
INDUSTRY OVERVIEW

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HISTORY OF THE HONG KONG STOCK MARKET

Development of the stock market

Hong Kong's first stock exchange was established in 1891 by The Association of Stockbrokers in Hong Kong. It was re-named as The Hong Kong Stock Exchange in 1914. In 1921, a second stock exchange, the Hong Kong Stockbrokers' Association was established and the two exchanges merged to form The Hong Kong Stock Exchange in 1947. The rapid economic growth of Hong Kong during the late 1960s and early 1970s led to the establishment of three other exchanges in 1969, 1971 and 1972 respectively, namely the Far East Exchange Limited, the Kam Ngan Stock Exchange Limited and the Kowloon Stock Exchange Limited.

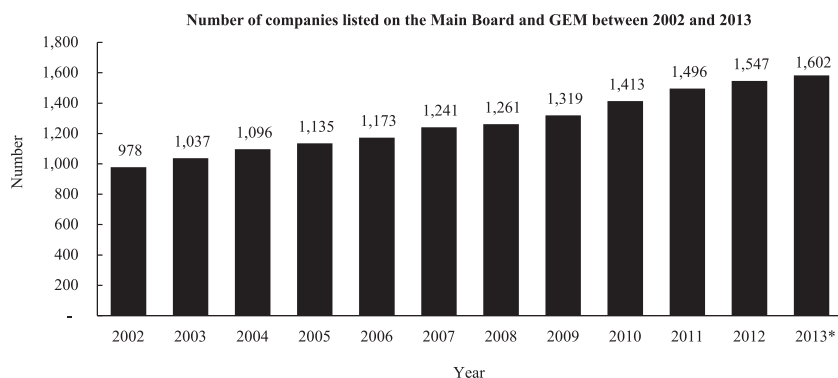
The Stock Exchange was formed from the unification of the four exchanges in 1986. After the 1987 market crash, the SFC was set up in 1989 to facilitate the regulatory and infrastructural development in the securities and futures markets. Further improvement to the stock market infrastructure was brought about the introduction of CCASS in 1992 and the AMS in 1993. In 1999, the Stock Exchange launched GEM to provide a platform of fund-raising for growth enterprises.

On 6 March 2000, the Stock Exchange, the Futures Exchange, and the HKSCC were merged under a single holding company, HKEx. On 27 June 2000, HKEx listed its shares on the Main Board by way of introduction.

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Growth of Hong Kong stock market

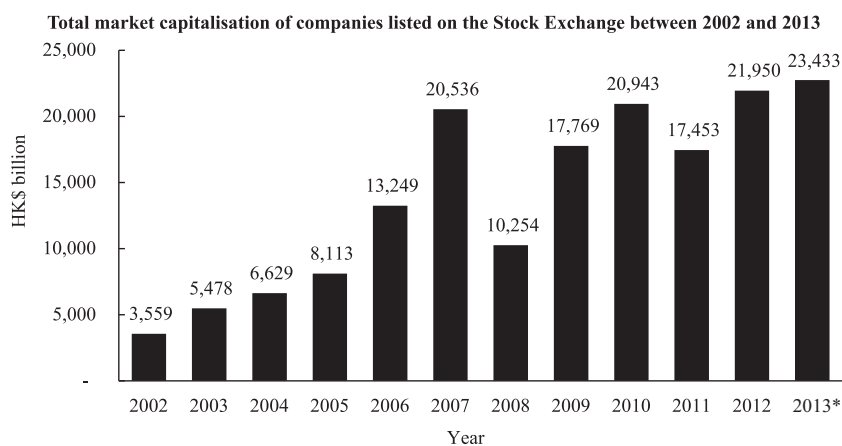
As at 31 December 2012 and as at 31 October 2013, there were 1,547 and 1,602 companies listed on the Stock Exchange (including both the Main Board and GEM) respectively.



* As at 31 October 2013

Source: HKEx website

The total market capitalisation of companies listed on the Stock Exchange was approximately HK\$21,950 billion as at 31 December 2012 and approximately HK\$23,433 billion as at 31 October 2013.



* As at 31 October 2013

Source: HKEx website

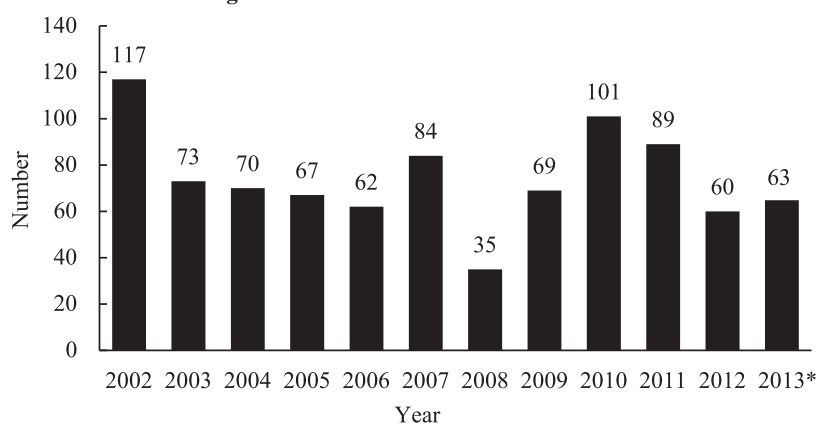
The first Mainland enterprise was listed in Hong Kong in July 1993. Since then, there have been an increasing number of Mainland enterprises listing on the Main Board and GEM. As at 31 December 2012 and as at 31 October 2013, the market capitalisation of Mainland enterprises (H-Share, non H-Share Mainland private enterprises and red chip companies) listed on the Main Board and GEM amount to approximately 57.4% and 56.5% of the total market capitalisation of companies listed on the Stock Exchange respectively. As at 31 December 2012 and as at 31 October 2013, there were 721 and 765 Mainland enterprises (comprising H-Share, non H-Share Mainland private enterprises and red chip companies) listed on the Main Board and GEM respectively. This number is expected to increase in the future as more and more Mainland enterprises seek to raise foreign funds for their continued growth.

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Fund-raising activities in the Hong Kong stock market

From 2009 to 2011, Hong Kong was the leading IPO centre in the world. A total of 69, 101 and 89 equity IPOs were launched during the period, raising a total of approximately HK\$248 billion, HK\$449 billion, and HK\$260 billion respectively. In 2012, 60 IPOs were launched in Hong Kong raising approximately HK\$90 billion, and Hong Kong's world ranking slipped to fourth place in terms of amount raised. Funds raised by IPOs for the ten months ended 31 October 2013 totalled approximately HK\$70.0 billion, an increase of approximately 43% compared with approximately HK\$48.9 billion for the same period in 2012.

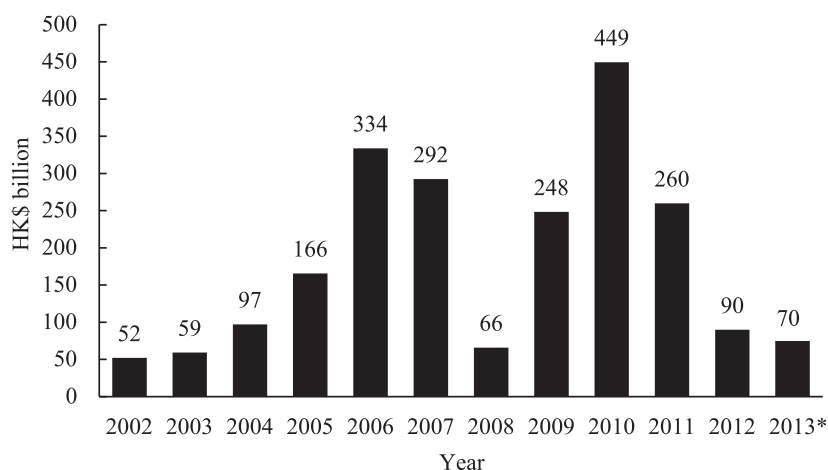
Number of new listings on the Main Board and GEM from 2002 to October 2013



* up to 31 October 2013

Source: HKEx website

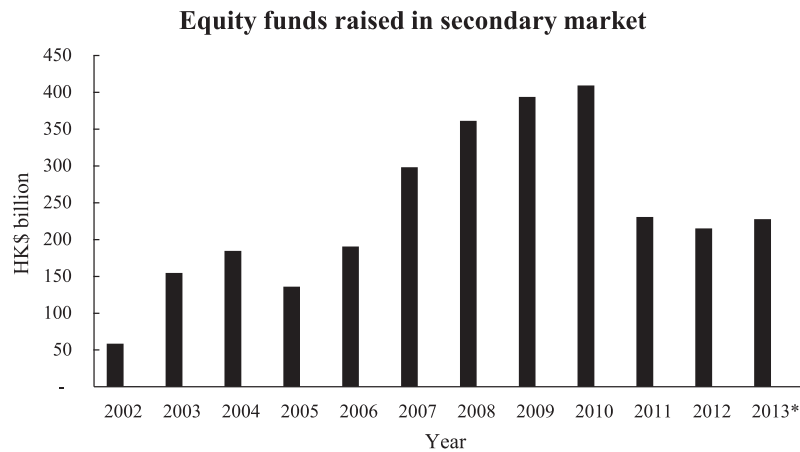
Funds raised from IPO from 2002 to October 2013



* up to 31 October 2013

Source: HKEx website

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* up to 31 October 2013

Source: HKEx website

Equity fund raising in secondary market in Hong Kong was active with year-on-year growth between from 2007 to 2010. However, by 2011 the amount raised fell significantly to approximately HK\$231 billion. In 2012, the amount decreased slightly to approximately HK\$215 billion and for the ten months ended 31 October 2013, the equity fund raising in secondary market amounted to approximately HK\$228 billion.

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World ranking of the Hong Kong stock market

According to the World Federation of Exchanges, Hong Kong ranked the sixth largest market of the world's leading stock exchanges in terms of domestic equity market capitalisation in 2012.

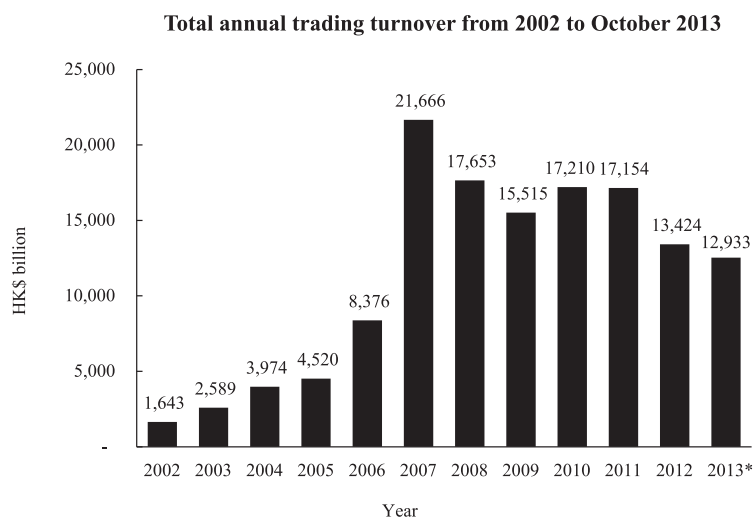
Rank	Exchange	US\$ billion (Year ended 31 December 2012)
1	NYSE Euronext (United States of America)	14,086
2	NASDAQ OMX (United States of America)	4,582
3	Tokyo Stock Exchange Group	3,479
4	London Stock Exchange Group	3,397
5	NYSE Euronext (Europe)	2,832
6	Hong Kong Stock Exchange	2,832
7	Shanghai Stock Exchange	2,547
8	TMX Group	2,059
9	Deutsche Borse	1,486
10	Australian Securities Exchange	1,387

Source: World Federation of Exchanges

SECURITIES TRADING IN HONG KONG

Securities trading

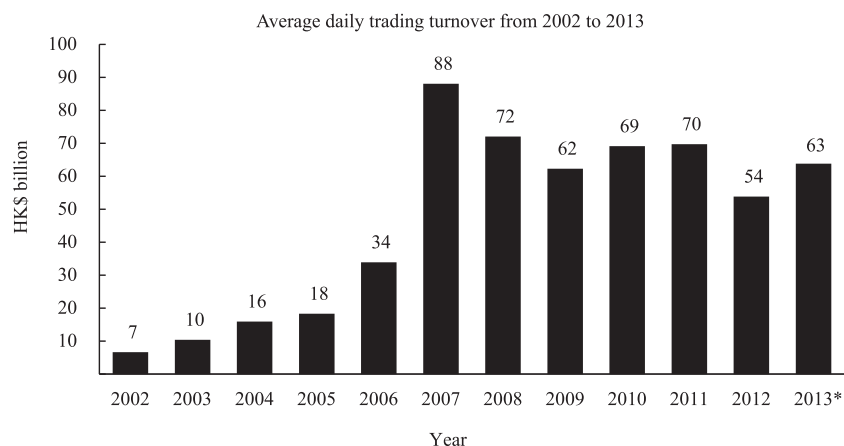
The Main Board and GEM are the two markets operated by the Stock Exchange for securities trading. The Main Board provides a platform for the trading of securities of larger and more established companies while the GEM provides a platform for the trading of securities of growth companies.



* up to 31 October 2013

Source: HKEx website

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* up to 31 October 2013

Source: HKEx website

Since 2002, trading turnover showed a general upward trend up until 2007. There was a downturn of trading turnover in 2008 and 2009 due to the global financial crisis which took place in the second half of 2008. Trading turnover in 2009 was approximately HK\$15,515 billion, representing a decrease of approximately 12.1% compared to 2008. Trading turnover improved in 2010 to approximately HK\$17,210 billion, representing an increase of approximately 10.9% compared to 2009. Trading activity was moderate in 2011. The average daily turnover amounted to about HK\$69.7 billion, approximately 1.4% higher than that in 2010. Clouded by uncertainties about the European debt problem, trading became less active in late 2011. Trading turnover was approximately HK\$17,154 billion in 2011.

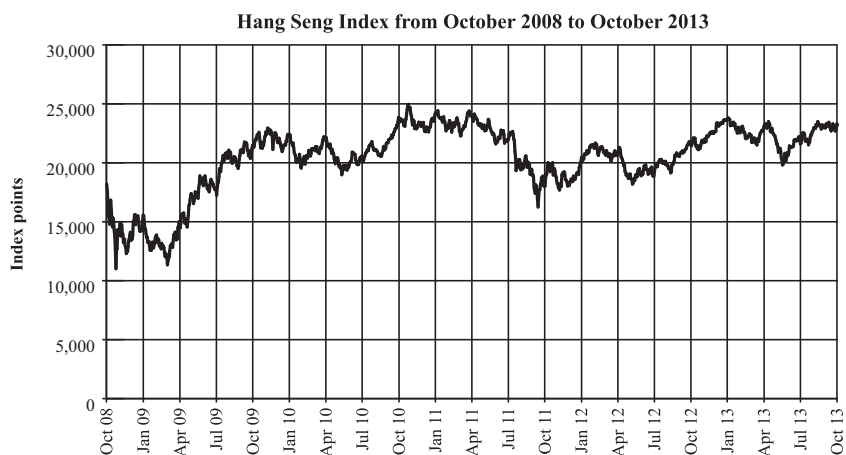
In 2012, trading activity further reduced and the average daily trading turnover decreased by approximately 22.9% from 2011 levels to approximately HK\$54 billion. Trading turnover was approximately HK\$13,424 billion in 2012.

The average daily trading turnover for the ten months ended 31 October 2013 was approximately HK\$63,207 million, an increase of approximately 19.1% compared with approximately HK\$53,073 million for the same period in 2012.

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Hang Seng Index

The chart below sets out the Hang Seng Index from 1 October 2008 to 31 October 2013.



Source: Hang Seng Indexes Company Limited

The Hang Seng Index was at its lowest point at less than 12,000 index points in October 2008. The index gradually increased and reached its peak at around 25,000 index points in November 2010. Subsequent to 2010, the index dropped to less than 20,000 index points in 2011 and increased back to the range of 19,800 to 23,900 index points during the ten months ended 31 October 2013.

Exchange participants

In order to trade in securities through the trading facilities of the Stock Exchange, a participant, among other things, shall hold a Stock Exchange Trading Right and be a Stock Exchange Participant. It must also be a licensed corporation under the SFO for Type 1 (dealing in securities) regulated activity and comply with the financial resources requirements as specified by the FRR and the Stock Exchange.

As at 31 October 2013, there were 545 Stock Exchange Participants including 505 trading participants and 40 non-trading participants in Hong Kong.

Stock Exchange Participants are divided into three categories by the Stock Exchange based on their market share:

- a. Category A (the top 14 firms in terms of their share of the total trading turnover);

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- b. Category B (firms ranked from 15 to 65 in terms of their share of the total trading turnover); and
- c. Category C (the remaining firms in the stock market).

TRADING INFRASTRUCTURE AND SETTLEMENT IN HONG KONG

Trading system

All securities listed on the Stock Exchange are traded through AMS. AMS was first introduced in 1993 to accommodate the increasing volume of business as well as to cope with the rapid technological advances and growing demand for more efficient trading environment. Prior to the launch of AMS, trading on the Stock Exchange was conducted manually, either through its internal telephone system or the “open outcry” system.

In December 2011, HKEx rolled out AMS/3.8 for its electronic trading platform. Order processing capacity of AMS/3.8 has been increased to 30,000 orders per second, with the average latency reduced to around 9 milliseconds on average (excluding the network transmission time).

Under AMS/3.8, there are two approaches to trading — terminal approach and gateway approach:

- Terminal approach — HKEx provides standalone trading terminals for Stock Exchange Participants, with first terminals at the trading hall and second terminals at the offices of Stock Exchange Participants. Transaction throughput is confined by the rate of data input.
- Gateway approach — HKEx also provides Open Gateway as a Windows-based device installed at Stock Exchange Participants’ offices to facilitate electronic interface of AMS/3.8 with front office systems operated by the Stock Exchange Participants. The input rate of orders that could be submitted via the Open Gateway is governed by a throttle mechanism and Stock Exchange Participants can subscribe necessary quantity of throttles from HKEx in accordance with their order flow demand. Stock Exchange Participants can connect to the Open Gateway through (i) BSS or; (ii) MWS.

Further, AMS/3.8 offers an order routing system for Stock Exchange Participants to collect investors’ orders from proprietary network service vendors (such as the Internet and mobile network) for processing order transactions entered directly by their investors.

Settlement

CCASS, a computerised book-entry clearing and settlement system for transactions executed on the Stock Exchange, was introduced in 1992. It accepts share certificates from its participants and holds them in the CCASS depository, and posts electronic share credits to the stock accounts of the depositing participants. Settlement of transactions is recorded electronically by HKSCC as net increases or decreases in participants’ stock account balances, without any physical transfer of share certificates. HKSCC also facilitates payments through the use of electronic money transfers between the participants’ designated banks. Stock Exchange Participants are required to settle all their trades

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in eligible securities through CCASS. Operation of investor accounts in CCASS was launched in May 1998. HKEx currently has six categories of CCASS participants, namely, investors, brokers, clearing agencies, custodians, stock lenders and stock pledgees. Trades executed on AMS/3.8 are automatically transferred to CCASS for clearing and settlement among the Stock Exchange Participants on T+2.

SECURITIES BROKERAGE INDUSTRY IN HONG KONG

Entry barriers

The main entry barriers in Hong Kong's securities brokerage business are the paid-up share capital, liquid capital and licensing requirements of the SFC. Securities dealing is a regulated activity under the SFO and is governed by the relevant rules and regulations. New entrants who wish to carry on such regulated activity must be licensed with the SFC to become a licensed corporation. Each licensed corporation must have not less than two Responsible Officers to directly supervise the conduct of each regulated activity. Depending on the type of regulated activity, licensed corporations have to at all times maintain paid-up share capital and liquid capital of not less than the specified amounts according to the FRR. Please also refer to the section headed "Regulatory and licensing requirements" of this document for details.

Competition

The rapid increase in the trading turnover of the stock market in Hong Kong has created strong demand to the local brokerage industry but at the same time competition had also been increasing in recent years. As at 31 December 2012, there were 511 Stock Exchange trading participants and 39 Stock Exchange non-trading participants. Below is the distribution of their market share from 2005 to 2012:

Year	Category A (Position 1 to 14)	Category B (Position 15 to 65)	Category C (Position 66 and above)
2005	53.1%	33.2%	13.8%
2006	52.0%	35.6%	12.4%
2007	50.4%	37.8%	11.9%
2008	53.0%	36.3%	10.7%
2009	52.0%	35.3%	12.6%
2010	51.1%	36.2%	12.8%
2011	53.6%	35.0%	11.4%
2012	57.8%	31.8%	10.5%

Source: HKEx website

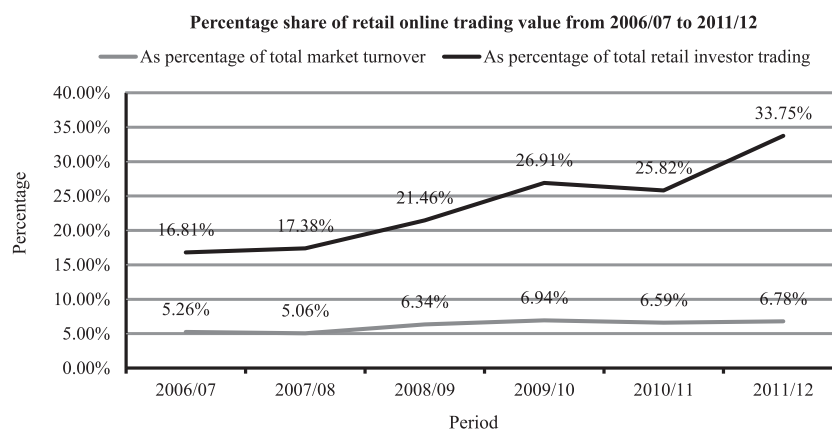
Note: The table includes all Stock Exchange Participants that had paid transaction levy, investor compensation levy (if applicable) and trading fee to the Stock Exchange. The Stock Exchange Participants are classified into Category A, Category B or Category C participant by the Stock Exchange in terms of their respective share of the total market turnover.

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As illustrated above, the brokerage business in Hong Kong is dominated by certain large firms, in particular those in Category A. The top 14 firms accounted for more than 50% of the market turnover in the past few years thus leaving competition among firms in Category B and Category C intense.

On 1 April 2003, minimum brokerage commission rates in respect of securities and commodities trading in Hong Kong had been deregulated. Since the deregulation, brokerage commissions have generally been subject to market forces and negotiations which had further intensified competition within the securities brokerage industry.

Online securities brokerage



Source: HKEx website

According to the “Cash Market Transaction Survey 2011/12” published by the Stock Exchange in February 2013, the number of brokers that offer online trading services to retail investors increased from 126 in the 2006/07 survey (or approximately 33% of all surveyed brokers) to 245 in the 2011/12 survey (or approximately 54% of all surveyed brokers), representing an increase of approximately 94%. The share of retail online trading value had risen from approximately 16.8% of total retail investor trading during the period from October 2006 to September 2007 to approximately 33.8% of total retail investor trading during the period from October 2011 to September 2012.

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	Cash Market Transaction Survey (2006/07 - 2011/12)					
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Respondent sample size	380	404	410	409	431	453
Online brokers						
Number of online brokers	126	155	173	185	209	245
As percentage of all responding Exchange Participants	33%	38%	42%	45%	48%	54%
Online trading						
Online trading value (HK\$ million)	845,014	1,156,321	921,416	1,095,691	1,252,109	919,187
As percentage of total retail investor trading	16.8%	17.4%	21.5%	26.9%	25.8%	33.8%
As percentage of total market turnover	5.3%	5.1%	6.3%	6.9%	6.6%	6.8%

Source: HKEx website

As indicated in the "Guidance Note on Internet Regulation" issued by the SFC in March 1999, in general, the SFC will not seek to regulate securities dealing conducted over the Internet that originate outside Hong Kong, provided that such activities are not detrimental to the interests of the investing public in Hong Kong. The SFC would expect registered persons to put in place additional operational measures if they intend to conduct securities dealing, commodity and futures trading and leveraged foreign exchange trading activities over the Internet. These measures cover aspects of suitability and general conduct, order handling and execution, system integrity, responsible personnel, written procedures, customer agreements, record keeping and reporting.

RETAIL INVESTORS

According to the findings of the "Retail Investor Survey 2011" published by the Stock Exchange in April 2012, in December 2011, approximately 35.8% of the Hong Kong adult population (equivalent to approximately 2.2 million individuals) were retail investors in stocks and/or derivatives traded on HKEx, of which approximately 33.8% of the adult population were stockowners, approximately 35.7% were stock investors, and approximately 2.0% were derivatives investors.

The typical Hong Kong retail stock investor was 47 years old, with matriculation or above education, a monthly personal income of about HK\$16,250 and a monthly household income of about HK\$35,000.

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SECURITIES AND IPO MARGIN FINANCING

Hong Kong has seen a significant growth in its stock market activities in recent years. This provided the authorised institutions ("AI", as defined under Banking Ordinance (Cap. 155)) with more opportunities to participate in IPOs, whether as a lending AI to finance the subscription for new shares or as a receiving bank. Lending AI means an AI which extends credit facilities to its customers for the purpose of: (i) facilitating their subscription for new shares in an IPO; (ii) financing their acquisition or holding of shares in listed stocks (in the case of lending to investors); or (iii) financing their business operations (in the case of lending to stockbrokers).

According to the statutory guideline "New share subscription and share margin financing" of the "Supervisory Policy Manual" issued by HKMA in January 2007, lending AIs should apply a reasonable margin requirement on their lending to individual customers. The market norm is a 10% margin on such lending. This requirement may be satisfied by the deposit of collateral (in the form of cash or securities) with the lending AIs or by setting an appropriate loan-to-value ratio. Lending AIs should exercise prudence in setting the ratios having regard to the underlying financial strength, liquidity and price volatility of individual stocks. As a reference, the current market norms are: (i) around 50-60% for blue chips (with higher ratios of 70% adopted by lending AIs which specialise in share margin financing and have the expertise and sophisticated risk management systems to control the risks involved); and (ii) around 30-40% or below for selected second and third liners. Such market norms may change from time to time according to market situations.

According to annual reports of 2010-11, 2011-12 and 2012-13 published by SFC, the following data were extracted from the monthly financial returns submitted to the SFC in accordance with the FRR by licensed corporations licensed for dealing in securities or securities margin financing:

	2009	As at 31 December		2012
		2010	2011	
Number of active margin customers	138,772	132,101	135,201	139,375
Amounts of receivables				
from margin customers (HK\$ million)	40,160	58,468	50,171	58,812
Average collateral coverage (<i>Note</i>)	5.2 times	4.7 times	3.9 times	4.2 times

Source: SFC Annual Report 2010-11, 2011-12 and 2012-13

Note: The number of times the aggregate market value of securities collateral deposited by customers over the total amounts of margin loan due from these margin customers on a given date on an industry-wide basis.