income tax rate on its global income. In 2009, the State Administration of Taxation further laid down certain criteria for determining if a foreign enterprise which is controlled by enterprises in the PRC has its "de facto management body" located in the PRC. If all of these criteria are satisfied, the relevant foreign enterprise controlled by a PRC enterprise will be deemed to have its "de facto management bodies" located in the PRC and therefore be considered a resident enterprise in the PRC. These criteria include: (i) the senior managing personnel and organisation responsible for the day-to-day operation of the enterprise discharge the duties primarily within the PRC; (ii) decisions about the enterprise's financial and human resource matters are made or subject to approval by organisation or personnel within the PRC; (iii) the enterprise's primary assets, books and records, company seals, and minutes of board and shareholders' meetings are located or maintained within the PRC; and (iv) 50% or more of voting board members or senior executives of the enterprise habitually reside in the PRC.

However, there have been no official implementation rules regarding the determination of the "de facto management bodies" for foreign enterprises which are not controlled by PRC enterprises (including companies like the Company). The Company is currently not treated as a PRC resident enterprise by the relevant tax authorities. Since some of the Group's management is currently based in the PRC and is expected to remain in the PRC in the future, the Company cannot guarantee that it will not be considered a "resident enterprise" under the new EIT Regulation and not be subject to the enterprise income tax rate of 25% on the global income of the Group. In addition, although the EIT Regulation provides that investment income (such as dividend and bonus) between "qualified resident enterprises" is exempted income, it is not clear what is considered a "qualified resident enterprise" under such law.

Furthermore, according to 中華人民共和國企業所得稅法 (the PRC Enterprise Income Tax Law*) (the "**EIT Law**") effective as at 1 January 2008, the capital gains made by foreign Shareholders from sales of the Shares and dividends on the Shares payable to foreign Shareholders may be regarded as income from "sources within PRC" and therefore subject to income tax of 10% (or lower if certain tax treaties apply). If the Company is required under the EIT Law to withhold PRC income tax on the dividends payable to the foreign Shareholders, or if the foreign investors are required to pay PRC income tax on the transfer of the Shares, the value of the foreign Shareholders' investment in the Shares may be materially and adversely affected.

**The Group may experience difficulties in effecting services of legal process, enforcing foreign judgement or bringing original actions in the PRC**

The Company is incorporated in the Cayman Islands. The majority of its assets and subsidiaries and their assets are located in the PRC. Moreover, a significant number of the officers of the Group reside within the PRC. Therefore it may be difficult for investors to effect service of process outside the PRC upon the Group's officers, including matters arising under applicable securities laws. Moreover, a judgement of a court of another jurisdiction may only be reciprocally recognised or enforced if the jurisdiction has a treaty with the PRC or if judgements of the PRC courts have been recognised in that jurisdiction. However, the PRC does not have treaties for the reciprocal enforcement of judgements of courts in the Cayman Islands. As a result, recognition and enforcement in the PRC of judgements of a court in Cayman Islands is subject to uncertainties.