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CORPORATE GOVERNANCE, CONNECTED TRANSACTIONS WITH
INSIDERS, AND FIRMS' RETURNS: EVIDENCE FROM HONG KONG

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Ph.D

The Hong Kong Polytechnic University

2016

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School of Accounting and Finance

Corporate governance, connected transactions with insiders, and firms' returns:
evidence from Hong Kong

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A thesis submitted in partial fulfillment of the requirements for the degree of
Doctor of Philosophy

January 2013

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_____ (Signed)

Ka Ho Derek YIM

To my parents and

in memory of my grandmother who lived her meaningful life for 96 years....

Abstract

Using a sample of Hong Kong listed firms from January 2003 to December 2006, this thesis provides evidence where firms announcing connected transactions with executives, directors or substantial shareholders, not only controlling shareholders, are having fewer independent directors and smaller board size than arm's length transactions firms. The short term announcement effect of the connected transactions drives the stock price significantly lower than firms announcing arms length transactions. This could be explained by the expropriation hypothesis and inequality of power (opportunity) theory where executives, directors, substantial shareholders or controlling shareholders are perceived to be taking advantage of minority shareholders in connected transactions. The discounting mechanism is going on to adjust the likelihood of deviance. As far as the environment is concerned, insiders seem to choose firms to conduct connected transaction where firms have significant higher level of assets and cash (to pay cash dividends). I also find that big four accounting firms are viewed by capital market to provide certain protection to minority shareholders in case connected transactions do happen in firms. In the long run (two to five years after announcement), the excess return of

connected transactions firms way underperform the arms length transaction firms. Furthermore, I find evidence operating performance such as asset turnover of connected transactions firms are significantly deteriorated starting from three to five years after announcement. A good corporate governance system cannot be static and works for decades. Insiders could always find new ways to hurt minority shareholders if they choose to. This study suggests that current regulatory requirement on connected transactions in Hong Kong has room to improve where minority shareholders will be better protected on potential expropriation. For example, big four accounting firms could be made mandatory as external auditor for firms planning to conduct connected transactions. These accounting firms are more adept to detect and report unusual behavior among the insiders. The marginal benefit of this policy (less potential stealing) might outweigh the marginal cost of this requirement (regulatory costs, compliance costs).

ACKNOWLEDGEMENT

At the Hong Kong Polytechnic University, I would like to express my heartfelt gratitude to my supervisors Dr Anthony NG and Dr Mujtaba MIAN who provide me all the help and guidance during my Ph.D. study. The completion of this thesis would not be possible without their inspiration, encouragement, and great knowledge and philosophy.

I am also indebted to John Braithwaite, Vincent Ching, ex-supervisor Professor Ferdinand Gul, Simon Fung, Ira Horowitz, Sugata Marjit, Harland Prechel, Sunny Sun and Anson Wong for their insightful comments in this study.

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(April 2003)**

References

Chapter 1:Introduction

For the past 15 years there has been a bull market in academic research addressing the implications of good corporate governance practices, and the absence of such. It gotan increasing attention in the western world as more corporate disasters surfaced and somehow related to governance arrangement. That research received particular impetus from the Enron, Worldcom, and Parmalat scandals at the turn of the century. On May 1, 2003, the United States Department of Justice alleged that “former CFO of Enron conspired with others, including his wife, to create an entity owned by the CFO in order to reap for themselves the profits generated by certain Enron wind farms, while simultaneously enabling Enron to fraudulently receive government financial benefits to which it was not entitled.” The corporate-governance issue, as it pertains to Hong Kong, has drawn its share of academic attention, witness the studies of (Classens, Djankov and Lang, 2000). Those studies, however, have not fully addressed the problem of possible deviance and tunneling in which enterprise assets and profits have been used to benefit executives, directors and substantial shareholders, particularly those that have served in the upper

echelons of the managerial hierarchy. The purpose of this thesis is to complete that particular discussion and shed new light on its underlying causes and consequences.

Specifically, in this thesis I gather comprehensive data including, for example, market capitalization, auditor information, ownership structure, and the like, for a sample of some 2,000 announced filings of economic significant financial transactions for Hong Kong enterprises, both arms-length transactions and connected transactions, for the four-year period from 2003 through 2006. I then apply a form of the classical event-study approach and multiple-regression analysis to test a set of five basic hypotheses, developed from the accounting, finance, economics, and, unique to this paper, the sociology literature, that link corporate-governance practices to the enterprise's bottom line, both in the short term and in the long term. Thus, while to a limited extent the results are consistent with prior studies of Cheung et. al. (2006), which serves to bolster confidence in their validity, they place an entirely new perspective on the coverage of who and how get involved in the connected transactions and the *raison d'être* for the aforementioned linkage.

The statistical analysis tends to support these five hypotheses and encourages the conclusion that firms announcing connected transactions with executives, directors and substantial shareholders earn negative excess returns that are below the positive excess returns of firms announcing arm's length transactions. This market reaction reflects the concern of possible expropriation of minority shareholders in connected transactions. These firms on average have smaller board size and fewer independent directors. The environment of the connected transactions firms also seems to carry high level of assets. Moreover, these poorly-governed firms that experience negative abnormal returns subsequent to the announcement of a connected transaction, find the opposite effect when more effective corporate governance may be inferred from the employment of more highly-regarded external auditing firm. Put otherwise, the market, at least in Hong Kong, appears to recognize the bottom-line benefits of sound corporate-governance practices. I would suggest that Hong Kong investors are unlikely to be unique in these regards, and thus that the inferences as to the benefits of sound corporate-governance practices can be more broadly drawn, well beyond the territory's limited boundaries. The

lasting impact of connected transactions hurt the firms fundamentally, as I find evidence that both the stock return and operating performance are sub-standard when compared with arms length transaction firms in two to five years after announcement.

Corporate governance has long been a popular topic to study in different context since the huge scandals in Enron, Worldcom and Parmalat. The issue of corporate governance has created lots of debate at the firm level. These cases highlighted the roles played by different people within and around the firms who tried to achieve their personal and/or organizational objectives (could be conflicting at times), subject to a pre-determined legal and regulatory framework. In terms of policy making departments, corporate governance has also received a lot of attention and importance in their execution in the last few years. This trend originated from developed market like the US to emerging market like South Korea. Governments around the world have enacted laws and institutions in an effort to improve corporate governance at the firm level. There seems to be no slowing down in this direction. To a certain extent, it reflects the complexity of execution and the problems are not easily solved.

In view of the recent importance of corporate governance in academic research and policy making trying to explain the ways how firms are controlled and directed, I ask a fairly straight forward question: Does better corporate governance at the firm level protect minority shareholders better in connected transactions in Hong Kong? It is well known that listed firms in Hong Kong, quite different from the western world, are largely controlled by one or a few members of family. The connected transactions in Hong Kong are mainly between the firm and four groups of people, namely executives, directors, substantial shareholders and controlling shareholders. While previous academic work is mainly focusing on the controlling shareholders versus minority shareholders based on the argument on control right over cash flow right, I am here interested to find the overall explanation of all other groups of insiders conducting connected transactions as well. Besides, the long term performance of these firms is rarely discussed in other studies and I will try to find some clues on that too. I make use of the stock price return as a proxy to capture the market perception of the protection to minority shareholders upon economic significant transaction announcement. That is, do investors care, via

valuations, if a firm practices better governance than one does not in significant transaction announcement?

1.1 Motivation of this study

There has been lots of literature to show firms practicing better corporate governance receive higher valuations in the market: (Black 2001), Klapper and Love (2004), Durnev and Kim (2005), Black et al. (2006) and Chua et al. (2007) among others. In an influential paper, Gompers, Ishii and Metrick (2003) find that firms with strong shareholder rights exhibit better operating performance than firms with weak shareholder rights. At the same time, they construct a hedge portfolio with long position on good governance firms and short position on weak governance firms. It generates an abnormal return of 8.5% annually over the period from 1990 to 1999. These lead to a natural belief that relationship of governance and performance is positive. Nonetheless, Johnson, Moorman and Sorescu (2009) reexamine the relationship between corporate governance and equity price. They find

statistically zero long term abnormal returns for the above mentioned portfolios sorted on governance. They highlight the importance of the coarseness of industry definitions in academic research. Not surprisingly, it seems that the general consensus of positive association of good governance and equity valuation is there. However, I have to be careful in looking in the characteristic of the samples before I make some strong conclusive remarks based on statistical analysis of the sample data.

In this research, I examine the issue of corporate governance and shareholder value, focusing on how corporate governance at the firm level can protect minority shareholders inpossible tunneling activities conducted by executives, directors, substantial shareholdersor controlling shareholders in Hong Kong. Tunneling is broadly defined as the transferring out of valuable assets or profits out of the firms for the benefit of controlling shareholders who are in many cases, also the top managementpersonnel (Johnson, La Porta, Lopez-de-Silanes and Shleifer (2000a). This kind of expropriation of minority shareholders is the dominant agency cost of firms in different countries. On top of that, controlling shareholders could also steal from the minority

shareholders through many other methods: dilution of ownership of minority shareholders through issuance of new shares, unreasonably high compensation to executives (if they are the same group of people), disposal of assets to themselves or firms they control at low prices, or acquisition of assets from themselves or firms they control at high prices etc. (Shleifer and Vishny (1997)). Irrespective of how these transactions are structured, there are typically three basic ways where tunneling could happen. Cash flow tunneling refers to the reduction of a portion of current year's cash flow, but it will not have adverse impact on the remaining stock of long term productive assets. For instance, outputs are sold to an intermediary controlled by insiders for below-market prices or purchase of inputs at above-market prices. Others include excessive compensation or perquisites for executives, small scale sales or purchases of assets. It can be repeated every single year but the portion of cash flow stolen will change over time. Secondly, asset tunneling refers to major long term tangible or intangible assets transfer in or out of the firm not at the market price, to the disadvantage of the firm. This kind of transfer has a long term effect on the firm's future cash generating capacity due to a much larger scale. It could be investments in an affiliated firm, overpriced purchase of assets etc.

The last type of tunneling refers to equity tunneling where the connected persons do not directly change the firm's productive assets. What they would do include dilutive offerings, insider trading, minority shareholder freeze-outs, loans to insiders or equity based incentive compensation that is excessive.

I have enclosed at the Appendix A on a case analysis of a public listed firm Pearl Oriental Innovation Limited (stock code 632.hk) in Hong Kong going through a connected transaction with the Chairman of the Board. The transaction received majority support by shareholders in the voting process. The case highlighted the sophistication plan of how the executives could get the deal done, satisfied the disclosure requirement of the regulators, and won the support voting by independent shareholders. The connected transaction was officially announced through the Hong Kong Exchanges Website (Appendix B). The firm also discussed about the connected transaction at the Management Discussion and Analysis on the Annual Report (Appendix C). It was three years after the deal closed when Independent Commission Against Corruption of Hong Kong (ICAC) accused the Chairman has involved in fraudulent activity in the transaction. It is typically complicated and hence

very difficult for law enforcement body to detect and prove. It has been five years ago since the beginning point of the purchase of oil and gas field asset in the United States by Pearl Oriental Innovation Limited. The case is still undergoing the legal process at the moment. The press release of ICAC charging fraud of the Chairman was enclosed (Appendix D). This case aroused my interest to understand a bit more on the potential negative damage of connected transactions to the minority shareholders and their long term impact at the firm level.

Typically, the study on the leverage on control right versus cash flow right by controlling shareholders have shown that there are incentives for them to expropriate minorities. Gomes (2000) model that all participants in the market recognize that there is room for the controlling shareholders to act opportunistically and expropriate minority shareholders. I conjecture the opportunity to steal by substantial shareholders, not necessary controlling shareholders, will be pronounced in listed firms in Hong Kong because there is a high concentration of controlling ownership by one person or one family. Cheung, Stouraitis and Wong (2005) document the controlling shareholder,

who often manage the firms they control, extract higher salaries not as a result of higher managerial effort. The median CEO and Chairman ownership of the firm was 11% and 30% respectively. One consequence is that the number of hostile takeover activity, one mechanism to remove incapable management, is on the low side due to the extreme difficulty getting the family to surrender its control. Besides, connected transactions that involve executives, directors or substantial shareholders and economic significant transactions are deals that may involve tunneling. From a global perspective, despite the lack of protection for minority shareholders, the average ratio of stock market capitalization held by minorities to gross national product is larger than 40% in a 49 countries sample (La Porta et al. 1997). This raises an interesting question as to why people are willing to be minority shareholders when they know expropriation by large shareholders happens. Do firms practice good corporate governance protect the minorities better than the others?

The theoretical framework and empirical evidence has shown that there exist differences in the level of how minority shareholder is protected at the country level. The consequence of this difference in protection will result in

the possible extent through which connected persons expropriate the minority shareholders. In the medium to long term, this difference will encourage (or discourage) the confidence of long term capital provider with good (or bad) investor protection and hence the economic development of a country (Shleifer and Vishny1997, La Porta et al. 1997,1998, Shleifer and Wolfenzon2002). The consensus argument seems to be tunneling happens in firms in different countries because there exists a limit and enforcement issue that law could eliminate tunneling. Has the regulatory body done enough to protect minority shareholders?

Obviously, tunneling is seldom voluntarily disclosed as such and accounting rules scarcely mandate disclosure which provides enough information for investors to digest the nature and degree of tunneling. It is reasonable to expect people involve in tunneling will try to hide the bad intention as far as possible. Furthermore, the legal enforcement and macro corporate governance standard differs among countries. As a result, the surprise element to investors when suspected tunneling activity happens in firms may differ among countries. Along this line, I witness an increasing

amount of paper tries to document tunneling in either developed or developing countries in the past decade: Bates, Lemmon and Linck 2006 [US]; Baek, Kang and Lee 2006 [Korea]; Bertrand, Mehta and Mullainathan 2002 [India]; Atanasov, Black, Ciccotello, and Gyoshev 2007 [Bulgaria]; Berkman, Cole, and Fu 2007 [China]; Bae, Baek, Kang and Lee 2012 [Korea]. Nevertheless, their main focus has been how controlling shareholders expropriate minority shareholders in transactions. Others look into how tunneling indirectly affects market prices such as the different classes of shares and control premiums (Barak and Lauterbach 2007; Dyck and Zingales 2004). The examination of equity tunneling in Bulgaria by Atanasov, Black, Ciccotello and Gyoshev (2010) documents how securities law changes (Anti-tunneling reform 2002) mitigate two forms of equity tunneling in Bulgaria. They provide evidence on the role of equity tunneling risk as an important factor in determining equity prices in both cross-section and time series samples. Investors in Bulgarian market consider this risk and update their valuation estimates when legal rules change. My study complements these countries research by look at how all other insiders possibly expropriate minority shareholders and the subsequent performance at the firm level both in the short term and long term.

As a matter of fact, tunneling activities still happen in the listed firms in Hong Kong within the Listing Rule of Hong Kong Stock Exchange. This diversion of corporate resources from minority shareholders in Hong Kong could take various forms. In this study, I focus the investigation in connected transactions with executives, directors, substantial shareholders or controlling shareholders of listed firms in Hong Kong that require minority shareholders approval only: connected transactions, arm's length major transactions and arm's length very substantial transactions. These are the discloseable transactions under the Listing Rule where they are all mandated to have independent shareholders (including minorities) approval before proceeding. The economic significance of major or very substantial transactions will provide possible temptation for the insiders to steal. Tunneling is therefore expected to happen possibly when they are either conducted with related party or economic significant in dollar amount. Whereas for the economic significant transactions that require minority shareholder approval, the surprise element of suspected diversion of resources is going on (if it does) is more likely to be reflected in the stock price.

After all, I am interested to investigate that in a relative good legal investor protection and anti-self dealing environment like Hong Kong based on other previous cross-country studies, do firms practice good governance protect minority shareholders better or not in connected transactions?

In this study, I classify the transactions in my sample into two broad categories: transactions announced that are likely to result in expropriation of minority shareholders (connected) and economic significant transactions that are not likely to result in expropriation of minority shareholders (arm's length). In the study of Cheung et al. (2006), their classification of connected transactions was that cash receipts, transactions that involve direct cash assistance or loan provided by the connected person to the listed firm is likely to benefit the listed firm's minority shareholders. However, this so called "benefit" depends also on the terms of the assistance or loans. If the interest rate is fixed at abnormal high level comparing with the prevailing market rate, the benefit in fact goes to the connected person, but not the listed firm and hence its minority shareholders. In fact, the regression result of their report did

reflect that the market respond negatively to this type of transaction. Nevertheless, the authors did not offer explanation as to why this happens. Simply put, all connected transactions with insiders are suspicious to be involved in tunneling because the resources are dealt between the firm (owned by all shareholders) and the connected persons only. The label of connected transaction itself could not exclude tunneling opportunity without going into the details of the terms of the transaction. Hence, individual transaction has to be examined thoroughly before I arrive at some conclusive remarks.

1.2 Main findings

The main focus of my study is to go one step further on whether good corporate governance, quality reporting environment are perceived to protect these minority shareholders in Hong Kong. My study tries to understand the relationship of corporate executives, directors, substantial shareholders, independent non-executive directors, external auditors towards minority shareholders interest upon economic significant transactions. Using a sample of Hong Kong firms from 2003 to 2006, I find that firms having fewer

independent directors and small board size announce connected transactions with their executives, directors, substantial shareholders or controlling shareholders. These firms earn significant negative excess returns in the short term, explained by controlling shareholders' expropriation hypothesis and likelihood of deviance by insiders who have an unequal higher level of power against the minority shareholders. Under the influential sociologist Sutherland (1940) paper, he argued that when insiders try to commit deviant behavior at firm level, they would like to misrepresent asset values. I try to follow this argument and do find that connected transactions do happen in firms either carrying more assets, which is a more convenient platform for insiders to steal. Nonetheless, when connected deals are happening, big four accounting firms are perceived as the reliable gatekeeper to protect minority shareholders among all. However, in the long run, connected transactions firms stock return is significantly lower than firms announcing arm's length major or very substantial transactions. It is consistent with the finding of Cheung et al. (2006) where 1998-2000 data were used when recession was experienced in Hong Kong in the midst of Asian Financial

Crisis, but I offer a broader group of insiders in the testing and during the period of healthy economic recovery from 2003-2006 data.

It is understood that asset disposal or asset acquisitions are the most popular categories of connected transaction announced by firms in Hong Kong. In a way, these are the simplest type of deals that could happen and likely to expropriate shareholders where assets are sold at underpriced level to insiders or assets are bought at overpriced level from connected firms. One major reason could be that it is always debatable what the reasonable value of the assets from the people involved is, even in the courtroom. Either way, after connected transactions are completed, I conjecture the overall quality of the assets of the firms will deteriorate or the ability to generate sales will be hurt in the long run. I find the asset turnover of connected transaction firms is adversely affected in three and five years time after the deal.

1.3 Contributions

In a nutshell, I try to provide a bit more insight to understand how different corporate stakeholders play some roles in connected transactions deals in Hong Kong. By identifying and examining the connected and arms length transactions in Hong Kong, this study extends the recent literature that shows expropriation of minority shareholder by executives, directors, substantial shareholders, not only controlling shareholder, does happen in connected transactions. Prior cross-country studies have shown that Hong Kong stands out to be an economy among emerging countries and common law countries (see Lemmon and Lins 2003, Djankov et al 2008) where at the macro level, legal investor protection in Hong Kong is above average. Yet it could not stop tunneling from happening and the market also fails to discount those firms value before it occurs. This paper contributes to the finance and corporate governance literature in the following ways: there is a role to play by good corporate governance practice because these firms are not associated to connected transactions that much. Furthermore, they are more likely to experience less penalty in valuation than those poorly-governed firms in case

connected transactions occur. The examination of the long term stock return and operating performance and asset quality of the firms engaging in connected transactions tells the damage of elite deviance is long lasting.

Another possible extension of my thesis contribution is to provide empirical support on how well-established sociologist Robert Merton's anomie-strain theory could be used to shed some lights on all connected persons involvement in connected transactions at the firm level. In their terminology, it seems the 'what' and 'how' the deviance in connected transactions is organized by high socio-economic powerful class based on their theory is backed by what I found in the analysis of connected transaction. The sociological standpoint could be further explored in future study to understand more about why the potential damage of connected transactions to minority shareholders happen, given those privilege class who has the power to control and make decisions at the firm level in the society. In sociology context, they define this act as white collar crime that is typically committed by executives for financial benefits at the expense of minority shareholders. The short term and long term market reaction to firms conducted connected transactions

underperform arms length transactions may somehow related to the potential and actual harm of the transactions to minority shareholders. This could be an interesting area for future study under sociological theories and explanation.

This paper is organized as follows: the coming chapters reviews previous literature and develops hypotheses. Chapter five goes through the design and sample selection procedures. I discuss and present the findings in chapter six. Chapter seven highlights a potential extension of this study related to sociological view. The final chapter wraps up the thesis with the summary and concluding remarks.

Chapter 2: Literature review

2.1 Corporate governance, operating performance and firm valuation

The assumption of executives working whole-heartedly for the shareholders does not represent a real picture in the corporate world. Similarly to anybody else, executives would like to serve their own interest would be understandable. The conflict of interest branches out not only confined to executives as firms operations expand. Different parties such as directors, substantial shareholders or controlling shareholders may also involve in transactions with the firms serving their own interest at the expense of minority shareholders. As a result, all these professionals could bring specialization and expertise benefits to the firms on one hand, they could also become the new sources of conflicts against the minority shareholders. Corporate governance, arguably is the mechanism of the firms to commit in the operation such that business principles and ethical standards are striking at highest level possible. Similarly, OECD emphasized on the five principles of decisions made at the firm level: efficiency, responsibility, transparency, fairness and ethics. The

importance of corporate governance and its value to shareholders has been discussed and questioned in recent studies. The data on firm level governance variables are not largely available until the 1980s. Since then, a lot of literature has covered mainly on the relationship between governance level, operating performance and firm valuation.

Making use of the data in early 1980s, Lehn, Patro and Zhao (2007) document that the market-to-book ratios, a period preceding the adoption of the provisions comprising the Gompers, Ishii and Metrick (GIM) governance index and Bebchuk, Cohen and Ferrell (BCF) entrenchment index, are significantly related to the subsequent value of the indices. The explanation they offer is that low market-to-book ratio firms are more likely to (cause) adopt provisions that comprised the governance indices in order to defend against potential takeover.

Similarly, Dittmar and Mahrt-Smith (2007) has found the importance of corporate governance to firm value. Their contribution was that market perceives the value of cash and the utilization of cash in a firm depends how

the firm is governed. They provide evidence that market value of cash reserve could drop by 50% if the firm is governed poorly. It largely originates from the investment of cash in a lousy way for these firms. The opposite would happen for firms which exhibit good governance.

Another line of research looks into firm level governance and operating performance, which requires a longer time period to monitor. One difficulty of this kind of study is that both variables are likely to change over substantial period of time. Similar to many event study, there could be many possible alternative explanation for the changes in the dependent variables in the long run. Hence, it is never easy to accurately measure the contribution of performance from governance. In this connection, Bhagat and Bolton (2008) contribute to the literature by showing that firms with better governance, stock ownership of board members, and CEO-Chair separation is positively related with better contemporaneous and subsequent operating performance. Secondly, contrary to claims in previous literature, they find that none of the governance measures are correlated with future stock price performance. Furthermore, given poor firm performance, the chance of disciplinary management turnover

is positively correlated with stock ownership of board members, and with board independence. However, better governed firms are less likely to experience disciplinary management turnover in spite of their poor performance. According to their result, it seems that firms should devote effort to improve corporate governance by focusing on the stock ownership by board members because it is positively related to future operating performance and the chance of disciplinary action to lousy management. In fact, John, Litov and Yeung (2008) echoed the argument by showing that firm's risk-taking and growth rates are positively related to the quality of investor protection. The reason is that better investor protection mitigates the taking of private benefits which leads to excessive risk-avoidance.

The board members carry an important role to protect minority shareholders. They are paid and responsible to do the hiring and firing jobs for management executives. Shareholders rely on the fiduciary duties of these board members to monitor the managers. As a result, some highlights the independence nature of directors and their qualitative involvement relationship to a firms' success. Among different studies, Jiraporn, Singh and Lee (2009)

enhance my understanding about the board busyness and firm performance link. They try to examine if multiple directorships adversely impact board committee memberships and hence dilute board members' ability to add value through monitoring and advisory services. Their results support the busyness hypothesis that a lack of committee work involvement may be a possible cause of the reported (Fich and Shivdasani 2006) negative value consequences of multiple board memberships. Besides, they also find that minority directors and independent directors tend to serve and hold more internal board committee memberships.

Apart from the very broad base coverage mainly on developed markets, like the US, recent literature has switched gear to some emerging markets. The reason is that the legal investor protection at macro level may not be sufficient in these markets. Even the black and white legal documents have covered pretty well, there is always the issue on enforcement in these countries. As a result, the firm level governance will be an important gate keeper to help out and protect minority shareholders against expropriation. Along this line, Chen, Chen and Wei (2009) show a positive association between corporate

governance and firm value. They separate the effect on equity cost from firm value and then investigate the effect of governance on equity cost in emerging markets (17 economies including Hong Kong in 2001 and 2002). Furthermore, they find that legal protection at country level and corporate governance at firm level can substitute each other. Firm-level, self-disciplined corporate governance is more effective in reducing equity cost in countries where the legal protection of investors is weak. Their results also show that institutional investors are willing to pay 20% more on stock price premium for firm having good corporate governance in place. This phenomenon is more obvious in countries where legal protection of investors is weak. A related study of Morey et al. (2009) manage to examine the changes in corporate governance ratings for firms in emerging markets (21 countries) on a monthly-updated frequency for a five year period. They also find that improvements in corporate governance at firm level are significantly linked with higher stock valuation. This happens even for a very short window governance change. The implication appears that corporate governance is important to investors.

For China related study, Berkman et al. (2009) analyze public listed firms in China where firms typically provide loan guarantee to controlling shareholders, and minority shareholders are expropriated. The issuance of guarantees is not likely to happen in small size, profitable and high growth firms.

Furthermore, Lo et al. (2012) provide evidence in China where good governance structure will reduce manager's opportunistic arrangement in connected transactions. They find that more independent board members are less likely to manipulate transfer pricing connected transactions.

It is not totally one-sided where good governance is related to strong performance and valuation. The evidence on the relationship of these variables are getting a bit confused after Johnson, Moorman and Sorescu (2009) reexamination of the long term abnormal returns for portfolios used by Gompers, Ishii and Metrick (2003) sorted on governance characteristics and portfolios used by Bebchuk, Cohen and Ferrell (2009) sorted on entrenchment index of firms. They find that firms with strong shareholder rights and firms

with weak shareholder rights differ from the population of firms and from each other in how they cluster across industries. They show statistically zero long term abnormal returns for portfolios sorted on firms' governance level. The possible interpretation is that industry, not necessary only governance, is an important source of return variation across the governance sorted portfolios back in the 1990s. Furthermore, Cai and Sevilir (2012) report that for merger and acquisition transactions between firms with current board connections, it would result in the target firm shareholders receiving lower takeover premiums from the acquirer. It suggests that business transaction between firms with connected persons involved may result in value loss to one group of minority shareholders, which may not happen otherwise.

Given the mix of evidence and interest from recent published papers, in this study, I examine this issue, focusing on how corporate governance at firm level can minimize tunneling activities related to connected transactions (or related party transactions in other countries) in Hong Kong. Connected transaction can be an important source of tunneling because it involves the

public firm and a connected person. According to the Listing Rules, some typical connected transactions include:”

- i) acquisition or disposal of interest in a firm
- ii) provision of financial assistance
- iii) firm grants an indemnity or guarantee for the benefit of a connected person
- iv) granting of security over the assets of the firm in respect of any financial assistance made to the firm by a connected person
- v) writing, acceptance, transfer, exercise or non-exercise of an option
- vi) entering into any agreement involving the formation of a joint venture.”

I learn from the previous studies that legal protection of investors at country has a role to play. It serves as the first defense for the well-being of minority shareholders’ interest in firms’ investment. There seems to be a substitution effect, i.e. when the law could not protect investors against expropriation well enough, there is a role of corporate governance at firm level to carry out the protection function. I find that connected transactions are detrimental to minority shareholders in Hong Kong using recent data. Then I

employ several corporate governance measures to examine whether the value destruction is less for better governed firms. The result shows that corporate governance is perceived by the market as important to protect minority shareholders when firms conduct connected transactions and arms length transactions.

2.2. Legal protection of investor in Hong Kong

Hong Kong was a British colony from late 19th century. As a result, it adopted the British common law system even after the takeover by China since 1997. Early on, Johnson, Boone, Breach and Friedman (2000b) show that countries whose legal systems restrict tunneling more effectively experienced milder financial crisis in 1997-8. They document at the country level, corporate governance explains better the depreciation of exchange rate magnitude and stock market reaction. Their argument is that expropriation by managers is more likely to happen in emerging countries where corporate governance is weak. As a result, asset prices tumble in these countries by a larger extent. That highlights the importance of corporate governance to

minority shareholders wealth across many countries, if not fully developed. In my study, I am interested to investigate the tunneling issues in Hong Kong. As a first step, I take a look of the macro legal environment as well as the corporate governance standings relative to the other emerging countries from the study of Johnson et al.

According to Appendix E, as a major international finance center, Hong Kong seems to achieve a reasonable level of legal rights protection and corporate governance standard among many emerging economies. In terms of stock market performance, they document corruption, rule of law variable, corporate governance variable significant explain the market reaction across different countries. They also bring out a very interesting message to the academics: corporate governance can be of first-order importance in determining the extent of macroeconomic problems and protection of minority shareholder matters. Furthermore, the models developed by Lombardo and Pagano (2002) and Durnev and Kim (2005) assume that there is a cost of extracting private benefits and establish that controlling shareholders consume

fewer private benefits in countries where the cost of extracting private benefits is high (Hong Kong for instance).

Modifying the existing measurement, Djankov, La Porta, Lopez-de-Silanes and Shleifer (2008) present a new method to quantify legal protection of minority shareholders against expropriation by corporate insiders: the anti-self-dealing index as shown in Appendix F.

In their report, the index of ex-ante control of self-dealing and ex-post private control of self-dealing and anti-self-dealing index in Hong Kong is 1.00 and 0.96 respectively where the average for 21 English common law origin countries including the US, UK, Australia, Singapore etc. is 0.58 and 0.66 respectively (the higher the better in terms of legal protection to minority shareholders). The average corresponding index for civil law countries (French, German and Scandinavian origin) is 0.27 and 0.35. They also look into the equity market development around the world. In Hong Kong, the stock market capitalization to GDP is 361.0, listed firms per million population are 129.2, IPOs to GDP is 9.12 and ownership concentration is 54% (average

of 21 English common-law origin countries corresponding numbers are 85.5, 32.6, 3.7 and 44% respectively). From these numbers, Hong Kong market is deemed to be well developed and important to the domestic economy with listed firms having above average ownership concentration, similar to many Asian countries.

2.3 Expropriation of minority shareholders

Firms are naturally organized in a way that set of contracts are developed to guide the behavior of the stakeholders. From a team approach on different factors of production, members on one hand will act according to his own interest, yet realize that the importance of the well-being of the firm in a competitive environment against other firms. According to Fama (1980), the idea of modern firms running under managers' control and at the same time there are separate individual firm's owners could be efficient indeed. The set of contracts, in theory, should be capable to handle and separate the two functions efficiently: management and risk bearing fairly well among

managers and shareholders. The external competitive environment for the firms to face, as well as the opportunities and disciplines in the labor market for managers' service, will be good device to keep the mechanism working.

Empirically, such diversion of resources from firms to their controllers has been studied in several contexts, including the US savings and loans crisis by Akerlof and Romer (1993), the Mexican and Asian financial crises by La Porta, Lopez-de-Silanes and Zamarripa (2003), and Johnson et al. (2000a) have shown that expropriation of minority shareholders actually happened even under the common-law regime characterized by effective legal enforcement, legal disputes over tunneling by Johnson et al. (2000b), and corporate governance during the transition from socialism by Glaeser, Johnson and Shleifer (2001). Studies of this area document theoretically and show empirically that differences in legal investor protection across countries shape the ability of controllers to expropriate minority shareholders, and thus drive investor confidence in financial markets and consequently their development [Shleifer and Vishny (1997), La Porta et al. (1997) (1998), Shleifer and Wolfenzon (2002)].

Another strand of study focusing on individual country where certain style of tunneling activities is more prevalent: resources transferred from one subsidiary to another subsidiary in a business group in Korea (Sung 2001), large portion of stealing happens with the non-operating portion such as miscellaneous and non-recurring items of profits among India firms (Bertrand, Metha and Mullainathan 2002), pervasive of corporate loans in China (Jiang, Yue and Lee 2005), equity-linked private securities offerings by Korean chaebols (Baek, Kang and Lee 2006). It seems the incentives for corporate insiders to steal happen everywhere indeed.

Furthermore, Lemmon and Lins (2003) made use of 800 sample firms in eight East Asian countries including Hong Kong and showed indirectly that firm ownership structure plays an important role in determining if insiders expropriate minority shareholders during the region's financial crisis that began in July 1997 from Thailand. Their argument is that firm's investment opportunities go down during economic downturn. It would raise the incentives for controlling shareholders to expropriate minority shareholders, instead of benefiting from any possible positive performance of the firms. The

large separation between control rights and cash flow ownership arises from the adoption of pyramidal ownership structures in these markets suggest that insiders have both the incentive and ability to get involve in expropriation. The stock return underperformance associated with pyramid ownership structure is present only in firms where the management group also has a high control right level. This underperformance could be as high as 20% worse than those of other firms. Their results contribute to the literature that highlights the importance between ownership structure and firm performance and also the proper role of corporate governance setting in developing economies.

The summary statistics by country in Appendix G has shown that in Hong Kong, the management group control rights ownership percentage is 40%, a bit on the high side because the range of the eight sample countries is 16% to 44%. On the other hand the management group cash flow rights leverage in Hong Kong is 1.49, which is the lowest among the samples: range from 1.49 to 3.11. It implies that in Hong Kong, the typical management group is able to turn one unit of cash flow ownership right into 1.49 control rights. From these, the potential for managerial agency problems due to the

separation of ownership and control is not as serious as the other Asian economies.

The economy of Hong Kong over the past twenty years has exhibited reasonable growth in general as shown in Figure 1 from Hong Kong Census and Statistics Department. Gross Domestic Product (GDP) is an important economic indicator and useful for analyzing the economic situation of the territory, particularly useful for reflecting the level of production. The chain volume measures of GDP and its components were released in mid-October 2007 to replace the previous constant price measures. This is to be in line with the latest international guidelines on the compilation of GDP in volume terms which provide a better measure on real growth of the aggregate economic activity of the territory.

[Insert Figure 1 here]

The period of my study from 2003 to 2006 covers the time when the economy experiences the final phase of the downturn in 2003 and the

beginning of a booming economic cycle starting from Q3 2003. The corresponding changes in real GDP performance are shown in Table 1.

[Insert Table 1 here]

Another important barometer of the economic condition in Hong Kong is the broad equity market index – Hang Seng Index which represents more than 70% of the whole market capitalization. During my study period, the Index has rallied from around 9000 to 20000 as shown in Figure 2 in late 2006 amid general rosy economic condition globally.

[Insert Figure 2 here]

Nevertheless, the market began to slide in 2008 and intensified when the bankruptcy of banking firm Lehman Brothers surfaced in September. The bull market technically came to an end and entered into the bear market in mid 2008 when the market index fell more than 20% from its top and never came back till now. The index tumbled by more than 65% to a low of about 11,000

in October 2008. The consumer confidence has weakened and the domestic business environment became very challenging for most firms in Hong Kong. It was followed by the global financial meltdown, pull back of export-oriented Chinese economy (year-to-year -17.5% in January 2009 and -25.7% in February 2009) and recession in most developed countries (except Australia) in late 2008 and early 2009.

Paul Krugman, Nobel Laureate in Economics 2008, stated “As economic historians can tell you, this is an old story, not that different from dozens of similar crises over the centuries.” Furthermore, Reinhart and Rogoff (2008) document that the US sub-prime financial crisis may lead to the US suffer a growth lapse comparable only to a mild case because the inflation is low and better anchored today worldwide. This backdrop provides an interesting motivation for us to study how the market interprets the important deals orchestrated by firms that require minority shareholders approval covering both very good and very bad economic and market sentiment during the study period.

Cheung et al. (2006) focus in connected transactions between Hong Kong listed firms and their controlling shareholders after the Asian financial crisis in late 1990s. They find that investors on average cannot predict expropriation of these transactions in advance of the deal and have to revalue downwards only when the transactions happen. The authors made use of abnormal return as reflected in the stock price of the connected transaction firms to provide evidence where minority shareholders are expropriated. They found that minority shareholders suffered large losses when firms underwent connected transactions.

These transactions are business deals where the parties are involved with a special prior relationship. For instance, it could be transactions between the controlling shareholders and the firm. Since most of these transactions are legal in nature, yet there exist special relationship inherent on the two parties might lead to conflict of interest. As a result, the deal could end up benefit largely the parties involved in the transaction, but not the owners, or other minority shareholders.

The sample period 1998-2000 of Cheung et al. (2006) study happened to be the worst economic performance three-year time period over the past 30 years in Hong Kong, as a consequence of Asian financial crisis. As a result, that would be a limitation to generalize the result of their study. According to Bae et al. (2012), the relationship of corporate governance and firm value during crisis period could be largely different from normal time period. It relates to the profit prospects as well as the investment opportunities where the firm is facing. Hence, controlling shareholders may choose to divert different amount of valuable assets depending on the opportunities available to the firm.

Most of the other related literature offer little evidence on the specific transactions through which expropriation of minority shareholders happen. [La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000a) (2002); Classens, Djankov, Fan and Lang (2002); Faccio, Lang and Young (2001)]. Among others, some country studies go deeper into specific expropriation activities: Buyschaert, Deloof and Jegers (2004) investigate equity sales transactions in Belgium corporate groups. Bertrand, Mehta and Mullainathan (2002) find a significant amount of tunneling occurring via non-operating components of

profit in Indian business groups. Baek, Kang and Lee (2006) find that Korean chaebol issuers involved in intergroup deals set the offering prices to benefit their controlling shareholders. Bae, Kang and Kim (2002) shows that minority shareholders of a chaebol-affiliated firm making an acquisition loss while the controlling shareholders of the firm benefits in general because the acquisition enhances the value of other firms of the controlling shareholders in the group. Most of these deals are very well organized by the insiders indeed.

After all, I learn from the result of the study of Djankov et al. (2008) that there exists above average legal protection of minority shareholders in self-dealing in Hong Kong. That could possibly imply the expected tunneling activities in Hong Kong will be relatively small compare with other common-law countries. Expropriation of minority shareholders may not be fierce in Hong Kong. However, Cheung et al. (2006) show that connected transactions where controlling shareholders impair minority shareholders wealth through tunneling activities. The logical explanation of the above findings is that the controlling shareholders are still capable to find avenue to tunnel assets legally out of the firms in Hong Kong.

I conjecture that the negative surprise element of stealing through connected transactions is significant and will reduce minority shareholders wealth when they are announced. As such, firms will earn negative abnormal return when they announce connected transactions.

Apart from connected transactions which require minority shareholders voting approval, major or very substantial transactions (arm's length) carries the same mandatory voting requirement under the Listing Rule Chapter 14 Equity Securities – notifiable transactions (www.hkex.com.hk). The arm's length transactions appear not to hurt minority shareholders because there will be no related (connected) party of the controlling shareholders involved in the transactions. In my sample, I have around 20% of notifiable transactions under Chapter 14 related to mergers and acquisition category, which is not a significant portion. In this connection, the connected transactions declared under Chapter 14A are believed to be comparable to notifiable transactions. As a result, I expect that firms announcing connected transactions will earn lower abnormal return than those announcing significant arm's length

transactions (very substantial or major category under Hong Kong Listing Rules).

If tunneling activities of the controlling shareholders that take place in connected transactions hurt minority shareholders across the board firms in Hong Kong, will good corporate governance of these firms perceive to protect minority shareholders on the contrary? Corporate governance deals with the ways in which suppliers of finance to firms assure themselves of getting a return on their investment, according to Shleifer and Vishny (1997). It is an important dimension to investigate if there is systematic difference in firm value and corporate governance. Doidge, Karolyi and Stulz (2007) show that corporate governance varies across firms and better governed firms could access capital markets on better terms. Moreover, Dittmar and Mahrt-Smith (2007) document how corporate governance impacts firm value by comparing the value and use of cash holding in poorly and well-governed firms. They show that governance has a substantial impact on value through its impact on cash. By the same token, I am interested to see if corporate

governance variables will play a role in driving firm values both in the short run and long term when significant transactions announcement are made.

Board independence: In the boardroom, the chairman is not the only one to make decisions for the firm. There is a check and balance function of the other directors to potentially outvote the chairman. As the firms these days try to form the board with both inside and independent directors where the latter normally do not have relationship with the firms or management. Most studies believe boards are more independent from management when the proportion of managers sitting at the board is limited and there is a minimum number of independent directors. I use the percentage of independent directors to measure board composition, similar to the method adopted by Cheng (2008) study. An independent director is not an employee, former executive, or relative of a current corporate executive of the firm, and does not have substantial business relationships with the firm, either personally or through his or her main employer. Independent directors are assumed to monitor inside directors and look after the minority shareholders interest. They have incentives to carry their monitoring tasks and to avoid colluding with top

managers to expropriate shareholder wealth. In theory, they could block managers' inappropriate decisions. Reputation could be enhanced if they are doing a good job as experts in decision control because it will increase the chance for them to secure other directorships according to Fama (1980), Fama and Jensen (1983).

Many studies suggest that outside directors provide better counsels that are not available from internal directors. For example, outside directors with political expertise account for a higher proportion if the firm is in need of political advice [Agrawal and Knoeber (2001)]. CEOs from other firms are hired as outside directors if they could provide counsels to improve firm performance and are perceived to have the sources of unique expertise, industry contacts and business acumen according to Fich (2005). Empirical study in the US and other developed countries show the ability of outside directors to monitor management in acute agency settings [Lee, Rangan and Davidson (1992); Kosnick (1990)]. On the performance side, Conyon and Peck (1996) conclude that firm performance and top management pay are more aligned for those having outsider-dominated boards and remuneration

committees. Hence, I expect high independent non-executive directors percentage in the board enhance corporate governance in Hong Kong firms.

CEO/Chairman duality: Chairman in the boardroom is deemed to be the most important person in the board. Meeting agenda is normally controlled by the chairman. Besides, he usually directs the executives to disseminate necessary information. When a firm's CEO also serves as the chairman of the board of directors, it provides CEO with a wider power base and locus of control. If they are different persons, chances are the independent board chairperson will facilitate objective assessment of the top management team performance[Boyd (1994)]. By sampling three industries to enhance generalizability, Finkelstein and D'Aveni (1994) found that board vigilance was positively associated with CEO duality. Furthermore, Finkelstein and Hambrick (1996) find that CEO duality is another indicator of CEO's power over the board. The breakdown of the 30 Dow Jones Industrial Average firms as of April 2008, 24 firms had the Chairman of the Board and the CEO being the same person. On the contrary, in the case of Hong Kong, there are more firms having CEO and the chair different persons. The Cadbury Committee

report in 1992 did recommend that there should be a clear division of responsibilities at the head of a firm, implying that the roles of CEO and chairman should not be combined. It suggested that organizing board meeting and taking the lead to hire, fire and compensate the CEO is the obvious role of the chairman. If the two positions are combined, potential conflict of interest in carrying his expected function might happen. Moreover, independent board members would find it difficult to maintain reasonable influence over management.

As Jensen (1993) argues that in order for the board to be effective, it is important to separate the chairman and CEO positions. Along this line, Cheng (2008) documents that if CEO is also the chair of the board, he/she is powerful to influence the board and firm decisions and consequently increases the variability of firm performance. I conjecture that CEO duality will exhibit a negative relationship with effective board control. The study by Rechner and Dalton (1991) has shown that firms opting for independent leadership consistently outperformed those relying upon CEO duality.

On the other hand, Baliga, Moyer and Rao (1996) suggest that there is only weak evidence that CEO duality status affects long term performance, after controlling for other factors that might impact that performance. In East Asia, Claessens, Djankov and Lang (2000) find that two-thirds of firms that are not widely held (Hong Kong is one of the seven economies in the study) have a controlling owner linked to a member of top management. As a result, separation of CEO and chairman in Hong Kong firms is the preferred arrangement by minority shareholders for better monitoring of top management.

The study in East Asia corporations, concentrated ownership by one controlling shareholder is common. [Claessens, Djankov and Lang (2000)]. They document about 75 percent of the 20 largest firms in Hong Kong are under family control, while less than 60 percent of the smallest firms fall in the same category. However, only a quarter of firms show pyramid structures where one owns the majority of the stock of one firm that holds a majority of the stock of another- a process that can be repeated a few times. Firms in Hong Kong show concentrated ultimate cash-flow rights, just behind the

highest Thailand firms among seven East Asian economies. The ultimate control rights of them are also concentrated, just behind Thailand and Indonesia. They show that only the firm valuation in Hong Kong and Korea is negatively related to cash flow rights. Besides, control has a negative effect on firm performance in most economies. Given the result of above study and strong family ties on Hong Kong firms, I conjecture that family board members represent poor governance whereas larger board size represents better governance to cross-check the insiders potential conflicts against minority shareholders.

In general, I would expect connected transactions will hurt minority shareholders in both short term and long term. Yet well governed firms will protect shareholders better and poorly-governed firms will experience negative abnormal return when they announce connected transactions. Besides, well-governed firms will experience higher long term abnormal return and better operating performance after significant transactions.

2.4 Auditors as gatekeeper to protect minority shareholders

In Hong Kong, most public listed firms are controlled by families. There could easily be conflict between controlling shareholders and minority shareholders in case there is a high level of ownership concentration. Auditors in this situation will be an important third party to ensure quality financial information being reported and transactions are conducted in a legitimate basis. If investors are confident that the auditing process is functioning well, they will be more willing to invest and require a lower return on the capital to the firm. Nevertheless, the auditors have to be capable to disclose full information on event such as connected transactions. In that case, controlling shareholders will not be easy going through some deviant behavior to expropriate minority shareholders. In fact, the large external audit firms do feel the pressure from controlling shareholders in the assurance procedure. Guedhami and Pittman (2006) tried to look into this situation. They picked sample firms many different countries and measured the potential conflict between controlling shareholders and minority shareholders using ownership concentration. They found evidence where countries having stringent regulations enforcing liability

of the external auditors, ownership concentration at the firm level goes lower. The explanation could be auditors in those countries do a better job under liabilities threat and reputation risk. As a result, small investors there will feel more confident to invest in firms, resulting in lower ownership concentration.

Another paper by Guedhami et al. (2009) reports strong evidence where privatized firms worldwide are more likely to appoint a big four auditor with increasing foreign ownership. The message is that superior external monitoring and trustworthy financial reporting by means of big four auditors is credible.

2.4.1 Concepts of auditor competence and independence

If the capital market expects the auditor is capable to reduce potential expropriation on minority shareholders, the employment of this auditor will be valuable to the firm. That also implies that if there is any wrongdoing being discovered by the auditors, they will not hesitate to report. The value of the

auditors' service depends on the discovery capability of a given breach by the firm and the willingness to report the discovered breach (Watts and Zimmerman 1982), if there is a breach going on. The discussion follows with the competence of auditors affect the likelihood of the first part and the independence of auditors affect the likelihood of the second part. Auditors need to convince the assurance market they are capable to find the breach and will report it if found.

One way managers could play games with the auditors is to change auditors from time to time. By doing this, the incumbent auditor feels costly to report a discovered breach and the independence of assurance service might be compromised. Auditors have to trade off the cost of not reporting (reputation risk) versus reporting a discovered breach of the firm (risk of losing assurance business). A couple of arrangements that last for centuries likely to provide motivation for auditors to conduct independent service as far as possible: reputation of auditors and auditors firm size.

2.4.2 Auditors independence determinants

It is expensive and time consuming for auditors to build the reputation to be one that could discover breaches and report them timely. This reputation helps the demand of their service and then the fees. On the other hand, auditors reputation get ruined easily if the market is aware of their less independence than the market expectation (Watts and Zimmerman 1983). It implies auditors are very careful to protect their reputation.

Large auditors are having a large scale of the bond size as well as the mutual monitoring by the partners. There exists the huge size of the partnership assets, individual partners' asset as well as the massive human capital of all partners in big auditors (Fama and Jensen 1983). The auditor's reputation is equivalent to large number of partners' reputation is on the table.

It is also expected that large auditors having more clients are less likely to be under managers' pressure and not report the breaches when they find. The failure to report a breach on the auditors' reputation and potential audit

fees to the others in total will be much larger than the loss of auditor fee of specific client decides to stop employing the service.

The reinforcement of mutual monitoring between partners is happening in large scale auditor where potential liabilities are bigger and the reputation of partners at stake is more. Every partner will spend more effort to monitor the other's performance and reinforce mechanism to strengthen the monitoring.

2.5 Board members as gatekeeper to protect minority shareholders

Yermack (1996) provide evidence that small number of board members exhibit more effective corporate governance, and hence higher market valuation as reflected in Tobin's Q ratio. His argument along this line is that managers' decisions are monitored by the board members. Yet in real life, most boardroom behavior is dysfunctional in the sense that directors not very often criticize the top management's policies. The more people in the boardroom, this will be more pronounced.

In the case of Hong Kong listed firms, it could be different in that our board size is a lot smaller than the US firms. As a result, increasing the board size might in fact more effective in governing the management's policy because board's capacities for monitoring is enhanced when board size increases when the average board size tends to be small to start with.

Chapter 3: Regulatory requirement

3.1 Legal definition of connected transactions

Under the Listing Rules Chapter 14A (last updated in January 2009) (Appendix H), a connected transaction is any transaction between a listed firm and a connected person. Connected persons are the listed firms (or the subsidiary's) substantial shareholders, the chief executive, the directors (current directors or anyone who held this position at any time during the preceding 12 months), and their associates, including any firm in which the above hold a substantial shareholding. The definition also applies to "any person cohabiting with the above and close relatives (spouses, parents, step-parents, brothers or sisters, step-brothers/sisters, and in-laws). The general requirement for connected transactions is public announcement, a circular must be sent to shareholders giving information about the transaction, and subject to independent shareholders' approval. A connected person with a material interest in the transaction will not be permitted to vote at the shareholder meeting on the resolution approving the transaction." The board has to

approve the connected transaction. Only those directors involved in the deal are exempted from the approval in the transaction.

Furthermore, under the Listing Rules, the following eight categories of connected transactions are exempted from independent shareholders' approval requirement:

- i) Intra-group transactions- transaction between a listed firm and a non wholly-owned subsidiary or between its non wholly-owned subsidiaries where no connected person of the listed firm is entitled to exercise 10% or more of the voting power at any general meeting of any of the subsidiaries concerned and none of the subsidiaries concerned is itself a connected person.
- ii) Commercial term transactions- each of the percentage ratios (other than the profit ratio) is less than 2.5% or if the ratios are between 2.5% and 25%, the total consideration is less than HKD10 million.
- iii) Securities issue- the listed firm issues new securities to a connected person who receives a pro-rata entitlement to securities in its capacity as shareholder.

iv) Stock exchange dealings- a transaction comprises dealing in securities listed on the Exchange or a recognized stock exchange by a listed firm in the ordinary and usual course of its business.

v) Purchase of own securities- any purchase by a listed firm of its own securities from a connected person on the Exchange or a recognized stock exchange or under a general offer made in accordance with the Code on Share Repurchases.

vi) Directors' service contracts- entering into a service contract by a director of the listed firm with the listed firm.

vii) Consumer goods or consumer services- the acquisition as consumer or realization in the ordinary and usual course of business of consumer goods or services by a listed firm from or to a connected person of the listed firm on normal commercial terms.

viii) Sharing of administrative services- the sharing has to be on a cost basis which is identifiable and allocated to the parties involved on a fair and equitable basis.

3.2 Legal definition of major transactions and very substantial transactions (Arm's length in nature)

Under Chapter 14 of the Listing Rules, it describes how certain transactions are classified, the details that are required to be disclosed and whether a circular and shareholders' approval are required. First of all, five percentage ratios are calculated:"

i) Assets ratio- total assets which are the subject of the transaction divided by total assets of the listed firm.

ii) Profits ratio- profits attributable to assets which are the subject of transaction divided by the profits of the listed firm.

iii) Revenue ratio- revenue attributable to the assets which are the subject of the transaction divided by the revenue of the listed firm.

iv) Consideration ratio- consideration divided by the total market capitalization of the listed firm.

v) Equity capital ratio- nominal value of the listed firm's equity capital issued as consideration divided by the nominal value of the listed firm's issued equity capital immediately before the transaction."

For major transaction (disposal), the relevant range of first four ratios is between 25% and 75% but equity capital ratio is not applicable. For major transaction (acquisition), the relevant range of the all ratios is between 25% and 100%. For very substantial disposal, the minimum of first four ratios is 75%. For very substantial acquisition, the minimum of all ratios is 100%.

Under either major or very substantial category, the listed firm has to notify the Stock Exchange, make a public announcement, dispatch a circular to shareholders with the accountants' report and obtain shareholders' approval (any shareholder and his associates must abstain from voting if such shareholder has a material interest in the transaction).

3.3 Auditor's responsibility for connected transactions

According to Hong Kong Accounting Standard 24, there exists a requirement to disclose the details of connected transactions in the financial statements. There could be tax consequence of connected transactions. Inland

Revenue Ordinance has specific provisions on connected transactions. In general, the audit evidence sourced from connected persons are not considered as highly reliable. The Standard also highlights the possible bad intention of connected transactions such as fraud may happen.

The nature of connected transactions may pose higher level of risks, resulting in significant misstatement of the information of financial statement: It could be that connected persons conduct the transaction by means of a complicated structure. Existing management information system setting may not be capable to identify outstanding balances between the connected persons and the entity. Some connected transactions are not using regular market terms and conditions. The entity dealing with is in distress, such as very tight liquidity condition or encounter material litigation.

The responsibility of auditor is to conduct audit procedures to identify, assess professionally and react to the material misstatement risks in case the firm is failed to disclose or account for the connected transactions in an appropriate manner. The understanding of the connected transactions is

important before the auditors are capable to conclude that the financial statements have achieved a true and fair presentation of the transactions. As fraud are more likely to happen through connected transactions, the auditors have to spend effort with professional skepticism to evaluate fraud risk factors in the deal, such as concealment of facts, management manipulation or collusion.

In order to understand the potential context of fraud in connected transactions, auditors should discuss extensively how the deal could be arranged to misappropriate the firm's assets for the wrong reason. Generally, getting a hold of the management to obtain information about the connected persons is common practice as well.

As a matter of practice, auditors will treat connected transactions carrying significant risks of material misstatement due to fraud if they happen beyond the firm's normal course of business. For example:"

a) complicated equity transactions like acquisition;

- b) deals with offshore firms incorporated in weak legal protection of property right jurisdiction;
- c) unusual large discount or return in sales transactions; or
- d) circular arrangement such as commit to repurchase in sales transactions.”

The existence of connected persons with dominant influence could be another sign of high risk of significant misstatement due to fraud. Other worrying signs might include very high turnover of top management executives, possibly the result of not ethical or fraudulent practices to serve connected persons have been going on. It could also be that connected persons excessive involvement in picking certain accounting policies which may also due to fraudulent financial reporting practice.

The auditors will modify the auditor’s report appropriately if appropriate audit evidence supporting for the connected transactions are not received or the auditors opined that the information disclosed of the connected transactions in the financial statement are not appropriate. In some cases, auditors may conclude that they have not received sufficient evidence on these

transactions. There is limitation of scope. Auditors may choose to put a qualified opinion. If the auditors feel the information disclosed on the connected transactions is not appropriate, auditors may choose to put a qualified opinion or adverse opinion.

On the surface, even though the auditors do not have a veto power on connected transactions per se, their duties to report the transaction in financial statement in a very careful manner indirectly and hopefully give pressure for the key stakeholders in the deal. As a result, they effectively audit the connected transactions even though it may not happen before the deal is announced. On top of that, the Accounting Standard does provide warning to auditors to exercise additional care in handling connected transaction reporting in light of the potential expropriation of minority shareholders. Obviously, the governing body is well aware of the potential expropriation of minority shareholder interest in connected transactions.

Chapter 4: Hypothesis Development

4.1 Corporate governance and connected transactions

La Porta et al. (2000) look at corporate governance as a set of mechanisms “through which outside investors protect themselves against expropriation by the insiders”. It implies firms adopting bad governance practice may involve more in value-reduction transactions. Furthermore, Cheung et al (2006) argue that investors are not capable in predicting tunneling activities when connected transactions are announced by firms. Capital market reacts to the announcement when it happens. What investors will generally do is to revalue the firm downwards when tunneling transactions may occur.

Based on the existing literature, I argue that there are two lines of opposing forces existing at the firm level when connected transactions are announced. One group of stakeholders (offenders) who are suspected of stealing includes the insiders: executives, directors or substantial shareholders. They are the one to push the deals to happen. The other group of stakeholders

(gatekeepers) which include independent directors and external auditors are there to protect minority shareholders' interest and mitigate the frequency of connected transactions to happen. Hence, I conjecture that when the firms do not practice good corporate governance, they are more associated with connected transactions. These arguments suggest the following hypothesis:

Hypothesis 1: Firms announcing connected transactions are poorly-governed than firms announcing arms length transactions.

To test this hypothesis, I will conduct a mean difference test to find out whether connected transactions firms, as compared with arms length transactions firms, on average having fewer board members, lower independent non-executive directors percentage in the board, higher percentages of family board, more often CEO and Chairman of the board as the same person, employ more non-big four external auditor to provide assurance service of accounting information.

4.2 Connected transactions and short term abnormal returns

As the result of Cheung et al. (2006) shows the short term market reaction to firms announcing connected transactions with controlling shareholders are more negative than other arms length transactions. It reflects the reaction in the capital market to discount the likelihood of minority shareholders interest being expropriated.

On top of that, the expropriation hypothesis argument from the controlling shareholders against minority shareholders is further enhanced with the study of Bae, Baek, Kang and Liu (2012) using Korea as the country evidence. They find that during the 1997 Asian financial crisis, the bigger tumble of stock prices are those firms subject to controlling shareholder expropriation.

Nevertheless, the connected transactions in Hong Kong under the Listing Rules include parties such as executives (for example CEO, CFO), directors (managing, non-executive), or substantial shareholders (controlling and non-controlling). All of these individuals are high up in the social status and have more power relative to the minority shareholders. According to the sociological theories, the empowered individuals would likely to take advantage of the relative powerless such that they could achieve their personal goals.

Edwin Sutherland (1939) first introduced the idea of white collar crime in sociology study. He argues that it is “crime committed by a person of respectability and high status within his occupation environment.” It is not violent or involved any physical force in nature. The offense may include trust violation, forgery, fraud, stock manipulation, bribery, computer crime, concealment. The offenders commit these in order to achieve monetary or property reward. In order to explain these offenses, a number of theories were

developed over the past decades, which include differential association theory, anomie-strain theory and rational choice theory.

Edwin Sutherland's differential association theory argues that individuals learn and commit offenses with others. "It highlights the importance of the working environment placing a big influence to individual to be willing and capable to commit some acts that hurt the others. The organizational setting may rationalize the offence behavior and the individual is not feeling that he is doing something wrong indeed, which may not happen in other organization." In a way, even the value system of an individual could be altered in a certain organizational environment.

The anomie-strain theory of Robert Merton (1957) explains these offenses are the result of some very important social and cultural structures. "In certain culture where certain goal is believed to be right to strive and the methods as to how to reach this goal. In the case of striving certain goal in a

culture is perceived to be much more important than the merits of the methods to reach the goal, according to Merton, a higher criminal activity level will be resulted as the imbalance increases.” It is because most think that reaching the final goal comes before whether one is using the proper and moral ways to get it. As a result, a strain towards anomie and deviant behavior becomes uncommon in a society. The general problem of the society would be for those once achieve their goals, most likely they are not going to stop there. It could become a big vicious cycle.

Rational choice theory depicts individual is rational to commit offense by making alternative choices. In a sense, the individual has considered all the pros and cons before doing it. It would not be impulsive at all. The criminal act would provide more pluses compared with not doing it. “For example, in order to reach financial freedom, one would compare with the choice of continued feeling pain when one has to struggle in life for money.” This is applicable to many cases in the business world where insiders who commit offenses may not be easily got caught. Even if they do, the consequences

could be to pay fines rather than imprisonment like a lot of street crimes. White collar criminals in general perceive the expected penalty of getting caught fairly affordable.

As connected transactions would be perceived as possible avenues where insiders expropriate the minority shareholders, the short term market reaction would be more negative than other arms length transactions firms. These arguments suggest the following hypothesis:

Hypothesis 2: short term abnormal return of firms announcing connected transactions are lower than firms announcing arms length transactions.

I will conduct a two-tailed test of the short term abnormal return of the connected transaction firms versus the arms length transaction firms, under

five different time window. It varies from one day before to one day after announcement, from one day before to two days after announcement, from one day before to three days after announcement, from one day before to five days after announcement, and from one day before to ten days after announcement.

4.3 Environment conducive to conduct connected transactions as predicted by sociologists

Furthermore, Sutherland posited that environment plays an important role affecting individuals to commit offense in white collar crime, under his theory of differential association. Since more than 70% of connected transaction involves buying or selling of assets of the firms, I conjecture that firms announcing connected transactions tend to carry more assets.

Hypothesis 3: Connected transaction firms carry more assets than arms length firms.

To test this hypothesis, I will conduct a mean difference test to find out whether connected transactions firms, as compared with arms length transactions firms, on average having more total assets.

4.4 Auditors as gatekeepers in connected transactions

Interestingly, auditing has been a popular monitoring device since the 16th century and has a long history (Watts and Zimmerman, 1978). Auditors are there to do the check and balance work on the accounting information of firms. In case of Hong Kong where lots of public listed firms are family-controlled, there could easily be conflicts between controlling shareholders and minority shareholders. External auditors are very important third party to

ensure the true and fair information is disclosed in financial statement and transactions are decided with merits. As for connected transactions, the role played by auditors would be even more important. Given a higher level of competence to discover potential deviant behavior by insiders and willingness to report them, big four accounting firms would be perceived to do a better job by capital market to protect minority shareholders when firms announce connected transactions. These arguments suggest the following hypothesis:

Hypothesis 4: There is a positive association between the abnormal return of connection transactions firms and the employment of big four accounting firms as external auditor exhibit.

4.5 Connected transactions and long term abnormal return/operating performance

I borrow the idea of Healy, Palepu and Ruback (1992) to look into long term performance of events that may have lasting effects to the firms. The paper looked into corporate performance after mergers. Similarly, it is reasonable to expect that connected transactions might have long term effect. I argue that for firms which have good governance in place and announce arms length significant transactions, the operating performance of them will be better. That will be reflected in the long term abnormal return of the stock price. On the contrary, if expropriation does happen in connected transactions, I conjecture that these firms will get hurt fundamentally. Sooner or later, it will affect their operating performance and the stock price of these firms will be impaired as a consequence. Hence the long term abnormal return by holding on these stocks will also underperform those firms announcing arms length transactions in the first place. These arguments suggest the following hypothesis:

Hypothesis 5a: Long term abnormal return of firms announcing connected transactions are lower than firms announcing arms length transactions.

Asset disposal or asset acquisitions are the most popular category of connected transaction (over 65%) announced by firms. Professional auditors are also very careful to look for any signs of misappropriation of assets related to connected transactions in Hong Kong. In the other words, these are the simplest type of deals that could happen and likely to expropriate shareholders where assets are sold at underpriced level to connected party or assets are bought at overpriced level from connected firms. Either way, after connected transactions are completed, I conjecture the overall quality of the assets of the firms will deteriorate or the ability to generate sales will be hurt, if enough time is given to observe the damage. These arguments suggest the following testable hypothesis:

Hypothesis 5b: Long term asset turnover of connected transactions firms will be lower than that of arms length transactions firms.

To test this hypothesis, I will conduct a mean difference test to find out whether connected transactions firms, as compared with arms length transactions firms, on average having lower asset turnover one to five years after deal announcement.

Chapter 5: Data, sample selection and research design

5.1 Data

I get the sample of all significant transactions from the listed company information advance search under the website of Stock Exchange of HongKong (http://www.hkexnews.hk/listedco/listconews/advancedsearch/search_active_main.asp). This database is updated daily by the Exchange. It contains firm documents filed with the regulator. From the database, I download the copies of all filings of the significant transactions announced by the listed firms in Hong Kong from January 2003 to December 2006. Originally I get 1035 significant and 1353 connected transactions from the website of The Exchange. After cutting out some extreme outliers (88 samples from connected firms and 93 samples from arms length firms where the data is 3.5 standard deviation from the mean), inmy sample there remains958 significant arm's length transactions and 1265 connected transactions from January 2003 to December 2006. Each filing consists of a detailed description of the transaction and most are accompanied by an

assessment report prepared by an independent financial advisor.(Appendix I Disclosure documents of Titan Holdings Limited on connected transactions in April 2003)

According to Johnson et al. (2000a), firms could be more likely to expropriate when they face worse economic prospects. Lemmon and Lins (2003) agreed that crisis period provide an absolute exogenous shock to individual firm which significantly reduced available return on investment opportunities of firms in countries being affected. They further document ownership structure plays an important role in deciding minority shareholders are expropriated by controlling shareholders.

I obtain data on stock returns, market capitalization, financial data, China influence, auditor information, ownership structure, industry classification, corporate governance for the firms from Datastream, S&P Capital IQ database, annual reports followed by phone request confirmation from the investor relations department of the listed firms. My sample size is about three times as compared with the one used in the study by Cheung et al.

(2006). I define the public announcement date as $d=0$ and estimate the daily abnormal return using the market adjusted returns approach, following Brown and Warner (1985). The Hang Seng Index return is used as the market index return. The market index return is subtracted from the actual return from the announcement date ($t=0$).

5.2 Descriptive statistics and correlation matrix

Table 2 reports the distribution of the sample firms by year and by transaction type. There were more connected transactions as compared to arms length transactions in each single year. The overall number of transactions was also increasing over time. It could be due to the bottoming out of the economy in Hong Kong since 2003 and firms started to engage more in either transactions since then. On top of that, the number of listed firms also increased over years and hence more transactions were executed.

[Insert Table 2 here]

Table 3 reports the distribution of the sample firms in ten different industries. It shows that significant transactions are mainly coming from four industries: consumer cyclicals, financials, industrials and technology firms. Financial firms were most active in carrying out significant transactions which could be related to banks, equity investment, insurance as well as real estate investment and services. These firms happened to dominate the transactions in both connected and arm's length transactions category as well.

[Insert Table 3 here]

Full sample descriptive statistics is provided in Table 4. Among all the sample firms, they generally paid cash dividends at around 1% yield. The portion of firms engaged in significant transactions were largely Hong Kong based. As far as governance arrangement is concerned, the average independent director percentage in the board was about 30-40%. The mean board size was around eight to ten members, yet the range of board size could go from four to 24. The proportion of firms having family members in the

board was low: only about 20%. CEO and chairman duality was not a common practice in Hong Kong anymore. In terms of external auditor decision, more than half of the sample firms employed the assurance service from big four accounting firm in both the year and one year after significant transactions. The bias is more prominent in the case of connected transaction firms. More than 90% of the sample firms received unqualified opinion from their auditors on the year when transactions took place. The average deal size for significant transactions was around HKD200 million.

[Insert Table 4 here]

Table 5 presents the Pearson and (Spearman) correlation matrix of the variables of both connected and arms length transaction firms that will be used in the later regression analysis. As expected, the abnormal return of the firms announcing significant transactions are negatively correlated with connected nature of the transactions, yet negatively correlated with firms having bigger size in terms of total assets. The reason could be that connected firms are positively correlated with the total assets. Besides, connected deal firms are

positively correlated with PRC based and big four accounting firm, but negatively correlated with deal size, asset turnover, proportion of independent board of director members, board size, CEO/chairman of the board duality. Other than that, deal size is positively correlated with board size. Big four accounting firm is positively correlated with the total asset size, return of asset, return of equity, board size and unqualified audit opinion, yet negatively correlated with asset turnover and the proportion of independent board members. A few other pairs of coefficient has also caught my attention: (a) the proportion of independent non-executive directors in the board is significantly negative correlated with family board characteristics, which is logical; (b) board size is positively correlated with CEO/chairman of the board duality, family board characteristics and unqualified audit opinion.

[Insert Table 5 here]

Chapter 6: Results and Discussion

6.1. Connected transactions firms features

From Table 6, connected transaction firms, as compared with arms length transactions firms have a lower independent board members representation and carry a small board size, a sign of not practicing good governance. I show that firms undertaking connected transactions are larger firms with more total assets, commanding higher market capitalization and paying more cash dividends. Yet the deal size was relative smaller compared with arms length transactions. Simply put, it is consistent with the prediction under sociological theories where potential deviance at the firm level will take place with more cash or more assets for insiders to take advantage.

[Insert Table 6here]

6.2 Short term market reaction on all economic significant transactions announcement

This chapter reports the evidence on connected transactions leading to expropriation of minority shareholders. Table 7 reports abnormal returns for firms conducting connected transactions versus firms undertaking major or very substantial transactions. I report cumulative abnormal returns for days (-1,+1), (-1,+2), (-1,+3), (-1,+5) and (-1,+10) relative to the official press announcement date. The announcement date is based on the exchange's information file. Connected transactions, which are more likely to result in expropriation of minority shareholders, do destroy shareholder value. Firms announcing connected transactions show significantly negative abnormal returns following the announcement for window (-1,+1), (-1,+2), (-1,+3), (-1,+5) and (-1,+10) by -0.14%, -0.33%, -0.64%, -0.55% and -0.36% respectively. On the contrary, for firms announcing major or very substantial arms length transactions experience significantly positive abnormal returns of 2.39%, 2.64%, 2.41%, 2.78% and 2.79% for windows (-1,+1), (-1,+2), (-1,+3), (-1,+5) and (-1,+10) respectively.

[Insert Table 7 here]

Table 8 presents the results of the comparison of short term CAR upon two groups of transactions announcement. As a consequence of what I observe in Table 7 (opposite sign for different transaction types and significant for all windows under arms length transaction), the mean difference of CAR for all windows of the two groups of transactions announcement are expected to be significant. On a relative scale, CAR for windows (-1,+1), (-1,+2), (-1,+3), (-1,+5) and (-1,+10) of connected transactions are significantly lower than arms length transactions by 2.53% ($t=-3.63$), 2.97% ($t=-4.26$), 3.05% ($t=-4.70$), 3.33% ($t=-4.99$) and 3.14% ($t=-3.58$) respectively. A similar comparison by the study of Cheung et al. (2006) using years 1998-2000 data reported significant negative abnormal return ten days after announcement.

[Insert Table 8 here]

After all, the result appears to suggest that the connected nature of transactions drives the negative impact of notifiable transactions on minority

shareholder wealth in Hong Kong. The higher social-economic class executives, directors or significant shareholders of listed firms are taking advantage of the minority shareholders. It is consistent with the tunneling literature (Johnson, La Porta, Lopez-de-Silanes and Shleifer [2000]) where the connected type of transactions will hurt and expropriate minority shareholders in the Hong Kong equity market. I conjecture that those firms not experiencing negative stock impact (announcing arms length transactions) may be a result of pre-announcement anticipation. As a result, I conduct a test (not reported) similar to the one used by Cheung et al (2006), I find that arms length firms on average experienced a significant abnormal positive return from 12 months before the deal until one month before the deal. The same happens to the connected transactions firms as well. When the pre-announcement abnormal returns between the two groups are compared, I find that arms length firms actually exhibit a significant pre-event premium, but not discount. This implies investors could not anticipate deal announcement and hence the stock price decline is likely to be a reflection of expropriation of minority shareholders when connected transactions announcement is made.

6.3 Regression analysis of short term market reaction on all economic significant transactions announcement

Our multivariate tests are estimated using ordinary least squares regression of announcement abnormal returns for (-1,+1), (-1,+2), (-1,+3), (-1,+5) and (-1,+10) window on the firm financial variables and corporate governance variables. I conjecture these governance variables could be perceived as offering protection to minority shareholders against expropriation by executives, controlling shareholders or directors when economic significant transactions are conducted. Table 9A and Table 9B present the empirical result for the test of the explanatory variables on the abnormal returns reported.

[Insert Table 9A and Table 9B here]

Across all transactions of the sample (connected, major or very substantial), the coefficient of employing non-big four accounting firm as external auditor has a negative sign that is statistically significant at 10% five days and ten days after announcement. This result possibly suggests that the

short term market view non-big four accounting firm is negative in protecting minority shareholders rights on any type of transactions. Let's say if the significant transaction involves disposal of an asset which is with the firm's book for some time, then market perceives the audit work of non-big four accounting firm may not provide a better estimate or valuation of this asset as compared to big four accounting firm. Hence the market reaction turns negative. Or else even if the significant transaction involves acquisition of an asset which is going to the firm's book after the deal is completed, market may perceive the future audit work of non-big four accounting may not provide a better estimate or valuation of this asset as compared to big four accounting firm. It is hard for shareholders to ascertain the merit of the transaction. The risk of the deal to shareholders increases and is reflected in the short term market reaction.

Furthermore, firms with more total assets are driving down the abnormal return in the five and ten days after deal announcement at 5% significance level. When I recall the correlation coefficient matrix on Table 5, it indicates a strong positive correlation between connected transactions and

total asset size of the firms. It could therefore be explained by negative market reaction related to more total assets because these are one of the typical characteristics of firms which announce connected deals.

Moreover, the connected nature of the transactions shows a negative driving factor on short term abnormal return, statistically significant at 1% during the first five days and 5% on the tenth day. This further confirms the expropriation on minority shareholder wealth is more pronounced in connected deals. Market participants do worry and label in general that stealing is likely to happen in connected transactions. They perceive more risks to these types of deals and hence penalize the stocks in the short run significantly.

On the positive side, a larger board size in the firms provides a plus in driving up the abnormal return, statistically significant at 10% level on the first day after announcement, 5% for the two, three and five days after announcement, and even 1% on ten days after announcement of the transaction. The explanation could be if there are more directors on the board, the aggregate check and balance power of significant transaction which involves

large amount of resources increases. So naturally bigger board size is expected to protect minority shareholders better as compared to fewer board members. On top of that, in case there exists certain executive, substantial shareholder or director who would like to steal from the firms through significant transaction, it becomes harder to influence a larger board (could be as many as 24 members in my sample) to get the necessary green light for the bad-intention deal done as compared to a small board (could be as few as only four members in my sample).

Table 9B reports the association between connected transactions firms and the board size (CONN*BRD SZ), and connected transaction firms and big four/non-big four auditor choice to test if more board members or big four auditor in connected transaction firms are associated with higher short term abnormal return reflected in the market. This is a test of hypothesis four. The coefficient of CONN is negative and significant. Whilst the coefficient of BRD SZ is positive and significant, the coefficient of CONN*BRD SZ is positive and significant. This result suggests that more directors in the board for connected transaction announcement would be perceived by the market to

be positive. Whilst the coefficient of B4/NB4 is negative and significant for five and ten days time period from announcement, the coefficient of $CONN*B4/NB4$ is negative and significant from three to 10 days after announcement. This result supports that there is an association of big four auditor in connected transaction firms are perceived by the market as positive (non-big four auditor in connected transaction firms are perceived by the market as negative).

The previous discussion shows the overall broad picture of how variables of all transactions affecting the abnormal return. Nevertheless, there may be systematic difference for these variables driving the abnormal returns in connected transactions comparing with arms length transactions. For example, big four accounting firm may play a more important role to protect minority shareholders against the executives, directors or substantial shareholders who plan to tunneling when the firm conducts connected transaction. One constructive way to understand better the dynamics of different variables on the short run abnormal return on the deal announcement is to segregate the sample firms for analysis into two panels: arms length

transaction firms and connected transaction firms. As an alternative, Table 10 presents how the tested variables explain the abnormal returns for windows (-1,+1), (-1,+3), (-1,+5) and (-1,+10) after deal announcement on arms length transaction firms versus connected transaction firms.

[Insert Table 10 here]

From the previous discussion, I have learnt that the possible tunneling activities in connected transactions result in more negative market reactions than arm's length transactions when the deal is announced. From Table 10, I show that the fear is mitigated by the big four accounting firm employment for firms engaging in connected transactions. The results are statistically significant (on Panel B) five and ten days after connected transaction announcement. Yet in the case of arm's length transaction, employment of big four accounting firm has no impact at all on the short term market perception. The beauty of this analysis is that it is able to visualize the distinct market reaction on two types of transactions: it seems that the big four accounting firm assurance work is an endorsement of existing quality financial information and

then connected transaction relating to existing asset disposal. It could also extend to a confidence support of a connected transaction involving acquisition of asset. Quality big four accounting firm is likely to be a gatekeeper which ensure the deal is within a credible boundary as far as price being paid and its value to the firm is concerned.

Table 10 also confirms the total asset size is driving down short term abnormal return, which is largely due to the strong linkage of big size firms are more likely to perform connected transaction in my sample, and hurting minority shareholders overall.

In the case of arm's length transactions, there is not much needed to be reported as most financial and governance variables do not yield much significant results on Panel A.

6.4 Long term buy-and-hold abnormal returns on firms announcing connected transactions versus arms length transactions

Figure 3 shows the long term abnormal return by holding the stocks of firms announcing connected transactions versus arms length transactions. The average abnormal returns for the investment over two to five years in connected deals were about 60% to 90% lower than that in arms length transactions firms.

[Insert Figure 3 here]

Table 11 presents the results of the comparison of long term abnormal return upon two groups of transactions announcement. As a consequence of what I observe in Figure 3, I expect the mean difference of long term abnormal return for all windows of the two groups of transactions announcement to be significant. On a relative scale, abnormal returns for windows over two, three, four and five years of connected transactions are significantly lower than arms length transactions by 75% ($t=-4.46$), 66% ($t=-4.91$), 91% ($t=-4.77$), and 92% ($t=-4.81$) respectively. After all, I find that the abnormal returns of firms

conducting connected transactions are significantly lower than arms length transactions both in the short and long run. This supports the tunneling argument and linkage of connected transactions that goes on in Hong Kong.

[Insert Table 11 here]

6.5 Regression analysis of long term buy-and-hold abnormal return on firms with significant transaction

Apart from the short term market reaction, another multivariate test is estimated using ordinary least squares regression of long term abnormal returns in hanging on the stocks for these firms announcing significant transactions. My tested buy and hold period is two, three, four and five years. I believe the time frame is long enough to provide insight as to whether some firm financial variables and corporate governance variables could shed some lights on a more patient portfolio setting. Table 12A presents the empirical result for the test of the explanatory variables on the abnormal returns reported.

[Insert Table 12A here]

The connected nature of transactions consistently yields negative returns to shareholders from two to five years after the deal at 1% significance level. This provides additional evidence that no matter short term or long term, connected transactions are more likely related to tunneling and hurt minority shareholders permanently.

Total asset size of the firm is driving down long run abnormal return in all years at 1% significance level. Similar to the previous discussion, firms carrying large total assets are positively correlated with connected deals which are likely expropriate minority shareholders.

PRC-based characteristics of firms exhibit a negative impact on one year and two years abnormal return at 5% significance. Based on my samples, PRC-based firms are strongly correlated with announcement of connected transaction, which is likely to expropriate minority shareholders. As a result, the long term stock performance of these firms is poorer.

On the other contrary, a larger board size in the firms provides a plus in driving up the long run return statistically significant at 5% level for two and five years holding period and 1% level for three and four years after deal announcement. Presumably the board membership tends to be quite stable over time, then if there are more directors on the board, the aggregate check and balance power of significant transaction which involves large amount of resources increases. (protection argument) The governance strength is enhanced with a larger board. Therefore bigger board size is expected to protect minority shareholders better even in the long run when I compared to fewer board member firms. In the event that certain executive, substantial shareholder or director who would like to steal from the firms through significant transaction, it becomes more difficult to influence a larger board to get the necessary green light for the bad-intention deal done as compared to a small board (approval argument).

Besides, I have employed more standard methodology on a portfolio approach, similar to Fama and French (1993). Every year of significant transaction announcement firms, I construct four portfolios (Big market

capitalization/High book-to-market, Big market capitalization/Low book-to-market, Small market capitalization/High book-to-market, and Small market capitalization/Low book-to-market) from the intersection two market capitalization and two book-to-market groups. Annual equal weighted returns on the four portfolios are calculated. The results are shown in Table 12B.

[Insert Table 12B here]

As the portfolios of transactions firms from 2003 to 2006 shown in Table 12B, after controlling for size and book-to-market, abnormal return are in general lower for connected transaction firms as compared to arms length transaction firms. To be more specific, 44 out of 64, or 75% of the connected transactions underperformed the arms length transaction firms for two to five years from the transaction announcement year.

A mean difference test is further conducted to provide evidence where the portfolio of stock returns of connected transaction firms are below that of arms length transaction firms are presented in Table 12C.

[Insert Table 12C here]

Table 12C seems to provide stronger statistical evidence where connected transaction firms by and large underperformed those arms length transaction firms. It may suggest that overall connected transactions are on average potentially hurt minority shareholders as compared with arms length transactions (or at least not benefit the minority shareholders as much).

6.6 Asset turnover for firms in the long run

Table 13 presents the future year asset turnover ratio of the firms engaging economic significant transactions at year 0. It shows that connected transaction firms turnover ratio per dollar of total asset was significantly lower than arms length firms three and five years after the deal. First of all, more than 60% of connected transactions involve disposal or acquisition of assets or interest. Besides, previous discussion already confirmed the expropriation of minority shareholder right evidence in connected transactions. It infers that given sufficient time, the asset quality or capability to generate sales or cash

flow will deteriorate for connected deal firms. Here the result seems to land support on this logical consequence.

[Insert Table 13 here]

Chapter 7: A potential extension: sociological view

7.1 Introduction

Willem Bonger, a Dutch Marxist (1916) was the pioneer to develop criminology theory under sociology discipline covering both “crime that happens on the streets’ as well as “crime that happens in the suites”. He believed capitalism has pushed the social development towards selfishness at the expense of altruism. The consequence was that the greed of the middle class reinforced a criminal attitude when capitalism prospered. His idea was contrary to the consensus back then where most believed the poverty class causes crime. He felt that the ruling class crime blossomed indeed. During the same period, there were numerous reports of sociologists and muckrakers relating to misconduct of firms.

It was until the great sociologist Edwin H. Sutherland (1940) delivered his presidential address to the American Sociological Society about “The white collar crime”. He spent ten years of research and published White Collar

Crime (1949) which was a classic and covered tens of American large firms misconduct stories. He decided to turn muckraking into sociology. According to his study, white collar crime is defined as “a crime committed by a person of respectability and high social status (the advantaged) in the course of his occupation. It is the most lucrative business in the world....not only of the crimes in the streets, the burglaries and the robberies which represent tens of billions of dollars each year....I call white collar crimes committed by advantage; the crimes committed with pen and pencil, not with gun or “jimmy”; under the bright lights of the chief executive offices, not by stealth in the dark”. Many of the white collar crimes in business basically violated of delegated or implied trust. Two major categories were resulted: asset value misrepresentation and duplicity in power manipulation.

Sutherland was the first to highlight the increasing numbers of white collar crime which contradicts the class-based criminology theories. This redirection of theory was made possible due to the concentration on the small domain of organizational crime. Geis& Goff (1983) also comprehended Sutherland’s Americanism of the white collar crime concept because ordinary

people understood the meaning well enough. As a result, it spread quickly as “crime en col blanc” in France, “criminalita in collettibianchi” in Italy and “weisse-kragen-kriminalitat” in Germany. Most sociology research in this field will focus on the plan and process of violation. From the standpoint of sociologist, connected transactions are categorized as one type of white collar crime. These are fraudulent transactions orchestrated by respectable and high social status individuals, for example listed firms management executives, major shareholders at the expense of minority shareholders. “It could be the intentional misrepresentation, inaccuracies or even deliberate omissions on the disclosure of information related to the transactions”.Hence, the “who”,“why”, “how” and “what” types of questions in connected transactions will be of typical interest to criminology researchers.

7.1.1 Deviance

It is defined as some behaviors that do not conform to the norms agreed by a large number of people in a society. Nonetheless, it is never easy to

simply distinguish who follow the norms and who do not in a society or a community. “A negative sanction is the reaction from third party that put on the individual to ensure conforming with an established norm. In modern societies, formal sanctions could be put forward by the courts and prisons to ensure a certain set of norms are followed by most individuals.” Yet many deviant behavior at the firm levels conducted by insiders are not sanctioned by law easily. The scope of deviance is definitely more diverse than crime. In many cases, crime and deviance do overlap each other where the former relates to law breaking activities. The study of deviance leads to the issues of power distribution at firms, the impacts of social class in the non-conformity of norms, as well as the division between rich and poor leads to more conflicts.

7.2 Sociologist theoretical framework

Generally speaking, crime and criminal motives are something normal and form an essential part of all healthy societies. It can be an expression of the same motivations that results in accepted behavior. The embezzler, the

fraudster and the law abiding storekeeper are focused in making money. Some make money for his own good and others do it for firms.

7.2.1 Differential association theory

Edwin H. Sutherland (1883-1950), brought white collar crime to the next level. On his thesis in 1939, he argued that people who were in the upper socio-economic class in fact commit a lot criminal behavior. This was where he made very large contribution to sociological research in the criminology study. It was a big contrast of previous theories in criminology where crime was dominated primarily with lower social class offenders. These offenders end up spared most of the time and space of the courtrooms and prisons. The ways and procedures of the criminal behavior of these privileged class happened to be different from those coming from the lower class of the society. He called for more attention and resources required to put in understanding white collar crime. It is as important as any crime I am normally aware of on the street.

He pointed out that white collar crime was not included usually within the scope of criminology. It highlighted the general lack of focus and understanding of this crime among sociologist research. Time has changed where white collar representatives such as business executives, directors, major shareholders were believed to committed crime as well. When they did, they did in a different way from the poverty group. His research in the ten years period from 1939-1949 revealed many leading and sizable firms violated many civil and criminal offenses. It was these fact findings from his hard work pushed the motivation and convinced other sociologists to include white collar crime under the general theories of crime.

It was not totally successful on this transition indeed. As Tappan (1977) criticized that criminology should only focus on crimes covered by the criminal law. A lot of the white collar crimes were definitely not under the domain of criminal law statue. He further argued that criminologists otherwise would cover any act they disapproved of as a crime. Then it would definitely impair the scientific objectivity of this sociologist discipline.

Yet Sutherland was keen to make it big on criminology theory based on his diligent research work. His differential association theory proposed that “individuals learn the values, attitudes, techniques, and motives for criminal behavior through interaction with others”. Having an authoritative position in the field of sociology, Sutherland was capable to make good explanation of his thesis which widens the theoretically possible universe of criminology research well beyond the past. Crime could be coming from different social classes to the same extent of damages. “The traditional way to look at crime or criminal offenders based on some more visible forms, for instance, murder and robbery had to change.” What Sutherland has implied was that conventional criminal offenders were not the only group of people who would violate the law. Those differential opportunities available to even high social status individuals to commit distinct crimes should fall into criminological research. It was under-research in the past for various reasons. His advocacy to widen criminology research scope covering white collar crime formed a major contribution to the discipline of sociology. Since then, more sociologists have echoed what Sutherland pushed in terms of research coverage in criminology. Some, like

Donald R Cressey (1961), even began to ask why white collar crime could remain under-researched for so long in criminological studies.

The traditional causal explanation of white collar crime was generated from an “evil causes evil” belief where lousy conditions of individuals or environments could result in criminal behavior. However, Sutherland argued that “though criminal behavior is an expression of general needs and values, it is not explained by those general needs and values, since non-criminal behavior is an expression of the same needs and values”. Since millions of other individuals have the same needs in this world but not commit crime, the need itself provided no solution to the methodology which is either criminal or non-criminal to satisfy it.

He then progressed further his own hypothesis where both white collar and lower class crimes are explained by reasons of economy, logic and simplicity. “It carries the duty of a theory to explain all crime. This theory of differential association emphasized that criminality is learned and environment-dependent.” Based on his observation, crime happens at all

social-economic levels. However, based on the official crime statistics, unfortunately it has always underreported the wrongdoing by high socioeconomic status individuals and firms. He emphasized the importance of generalization of white collar crime and stop the privileged group from taking advantage of the justice system. The Enron case in 2001 and Worldcom case in 2002 illustrated that the powerful people commit crimes for personal gains where the damage to other stakeholders and the society could be huge.

These people from the most affluent sector of the society are the ones who hurt the minority shareholders who own the firms they work. It could include many behaviors such as frauds, embezzlement and stealing. The difficulty in studying white collar crimes has been the lack of official data to conduct analysis. They are not easily discovered as in my real case in the beginning of this paper. However, the pain and damage to the stakeholders could be large. In the US, it is reported that the money involved in white collar crime is 40 times bigger than normal crimes against property (Giddens and Sutton 2013). Insiders at firms are in general wealthy and powerful actors. They are very capable to use the resources skillfully, fulfill the regulatory

requirement and yet stealing from the firm, as I could refer to the short case at the beginning of this paper.

7.2.2 Strain-anomie theory

Robert Merton (1968) presented his major contribution in sociology of the relationship between culture, social structure and anomie. “He defines culture as the normative values that guide individual behavior in a society. Social structure is defined as the set of social relationships where society members imply. Anomie, a social dysfunction, will happen when there is a conflict between the overall value of society members and opportunities are available to some in a certain social group. That implies some people due to their position in the social structure, they may be capable to take advantage of the others in order to achieve certain society agreed goal.” For example, the culture of Hong Kong with its over-emphasis on financial success of individual, as I always find the headlines on the media about the list of the riches based on their total monetary wealth. The capitalist method of production brought about

from the West also encourage chasing for financial success. For those who are higher up in the socioeconomic classes, they may take the opportunity to expropriate the others which deviant behavior may be possible outcomes. The deviance could be in forms of stealing, forgery and many types of illegal ways to achieve economic success. Anomie is seen as something necessary and unavoidable because of deviance and crime are basically modern society by-products.

People in the past are more constrained in terms of personal choice than nowadays. The consequence is that I would come across more deviance and non-conformity of norms than before. Regulators and governments are encouraged to maintain the boundary between good and bad behavior over time, as the society and culture continues to change.

The victims of deviance at the firm level do not easily observe the damage. In traditional crimes, the physical distance between the offender and the victim is fairly short. For this elite deviance, many victims could not recognize they are hurt at all. Even if they are aware, they do not know how to

look for redress. Definitely it is not easy to blame the group of directors who make bad-intension decision in the boardroom than to one specific individual.

7.2.3 Rational choice theory

Here sociologists see deviant offenders are people who reason and behave strategically. They could gauge the benefits against costs before their moves. They would try to understand the environment before they commit. The consequence of non-conformity to the society norm will be analyzed against the potential personal benefit of deviance. Those who are well-educated and high up in the socio-economic class are more capable to ascertain the accuracy of cost-benefit of deviance than the others in the society. Thereafter, they commit after their rational choice analysis. Donald Cressey (1953) put strong emphasis on the rationalization argument to explain the deviant behavior of white collar individuals. He found that most offenders are in the positions of trust and tried to embezzle money while rationalize the move that merely “borrowing” it.

7.2.4 Society view about elite deviance

Definitely the punishment of elite deviance is relatively infrequent. Research has continued to show that people believe that the penalty to white collar crime criminals are too lenient (Grabosky, Braithwaite and Wilson 1987). The pain and damage that these deviance behavior is way larger than what they are treated after getting caught. Besides, investigating elite deviance is very complicated and time consuming, as I could see from my real case. A lot of evidence could be covered, or even destroyed by the offenders during and after the deviance behavior. The jail terms on individual offenders are not normally over 30 days and money fines are not large as well, according to some US studies.

On top of that, Shapiro (1990) also collared the crime where these agents such as executives, directors are entrusted often direct businesses to the companies where they are connected. She labeled these activities under white collar crime as self-dealing and the opportunities to be involved in these activities are huge. In fact, it is largely due to the information asymmetries

between the principals (minority shareholders) and trustees (executives, directors). In many cases, the minority shareholders who get hurt, through a depressed stock price reaction, will have no choice but accept the losses. She argues that most of the setting of organizations in the society is based on trust between principals and agents. In many cases, these agents are well compensated on the remuneration due to the ownership of some forms of expertise. The pricing reflects the relative difficulty to get to these positions as well as the responsibilities these positions require. Yet the reality is these agents could get even richer by official arrangement such as share options, golden parachutes even if they get fired. They would even attempt to get more through illicit method, a large extent reflects their level of greed. She suggests more research to focus and examine how these fiduciaries are defined and how they abuse the opportunities as well as the likely pattern of wrongdoing.

Chapter 8: Conclusions

8.1 Findings and contributions

This thesis attempts to examine the issue of corporate governance and shareholder value in connected transactions with executives, directors, substantial shareholders or controlling shareholders in Hong Kong. Using a sample of Hong Kong firms covering the time period of 2003 to 2006 when the general economy recovered from the fallout of Asian financial crisis and the SARS crisis, I verify that firms announcing connected transactions by executives, directors, substantial shareholders or controlling shareholders earn significant negative excess returns, significantly lower than firms announcing arm's length major or very substantial transactions. On the contrary, arm's length transaction announcement firms have yielded significant positive excess return. Expropriation of minority shareholder by these elite group of insiders exists in connected transaction. These connected-transaction firms are on average having fewer independent directors and smaller board size.

Well-governed firms experience higher returns when they announce economic significant transactions. Specifically, when firms decide to have a larger board of directors (a symbol of more effective corporate governance), it exhibits significant positive abnormal return in the short term and long run when economic significant transaction is announced. When firms announce connected transactions but they hire big four accounting firms as external auditor, capital market will penalize less on the firms' stock to the downside. This is an obvious reflection of market belief big four auditors will serve as gatekeeper to protect minority shareholders in connected deals.

In fact, it is not only the short term and long term stock price being affected, the long term operating performance such as asset turnover is also impaired after connected transactions are completed. I admit that not all governance measures have significant impact to the performance of the firm when economic significance transactions are executed. I am not intended to generalize my findings to other settings. Yet this study provides an interesting insight to understand how different corporate settings affect the market reaction on some important deals of the firms in Hong Kong. On top of

that,my analysis along the line of sociological literature also supports that connected transactions could be classified as possible elite deviance where high socio-economic class of corporate executives, directors or substantial shareholders or controlling shareholders are the offenders, in order to achieve their personal goals, try to steal at the expense of minority shareholders who are the victims, given the environment at the firm level is conducive for such deviant behavior to happen.

8.2 Limitations and future research suggestions

This study is subject to a few limitations. Firstly, my dataset does not contain complete categories of the control observations (notifiable transactions) to disentangle those are of dissimilar nature when compared with the connected transactions. The results could be improved if I could retrieve more detailed information of each transaction. Besides, the reputation of the financial advisors (measured by the market share of these advisors) could have an impact on their monitoring/corporate governance role in connected transactions. Yet, I have no information about the market share of them and it

is hard to estimate their reputation and impact on monitoring thereafter. Thirdly, my dataset does not contain complete ownership structure and audit committee information (other elements of corporate governance) of the firms announcing transactions. The study could be enhanced if we could retrieve more detailed information of each transaction firm. It could be addressed in future study. Last but not least, the market reaction to connected transactions could depend on the corporate information environment. It is hard to estimate the information disclosure quality concerning connected transactions in this regard since I have only scattered information about the analyst following statistics of the firms.

Another possible extension of my study is to provide empirical support on how well-established sociologist Robert Merton's anomie-strain theory could be used to shed some lights on all connected persons involvement in connected transactions at the firm level. In their terminology, it seems the 'what' and 'how' the deviance in connected transactions is organized by high socio-economic powerful class based on their theory is backed by what I found in the analysis of connected transaction. The sociological standpoint could be

further explored in future study to understand more about why the potential damage of connected transactions to minority shareholders happen, given those privileged class who has the power to control and make decisions at the firm level in the society. This could be an interesting area, from a different perspective to understand connected transactions, for future study under sociological theories and explanation.

Table 1**Annual percentage change of quarterly GDP**

This table presents the annual percentage change of quarterly GDP in Hong Kong for the past ten quarters (Q1 2007 to Q2 2009). The positive change lasted until the third quarter of 2008, followed by three consecutive quarters of negative GDP performance.

Year	Quarter	Year on year real GDP change
2002	Q1	-0.6%
	Q2	0.5%
	Q3	2.4%
	Q4	4.1%
2003	Q1	3.9%
	Q2	-0.6%
	Q3	4.0%
	Q4	4.7%
2004	Q1	7.9%
	Q2	12.1%
	Q3	6.9%
	Q4	8.2%
2005	Q1	6.4%
	Q2	7.3%
	Q3	8.3%
	Q4	7.4%
2006	Q1	9.0%
	Q2	6.1%
	Q3	6.4%
	Q4	6.8%
2007	Q1	5.9%
	Q2	6.2%
	Q3	6.7%
	Q4	7.0%
2008	Q1	7.0%
	Q2	4.0%
	Q3	0.9%
	Q4	-2.7%
2009	Q1	-3.4%
	Q2	3.6%

Table 2

Frequency of firms' transactions by year and by transaction type

Year	Connected	Arms length	
2003	189	49	
2004	299	224	
2005	339	273	
2006	438	412	
	Subtotal:1265	Subtotal:958	Total:2223

Table 3**Number of observations by Industry**

This table presents the industry distribution of the sample firms announcing connected transactions and arm's length transactions. Under the industry classification of Datastream, basic materials include mining, chemicals, forestry and paper, industrial metals and mining. Communications include fixed line telecommunications and mobile telecommunications. Consumer cyclical include food and drug retailers, general retailers, media and travel & leisure. Consumer non-cyclical includes healthcare equipment & services and pharmaceuticals & biotechnology. Diversified include automobiles and parts, beverages, food producers, household goods and home construction, leisure goods and personal goods. Energy includes alternate energy, oil & gas producers and oil equipment & services. Financials include banks, equity investment instruments, financial services sector, life insurance, nonlife insurance and real estate investment & services. Industrials include aerospace and defense, construction and materials, electronic and electrical equipment, general industrials, industrial engineering, industrial transportation and support services. Technology includes software and computer services and technology hardware & equipment. Utilities include electricity and gas, water & multiutilities.

Industry	Connected transactions	Arm's length transactions
Basic materials	120	51
Communication	12	1
Consumer cyclical	198	178
Consumer non-cyclical	55	40
Diversified	177	103
Energy	37	18
Financial	218	249
Industrial	210	147
Technology	195	144
Utilities	43	27
<i>Total</i>	<i>1265</i>	<i>958</i>

Table 4**Summary Statistics**

This table presents the summary statistics of the mean, standard deviation, median, minimum (Min) and maximum (Max) of the sample for arm's length transactions firms and connected transaction firms (in bracket) for the whole sample period four years.

Variable	Mean	Standard deviation	Median	Min	Max
TOT ASSET (\$M)	38.251 (87.818)	99.396 (392.22)	5.626 (11.26)	41.8 (6.22)	685.6 (6,710)
MKT CAP (\$M)	8,076 (23,323)	19,314 (83,095)	1,695 (2,925)	24 (137)	242,738 (1,143,144)
M/B	4.23 (1.68)	92.6 (7.86)	0.91 (1.10)	0.02 (0.08)	2811 (179.3)
DIVIDEND YIELD (%)	1.068 (1.45)	2.19 (2.06)	0.00 (0.00)	0 (0.00)	26.9 (10.7)
ROA (%)	-0.303 (-0.092)	0.0508 (0.0708)	0.259 (0.464)	-42 (-185)	47 57
ROE (%)	1.93 (1.49)	0.2627 (0.2350)	1.57 (2.47)	-277 (-513)	369 (368)
ASSET T/O	17.5 (5.90)	112.4 (22.1)	1.73 (1.49)	0 (0)	1493 (522)
PRC-based	0.08 (0.18)	0.27 (0.38)	0.00 (0.00)	0 (0)	1 (1)
INED	0.43 (0.35)	0.15 (0.14)	0.55 (0.30)	0.14 (0.13)	0.67 (0.67)
BOARD SIZE	9.88 (8.25)	2.30 (2.49)	10 (8)	4 (4)	24 (23)
FAMILY BOARD	0.22 (0.21)	0.41 (0.41)	0 (0)	0 (0)	1 (1)
CEO DUAL	0.30 (0.08)	0.46 (0.28)	0 (0)	0 (0)	1 (1)
B4/NB4 (0)	0.38 (0.22)	0.48 (0.42)	0 (0)	0 (0)	1 (1)
B4/NB4 (+1)	0.41 (0.27)	0.49 (0.45)	0 (0)	0 (0)	1 (1)
AUD OPIN	0.093 (0.072)	0.29 (0.26)	0 (0)	0 (0)	1 (1)
DEAL SIZE (\$M)	240 (159)	563 (854)	283 (37)	8.4 (0.56)	16,912 (28,468)
BANK IND	0.11 (0.05)	0.31 (0.23)	0.00 (0.00)	0 (0)	1 (1)
R/E IND	0.14 (0.11)	0.35 (0.31)	0.00 (0.00)	0 (0)	1 (1)
C/C IND	0.026 (0.028)	0.16 (0.16)	0.00 (0.00)	0 (0)	1 (1)

ASSET T/O = sales/total asset in percentage

AUD OPIN = indicator variable, 1 for auditor opinion not unqualified

B4/NB4 (+1) = indicator variable, 1 for firms audited by non-big four accounting firms at the post transaction year 1

B4/NB4 (0) = indicator variable, 1 for firms audited by non-big four accounting firms at the transaction year

BANK IND = indicator variable, 1 for firms which are commercial banks

BOARD SIZE = number of directors on the board

C/C IND = indicator variable, 1 for firms engaging in consumer cyclical business

CEO DUAL = indicator variable, 1 for same person serving as CEO and chairperson of the board

DEAL SIZE = transaction amount in millions of HK dollars

DIVIDEND YIELD = dividend yield of the firm in percentage

FAMILY BOARD = indicator variable, 1 for firms having two or more family board members

INED = number of independent non-executive directors divided by board size

M/B = the ratio of market value of equity to book value of equity

MKT CAP = market capitalization of the firm in millions of HK dollars

PRC-based = indicator variable, 1 for H-shares or red chip firms

R/E IND = indicator variable, 1 for firms engaging in real estate development business

ROA = (net income – total cash preferred dividends)/average total assets in percentage

ROE = (net income – total cash preferred dividends)/average total common equity in percentage

TOT ASSET = book value of the total assets in millions of HK dollars

Table 5
Correlation Matrix

This table reports the Pearson correlation coefficient and Spearman rank correlation coefficient between the variables of my sample firms.

	CAR	CONN	PRC	LN DS	B4/NB4	LN TA	M/B	ROA	ROE	ATO	INED	BRD SZ	AUD O	CEO DL	FAM B	BANK D	R/E D	CC D
CAR	-	-0.77**	-0.16	0.019	0.019	-0.064**	0.030	0.002	0.003	0.009	0.018	0.036	-0.006	-0.015	0.006	0.010	0.001	0.007
CONN	-0.009	-	0.144**	-0.094**	-0.166**	0.173**	-0.021	0.017	-0.009	-0.076**	-0.268**	-0.316**	-0.037	-0.284**	-0.004	-0.103**	-0.051*	0.005
PRC	0.017	0.144**	-	0.029	-0.064**	0.282**	-0.008	0.038	0.010	-0.045*	-0.082**	0.068**	0.018	-0.167**	-0.145**	-0.116**	-0.134**	-0.065**
LN DS	0.029	-0.057**	-0.102**	-	-0.018	0.089**	0.005	0.014	0.020	0.005	0.013	0.152**	-0.015	-0.003	-0.032	-0.006	-0.008	-0.010
B4/NB4	-0.009	-0.166**	-0.064**	0.071**	-	-0.449**	0.027	-0.087**	-0.098**	0.088**	0.125**	-0.111**	0.198**	0.053	-0.057	-0.039	-0.071**	0.065**
LN TA	0.026	0.172**	0.259**	-0.040	-0.459**	-	-0.043*	0.257**	0.179**	-0.146**	-0.176**	0.232**	-0.177**	0.078*	0.030	-0.024	0.177**	-0.007
M/B	0.012	0.075**	0.075**	-0.034	0.021	-0.008	-	-0.011	-0.001	0.027	0.041	-0.034	0.001	-0.013	-0.014	-0.006	-0.012	0.149**
ROA	0.092**	0.084**	0.034	-0.005	-0.214**	0.330**	0.146**	-	0.471**	-0.050*	0.000	0.058**	-0.118**	-0.009	0.020	0.042	0.047*	0.056**
ROE	0.095**	0.050*	0.086**	-0.006	0.238**	0.409**	-0.007	-0.851**	-	0.006	0.001	0.054*	-0.155**	-0.008	0.047	0.027	0.051*	0.046*
ATO	-0.005	-0.033	-0.053*	0.001	0.096**	-0.322**	0.130**	-0.042	-0.118**	-	-0.025	-0.021	-0.009	-0.031	-0.025	0.010	-0.025	0.006
INED	0.008	-0.256**	-0.081**	0.165**	0.106**	-0.147*	-0.073**	-0.019	0.002	0.035	-	0.012	0.046*	0.358**	-0.208**	0.081**	0.077**	-0.015
BRD SZ	0.021	-0.335**	0.062**	0.418**	-0.106**	0.226**	-0.026	0.069**	0.109**	-0.110**	0.042*	-	-0.052*	0.204**	0.073*	-0.002	0.036	-0.067**
AUD O	0.004	-0.037	0.018	0.003	0.198**	-0.183**	-0.076**	-0.178**	-0.224**	-0.013	-0.073	-0.047*	-	0.056	0.003	-0.028	0.025	-0.029
CEO DL	0.005	-0.284**	-0.167**	0.162**	0.053	0.092**	-0.220**	-0.077*	0.052	-0.100**	0.244**	0.235	0.056	-	0.118**	0.153**	0.164**	-0.053
FAM B	0.049	-0.004	-0.145**	0.009	-0.057	0.036	-0.127**	0.104**	0.093**	-0.035	-0.221**	0.098**	0.003	0.118**	-	-0.027	0.119**	-0.061*
BANK D	0.000	-0.103**	-0.116**	0.046*	-0.039	-0.033	-0.116**	0.010	0.021	-0.155**	0.069**	0.004	0.028	0.153**	-0.027	-	-0.110**	-0.049*
R/E D	0.090**	-0.051*	-0.134**	0.050*	-0.071**	0.195**	-0.205**	0.023	0.120**	-0.302**	0.082**	0.045*	0.025	0.164**	0.119	-0.110**	-	-0.062**
CC D	-0.025	0.005	-0.065**	-0.009	0.065**	0.001	0.089**	0.048*	0.023	0.110**	-0.017	-0.068**	-0.029	-0.053	-0.061*	-0.049*	-0.062**	-

The Pearson (Spearman) correlation coefficients are presented above (below) the diagonal.

* and ** denotes two-tailed statistical significance at the 10% and 5% levels respectively.

Table 5 foot note (cont'd)

ASSET T/O = sales/total asset in percentage

AUD O = indicator variable, 1 for auditor opinion not unqualified

B4/NB4 = indicator variable, 1 for firms audited by big four accounting firms
BANK D = indicator variable, 1 for firms which are commercial banks
BRD SZ = number of directors on the board
CAR = cumulative abnormal return from one day before to one day after transaction announcement
CC D = indicator variable, 1 for firms engaging in consumer cyclical business
CEO DL = indicator variable, 1 for same person serving as CEO and chairperson of the board
CONN = 1 for connected transaction; 0 otherwise
LN DS = natural logarithm of transaction amount in millions of HK dollars
FAM B = indicator variable, 1 for firms having two or more family board members
INED = number of independent non-executive directors divided by board size
LN TA = natural logarithm of book value of the total assets in millions of HK dollars
M/B = the ratio of market value of equity to book value of equity
PRC = 1 for the firm either is H-share or red chip; 0 otherwise
R/E D = indicator variable, 1 for firms engaging in real estate development business
ROA = (net income – total cash preferred dividends)/average total assets in percentage
ROE = (net income – total cash preferred dividends)/average total equity in percentage

Table 6
Mean Difference Test

The table presents the Levine test on whether the mean of the variables are different when 958 arm's length transaction firms are compared with 1265 connected transaction firms.

Variables	T	p-value
TOT ASSET	-3.806	0.000***
MKT CAP	-5.558	0.000***
DIVIDEND YIELD	-4.246	0.000***
ROA	-0.780	0.218
ROE	0.404	0.320
DEAL SIZE	2.542	0.000***
FAMILY BOARD	0.139	0.445
INED	13.09	0.000***
BOARD SIZE	15.69	0.000***
CEO DUAL	9.527	0.000***
B4/NB4 (0)	7.937	0.000***
B4/NB4 (+1)	6.946	0.000***
AUD OPIN	1.723	0.043**
MB	0.166	0.867
ASSET T/O	3.081	0.002***

* indicates statistical significance at the 10% level, ** at the 5% level and *** at the 1% level.

AUD OPIN = indicator variable, 1 for auditor opinion not unqualified
B4/NB4 (+1) = indicator variable, 1 for firms audited by non-big four accounting firms at the post transaction year 1
B4/NB4 (0) = indicator variable, 1 for firms audited by non-big four accounting firms at the transaction year
BOARD SIZE = number of directors on the board
CEO DUAL = indicator variable, 1 for same person serving as CEO and chairperson of the board
DEAL SIZE = transaction amount in millions of HK dollars
DIVIDEND YIELD = dividend yield of the firm in percentage
FAMILY BOARD = indicator variable, 1 for firms having two or more family board members
INED = number of independent non-executive directors divided by board size
MKT CAP = market capitalization of the firm in millions of HK dollars
ROA = (net income – total cash preferred dividends)/average total assets in percentage
ROE = (net income – total cash preferred dividends)/average total common equity in percentage
TOT ASSET = book value of the total assets in millions of HK dollars

Table 7
Descriptive statistics of cumulative abnormal return upon transactions announcement

This table presents the mean, standard deviation (Std. Dev.), median, minimum (Min) and maximum (Max) of the cumulative abnormal return of sample firms from one day before to one day after announcement CAR(-1,+1), from one day before to two days after announcement CAR(-1,+2), from one day before to three days after announcement CAR(-1,+3), from one day before to five days after announcement CAR(-1,+5) and from one day before to ten days after announcement CAR(-1,+10). Under the Conn column, connected transactions are denoted by 1; Major or very substantial arms length transactions are denoted by 0. The asterisks ***, **, * indicate statistical significance levels in a 2-tailed test at the 1%, 5% and 10% respectively.

Cumulative abnormal return	Conn	N	Mean	Std. Dev.	Median	Min	Max
CAR(-1,+1)	1	1265	-.0014***	.0438	-.0020	-.2241	.2042
	0	958	.0239***	.2431	-.0011	-.1892	.5396
CAR(-1,+2)	1	1265	-.0033***	.0524	-.0033	-.3061	.2301
	0	958	.0264***	.2399	-.0019	-.2373	.5385
CAR(-1,+3)	1	1265	-.0064***	.0600	-.0056	-.4078	.1944
	0	958	.0241***	.2202	-.0033	-.2010	.4689
CAR(-1,+5)	1	1265	-.0055***	.0804	-.0084	-.3547	.5429
	0	958	.0278***	.2183	-.0064	-.3437	2.987
CAR(-1,+10)	1	1265	-.0036**	.1242	.0108	-.3794	2.056
	0	958	.0279***	.2777	-.0075	-.8326	3.953

Table 8**Difference in short term abnormal returns of connected versus arms length transaction firms**

This table shows the test of equality of means of abnormal return upon announcement of connected transaction firms versus arms length transaction under five different windows: from one day before to one day after announcement CAR(-1,+1), from one day before to two days after announcement CAR(-1,+2), from one day before to three days after announcement CAR(-1,+3), from one day before to five days after announcement CAR(-1,+5) and from one day before to ten days after announcement CAR(-1,+10). The asterisks ***, **, * indicate statistical significance levels in a 2-tailed test at the 1%, 5% and 10% respectively.

Cumulative abnormal return		F	Sig.	t	df	Mean Difference
CAR(-1,+1)	Equal variances assumed	25.95	.000	-3.631***	2221	-.0253
	Equal variances not assumed			-3.188***	1004	-.0253
CAR(-1,+2)	Equal variances assumed	34.28	.000	-4.264***	2221	-.0297
	Equal variances not assumed			-3.758***	1004	-.0297
CAR(-1,+3)	Equal variances assumed	38.39	.000	-4.700***	2221	-.0305
	Equal variances not assumed			-4.170***	1004	-.0305
CAR(-1,+5)	Equal variances assumed	51.29	.000	-4.990***	2221	-.0333
	Equal variances not assumed			-4.490***	1004	-.0333
CAR(-1,+10)	Equal variances assumed	27.61	.000	-3.578***	2221	-.0314
	Equal variances not assumed			-3.263***	1004	-.0314

Table 9A**Determinants of short term cumulative abnormal return**

$$AR_{-1,t} = \beta_0 + \beta_1 BRD\ SZ + \beta_2 CEO\ DL + \beta_3 INED + \beta_4 FAM\ B + \beta_5 B4/NB4 + \beta_6 CONN + \beta_7 LN\ TA + \beta_8 ROA + \beta_9 AUD\ O + \beta_{10} PRC + \beta_{11} MB/GEM + \beta_{12} PAST\ RETURN + \beta_{13} LN\ D\ SIZE + \beta_{14} BANK\ D + \beta_{15} R/E\ D + \beta_{16} CC\ D + \varepsilon_{-1,t}$$

This table reports regression results on the determinants of cumulative abnormal returns from one day before to one (to ten) day(s) after transactions announcement. Independent variables are on the left column of the table. ***P<0.01; **P<0.05; *P<0.1. The asterisks indicate two-tailed statistical significance at the 1%, 5% and 10% respectively.

Dependent Variables:	CAR(-1,+1)	CAR(-1,+2)	CAR(-1,+3)	CAR(-1,+5)	CAR(-1,+10)
Independent variables:					
(Predicted sign in bracket)					
Intercept (?)	0.044	0.034	0.018	0.074	0.057
CONN (-)	-0.020***	-0.023***	-0.024***	-0.027***	-0.020**
LN TA (-)	-0.003	-0.003	-0.002	-0.005**	-0.006**
ROA (+)	0.034	0.029	0.025	0.041	0.054
BRD SZ (+)	0.002*	0.003**	0.003**	0.004**	0.006***
CEO DL (-)	-0.011	-0.014	-0.010	0.000	-0.011
INED (+)	-0.022	-0.007	-0.005	-0.006	0.013
FAM B (-)	-0.001	-0.003	-0.006	0.010	0.010
B4/NB4 (-)	-0.009	-0.009	-0.007	-0.015*	-0.019*
AUD O (-)	-0.010	-0.008	-0.009	-0.018	-0.023
BANK D (+)	0.006	0.011	0.014	0.010	0.006
R/E D (+)	0.011	0.018	0.013	0.030***	0.022
CC D (-)	-0.001	0.000	-0.004	-0.004	-0.014
PRC (-)	-0.005	-0.002	-0.005	0.005	-0.005
MB/GEM (-)	0.036***	0.032***	0.028***	0.022**	0.037***
PAST RETURN (-)	0.000	0.000	-0.001	-0.002	-0.000
LN D SIZE (+)	0.03	0.026	0.025	0.048	-0.024
Observations	2223	2223	2223	2223	2223
Adj. R ²	0.030	0.026	0.024	0.039	0.027
F-value	1.286	1.432	1.328	2.208***	1.537*

AUD O = indicator variable, 1 for auditor opinion not unqualified
B4/NB4 = indicator variable, 1 for firms audited by non-big four accounting firms
BANK D = indicator variable, 1 for firms which are commercial banks
BRD SZ = number of directors on the board
CAR = cumulative abnormal return from one day before to one day after transaction announcement
CC D = indicator variable, 1 for firms engaging in consumer cyclical business
CEO DL = indicator variable, 1 for same person serving as CEO and chairperson of the board
CONN = 1 for connected transaction; 0 otherwise
FAM B = indicator variable, 1 for firms having two or more family board members
INED = number of independent non-executive directors divided by board size
LN D SIZE = natural logarithm of transaction amount in millions of HK dollars
LN TA = natural logarithm of book value of the total assets in millions of HK dollars
MB/GEM = 1 for firms listed on the Growth Enterprise Board; 0 otherwise
PAST RETURN = abnormal return of the firm from 12 months to 1 month prior transaction announcement
PRC = 1 for the firm either is H-share or red chip; 0 otherwise
R/E D = indicator variable, 1 for firms engaging in real estate development business
ROA = (net income – total cash preferred dividends)/average total assets in percentage

Table 9B**Determinants of short term cumulative abnormal return (with interaction terms)**

$$AR_{-1,t} = \beta_0 + \beta_1 BRD\ SZ + \beta_2 CEO\ DL + \beta_3 INED + \beta_4 FAM\ B + \beta_5 B4/NB4 + \beta_6 CONN + \beta_7 LN\ TA + \beta_8 ROA + \beta_9 AUD\ O + \beta_{10} PRC + \beta_{11} MB/GEM + \beta_{12} PAST\ RETURN + \beta_{13} LN\ D\ SIZE + \beta_{14} BANK\ D + \beta_{15} R/E\ D + \beta_{16} CC\ D + \beta_{17} CONN*BRD\ SZ + \beta_{18} CONN*B4/NB4 + \varepsilon_{-1,t}$$

This table reports regression results on the determinants of cumulative abnormal returns from one day before to one (to ten) day(s) after transactions announcement. Independent variables are on the left column of the table. ***P<0.01; **P<0.05; *P<0.1. The asterisks indicate two-tailed statistical significance at the 1%, 5% and 10% respectively.

Dependent Variables:	CAR(-1,+1)	CAR(-1,+2)	CAR(-1,+3)	CAR(-1,+5)	CAR(-1,+10)
Independent variables:					
(Predicted sign in bracket)					
Intercept (?)	0.042	0.031	0.021	0.065	0.052
CONN (-)	-0.018***	-0.021***	-0.025***	-0.026***	-0.019**
LN TA (-)	-0.002	-0.003	-0.018	-0.049**	-0.006**
ROA (+)	0.033	0.027	0.022	0.039	0.051
BRD SZ (+)	0.002*	0.002**	0.003**	0.003**	0.005***
CEO DL (-)	-0.011	-0.014	-0.010	0.000	-0.011
INED (+)	-0.021	-0.006	-0.004	-0.005	0.011
FAM B (-)	-0.001	-0.002	-0.005	0.009	0.010
B4/NB4 (-)	-0.008	-0.009	-0.008	-0.014*	-0.018*
AUD O (-)	-0.010	-0.009	-0.009	-0.017	-0.022
BANK D (+)	0.007	0.012	0.013	0.010	0.005
R/E D (+)	0.012	0.017	0.012	0.031***	0.023
CC D (-)	-0.002	0.000	-0.003	-0.002	-0.011
PRC (-)	-0.003	-0.003	-0.004	0.004	-0.005
MB/GEM (-)	0.035***	0.031***	0.029***	0.023**	0.035***
PAST RETURN (-)	0.000	0.000	-0.002	-0.003	-0.000
LN D SIZE (+)	0.032	0.025	0.026	0.049	-0.023
CONN*BRD SZ(+)	0.001*	0.015**	0.021**	0.023**	0.018**
CONN*B4/NB4(-)	-0.021	-0.025	-0.025*	-0.029**	-0.021*
Observations	2223	2223	2223	2223	2223

Adj. R ²	0.029	0.027	0.025	0.038	0.026
F-value	1.275	1.422	1.332	2.198***	1.535*

AUD O = indicator variable, 1 for auditor opinion not unqualified
 B4/NB4 = indicator variable, 1 for firms audited by non-big four accounting firms
 BANK D = indicator variable, 1 for firms which are commercial banks
 BRD SZ = number of directors on the board
 CAR = cumulative abnormal return from one day before to one day after transaction announcement
 CC D = indicator variable, 1 for firms engaging in consumer cyclical business
 CEO DL = indicator variable, 1 for same person serving as CEO and chairperson of the board
 CONN = 1 for connected transaction; 0 otherwise
 FAM B = indicator variable, 1 for firms having two or more family board members
 INED = number of independent non-executive directors divided by board size
 LN D SIZE = natural logarithm of transaction amount in millions of HK dollars
 LN TA = natural logarithm of book value of the total assets in millions of HK dollars
 MB/GEM = 1 for firms listed on the Growth Enterprise Board; 0 otherwise
 PAST RETURN = abnormal return of the firm from 12 months to 1 month prior transaction announcement
 PRC = 1 for the firm either is H-share or red chip; 0 otherwise
 R/E D = indicator variable, 1 for firms engaging in real estate development business
 ROA = (net income – total cash preferred dividends)/average total assets in percentage
 CONN*BRD SZ = interaction term between CONN and BRD SZ
 CONN*B4/NB4 = interaction term between CONN and B4/NB4

Table 10**Determinants of short term cumulative abnormal return under different transaction type samples**

$$AR_{-1,t} = \beta_0 + \beta_1 BRD\ SZ + \beta_2 CEO\ DL + \beta_3 INED + \beta_4 FAM\ B + \beta_5 B4/NB4 + \beta_6 LN\ TA + \beta_7 ROA + \beta_8 AUD\ O + \beta_9 PRC + \beta_{10} MB/GEM + \beta_{11} PAST\ RETURN + \beta_{12} LN\ D\ SIZE + \beta_{13} BANK\ D + \beta_{14} R/E\ D + \beta_{15} CC\ D + \varepsilon_{-1,t}$$

This table reports regression results on the determinants of cumulative abnormal returns from one day before to one (to five) day(s) after transactions announcement in Panel A: (1) arm's length transaction firms and Panel B: (2) connected transaction firms. Independent variables are on the left column of the table. ***P<0.01; **P<0.05; *P<0.1. The asterisks indicate two-tailed statistical significance at the 1%, 5% and 10% respectively.

	Panel A: (1) Arm's length transaction firms				Panel B: (2) Connected transaction firms			
Dependent variables:	CAR(-1,+1)	CAR(-1,+3)	CAR(-1,+5)	CAR(-1,+10)	CAR(-1,+1)	CAR(-1,+3)	CAR(-1,+5)	CAR(-1,+10)
Independent variables: (Predicted sign in bracket)								
Intercept (?)	0.082	0.053	0.207	0.103	-0.017	-0.014	0.091	0.067
LN TA (-)	-0.002	0.003	-0.008	-0.007	0.001	0.001	-0.006**	-0.006*
ROA (+)	0.177*	0.203	0.226	0.193	-0.004	-0.003	0.045	0.043
BRD SZ (+)	-0.002	-0.005	-0.002	0.002	0.000	0.001	0.002	0.003
CEO DL (-)	-0.002	-0.008	0.008	-0.015	-0.011	-0.018	0.005	-0.031
INED (+)	-0.080	-0.156*	-0.155	-0.013	-0.022	-0.045	-0.045	0.037
FAM B (-)	-0.004	-0.009	-0.009	-0.007	-0.006	-0.007	0.007	0.023*
B4/NB4 (-)	0.075	-0.007	-0.011	-0.023	-0.003	-0.002	-0.017*	-0.032**
AUD O (-)	0.011	0.011	-0.014	-0.001	0.007	0.007	0.000	-0.015
MB/GEM (-)	0.002	-0.003	-0.024	-0.030	0.004	-0.007	-0.028***	-0.003
BANK D (+)	0.034	0.027	0.025	-0.023	0.011	-0.001	-0.008	-0.011
R/E D (+)	0.009	0.003	0.050	0.019	0.005	0.008	0.027**	0.008
CC D (-)	-0.007	0.038	0.023	0.022	-0.033**	0.019	-0.012	0.014
PRC (-)	0.009	0.013	0.011	0.004	0.002	0.002	0.016*	0.011
PAST RETURN (-)	0.001	-0.001	-0.004	0.004	-0.001	-0.001	-0.002	0.003
LN DS (+)	0.053	0.040	0.010	0.057	0.015	-0.018	0.017	0.009
Observations	958	958	958	958	1265	1265	1265	1265
Adj. R ²	0.027	0.026	0.026	0.026	0.031	0.038	0.046	0.027
F-value	0.513	0.491	0.491	0.491	1.224	1.552*	1.889**	1.802*

AUD O = indicator variable, 1 for auditor opinion not unqualified

B4/NB4 = indicator variable, 1 for firms audited by non-big four accounting firms

BANK D = indicator variable, 1 for firms which are commercial banks

BRD SZ = number of directors on the board

CAR = cumulative abnormal return from one day before to one day after transaction announcement

CC D = indicator variable, 1 for firms engaging in consumer cyclical business

CEO DL = indicator variable, 1 for same person serving as CEO and chairperson of the board

FAM B = indicator variable, 1 for firms having two or more family board members

INED = number of independent non-executive directors divided by board size

LN DS = natural logarithm of transaction amount in millions of HK dollars

LN TA = natural logarithm of book value of the total assets in millions of HK dollars

MB/GEM = 1 for firms listed on the Growth Enterprise Board; 0 otherwise
PAST RETURN = abnormal return of the firm from 12 months to 1 month prior transaction announcement
PRC = 1 for the firm either is H-share or red chip; 0 otherwise
R/E D = indicator variable, 1 for firms engaging in real estate development business
ROA = (net income – total cash preferred dividends)/average total assets in percentage

Table 11**Difference in long term abnormal returns of connected versus arms length transaction firms**

This table shows the test of equality of means of long term abnormal return upon announcement of connected transaction firms versus arms length transaction under four different time period: from announcement date to two years after announcement CAR(0,+500), from announcement date to three years after announcement CAR(0,+750), from announcement date to four years after announcement CAR(0,+1000) and from announcement date to five years after announcement CAR(0,+1250). The asterisks ***, **, * indicate statistical significance levels in a 2-tailed test at the 1%, 5% and 10% respectively.

Cumulative abnormal return		F	Sig.	t	df	Mean Difference
CAR(0,+500)	Equal variances assumed	47.69	.000	-4.463***	2221	-.7476
	Equal variances not assumed			-3.959***	1064	-.7476
CAR(0,+750)	Equal variances assumed	59.16	.000	-4.911***	2221	-.6571
	Equal variances not assumed			-4.457***	1213	-.6571
CAR(0,+1000)	Equal variances assumed	58.69	.000	-4.766***	2221	-.9069
	Equal variances not assumed			-4.220***	1053	-.9069
CAR(0,+1250)	Equal variances assumed	51.28	.000	-4.810***	2221	-.9191
	Equal variances not assumed			-4.264***	1060	-.9191

Table 12A**Determinants of long term cumulative abnormal return**

$$AR_{-1,t} = \beta_0 + \beta_1 BRD\ SZ + \beta_2 CEO\ DL + \beta_3 INED + \beta_4 FAM\ B + \beta_5 B4/NB4 + \beta_6 CONN + \beta_7 LN\ TA + \beta_8 ROA + \beta_9 AUD\ O + \beta_{10} PRC + \beta_{11} MB/GEM + \beta_{12} PAST\ RETURN + \beta_{13} LN\ D\ SIZE + \beta_{14} BANK\ D + \beta_{15} R/E\ D + \beta_{16} CC\ D + \varepsilon_{-1,t}$$

This table reports regression results on the determinants of long term abnormal returns from the announcement date to two (to five) years. Independent variables are on the left column of the table. ***P<0.01; **P<0.05; *P<0.1. The asterisks indicate two-tailed statistical significance at the 1%, 5% and 10% respectively.

Dependent Variables:	CAR(0,+500)	CAR(0,+750)	CAR(0,+1000)	CAR(0,+1250)
Independent variables:				
(Predicted sign in bracket)				
Intercept (?)	3.617	3.319	3.929	2.133
CONN (-)	-0.519***	-0.457***	-0.477**	-0.605***
LN TA (-)	-0.228***	-0.220***	-0.316***	-0.188***
ROA (+)	1.092	-2.665**	-3.217**	-1.443
BRD SZ (+)	0.086**	0.080***	0.181***	0.156**
CEO DL (-)	0.671**	-0.048	-0.154	-0.095
INED (+)	-0.127	0.567	0.843	0.937
FAM B (-)	0.167	0.174	0.116	0.084
B4/NB4 (-)	-0.006	0.089	-0.068	-0.037
AUD O (-)	-0.473	-0.599**	-0.693*	0.167
BANK D (+)	0.751**	0.279	0.365	-0.154
R/E D (+)	0.621**	0.660***	0.867***	0.328
CC D (-)	-0.522	-0.450	-0.325	0.058
PRC (-)	0.707**	0.547**	0.477	0.289
MB/GEM (-)	-0.304	-0.445**	-0.004	0.078
PAST RETURN (-)	-0.043*	-0.051***	-0.060**	-0.072***
LN D SIZE (+)	0.027	0.058	0.014	0.079
Observations	2223	2223	2223	2223
Adj. R ²	0.064	0.052	0.088	0.086
F-value	4.803***	4.072***	6.358***	6.216***

AUD O = indicator variable, 1 for auditor opinion not unqualified

B4/NB4 = indicator variable, 1 for firms audited by non-big four accounting firms

BANK D = indicator variable, 1 for firms which are commercial banks

BRD SZ = number of directors on the board

CAR = cumulative abnormal return from one day before to one day after transaction announcement
CC D = indicator variable, 1 for firms engaging in consumer cyclical business
CEO DL = indicator variable, 1 for same person serving as CEO and chairperson of the board
CONN = 1 for connected transaction; 0 otherwise
FAM B = indicator variable, 1 for firms having two or more family board members
INED = number of independent non-executive directors divided by board size
LN D SIZE = natural logarithm of transaction amount in millions of HK dollars
LN TA = natural logarithm of book value of the total assets in millions of HK dollars
MB/GEM = 1 for firms listed on the Growth Enterprise Board; 0 otherwise
PAST RETURN = abnormal return of the firm from 12 months to 1 month prior transaction announcement
PRC = 1 for the firm either is H-share or red chip; 0 otherwise
R/E D = indicator variable, 1 for firms engaging in real estate development business
ROA = (net income – total cash preferred dividends)/average total assets in percentage

Table 12BPortfolios long term abnormal return for arms length versus connected firms

2003 Arms-length	CAR 0 to +500	CAR 0 to +750	CAR 0 to +1000	CAR 0 to +1250
Big High	4.48%	7.75%	6.37%	5.74%
Big Low	1.75%	0.829%	1.228%	1.267%
Small High	0.188%	-0.127%	2.897%	0.174%
Small Low	-0.434%	-0.102%	5.04%	1.76%
2003 Connected				
Big High	-0.13%	-0.312%	0.551%	0.138%
Big Low	0.304%	0.183%	0.686%	0.199%
Small High	-0.282%	-0.343%	-0.148%	-0.576%
Small Low	-0.715%	-0.844%	-0.25%	-1.26%
2004 Arms-length	CAR 0 to +500	CAR 0 to +750	CAR 0 to +1000	CAR 0 to +1250
Big High	0.984%	2.038%	0.643%	0.188%
Big Low	0.728%	0.683%	0.200%	-0.284%
Small High	-0.417%	0.745%	0.505%	0.266%
Small Low	-0.445%	1.677%	0.845%	-0.005%
2004 Connected				
Big High	0.241%	0.925%	0.783%	0.276%
Big Low	0.526%	1.043%	0.494%	-0.448%
Small High	-0.254%	0.809%	0.342%	0.185%
Small Low	-0.213%	0.563%	-0.361%	-0.261%

Table 12B (continued)

2005 Arms-length	CAR 0 to +500	CAR 0 to +750	CAR 0 to +1000	CAR 0 to +1250
Big High	3.611%	0.473%	0.614%	0.813%
Big Low	1.576%	0.749%	0.046%	0.870%
Small High	0.923%	0.284%	0.260%	0.544%
Small Low	0.856%	2.144%	0.424%	3.391%
2005 Connected				
Big High	0.541%	0.747%	0.089%	0.127%
Big Low	0.991%	0.331%	0.213%	0.687%
Small High	0.453%	0.015%	-0.022%	0.203%
Small Low	-0.544%	-0.848%	-0.170%	0.074%
2006 Arms-length	CAR 0 to +500	CAR 0 to +750	CAR 0 to +1000	CAR 0 to +1250
Big High	0.135%	-0.388%	-0.506%	-0.586%
Big Low	0.884%	0.395%	0.671%	0.822%
Small High	0.605%	0.0904%	1.77%	1.325%
Small Low	3.305%	3.825%	8.358%	6.265%
2006 Connected				
Big High	-0.204%	-0.179%	-0.067%	-0.123%
Big Low	0.481%	0.333%	0.782%	0.881%
Small High	-0.194%	-0.171%	0.008%	-0.054%
Small Low	0.719%	0.224%	0.874%	0.641%

Table 12C
Mean difference test of long term abnormal return of connected firms versus
arms-length firms

2003	Connectedvs	CAR 0 to	CAR 0 to	CAR 0 to	CAR 0 to
arms-length		+500	+750	+1000	+1250
Big High		-4.61%***	-8.062%***	-5.819%***	-5.602%***
Big Low		-1.446%***	-0.646%**	-0.542%***	-1.068%**
Small High		-0.47%**	-0.216%***	-3.045%**	-0.75%***
Small Low		-0.281%***	-0.742%***	-5.29%***	-3.02%**
2004	Connectedvs				
arms-length					
Big High		-0.743%***	-1.113%***	0.14%	0.088%
Big Low		-0.202%***	0.36%	0.294%	-0.164%***
Small High		0.163%	0.064%	-0.163%***	-0.081%**
Small Low		0.232%	-1.114%***	-1.206%***	-0.256%***
2005	Connectedvs				
arms-length					
Big High		-3.07%***	0.274%	-0.525%***	-0.686%***
Big Low		-0.585%***	-0.418%***	0.167%	-0.183%***
Small High		-0.47%**	-0.269%***	-0.282%**	-0.341%**
Small Low		-1.4%***	-2.992%***	-0.594%***	-3.317%***
2006	Connectedvs				
arms-length					
Big High		-0.339%***	0.209%	0.439%	0.463%
Big Low		-0.403%***	-0.062%***	0.111%	0.059%
Small High		-0.647%***	-0.261%**	-1.762%***	-1.379%***
Small Low		-2.586%***	-3.601%***	-7.484%**	-5.624%***

***P<0.01; **P<0.05; *P<0.1. The asterisks indicate two-tailed statistical significance at the 1%, 5% and 10% respectively

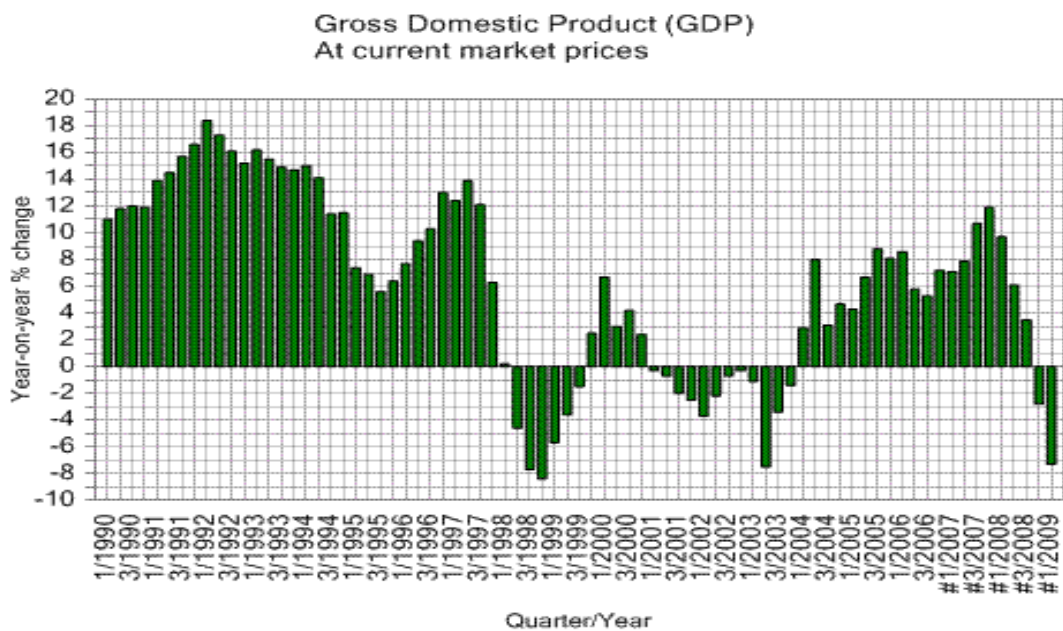
Table 13**Difference in asset turnover in the long run of connected versus arms length transaction firms**

This table shows the test of equality of means of abnormal return upon announcement of connected transaction firms versus arms length transaction over five-year period: one year after announcement AT Year 1, two years after announcement AT Year 2, three years after announcement AT Year 3, four years after announcement AT Year 4 and five years after announcement AT Year 5. The asterisks ***, **, * indicate statistical significance levels in a 2-tailed test at the 1%, 5% and 10% respectively.

Asset Turnover		F	Sig.	t	df	Mean Difference
AT Year 1	Equal variances assumed	0.002	.962	-0.049	2170	-.0635
	Equal variances not assumed			-0.052	2143	-.0635
AT Year 2	Equal variances assumed	5.61	0.018	-1.480	2172	-1.839
	Equal variances not assumed			-1.441	1775	-1.839
AT Year 3	Equal variances assumed	8.29	.004	-1.698*	2155	-1.891
	Equal variances not assumed			-1.596	1465	-1.891
AT Year 4	Equal variances assumed	0.425	.514	-0.388	2153	-.8232
	Equal variances not assumed			-0.396	2086	-.8232
AT Year 5	Equal variances assumed	16.44	.000	-2.213**	2150	-4.634
	Equal variances not assumed			-1.953*	1042	-4.634

Figure 1 Annual percentage change of bi-quarterly gross domestic product (GDP)

This figure presents the GDP of Hong Kong from Q1 1990 to Q1 2009. There were robust growth in the 1990s. The Asian financial crisis in late 1997, the global recession at the turn of the century and the SARS during 2003 brought difficult moments to the economy. The latest economic boom lasted for about four years. (Source: Hong Kong Census and Statistics Department).



Figures are subject to revision later on as more data become available. Figures are the latest data released on 15 May 2009.

Figure 2 Hong Kong broad equity market index: Hang Seng Index

This figure presents the index performance from January 2002 to December 2011. The chart shows that the overall market has experienced a volatile ten-year period.

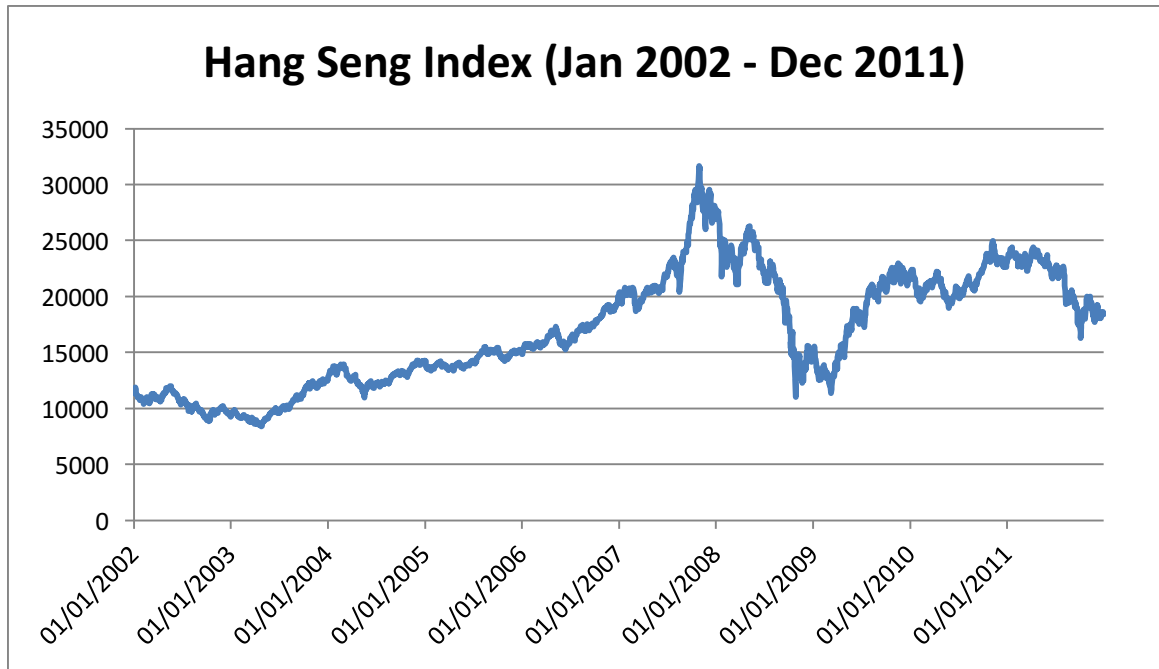
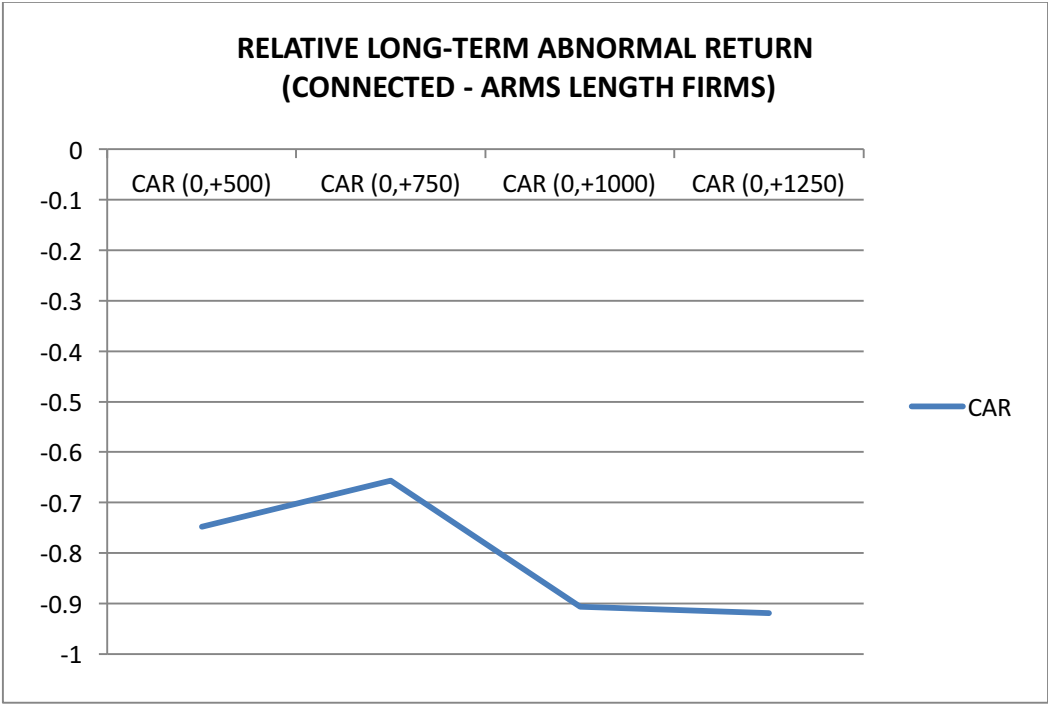


Figure 3 Relative long-term abnormal return (connected - arms length firms)



Appendix A: A short case analysis- Connected transaction of Pearl Oriental Innovation

Limited (POIL) with its chairman of the board

Company background

POIL was first incorporated to participate in logistics assets and warehouse businesses before 2009. It is a public listed firm incorporated in Hong Kong under the ticker 632.HK. It then mainly engages in processing and sales of plastic raw material, environmental recycling business. Lately it changed its name to Pearl Oriental Oil Limited (POOL) after its acquisition of petroleum related business in 2010 and involved in exploration and production of petroleum and natural gas in Utah in the United States.

The chairman and executive director of POOL is Wong, Yuk-kwan (since 2006), alias Wong Kwan, 65. He owns 26.2% of the common shares of the firm.

It has about 60 employees in Hong Kong. Sales for the year ending January 2013 was HKD444,176,000. The common shares outstanding of the firm are 3,241,519,000. About 51.9% of these are closely held shares for 1,681,226,000.

Financial highlights (Appendix A financial report of POOL)

	<u>2013 (6-month)</u>	<u>2012</u>	<u>2009</u>
Sales	\$232,626,000	\$444,176,000	\$195,530,000
Operating loss	\$53,210,000	\$35,901,000	\$39,180,000
Net loss	\$82,989,000	\$303,321,000	\$566,840,000
Cash	\$19,769,000	\$207,816,000	\$224,314,000
Total assets	\$2,688,029,000	\$2,824,390,000	\$473,912,000
Shareholders equity	\$2,099,594,000	\$2,241,468,000	\$344,987,000
Total liabilities	\$588,435,000	\$582,922,000	\$128,925,000
External auditors	N/A	Cheng & Cheng	Ascenda Cachet
Board size	6	6	6

Independent Non-executive directors	3	3	3
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What happened?

In June 2009, Mr. Wong, through a middleman, contacted and felt interested in the natural gas and petroleum business of Thurston Energy LLC in the United States. Two months later, Mr. Wong started to get into the terms of a possible purchase of Thurston Energy. In November, Shiny One, a firm owned by Ms. Yik Siu-hung, 44, the girl friend of Mr. Wong and incorporated at British Virgin Island acquired Thurston Energy for USD60 million. In December, Mr. Wong's 100% owned Festive Oasis Limited bought 35% ownership of Shiny One from Ms. Yik.

On January 9, 2010, POIL announced a very substantial acquisition and connected transaction and need to issue new shares for the payment of the acquisition. The agreement was POIL would purchase all issued share capital of Festive Oasis, which was engaged in natural gas and petroleum production in Utah of the United States. The Utah natural gas and oil field represented a total net probable and possible natural gas reserve of 454.5 Bcf and oil reserve of 1,860,000 barrels. The consideration of the deal was USD225 million, which would be paid by issuing some new shares of POIL. (Appendix B connected transaction announcement)

Since Mr. Wong was the beneficial owner of Festive Oasis and he was also a substantial shareholder of POIL, the acquisition constituted a connected transaction for the firm under the Listing Rule. As a result, the transaction was subject to the approval of independent shareholders by voting at the special general meeting. Mr. Wong was abstained from the voting at the meeting in respect of the acquisition.

Furthermore, an independent board committee, only comprised of independent directors only, was formed to advise the independent shareholders as to the fairness and reasonableness of the acquisition.

Moreover, Wallbank Brothers Securities (Hong Kong) Limited was appointed by the independent board committee as the independent financial adviser to advise the independent board committee and independent shareholders related to the merits of the transaction.

The transaction was approved at the special general meeting in 2010.

Charges on Mr. Wong

In October 2013, the Chairman of POOL, Mr. Wong Yuk-kwan was charged by the Independent Commission Against Corruption (ICAC) with conspiracy to defraud in relation to POIL's purchase of natural gas and oil fields in Utah of the United States. He was alleged to conspire together with other senior executives of POIL to defraud the Stock Exchange of Hong Kong Limited by falsely representing that the original acquisition cost of the Utah oilfield, on 35% interest of Festive Oasis Limited, that he owns 100%, was USD70 million. (Appendix C ICAC press release)

On top of that, Mr. Wong also faced a similar charge alleging him of conspiring with other senior executives to defraud POIL, and then the shareholders. It led shareholders of POIL to

approve the acquisition agreement on all issued share capital of Festive Oasis and then the issue of new shares of POIL as the payment.

As a starting point, I can try to think the possible crime committed in a few perspectives:

1. Why does Mr. Wong, the Chairman of POIL, commit the stealing from the listed firm? Mr. Wong might think that a complicated overseas deal structure could cheat shareholders.
2. POIL, the listed firm has fulfilled all the regulatory disclosure requirements of Chapter 14 and Chapter 14A of the Listing Rules of Hong Kong Stock Exchange in this connected transaction. Yet stealing is still happening. Why? The existing disclosure requirement still has loopholes where bad intention executives do not find it difficult to get around.
3. Is there anything going wrong such as the financial details of the connected transactions, a technical report on the Oil Field in the United States, a valuation report on the Oil Field from the United States, recommendation of independent board committee and opinion of independent financial advisor? Where is the check and balance? The firm could choose the service providers which are committed to favorable report to the connected person. Besides, the financial details or valuation have a rather big room of possible ranges, especially happening overseas. It might not be practically possible to go through a rigorous procedure to get these reports.
4. How come it takes more than three years to discover some possible wrong-doings in this connected transaction and lay charges on the Chairman by the regulator, ICAC, but not the Stock Exchange of Hong Kong or Securities and Futures Commission? As the connected parties have fulfilled the legal requirement on disclosure, the Stock Exchange is not that easy

to spot wrongdoings. Fraud is something way more difficult to find evidence and hence it will take long time to lay charges by the other regulators.

5. Is there any room for improvement at the Stock Exchange to mitigate some cases like this to happen in the future? In terms of the quality of the reports, financial advisors, Stock Exchange may consider to impose scoring system to signal quality of the service over time. Besides, random surprise check has to be conducted to enhance disclosure accuracy.

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東方明珠創業有限公司*
Pearl Oriental Innovation Limited

(the “Company”)

(Incorporated in the Bermuda with limited liability)

(Stock Code: 632)

**(1) VERY SUBSTANTIAL ACQUISITION
AND
CONNECTED TRANSACTION;
(2) SPECIFIC MANDATE TO ISSUE NEW SHARES;
AND
(3) RESUMPTION OF TRADING**

On 9 January 2010, the Company and the Vendors entered into the Agreement pursuant to which the Vendors have agreed to sell to the Company the Sale Shares. The Sale Shares represent the entire issued share capital of Oasis, subsidiaries of which will be principally engaged in natural gas and petroleum production in the Areas located in Utah, USA.

Ownership interest in the Utah Gas and Oil Field which has a total net probable and possible natural gas reserve of 454.5 Bcf and oil reserve of 1.86 million barrels will be conditionally transferred to the Target Group pursuant to the Agreement.

Phase 1 Acquisition

The consideration for the Phase 1 Acquisition is US\$200 million (equivalent to approximately HK\$1,560 million and shall be satisfied by the Group at Completion (i) as to US\$50 million (equivalent to approximately HK\$390 million) by cash; and (ii) as to US\$150 million (equivalent to approximately HK\$1,170 million) by the issue of up to 847,810,000 Phase 1 Consideration Shares at a price (the “Price”) of HK\$1.38 per Share.

After completion of the Phase 1 Acquisition, Oasis shall own 70% of the Ownership Interest.

* For identification purposes only

The Company shall comply with the relevant requirements under Chapter 14 and/or Chapter 14A of the Listing Rules upon exercise of the option (see below).

Phase 2 Acquisition

The Company may, at its option, pay the JV Partner an aggregate sum of US\$25 million (equivalent to approximately HK\$195 million) for the remaining 30% Ownership Interest. The said amount of US\$25 million will be paid by cash in full or if the JV Partner elects, will be paid by cash as to US\$12.5 million and the remaining sum of US\$12.5 million (equivalent to approximately HK\$97.5 million) will be satisfied by the issue and allotment of 70,650,000 Phase 2 Consideration Shares at the Price of HK\$1.38 per Share to the Vendors (including the JV Partner).

The Consideration Shares represent (i) approximately 74.89% of the existing issued share capital of the Company of 1,226,416,960 Shares as at the date of this announcement; and (ii) approximately 42.82% of the issued share capital of the Company of 2,144,876,960 Shares as enlarged by the Proposed Issue.

Since the relevant percentage ratio(s) (as defined under the Listing Rules) in respect of the Acquisition is more than 100%, the Acquisition constitutes a very substantial acquisition for the Company under the Listing Rules and is subject to the reporting, announcement, circular and shareholders' approval requirements under Chapter 14 of the Listing Rules.

As at the date of this announcement, Mr. Wong, being beneficial owner of one of the Vendors, is a substantial Shareholder. The Company has been informed that 15% interest in Oasis will be conditionally transferred from Marvel to Dr. Lew, being the Deputy Chairman and executive Director of the Company, prior to the Completion at a consideration of US\$30 million payable to Marvel, another Vendor. Accordingly, the Acquisition also constitutes a connected transaction for the Company under the Listing Rules due to the acquisition of 15% interest of Oasis from Dr. Lew and 35% interest of Oasis from Charcon. Completion of the Acquisition involving the transactions contemplated under the Agreement and the issue of the Consideration Shares under the Specific Mandate is therefore subject to, among other things, approval of the Independent Shareholders by way of poll at the SGM. The Vendors, Mr. Wong, Dr. Lew and their associates shall abstain from voting at the SGM in respect of the Acquisition.

An Independent Board Committee (comprising independent non-executive Directors only) will be formed to advise the Independent Shareholders as to the fairness and reasonableness of the Acquisition and the transactions contemplated thereunder. Wallbank Brothers Securities (Hong Kong) Limited has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Acquisition, the issue of the Consideration Shares and the transactions contemplated therein, and that the appointment has been approved by the Independent Board Committee.

A circular containing, among other things, details of the Acquisition and the transactions contemplated under the Agreement, financial information of the Group and the Target Group, a technical report on the Utah Gas and Oil Field prepared by HAAS in accordance with the requirements under Chapter 18 of the Listing Rules, a valuation report on the Utah Gas and Oil Field, the letter of advice from the independent financial adviser, the recommendation of the Independent Board Committee to the Independent Shareholders and the notice of the SGM will be despatched to the Shareholders as soon as practicable.

At the request of the Company, trading in the Shares on the Stock Exchange was suspended with effect from 9:30 a.m. on 11 January 2010 pending the release of this announcement. Application has been made by the Company to the Stock Exchange for the resumption of trading in the Shares with effect from 9:30 a.m. on 26 January 2010.

The Board is pleased to announce that the Company entered into the Agreement with the Vendors on 9 January 2010 in relation to the Acquisition. Details of the Agreement are set out below.

THE AGREEMENT

Date: 9 January 2010

Parties

- (i) the Company, the purchaser;
- (ii) the Vendors, Charcon Assets Limited (“**Charcon**”) and Marvel Sunlight Limited (“**Marvel**”)

To the best of the Directors’ knowledge, information and belief and having made all reasonable enquiries, Marvel and its beneficial owners are third parties independent of the Company and its connected persons. Charcon is a company wholly owned by Mr. Wong.

The Company has been informed that 15% interest in Oasis will be conditionally transferred from Marvel to Dr. Lew (“Dr. Lew’s Equitable Interest”) prior to Completion at a consideration of US\$30 million payable to Marvel by Dr. Lew. Such transfer was merely based on the negotiation and agreement between Marvel and Dr. Lew. Dr. Lew is not yet the legal owner of these 15% interest in Oasis at the date of this announcement.

Assets to be acquired

Pursuant to the Agreement, the Vendors have conditionally agreed to sell and the Company has conditionally agreed to acquire the Sale Shares, representing the entire issued share capital of Oasis which shall include Dr. Lew’s Equitable Interest. After the Completion, Oasis will be a 100% owned subsidiary of the Company.

Ownership Interest in the Utah Gas and Oil Field which has a total net probable and possible natural gas reserve of 454.5 Bcf and oil reserve of 1.86 million barrels is currently held by the JV Partner and will be conditionally transferred to the Target Group by the JV Partner (as agreed by the Vendors and the JV Partner) pursuant to the Agreement in the following manner:

Phase 1 Acquisition

Consideration

The total consideration for the Phase 1 Acquisition is US\$200 million (equivalent to approximately HK\$1,560 million) which shall be satisfied by the Company as follows:

- (a) Upon the signing of the Agreement, the Company shall pay to Marvel a sum of US\$20 million (equivalent to approximately HK\$156 million) in cash as a refundable deposit (the “**Deposit**”) for the Acquisition, and upon the date of first completion of the Acquisition (the “**First Completion Date**”), the Vendors shall cause and procure 10.5% Ownership Interest be transferred to Shiny One USA (the “**Phase 1a Acquisition**”). The First Completion Date will be on the date on which all the Conditions Precedent are fulfilled or waived by the Company (as the case may be).
- (b) On or before 12 March 2010, the Company may, at its option, pay Marvel an aggregate sum of US\$80 million as consideration for the Vendors’ causing and procuring a further 31.5% Ownership Interest be transferred to Shiny One USA (the “**Phase 1b Acquisition**”), out of which US\$30 million (equivalent to approximately HK\$234 million) will be paid by cash and the remaining sum of US\$50 million (equivalent to approximately HK\$390 million) will be satisfied by the issue and allotment of 282,600,000 new Consideration Shares to Marvel. The completion date of the Phase 1b Acquisition will be on or before 12 March 2010 (the “**Second Completion Date**”).
- (c) On or before 12 May 2010, the Company may, at its option, pay an aggregate sum of US\$100 million as consideration for the Vendors’ causing and procuring a further 28% Ownership Interest be transferred to Shiny One USA (the “**Phase 1c Acquisition**”), out of which US\$30 million (equivalent to approximately HK\$234 million) will be satisfied by the issue and allotment of 169,560,000 new Consideration Shares to Dr. Lew and the remaining sum of US\$70 million (equivalent to approximately HK\$546 million) will be satisfied by the issue and allotment of 395,650,000 new Consideration Shares to Charcon. The Completion date of the Phase 1c Acquisition will be on or before 12 May 2010 (the “**Third Completion Date**”).

After completion of the Phase 1 Acquisition, the Company shall hold 100% equity interest of Oasis and Oasis shall own 70% of the Ownership Interest. A total of up to 847,810,000 new Shares (the “**Phase 1 Consideration Shares**”) will be issued by the Company to the Vendors for the Phase 1 Acquisition.

The Company shall comply with the relevant requirements under Chapter 14 and/or Chapter 14A of the Listing Rules upon exercise of the aforesaid option.

Phase 2 Acquisition

On or before 12 December 2011, the Company may, at its option, pay the JV Partner an aggregate sum of US\$25 million (equivalent to approximately HK\$195 million) (the “**Phase 2 Consideration**”) for the remaining 30% Ownership Interest (the “**Phase 2 Acquisition**”) to be transferred in Shiny One USA. The said amount of US\$25 million will be paid by cash in full or if the JV Partner elects, will be paid by cash as to US\$12.5 million and the remaining sum of US\$12.5 million (equivalent to approximately HK\$97.5 million) will be satisfied by the issue and allotment of 70,650,000 new Shares at the Price of HK\$1.38 per Share (the “**Phase 2 Consideration Shares**”) to the JV Partner. The completion date of the Phase 2 Acquisition will be within 14 days after the Company’s exercise of its option to proceed with the Phase 2 Acquisition (the “**Final Completion Date**”).

After the Final Completion Date, the Company shall own 100% of the Ownership Interest through its then wholly owned subsidiary, Oasis. In such circumstances, the Company and the Vendors (including the JV Partner) shall only share the Net Operating Income from the First 14 Wells, and all the Net Operation Income of any other new wells shall be received by the Company only (details of the share of the Net Operating Income are set out in the sub-section headed “Share of the Net Operating Income”).

The Company shall finance the Consideration by its internal resources or possible fund raising activities.

Price per Consideration Share

The Price of HK\$1.38 represents (i) a discount of approximately 30.3% to the closing price of HK\$1.98 per Share as quoted on the Stock Exchange on the Last Trading Day; (ii) a discount of approximately 17.9% to the average closing price per Share of approximately HK\$1.68 as quoted on the Stock Exchange for the last five consecutive trading days up to and including the Last Trading Day; and (iii) a premium of approximately 2.7% over the average closing price per Share of HK\$1.344 as quoted on the Stock Exchange for the last 20 consecutive trading days up to and including the Last Trading Day.

The Price has been determined and has been negotiated on an arm’s length basis between the Vendors and the Company.

The Consideration Shares

The Consideration Shares represent (i) approximately 74.89% of the existing issued share capital of the Company of 1,226,416,960 Shares as at the date of this announcement; and (ii) approximately 42.82% of the issued share capital of the Company of 2,144,876,960 Shares as enlarged by the Proposed Issue.

Ranking of Consideration Shares

The Consideration Shares rank pari passu among themselves and with Shares in issue as at the date of this announcement.

The Consideration was determined after arm's length negotiations between the parties.

In determining the Consideration, the Board has obtained a preliminary valuation report on 100% of Ownership Interest prepared by BMI, an independent valuer, and a technical report on the natural gas and petroleum resources prepared on 25 November 2009 by HAAS, a distinguished American petroleum engineering consultant, in which the reserves estimates conformed to the PRMS.

Taking into account, among other things, (i) the preliminary valuation of 100% Ownership Interest of the Utah Gas and Oilfield prepared by BMI of approximately US\$500 million (equivalent to approximately HK\$3.9 billion). The discount of approximately 55% represented by the Consideration to such indicated valuation; (ii) the technical report issued by HAAS on 25 November 2009, confirming that the Utah Gas and Oilfield has a total net probable and possible natural gas reserves of 454.5 Bcf and oil reserves of 1.86 million barrels.; and (iii) the expected total exploitation value of the Utah Gas and Oilfield of US\$2.5 billion with reference to the international market price of natural gas and oil at the end of December 2009, the Directors consider that the Consideration is fair and reasonable.

In addition, the Directors are also of the view that the acquisition of the Sale Shares by the Company which shall include Dr. Lew's Equitable Interest (subsequent to the transfer of Dr. Lew's Equitable Interest to Dr. Lew from Marvel) is fair and reasonable and in the interests of the Shareholders as a whole since the consideration of US\$30 million payable to Marvel by Dr. Lew equals to part of the Consideration (i.e. US\$30 million) to be received by Dr. Lew under the acquisition of the Sales Shares by the Company.

As advised by the Vendors, the original acquisition cost incurred by Charcon on 35% equity interest of Oasis was US\$70 million while Dr. Lew's original acquisition cost payable to Marvel was US\$30 million.

Conditions precedent

Completion of the Acquisition is subject to the following conditions precedent (the "**Conditions**"):

- (i) the passing of the necessary resolution(s) by the Independent Shareholders in a general meeting to approve the Agreement, the Proposed Issue and the transactions contemplated thereunder and the implementation thereof (including but not limited to, the acquisition of the Sale Share by the Company);
- (ii) the Listing Committee granting the listing of, and permission to deal in, the Consideration Shares on the Stock Exchange;

- (iii) the Company being satisfied with the results of its due diligence review and investigation on Oasis and the Utah Gas and Oil Field including the legal title thereof;
- (iv) the approval required to be obtained from the Committee on Foreign Investment in the United States in respect of the Company's acquisition of Ownership Interest in the Utah Gas and Oil Field; and
- (v) the Company having obtained a legal opinion issued by USA legal advisers acceptable to the Company in respect of the due diligence on and the legal title of the Utah Gas and Oil Field confirming that it is in both form and substance and in all respects satisfactory to the Company.

The Company may at its absolute discretion at any time waive the above Conditions (iii) to (v) by written notice to the Vendors.

If the conditions above are not fulfilled or waived (as the case may be) on or before 12 May 2010 or such other date as the Company and the Vendors may agree in writing and/or the conditions (iii) to (v) do not remain fulfilled (and is not waived by the Company or, where applicable, the Vendors) on the date of Completion, all rights, obligations and liabilities of the parties under the Agreement shall cease and determine and none of the parties shall have any claim against the other save and except any antecedent breach, and the Vendors shall refund the Deposit to the Company within 3 days after the Company has given a written notice to the Vendors to cancel the Acquisition.

The transfer of total Ownership Interest to Shiny One USA is not one of the conditions precedent. Nevertheless, the Consideration will be paid in proportion upon different phases of transfer of the Ownership Interest pursuant to the Agreement as disclosed above.

Completion

Completion shall take place on the date falling on the third business day after the fulfillment or, where applicable, waiver of the relevant conditions precedent.

Share of the Net Operating Income

The Company has agreed to bear the costs (the "**Development Costs**") of re-development of 7 existing wells and the drillings of 7 new wells (together, the "**First 14 Wells**") in the Utah Gas and Oil Field in the aggregate sum of US\$15 million, by 3 instalments of US\$2.4 million, US\$7.2 million and US\$5.4 million on the First Completion Date, the Second Completion Date and the Third Completion Date respectively. The Company and the Vendors (including the JV Partner) will share the Net Operating Income from the First 14 Wells at the ratio of 70:30.

The Company shall have the right to provide additional funding to develop more new wells in the Utah Gas and Oil Field, if the Vendors (including the JV Partner) cannot contribute additional funding, then the Company and the Vendors (including the JV Partner) will share the Net Operating Income from these additional new wells at the ratio of 90:10. The Company shall comply with the Listing Rules requirements (if any) arising from the provision of the aforesaid funding.

The JV Partner does not hold any interests in Oasis nor have any relationship with the Company, its connected persons and its associates except that the JV Partner has business relationship (in relation to the Acquisition as it owns interests in the Utah Gas and Oil Field) with the Vendors.

To the best of the Directors' knowledge, information and belief and having made all reasonable enquiries, the JV Partner and its ultimate beneficial owners are independent and are not connected persons of the Company and its associates.

The Company shall finance the Development Costs by its internal resources or possible fund raising activities.

Other Terms

An operating company (the "**Operating Company**") will be responsible for the exploration, development and drillings of the existing and new wells and production in the Utah Gas and Oil Field. After the Third Completion Date and the Group's acquisition of 70% Ownership Interest, the Group shall have the right to appoint 3 (three) of the total 5 (five) directors of the Operating Company, its board of directors will decide the administration and finance matters of exploitation in the Utah Gas and Oil Field.

The JV Partner will participate in the operations of the Operating Company and will supervise that the day-to-day activities including exploration and exploitation of the Utah Gas and Oil Field.

INFORMATION ON OASIS

Oasis was incorporated in the British Virgin Islands which is an investment holding company. At the date of this announcement, the Target Group has not yet engaged in exploration or exploitation works. As at the date of the Agreement, Oasis was owned as to 65% by Marvel, and 35% by Charcon. The Company has been informed that 15% interest in Oasis may be conditionally transferred from Marvel to Dr. Lew prior to Completion at a consideration of US\$30 million payable to Marvel.

After completion of the Agreement, the Target Group will be principally engaged in the exploration, exploitation and production of natural gas and petroleum in the Areas. According to the unaudited consolidated management accounts of the Target Group, it recorded a loss before and after taxation of approximately HK\$1,036,000 during the first financial period from 29 September 2009 (date of incorporation) and up to 31 December 2009, representing mainly the legal and professional fee incurred by the Target Group. As at 31 December 2009, the net liabilities of the Target Group amounted to approximately HK\$4,950,000. After the Final Completion Date, the Company shall own 100% of the Ownership Interest through its then wholly owned subsidiary, Oasis. The preliminary valuation of the Utah Gas and Oilfield prepared by BMI on 19 January 2010 is approximately US\$500 million (equivalent to approximately HK\$3.9 billion).

Information on the Utah Gas and Oil Field

The Utah Gas and Oil Field are located in Uinta Basin gas and oilfield area, Utah, United States. It covers an area of around 3,692 acres. Haas Petroleum Engineering Services, Inc, a distinguished American petroleum engineering consultant, issued a technical report on 25 November 2009, confirming that this Utah Gas and Oilfield project has a total net Probable & Possible natural gas reserves of 454.5 Bcf and oil reserves of 1.86 million barrels. The Company has an intention to drill, explore and exploit 360 wells in the Utah Gas and Oil Field in coming years after Completion of the Acquisition.

The Utah Gas and Oil Field are located in the quality production area of Uinta Basin. It is surrounded by the renowned U.S. oil exploration companies, including Anadarko Petroleum Corporation (“**Anadarko**”) (NYSE: APC, market capitalization of US\$ 31.5 billion), Questar (NYSE: STR, market capitalization of US\$7.46 billion) and other oil exploration enterprises, which have successfully recorded excellent exploitation and operating results of natural gas in the region for many years.

There is an existing main natural gas pipeline across the Areas, therefore the natural gas to be produced in the Utah Gas and Oil Field can be sold soon after the commencement of the production of natural gas in the Utah Gas and Oil Field.

In accordance to the U.S. well-known and one of the world’s largest technical engineering companies, Halliburton, (NYSE: HAL, market capitalization of US\$ 27.3 billion, Mr. Dick Cheney, former U.S. Vice President was the former Chairman and CEO of Halliburton) has provided the entire oil and gas wells exploitation and distribution status in 1980 and 2007, which showed clearly the Utah Gas and Oil Field is at a ready-to-go stage with huge earning prospect.

Management of the Company has visited the Utah Gas and Oil Field and has also discussed with Halliburton and Anadarko on the prospects of the future gas and oil production and cooperation among each others. Halliburton and Anadarko will continue to give their marketing and professional services to the Utah Gas and Oil Field project, and Management has great confidence in the future economic benefits of our investment.

New Management Team

Ralph Curton Chief Operating Officer

Mr. Ralph Curton, will be appointed as the Chief Operating Officer (COO) of Pearl Oriental. Mr. Curton has 40 years of experiences in the operation and management in the oil and natural gas industry. In the 70’s, Mr. Curton invested 50,000 productive acres in oil and natural gas enterprise in East Texas and Louisiana, and had successfully developed more than 300 oil and gas wells.

Over the years, Mr. Curton has established close relationships with Halliburton and Anadarko. Upon completion of the Acquisition, Halliburton will continue to provide world-class professional technical and engineering services to the Utah Gas and Oil Field. As advised by Mr. Curton, Anadarko will continue to purchase all the natural gas produced by the Utah Gas and Oil Field. The Management Team has strong confidence that this Utah gas and oilfield project can create long term stable income.

Bryan Yam Chief Technical Officer

Mr. Yam will be appointed as the Chief Technical Officer (CTO) of Pearl Oriental, to be responsible for Pearl Oriental's development of energy and resources businesses and technical supervision. Mr. Yam has a Master degree in Aerospace Engineering and a Bachelor degree in Mechanical Engineering. He is a member of Society of Petroleum Engineers, Hong Kong Institute of Engineers and Professional Engineer registered in the State of Texas respectively.

Mr. Yam has more than 30 years of extensive management experience in the oil and natural gas sector. He has held senior management positions in the U.S. prestigious petroleum and technology companies such as Hughes Offshore, NL Rig Equipment and Kerr-McGee Corporation etc, to render diversified professional services including operation management, design co-ordination and international business expansion of natural gas and oilfield projects for various states in the U.S., Gulf of Mexico, North Sea, Asia Pacific and Australia etc.

Before joining Pearl Oriental, Mr. Yam was the Deputy JMC Chairman and Operation Manager for a famous US natural gas company, Anadarko's South China Sea deep water gas and oilfield project, which successfully exploited oil reserve of 150 million barrels. He is also the team member of the joint venture of China National Offshore Oil Corporation and Anadarko for Bohai Bay oilfield project.

Current status of Exploitation

The Operating Company will use around US\$2.4 million out of the Development Costs to repair and fix the 7 existing wells in the Utah Gas and Oil Field, and to the best of the Company's knowledge that, within 3 months after the commencement of the repair works, there will be natural gas production. Also, the Operating Company will spend the remaining US\$12.6 million of the Development Costs in total to drill 7 new wells on the Utah Gas and Oil Field. Currently, there is no production in the Utah Gas and Oil Field.

RISK FACTORS

No track record of operation

Potential risk is involved in the hydrocarbon future productions as a consequence of new drillings and the operation of new wells in the Areas. This is due to the lack of track record of operation in relation to the new drillings and the operation of new wells in the Areas. Therefore, no profit contribution has been recorded so far.

New business segment of the Group

The Acquisition constitutes an investment in a new business sector, being natural gas and petroleum exploitation and production. The Acquisition will not result in a change of business of the Company, but will result in a new business being injected into the Company. Therefore, the Board confirms that the Company will continue its existing business.

The new business, coupled with the regulatory environment, may pose significant challenges to the Company's administrative, financial and operational resources. The Company has no relevant experience and expertise to run and manage the new business in the past except that the Company will form a new Management Team comprising professional personnel from gas and oil industry as mentioned above.

Fluctuations on natural gas and petroleum prices

The fluctuations in supply and demand of natural gas and petroleum are caused by numerous factors beyond the Company's control, which include but not limited to global and domestic economic and political conditions and competition from other energy sources, and the growth and expansion in industries with natural gas and high petroleum demand. There is no assurance that the international demand for natural gas and petroleum and petroleum-related products will continue to grow, or that the international demand for natural gas and petroleum and petroleum-related products will not experience excess supply.

Significant and continuous capital investment

The natural gas and petroleum business requires significant and continuous capital investment. The major natural gas and petroleum exploration and exploitation projects may not be completed as planned, may exceed the original budgets and may not achieve the intended economic results or commercial viability. Actual capital expenditures for this business may significantly exceed the Company's budgets because of various factors beyond the Company's control, which in turn may affect the Company's financial condition.

Laws and regulations

This business is subject to extensive governmental regulations, policies and controls. There can be no assurance that the relevant government will not change such laws and regulations or impose additional or more stringent laws or regulations. Failure to comply with the relevant laws and regulations in the energy development and natural gas and petroleum exploitation projects may adversely affect the Company.

Country risk

The Company is entering a new business in the USA, in which the Company does not have any business presence. There can be a risk relating to the likelihood that changes in the business environment will occur which may affect the profitability of doing business in the USA. The change of political and economic conditions in the USA may also adversely affect the Company.

REASONS FOR THE ACQUISITION

After the disposal and cessation of its logistics assets and businesses in 2009, the Group's main focus is on energy and environmental recycling sectors.

Before the global financial tsunami took place in end of 2008, the highest international market prices of natural gas and oil was US\$15.5/Mcf and US\$147 per barrel respectively. After the financial crisis, as in December 2009, the prices of natural gas and oil were US\$5.2/Mcf and US\$74/barrel respectively, which were only 33.5% and 50.3% when compare to the highest prices. Hence, the natural gas has room for appreciation.

Countries around the world are striving for reducing emissions and solving the problems of global warming. A number of international energy enterprises are increasing their investments actively in the green energy sector. Therefore, the exploring, mergers and acquisitions of natural gas has become a crowded situation. Experts forecasted the future demand for natural gas will increase and the market price will definitely rise steadily which is favorable for increasing the operating profit.

Accordingly, the Group welcomed every investment opportunities which are beneficial to its long term development, with an aim to generate long term stable income. The Board believes that Acquisition is a good opportunity for the Group to achieve good investment returns in the energy sector.

Especially, as a result of the recent global financial tsunami, it is difficult for small non-listed gas and oil enterprises in United State to raise financing for their operations. In such situation, good opportunity for the Acquisition has therefore arisen.

Before the investment opportunity for the Acquisition was first introduced to the Group by the Vendors, Marvel has already reached an agreement with the JV Partner for its investment.

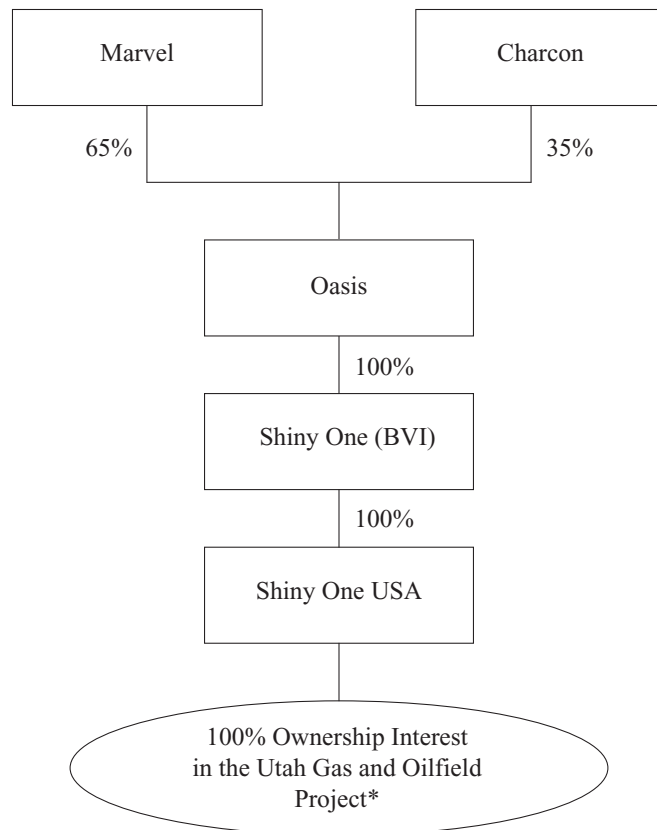
After market research on gas exploration and exploitation businesses and considered its development potential, the Company asked Marvel, Charcon and Dr. Lew to transfer their interests in this project to the Company. Therefore, the Company has entered into the Agreement with the Vendors to acquire the Target Group. The Directors consider the above arrangement is fair and reasonable and in the interest of the Company and Shareholders as a whole.

Based on the above, the Directors consider that the terms of the Acquisition are fair and reasonable and in the interests of the Company and its Shareholders as a whole.

SHAREHOLDING CHARTS

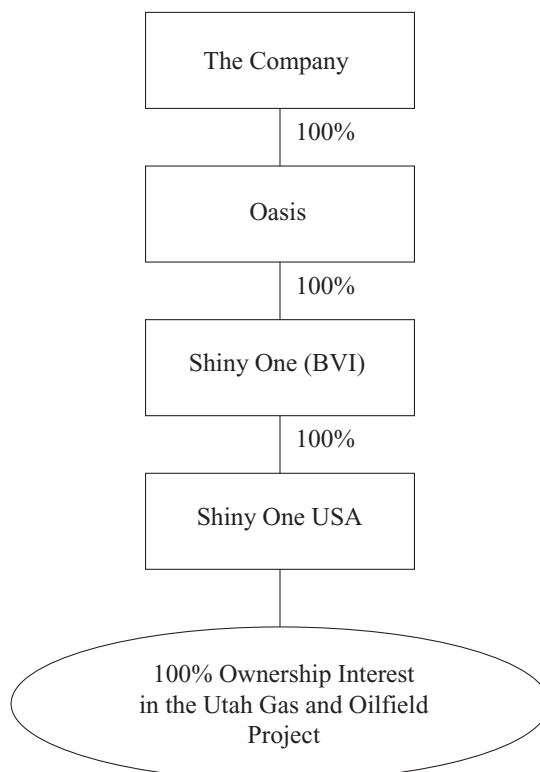
The following charts show the shareholding structure of the Target Group as at the date of this announcement and immediately upon Completion, and the relationship between the parties involved in the Acquisition.

Before the Acquisition



* after the transfer of the Ownership Interest to Shiny One USA as agreed by the Vendors and the JV Partner

After the Acquisition



FUND RAISING ACTIVITIES IN THE PAST TWELVE MONTHS

The following is the fund raising activities conducted by the Group in the past 12 months immediately preceding the date of this announcement:

Date of announcement	Event	Net proceeds (approximately)	Intended use of proceeds as announced	Actual use of proceeds
5 March 2009	Issue of Convertible notes	HK\$45 million	Partly for settlement of loan from Orient Day and partly as general working capital for the Group	Partly for settlement of loan from Orient Day and partly as general working capital for the Group
4 June 2009	Issue of Convertible notes	HK\$30 million	As general working capital for the Group	As general working capital for the Group
11 December 2009	Subscription of 115,680,000 Shares	HK\$114 million	Partly as general working capital for the Group and partly for possible acquisition of overseas energy and natural resources projects	As the Deposit for the Acquisition
14 December 2009	Subscription for 65,000,000 Shares	HK\$64 million	For possible acquisition of overseas energy and natural resources projects	Has not yet been utilized

EFFECTS ON SHAREHOLDING STRUCTURE

	As at the date of this announcement		Assuming completion of the Acquisition and the Company exercising all options under the Agreement (Note 2)	
	(No. of Shares)	(%)	(No. of Shares)	(%)
Orient Day Developments Limited (Note 1)	517,084,800	42.16	517,084,800	24.11
Charcon Assets Limited (Note 1)	–	–	395,650,000	18.45
Sub-total for Mr. Wong Kwan	517,084,800	42.16	912,734,800	42.56
Marvel Sunlight Limited and its beneficial owner	25,077,800	2.04	307,677,800	14.34
JV Partner	–	–	70,650,000	3.29
Dr. Lew Mon Hung	–	–	169,560,000	7.91
Other Directors	6,912,090	0.56	6,912,090	0.32
Public Shareholders	677,342,270	55.24	677,342,270	31.58
Total	1,226,416,960	100.00	2,144,876,960	100.00

Note 1: Orient Day Developments Limited and Charcon Assets Limited are limited liability companies incorporated in the British Virgin Islands and wholly owned by Mr. Wong Kwan.

Note 2: Assuming the JV Partner elects the payment of US\$12.5 million (equivalent to approximately HK\$97.5 million) of the Phase 2 Consideration to be satisfied the Company by the issue and allotment of the Phase 2 Consideration Shares to the JV Partner.

INFORMATION ON THE GROUP

The Company is an investment holding company and its subsidiaries are principally engaged in energy and recycling businesses.

Update on legal action

Reference is made to the Company's announcements dated 12 August 2008 and 28 November 2008 and also the Company's 2009 interim report, the Group and the other defendants have made applications for striking out of Zhang Jingyuan's ("Zhang") claims against the Group and the other defendants and also a summary judgment for counterclaims against Zhang for dividend from China Coal Energy Holdings Limited of HK\$80 million and other damages. The Group's (and the other defendants') said applications have been recently heard but have been dismissed by the Court with costs, and the parties to the legal action will proceed to trial on dates to be fixed.

After consulted with the Company's legal advisors, the Board has confidence that the Group's rights and interests can be fully protected during the coming trial.

GENERAL

Application will be made by the Company to the Listing Committee of the Stock Exchange for the grant of the listing of, and permission to deal in, the Consideration Shares.

Since the relevant percentage ratio(s) (as defined under the Listing Rules) in respect of the Acquisition is more than 100%, the Acquisition constitutes a very substantial acquisition for the Company under the Listing Rules and is subject to the reporting, announcement, circular and shareholders' approval requirements under Chapter 14 of the Listing Rules.

As at the date of the announcement, Mr. Wong, being beneficial owner of one of the Vendors, is a substantial Shareholder, Dr. Lew, being a party having interest in the Acquisition is the Deputy Chairman and an executive Director. Accordingly, the Acquisition also constitutes a connected transaction for the Company under the Listing Rules due to the acquisition of 15% interest of Oasis from Dr. Lew and 35% interest of Oasis from Charcon. Completion of the Acquisition involving the transactions contemplated under the Agreement and the Proposed Issue pursuant to the Specific Mandate is therefore subject to, among other things, approval of the Independent Shareholders by way of poll at the SGM. The Vendors, Mr. Wong, Dr. Lew and their associates shall abstain from voting at the SGM in respect of the Acquisition.

An Independent Board Committee (comprising independent non-executive Directors only) will be formed to advise the Independent Shareholders as to the fairness and reasonableness of the Acquisition and the transactions contemplated thereunder. Wallbanck Brothers Securities (Hong Kong) Limited has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Acquisition, the issue of the Consideration Shares and the transactions contemplated therein, and that the appointment has been approved by the Independent Board Committee.

A circular containing, among other things, details of the Acquisition and the transactions contemplated under the Agreement, financial information of the Group and Oasis, a technical report on the Areas prepared by HAAS in accordance with the requirements under Chapter 18 of the Listing Rules, a valuation report on the Utah Gas and Oil Field, the letter of advice from the independent financial adviser, the recommendation of the Independent Board Committee to the Independent Shareholders and the notice of the SGM will be dispatched to Shareholders as soon as practicable.

At the request of the Company, trading in the Shares on the Stock Exchange was suspended with effect from 9:30 a.m. on 11 January 2010 pending the release of this announcement. Application has been made by the Company to the Stock Exchange for the resumption of trading in the Shares with effect from 9:30 a.m. on 26 January 2010.

DEFINITIONS

In this announcement, the following expressions have the meanings set out below unless the context requires otherwise:

“Acquisition”	the acquisition of the entire issued share capital of Oasis and in turn the Ownership Interest by the Company from the Vendors comprising the Phase 1 Acquisition and the Phase 2 Acquisition pursuant to the terms and conditions of the Agreement
“Agreement”	the agreement dated 9 January 2010 entered into among the Company and the Vendors in relation to the Acquisition
“Areas”	certain acreage in Township 9 South – Range 24 East, Uintah County, Utah, USA
“Bcf”	billion cubic feet
“BMI”	BMI Appraisals Limited, an independent valuer
“Board”	the board of Directors
“Company” or “Pearl Oriental”	Pearl Oriental Innovation Limited, a company incorporated in Bermuda with limited liability and the shares of which are listed on main board of the Stock Exchange
“Completion”	completion of the Agreement
“connected person(s)”	has the meaning ascribed to it under the Listing Rules
“Consideration”	the total consideration payable in respect of the Acquisition pursuant to the Agreement comprising the Phase 1 Consideration and the Phase 2 Consideration

“Consideration Shares”	918,460,000 new Shares to be issued to the Vendors or their nominees as part of the Consideration for the Acquisition pursuant to the Agreement comprising the Phase 1 Consideration Shares and the Phase 2 Consideration Shares
“Director(s)”	director(s) of the board of the Company
“Dr. Lew”	Dr. Lew Mon Hung, the Deputy Chairman and executive Director of the Company
“Group”	the Company and its subsidiaries
“HAAS”	Haas Petroleum Engineering Services, Inc
“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“Independent Board Committee”	An independent board committee of the Board comprising all the independent non-executive Directors, namely Mr. Yu Jianmeng, Mr. Fung Hing Chiu, Cyril and Mr. Lam Ka Wai, Graham who did not have material interests in the Acquisition
“Independent Shareholders”	Shareholders (Other than the Vendors, Mr. Wong, Dr. Lew and their respective concert parties and associates and those Shareholders who are involved in, or interested in the Acquisition) who are not required to abstain from voting on the resolutions to be proposed at the SGM to approve the Acquisition under the Listing Rules
“JV Partner”	Thurston Energy, LLC, a limited liability company incorporated in the USA which is owned by Mr. Ralph Curton and his partners
“Last Trading Day”	8 January 2010, being the last full trading day for the Shares immediately before the date of this announcement
“Listing Committee”	the listing committee of the Stock Exchange
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Mcf”	thousand cubic feet
“Mr. Wong”	Mr. Wong Kwan, Chairman and Chief Executive of the Company and an executive Director

“Net Operating Income”	Total revenue from gas and oil production less net tax severance, net tax ad valorem, royalties and operating expenses for the wells in the Utah Gas and Oil Field
“Oasis”	Festive Oasis Limited, a company incorporated in the British Virgin Islands
“Orient Day”	Orient Day Developments Limited, a company incorporated in the British Virgin Islands with limited liability, and wholly owned by Mr. Wong
“Ownership Interest”	ownership interest in respect of oil, gas and/or mineral leases, title and related rights in the Utah Gas and Oil Field
“Phase 1 Acquisition”	the Phase 1a, 1b and 1c Acquisitions pursuant to the terms and conditions of the Agreement
“PRC”	The People’s Republic of China
“PRMS”	the 2007 Petroleum Resources Management System approved by the Society of Petroleum Engineers
“Proposed Issue”	the proposed issue and allotment of the Consideration Shares
“Sale Shares”	the 1,000 shares of par value of US\$1.0 each in the share capital of Oasis, representing the entire issued share capital of Oasis which shall include Dr. Lew’s Equitable Interest
“SGM”	A special general meeting of the Company to be convened to, amongst other things, consider and approve the Acquisition; and the Proposed Issue
“Share(s)”	ordinary share(s) of HK\$0.1 each in the issued share capital of the Company
“Shareholder(s)”	holder(s) of the Share(s)
“Shiny One (BVI)”	Shiny One Limited, a company incorporated in the British Virgin Islands which is a directly and wholly owned subsidiary of Oasis
“Shiny One USA”	Shiny One USA, LLC, a limited liability company incorporated in USA which is an indirectly and wholly owned subsidiary of Oasis
“Specific Mandate”	A specific mandate to be sought from the Independent Shareholders at the SGM for the Proposed Issue

“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Target Group”	Oasis and all its subsidiaries to be acquired by the Company pursuant to the Agreement
“Utah Gas and Oil Field”	Certain natural gas and oilfield located in the Areas in the Uinta Basin, Uintah County, Utah, USA
“Vendors”	Charcon and Marvel
“US\$”	United States dollars, the lawful currency of the United States of America
“USA”	the United States of America
“%”	per cent

For the purpose of this announcement and for reference only, unless otherwise specified exchange of US\$1.00 to HK\$7.80 is adopted.

As at the date hereof, the Board comprises six executive Directors, namely Mr. Wong Yuk Kwan (alias: Wong Kwan), Dr. Lew Mon Hung, Mr. Cheung Kwok Yu, Mr. Zhou Li Yang, Mr. Zheng Yingsheng and Mr. Johnny Yuen; and three independent non-executive Directors, namely Mr. Yu Jianmeng, Mr. Fung Hing Chiu, Cyril and Mr. Lam Ka Wai, Graham.

By Order of the Board
Pearl Oriental Innovation Limited
Cheung Kwok Yu
Executive Director and Company Secretary

Hong Kong, 25 January 2010

* *For identification purposes only*

Annual Report 2009



東方明珠創業有限公司
Pearl Oriental Innovation Limited

Stock Code : 0632

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DIRECTORS

EXECUTIVE DIRECTORS:

Wong Yuk Kwan (alias: Wong Kwan) (*Chairman*)
Lew Mon Hung
Cheung Kwok Yu
Zhou Li Yang
Zheng Yingsheng
Johnny Yuen

INDEPENDENT NON-EXECUTIVE DIRECTORS:

Yu Jianmeng
Fung Hing Chiu, Cyril
Lam Ka Wai, Graham

SOLICITORS

Hastings & Co.
Lau Kwong & Hung

PRINCIPAL BANKERS

Hang Seng Bank
Industrial and Commercial Bank of China (Asia) Limited

COMPANY SECRETARY

Cheung Kwok Yu

AUDITORS

Ascenda Cachet CPA Limited
(formerly Cachet Certified Public Accountants Limited)

AUTHORISED REPRESENTATIVES

Wong Kwan
Cheung Kwok Yu

REGISTERED OFFICE:

Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

PRINCIPAL OFFICE:

Suite 1908, 19th Floor
9 Queen's Road Central
Hong Kong

BERMUDA RESIDENT REPRESENTATIVE

John C.R. Collis

BERMUDA PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Codan Services Limited
2 Church Street
Hamilton HM11
Bermuda

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Tricor Tengis Limited
26/F, Tesbury Centre
28 Queen's Road East, Wanchai
Hong Kong

WEBSITE AND OTHER INFORMATION

For more information on the Company, please find us on the World-Wide-Web at www.pearloriental.com

To access the Company on Bloomberg, please type "632 HK".

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
For the year ended 31 December		
Turnover	195,530	78,783
Operating loss	(39,180)	(20,599)
Net Profit/(Loss) attributable to shareholders	(566,840)	(38,310)
Loss per share		
Basic (cents)	(87.6)	(8.5)
Diluted (cents)	(87.6)	(8.5)
Average shareholders' equity	421,062	491,622
Average capital employed	513,283	574,419
At 31 December		
Total indebtedness	—	60,380
Shareholders' equity	344,987	521,943
Capital employed	411,287	615,278
Ratio		
Return on average capital employed (%)	188.6%	(7.2%)
Return on average equity (%)	134.6%	(7.8%)
Total debt to total capital (%)	N/A	15%

Notes:

1. Total indebtedness = total bank borrowings
2. Capital employed = shareholders' funds + minority interests + non-current liabilities
3. Return on average capital employed = operating (loss) profit after tax and interest/average capital employed
4. Return on average equity = net (loss) profit attributable to shareholders/average shareholders' equity
5. Total debt to total capital = debt/(shareholders' funds + minority interests + debt)

In 2009, a year full of challenges and opportunities, Pearl Oriental Innovation Limited has unfolded a new chapter.

The turnover of the Company and its subsidiaries (collectively the "Group") for the year ended 31 December 2009 (the "Year") was approximately HK\$195,530,000, representing an increase of 148% as compared with that of 2008. The loss attributable to the shareholders of the Company was approximately HK\$566,840,000. Such significant loss is mainly attributed to a full provision for impairment loss on the coal mining assets owned by China Coal Energy Holdings Limited with a book value of approximately HK\$922,318,000, in which the Group held a 55.11% equity interest. The provision attributable to the equity shareholders of the Company was approximately HK\$523,224,000. The Group's cash and bank balances as at the end of the reporting period was approximately HK\$224,314,000, representing an increase of 13.2 times as compared with that of 2008, which manifested our healthy financial condition.

The Board has adopted a prudent fiscal policy after considering professional advice cautiously. As a result of the judgment made by the People's High Court of Shanxi Province (山西省高級人民法院), it was held that the Department of Land and Resources, Shanxi Province (山西省政府國土資源廳) has acted illegally in administration and the mining permit of a coal mine owned by China Coal's subsidiary has been cancelled, and the Group has decided to make a full provision for an one-off non-cash impairment loss on the related asset.

The Board is pleased that during the annual conferences of the Chinese People's Political Consultative Conference ("CPPCC") and the National People's Congress of the People's Republic of China held in March 2010, a motion was put forward and jointly signed by 28 committee members of CPPCC from Hong Kong requesting the Government of Shanxi Province (山西省政府) to assume responsibility of compensation to the Company in accordance with the laws which has caused serious concerns from the Central Authorities including the Supreme People's Court (最高人民法院). Currently, Management is under negotiation with the related authorities of Shanxi Province to resolve the matters. In addition, since the second half of 2009, the Group has started to negotiate with independent third parties for disposal of the controlling shareholding of China Coal and the negotiation is still ongoing. The Board will take all the lawful, reasonable and effective measures to protect and even enhance the interests of the shareholders as a whole.

The Group has restructured its core business last year. With the acquisition of IB Group's recycled plastic business, which had an annual turnover over HK\$500 million, and forming the joint venture, China Environmental Resources Limited, the Group has resolutely cut loss by disposing of logistics business and the bonded warehouse which had been suffering losses for years. After the disposal, the Group has realized a net proceed of approximately HK\$54,987,000 and does not have any outstanding bank loans by then.

Dr. Lew Mon Hung, a committee member of CPPCC, a member of the Commission on Strategic Development of HKSAR and a financial expert, joined the Company as the Deputy Chairman and Executive Director in December 2009. The Company also appointed Mr. Yu Jianmeng, who has extensive connections in commercial and political areas in China, as an Independent Non-executive Director. Thereafter, the Company has successfully accomplished two shares placements, raising fund of approximately HK\$500 million, and a number of reputable international funds and strategic investors have become our new shareholders. The Company's financial position has been further strengthened. By capitalizing the favourable situation, the Group will invest US\$225 million to acquire 100% ownership interest in the Utah Gas and Oil Field which will be satisfied by a relatively small portion of cash and mainly by issuing new shares of the Company. The transaction has been approved by the Committee of Foreign Investment of the United States ("CFIUS"). At the same time, the Company is going to take this opportunity to build up a long-term mutual beneficial partnership with large-scale state-owned enterprises. It is expected upon completion of the transaction, the Utah Gas and Oil Field project will bring long-term and steady income and desirable return on investment to the Group. The Company is on the track moving into a new era of development at full speed.

"Although the road is challenging, we will explore right ways to move forward!" The core business of the Group will concentrate on investment and operation in energy and environmental recycling resources. Together with our management team, I do have full confidence on the development of Pearl Oriental and strongly believe that under the dynamic leadership of the Board, the Company will achieve good results at a firm and vigorous pace.

I would like to take this opportunity to thank all of our shareholders, directors and staff for their full and hearted support.

By order of the Board
Pearl Oriental Innovation Limited
Wong Kwan
Chairman and Chief Executive

28 April 2010, Hong Kong

PROFILES OF DIRECTORS

EXECUTIVE DIRECTORS

MR. WONG KWAN (CHAIRMAN)

Aged 62, is currently the Chairman and chief executive of the Company, Mr. Wong is a veteran in the investment and property development fields and has over 30 years of experience in diversified investment, operation & management in Hong Kong, China and overseas. Mr. Wong is also well known in the Asian business world with extensive business connections in the Asia Pacific region. Mr. Wong was appointed as our Chairman and chief executive in May 2006.

DR. LEW MON HUNG (DEPUTY CHAIRMAN)

Aged 61, is a renowned figure in political and economical sectors in China and Hong Kong. Dr. Lew is currently a committee member of the National committee of the Chinese People's Political Consultative Conference and a member of the Executive Committee Commission on Strategic Development of HKSAR, Chairman of Smart Strategy Limited and Chairman of ABC Communications (Holdings) Limited. Dr. Lew was appointed as our Deputy Chairman and executive director in December 2009.

Dr. Lew has more than 30 years of experience in financial investment and corporate management; and has remarkable results in corporate finance, mergers and acquisitions. Dr. Lew was recently the chairman of G-Resources Group Ltd. Under his leadership, its management team had successfully acquired a US\$ 200 million gold mine project and arranged a fund raising of US\$ 600 million which has established a good foundation for the restructuring of its listed company.

MR. CHEUNG KWOK YU

Aged 40, has over 18 years of experience with international accounting firms and law firms and listed companies in direct investment, accounting, legal, corporate finance and mergers and acquisitions. Mr. Cheung is a Chartered Financial Analyst charterholder and a professional accountant in Hong Kong, and is also qualified as a solicitor in Hong Kong. Mr. Cheung has a Master degree in Applied Finance from Macquarie University in Sydney and a Bachelor of Arts degree in Accountancy from Hong Kong Polytechnic University. Mr. Cheung was appointed as our executive director in May 2006.

MR. ZHOU LI YANG

Aged 51, is currently the Managing Director of the Company. Mr. Zhou is responsible for execution of the strategic development and daily operation of the Group. Mr. Zhou has substantial experience in listed company management, mergers and acquisitions, direct investment, corporate finance and fund management acquired from more than 10 years managerial and professional work experience for 5 listed companies, an investment fund and a banking institute of Hong Kong. He also has more than 10 years management working experience in a provincial government and a conglomerate of China. Mr. Zhou holds a Bachelor degree in Physics from Central-South University, PRC and a Master degree in Business/Finance from University of Baltimore, USA. Mr. Zhou was appointed as our managing director and executive director in September 2004.

MR. ZHENG YINGSHENG

Aged 49, has had over 26 years working experience in logistics management and transportation operations. Mr. Zheng is responsible for overseeing the logistics business of the Group. He had worked for several sizeable and reputable transportation and logistics companies at senior management level being respectively in charge of land transportation, ocean cargo forwarding, warehouse management, fleet management and container terminal operations, etc. He is particularly experienced in transportation and logistics work flow and systems designs and

management. Mr. Zheng holds a Bachelor of Economics degree in Marine Economics from School of Economics & Management, Shanghai Maritime University and a Diploma in Business Administration from Zhejiang University, the PRC. Mr. Zheng was appointed as our executive director in March 2003.

MR. JOHNNY YUEN

Aged 64, American Chinese, he is one of the management experts in the first group whom came back to China at the end of 1985. He has more than 30 years of hotel, property investment and management experiences. He is currently the Chairman of Renel Group Co. Ltd and also the Chairman of the Les Amis d'Escoffier Society, Asia-Pacific region. Mr. Yuen also serves as the life member of US Republican Presidential Task Force. He has been awarded successively with the "Foreign Expert Friendship Award of People's Republic of China" and the "Outstanding Contribution Award of Guangzhou City" etc. Mr. Yuen was appointed as our executive director in January 2007.

INDEPENDENT NON-EXECUTIVE DIRECTORS ("INEDs")

YU JIAN MENG

Aged 58, Mr. Yu has extensive personal connections and commercial relationships in China. He has over 30 years' experience in press publication, telecom technology, tourism, financial investment and industrial development. He was the Chief Reporter of Xinhua News Agency in Putong, Shanghai and the President of Xinhua Agency East Development Company. Since 1999, he was appointed as the President of Shanghai SIIT Development Holdings Ltd, President of China in Investment and Development of Star Cruise Group and the Executive Director of VODone Ltd. Mr. Yu is currently the Director and CEO of WorldVest Capital Ltd. Mr. Yu holds a Master Degree in Economics from East China Normal University, in jointly course with the University of Hawaii. He was awarded the Senior Economist by Xinhua News Agency. Mr. Yu was appointed as our independent non-executive director in September 2009.

MR. FUNG HING CHIU, CYRIL

Aged 70, is a prominent international and Hong Kong entrepreneur. Mr. Fung graduated from Harvard Graduate School of Business Administration with an Master Degree in Business Administration in 1965. He had worked for Morgan Guaranty Trust in New York head office and Bank of East Asia. Mr. Fung was the Managing Director of Fung Ping Fan Holdings. He was also the Co-founder and Chairman of the first venture capital fund in Asia, Inter-Asia Management Co. Ltd. and succeeded in bringing McDonald's to Hong Kong and Singapore. Mr. Fung's strong strategic sense, proven value-enhancement expertise and very diverse business experience made him a distinct business investment consulting professional. Mr. Fung was appointed as our independent non-executive director in July 2007.

MR. LAM KA WAI, GRAHAM

Aged 42, graduated from the University of Southampton, England with a Bachelor of Science degree in Accounting and Statistics. He is a member of Hong Kong Institute of Certified Public Accountants and a member of the American Institute of Certified Public Accountants. Mr. Lam is currently the Managing Director and Head of Corporate Finance of an investment bank and has around 16 years experience in investment banking as well as around 4 years experience in accounting and auditing. He is also the independent non-executive director of Cheuk Nang (Holdings) Limited (stock code: 131), Applied Development Holdings Limited (stock code: 519), China Fortune Group Limited (stock code: 290), ZZNode Technologies Company Limited (stock code: 2371), China Sonangol Resources Enterprise Limited (stock code: 1229), Pearl Oriental Innovation Limited (stock code: 632) and Value Convergence Holdings Ltd (stock code:821), companies listed on the Main Board of The Stock Exchange of Hong Kong Limited; and China Railway Logistics Limited (stock code: 8089) and Finet Group Limited (stock code: 8317), companies listed on The Growth Enterprise Market of The Stock Exchange of Hong Kong Limited. Mr. Lam was appointed as our independent non-executive director in October 2008.

MR. DONG ZHIXIONG

Aged 63, has 41 years solid experience in metallurgy, steel industry and mining operation. He has joined China Metallurgy Import and Export Company in 1982 and become the General Manager of one of its mining subsidiaries. Mr. Dong has subsequently been promoted to the Vice President of China Sinosteel Group Company and be responsible for its investments in international resources, development and supervision. Mr. Dong has also been the Chairman of ASA Metal Co. Ltd, the largest mining company for chromate mines in South Africa for 10 years. Mr. Dong has graduated from the Faculty of Automatization of University of Science and Technology of Beijing (formerly known as Beijing Institute of Iron and Steel Engineering) and has a bachelor degree in Industrial Studies. Mr. Dong resigned as an INED on 1 October 2009 and become a consultant of the Company effective from 1 October 2009 for two years.

PROFILES OF SENIOR MANAGEMENT

MR. RALPH CURTON, CHIEF OPERATING OFFICER

Mr. Ralph Curton, has 40 years of experiences in the operation and management in the oil and natural gas industry. In the 70's, Mr. Curton invested 50,000 productive acres in oil and natural gas enterprise in East Texas and Louisiana, and had successfully developed more than 300 oil and gas wells. Over the years, Mr. Curton has established close relationships with U.S. well-known oilfield engineering services company, Halliburton and natural gas exploration enterprise, Anadarko. The next mutual development goal between Pearl Oriental and Mr. Curton is to work together to acquire a huge natural gas and oilfield project around this Utah Gas and Oilfield with a natural gas reserve exceeding 2,000 Bcf, then to invite China and international first-class oil enterprises to be the strategic partners.

MR. YAM KWOK SHUN, CHIEF TECHNICAL OFFICER

Aged 59, Mr. Yam is responsible for Pearl Oriental's development of energy and resources businesses and technical supervision. Mr. Yam has a Master degree in Aerospace Engineering and a Bachelor degree in Mechanical Engineering. He is a member of Society of Petroleum Engineers, Hong Kong Institute of Engineers and Professional Engineer registered in the State of Texas respectively. Mr. Yam has more than 30 years of extensive management experience in the oil and natural gas sector. He has held senior management positions in the U.S. prestigious petroleum and technology companies such as Hughes Offshore, NL Rig Equipment and Kerr-McGee Corporation etc, to render diversified professional services including operation management, design co-ordination and international business expansion of natural gas and oilfield projects for various states in the U.S., Gulf of Mexico, North Sea, Asia Pacific and Australia etc. Before joining Pearl Oriental, Mr. Yam was the Deputy JMC Chairman and Operation Manager for Anadarko's South China Sea deep water gas and oilfield project, which successfully exploited oil reserve of 150 million barrels. He is also the team member of the joint venture of China National Offshore Oil Corporation and Anadarko for Bohai oilfield project.

MR. CHEUNG MO KIT, MANAGING DIRECTOR OF CHINA ENVIRONMENTAL RESOURCES LIMITED

Aged 59, Mr. Cheung has over 30 years solid experience in environmental plastic industry. Mr. Cheung founded IB Group in 1978, engaging in the processing of plastic waste materials and trading of recycled plastics. IB Group has also established recycled plastic factories in PRC and Malaysia. After years of development, IB Group has extensive sales network in PRC and supply network in Japan. The annual turnover of IB Group exceeds HK\$ 500 million. The strategic restructuring of IB Group and Euro Resources will bring rapid business development potential to China Environmental.

MR. YU KIN WING, FINANCE MANAGER AND ASSISTANT COMPANY SECRETARY

Aged 38, Mr. Yu obtained his bachelor of business administration degree in accounting from the Hong Kong University of Science and Technology and his master of business administration in the University of South Australia. He is a member of the Association of Chartered Certified Accountants and the Hong Kong Institute of Certified Public Accountants. He has extensive knowledge in the accounting field and had worked for several Hong Kong listed companies before joining the Group.

RESULTS AND REVIEW OF OPERATIONS

For the year ended 31 December 2009 (the “Year”), the Company and its subsidiaries (the “Group”) recorded a consolidated turnover of HK\$195,530,000 (2008: HK\$78,783,000), implying an increase of approximately 148%. The share of loss of associates for the Year was HK\$548,000 (2008: HK\$12,752,000). Basic loss per share was 87.6 HK cents for the Year as compared to the basic loss per share of 8.5 HK cents for the year ended 31 December 2008.

BUSINESS REVIEW

The substantial increase in the turnover was due to the formation of the joint venture company, China Environmental Resources Limited (“China Environmental”), which is 60% owned by the Group and its sales of plastic recycling materials accounted for over 80% of the Group’s turnover during the Year, although the logistics business has decreased due to the Board’s decision to disposing of the loss making business, Guangzhou Pearl Oriental Logistics Limited and the bonded warehouse in Shenzhen during the year 2009.

The global economic downturn has impacted the entire export and logistics industries substantially, and in turn, our business. The gross profit margin has decreased from approximately 35% in 2008 to 10.5% during the Year as the margin of trading of recycling material is generally lower than that of logistics service income.

PROSPECTS

LOGISTICS

As previously announced by the Company, during the Year, the Group has disposed of a bonded warehouse property in Futian, Shenzhen, PRC (the “Warehouse”) and the Group will concentrate on its core business in the energy and environmental recycling plastic resources sectors.

Following the completion of the disposal of the Warehouse, the logistics operations of the Group has substantially scaled down accordingly. As a result and as announced before, the Group will focus its effort on energy, natural resources and environmental plastic recycling businesses by utilizing the proceeds from the recent placing of Shares and the disposal of the Warehouse.

COAL INVESTMENT

In July 2009, the Company has completed the acquisition of additional 15.18% equity interest of China Coal Energy Holdings Limited (“China Coal”). Accordingly, the Group holds an aggregate 55.11% controlling shareholding of China Coal and it renders the Group at a better position.

PLASTIC RECYCLING INDUSTRY

The Company is optimistic on the potential development of the environmental plastic recycling business. In August 2009, the Company announced to invest at a total of HK\$100 million to acquire IB Group’s recycled plastic business with its 2008 annual turnover exceeding HK\$500 million and 20% minority interests of Euro Resources China Limited (“Euro Resources”). The Group currently owns 60% equity interest of the restructured China Environmental. The Board anticipates that the plastic recycling business will make a significant contribution to the leap development of the Group in 2010.

After the completion of the acquisition and restructuring, China Environmental owns the entire equity interest of IB Environmental Plastic and Euro Resources.

The Board is pleased to point out that Mr. Cheung Mo Kit has founded the IB Group to operate the environmental plastic business for over 30 years, and has a large number of stable customers in China and has a good reputation in the market, and also has extensive supplier networks in Japan. The Company's plastic recycling business will have a greater development potential after the joining of Mr. Cheung Mo Kit and the management team led by him given their solid experience.

OUTLOOK

UTAH GAS AND OIL FIELD PROJECT

Subsequent to the end of the reporting period, the Group has announced an acquisition of the Utah Gas and Oil Field project (the "Acquisition") for a consideration of up to US\$225 million in January 2010.

Countries around the world are striving for reducing emissions and solving the problems of global warming. A number of international energy enterprises are increasing their investments actively in the green energy sector. Therefore, the exploring, mergers and acquisitions of natural gas has become a crowded situation. Experts forecasted the future demand for natural gas will increase and the market price will definitely rise steadily which is favourable for increasing the operating profit.

The Board believes that the Acquisition is a good opportunity for the Group to achieve good investment returns in the energy sector. Especially, as a result of the global financial tsunami, it is difficult for small non-listed gas and oil enterprises in United States to raise financing for their operations. In such situation, good opportunity for the Acquisition has therefore arisen.

Together with internal resources of the Company and upon the completion of the recent issues of new shares raised about HK\$319 million in April 2010, the Company will have adequate funding to finance the consideration and the development costs for the Acquisition. In addition, as CFIUS has already granted approval for the Company's acquisition of ownership interest in the Utah Gas and Oil Field, the Company will complete the Acquisition soon after obtaining independent shareholders' approval at a special general meeting of the Company to be held since most of the Conditions Precedent have been fulfilled.

The Board is pleased to be advised that, the rework of seven (7) existing wells of Utah Gas and Oil Field project has been started, and that of other seven (7) new wells are under planning. We expect that there will be the first gas production in sales within 3 months. The Board believes that the Utah Gas and Oil Field project will bring long-term, steady and desirable return on investment to the Group.

As the Group has effectively managed through the turbulent economic times and emerges as a more healthy company which is positioned to take advantage of growth in the energy and recycling sectors in the near future.

As disclosed before, Management has been making its best endeavour to protect and maximize the Group's interest in China Coal Group, including without limitation, by taking appropriate legal and other actions, and considering to dispose of its interest in China Coal Group if such terms of disposal are to the best interests of the Group and its shareholders as a whole.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group generally finances its operations with issue of new shares and convertible notes and internally generated resources. As at 31 December 2009, the Group has a net cash position while the Group's gearing ratio (calculated on the basis of the Group's bank borrowings over total assets) was 19% as at 31 December 2008. At the end of the reporting period, the Group did not have any outstanding bank borrowings (2008: HK\$60,000,000), which was secured by certain properties of the Group located in the PRC and the trade receivables of a subsidiary. The Group has received proceeds of approximately HK\$53 million from the disposal of the Warehouse, and the Group does not have any outstanding bank loan upon the completion. Furthermore, the Group's cash and bank balances as at 31 December 2009 have substantially increased to approximately HK\$224 million from HK\$15.8 million as at 31 December 2008 due to the placing of about 180 million new shares in December 2009. The current ratio (calculated on the basis of the Group's current assets over current liabilities) has increased to 4.7 as at 31 December 2009 (2008: 0.89).

During the year, the Group's bank loan facilities were subject to the fulfilment of covenants relating to certain capital requirements, as are commonly found in lending arrangements with financial institutions. If the Group were to breach the covenants, the drawn down facilities would become payable on demand. The Group regularly monitors its compliance with these covenants. As at 31 December 2009, the banking facilities have been terminated following the disposal of the related subsidiaries.

During the year, the Group conducted its business transactions principally in Renminbi, Euro and Hong Kong dollars, or in the local currencies of the operating subsidiaries. The Directors considered that the Group had no significant exposure to foreign exchange fluctuations and believed it was not necessary to hedge against any exchange risk. Nevertheless, Management will continue to monitor the foreign exchange exposure position and will take any future prudent measure it deems appropriate.

LITIGATIONS

The litigations detailed in notes 22 and 41 to the financial statements.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2009, the number of employees of the Group was about 80 (2008: 950). The remuneration packages of employees are maintained at competitive levels and include monthly salaries, mandatory provident fund, medical insurance and share option schemes; other employee benefits include meal and travelling allowances and discretionary bonuses.

FINANCIAL POSITIONS OF THE GROUP

As at 31 December 2009, the Group does not have any outstanding bank loans (31 December 2008: HK\$60,000,000).

SIGNIFICANT INVESTMENTS AND MATERIAL ACQUISITIONS

During the year, the Group has increased its interests in China Coal, Euro Resources, China Environmental.

CONTINGENT LIABILITIES

As at 31 December 2008, corporate guarantees were given to the banks by the Company for the banking facilities granted to the subsidiary of the Company, which were utilised to the extent of approximately HK\$60,000,000. The relevant corporate guarantees were released upon the disposal of subsidiaries during the year ended 31 December 2009.

Details of the Group's litigation and the related contingent liabilities (if any) are set out in notes 22 and 41 to the financial statements.

CAPITAL COMMITMENTS

As at 31 December 2009, the Group had contracted but not provided for capital commitments for the proposed acquisition of a subsidiary and leasehold improvements of approximately HK\$8,384,000.

ASSETS PLEDGED

As at 31 December 2009, no asset (31 December 2008: carrying value of approximately HK\$106,237,000) was pledged with banks as security for loan facilities granted to the Group.

SHARE OPTION SCHEME

The Company has a share option scheme ("the Old Scheme") which was adopted on 21 June 2002 whereby, pursuant to a written resolution of the sole shareholder, was set up for the primary purpose of providing incentives to directors and eligible employees, and which will expire on 20 June 2012. Under the Old Scheme, the directors of the Company may grant options to eligible employees, including directors of any companies in the Group, to subscribe for shares in Company.

Reference is made to the Company's circular dated 21 October 2008 in relation to the cancellation of all the then outstanding share options granted but not exercised.

An ordinary resolution of the Company was passed on 15 July 2009 in respect of terminating the Old Scheme (such that no further options could be granted under the Old Scheme but in all other respects the provisions of the Old Scheme shall remain in force to the extent necessary to give effect to the exercise of any options granted prior thereto or otherwise as may be required in accordance with the provisions of the Old Scheme and options granted prior to such termination shall continue to be valid and exercisable in accordance with the Old Scheme) and the adoption of New Share Option Scheme whose terms will comply with Chapter 17 and other relevant provisions of the Listing Rules and which became effect on 15 July 2009.

It is proposed that the Company shall adopt the New Share Option Scheme to provide the Eligible Persons a performance incentive for continued and improved service with the Company and its Subsidiaries and by enhancing such persons' contribution to increase profits by encouraging capital accumulation and share ownership.

The directors present their annual report and the audited financial statements for the year ended 31 December 2009.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The activities of its principal subsidiaries are set out in note 17 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the period ended 31 December 2009 are set out in the consolidated statement of income on page 25.

The directors do not recommend the payment of a dividend for the year.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements during the year in the property, plant and equipment of the Group are set out in note 14 to the financial statements.

DISTRIBUTABLE RESERVES OF THE COMPANY

At 31 December 2009, no distributable reserves were available for distribution to the equity shareholders of the Company.

SHARE CAPITAL

Details of the movements during the year in the share capital of the Company together with the reason therefor are set out in note 30 to the financial statements.

DIRECTORS

The directors of the Company during the year were:

EXECUTIVE DIRECTORS:

Wong Kwan
Lew Mon Hung (appointed on 3 December 2009)
Cheung Kwok Yu
Zhou Li Yang
Zheng Yingsheng
Johnny Yuen
Chan Yiu Keung (resigned on 6 February 2009)

INDEPENDENT NON-EXECUTIVE DIRECTORS:

Dong Zhixiong (resigned on 1 October 2009)
Yu Jianmeng (appointed on 19 September 2009)
Fung Hing Chiu, Cyril
Lam Ka Wai, Graham

In accordance with Clause 86(2) of the Company's Bye-Laws, Dr. Lew Mon Hung and Mr. Yu Jianmeng so appointed by the Board to fill a causal vacancy on the Board shall hold office only until the next following general meeting of the Company and shall then be eligible for re-election at that general meeting.

In accordance with Clause 87(1) of the Company's Bye-Laws, each of Mr. Zheng Yingsheng, Mr. Johnny Yuen and Mr. Lam Ka Wai, Graham will retire as director by rotation at the forthcoming annual general meeting and being eligible, offer himself/herself for re-election as director. All other remaining directors continue in office. Other than as disclosed above, no director being proposed for re-election at the forthcoming annual general meeting has a service contract which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 6, 7 and 8 of the annual report.

DIRECTORS' SERVICE CONTRACTS

None of the executive directors of the Company has each entered into a service contract with the Company. All the abovementioned service contracts are continuous until terminated by either party giving to the other not less than six months notice in writing or otherwise in accordance with its terms.

Apart from the foregoing, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

DIRECTORS' INTERESTS IN SHARES AND UNDERLYING SHARES

At 31 December 2009, the interests of the directors and their associates in the shares, underlying shares and convertible bonds of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows:

LONG POSITIONS

(A) ORDINARY SHARES OF HK\$0.10 EACH OF THE COMPANY

Name of Directors	Number of Shares held in the Capacity of			Total number of Shares held	Percentage of the issued share capital of the Company
	Beneficial owner	Held by controlled corporation	Held by trust		
Wong Kwan (note)	—	452,084,800	—	452,084,800	39.86%
Johnny Yuen	640,000	—	—	640,000	0.06%
Fung Hing Chiu, Cyril	—	—	1,272,090	1,272,090	0.11%
Cheung Kwok Yu	3,000,000	—	—	3,000,000	0.26%
Zheng Yingsheng	1,000,000	—	—	1,000,000	0.09%

Note: These Shares were held by Orient Day Developments Limited, which is wholly-owned by Mr. Wong Kwan.

(B) SHARE OPTIONS

Name of Directors	Capacity	Number of options held	Exercise Period	Exercise Price (HK)
Wong Kwan	Beneficial owner	3,000,000	05/08/2009-14/07/2019	0.56
Zhou Li Yang	Beneficial owner	3,000,000	05/08/2009-14/07/2019	0.56
Johnny Yuen	Beneficial owner	3,000,000	05/08/2009-14/07/2019	0.56
Fung Hing Chiu, Cyril	Beneficial owner	3,000,000	05/08/2009-14/07/2019	0.56
Dong Zhixiong	Beneficial owner	3,000,000	05/08/2009-14/07/2019	0.56
Lam Ka Wai, Graham	Beneficial owner	3,000,000	05/08/2009-14/07/2019	0.56
Yu Jianmeng	Beneficial owner	1,000,000	05/08/2009-14/07/2019	0.56
Zheng Yingsheng	Beneficial owner	1,000,000	05/08/2009-14/07/2019	0.56
Lew Mon Hung	Beneficial owner	3,000,000	03/12/2009-14/07/2019	0.83

Other than as disclosed above, none of the directors nor their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at 31 December 2009.

SUBSTANTIAL SHAREHOLDERS

The register of substantial shareholders maintained by the Company pursuant to Section 336 of the Securities and Futures Ordinance shows that, as at 31 December 2009, other than the interests disclosed above in respect of certain directors, the following shareholders had notified the Company of relevant interests in the issued share capital of the Company:

LONG POSITIONS

Name of Substantial Shareholder	Capacity	Number of issued ordinary shares held	Percentage of issued share capital of the Company
Orient Day Developments Limited (Note)	Beneficial owner	452,084,800	39.86%

Note: Orient Day Developments Limited is wholly-owned by Mr. Wong Kwan.

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at 31 December 2009.

APPOINTMENT OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited. The Company considers all of the independent non-executive directors are independent.

EMOLUMENT POLICY

The emolument policy regarding the employees of the Group is set up by the Remuneration Committee and is based on their merit, qualifications and competence.

The emoluments of the directors of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market statistics.

The Company has adopted a share option scheme as an incentive to directors and eligible employees, details of the scheme is set out in note 31 to the financial statements.

RELATED PARTY TRANSACTIONS

Details of the significant related party transactions during the year are detailed in note 40 to the financial statements.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights, under the Company's Bye-Laws or the laws of Bermuda, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the year under review, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed shares.

MAJOR CUSTOMERS AND SUPPLIERS

During the year, the aggregate sales attributable to the Group's largest customers and five largest customers taken together accounted for 10.5% and 39.4% respectively of the Group's total sales for the year. The aggregate purchases attributable to the Group's largest supplier and five largest suppliers taken together accounted for 19.0% and 56.3% respectively of the Group's total purchases for the year.

At no time during the year did a director, an associate of a director or a shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) have an interest in any of the Group's five largest suppliers or customers.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year.

EVENTS AFTER THE END OF THE REPORTING PERIOD

Details of the events taken place after the end of the reporting period are set out in note 42 to the financial statements.

AUDITORS

The financial statements for the period from 1 April 2007 to 31 December 2007 were audited by KPMG.

The financial statements for the years ended 31 December 2008 and 2009 have been audited by Ascenda Cachet CPA Limited (formerly Cachet Certified Public Accountants Limited), who retire and a resolution will be submitted to the annual general meeting of the Company to re-appoint the auditors, Ascenda Cachet CPA Limited.

By order of the Board

Cheung Kwok Yu

Executive Director & Company Secretary

28 April 2010

SHAREHOLDERS' RIGHTS AND INVESTOR RELATIONS

The rights of shareholders of the Company are contained in the Articles. The Group firmly believes the importance of communicating with the investment community and the shareholders in attaining a high level of transparency. The general meetings of the Company provide a platform for communication between the shareholders and the Board. The Chairman of the Board as well as chairman of the Audit Committee or if, in their absence, other members of the respective committees, and where applicable, the independent board committee, are available to answer questions at the shareholders' meetings. The Company endeavours to provide timely and accurate information to the investors to enhance the business development strategy and direction of the Group.

The Group will continue to maintain a close relationship with investors and develop greater understanding about the Group for international investors, to enhance investors' confidence in the Group.

CORPORATE GOVERNANCE PRACTICES

The board of Directors of the Company (the "Board") is committed to achieving high standard of corporate governance. In the opinion of the Board, the Company has complied throughout the year ended 31 December 2009 (the "Year") with the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"), which was in force on 1 January 2005, save for the following:

- (a) The Chairman and the Managing Director are not subject to retirement by rotation pursuant to Bye-laws of the Company.
- (b) Pursuant to Bye-law 87(1) of the Company, at each annual general meeting one-third of the Directors for the time being, (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) shall retire from office by rotation provided that, the Chairman of the Board and/or the Managing Director of the Company shall not, whilst holding such office, be subject to retirement by rotation or be taken into account in determining the number of Directors to retire in each year.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standard set out in Appendix 10 to the Listing Rules (the "Model Code"). Having made specific enquiry of all directors, all directors confirmed they have complied with the required standard set out in the Model code and the code of conduct regarding securities transactions by directors adopted by the Company throughout the Year ended 31 December 2009.

BOARD OF DIRECTORS

The Board is collectively responsible for the oversight of the management of the business and affairs of the Group with the objective of enhancing shareholders value. It is responsible for the formulation and the approval of the Group's development and business strategies and policies, approval of annual budgets and business plans, and supervision of management in accordance with the governing rules. The management of the Company is responsible for the oversight of the realization of the objectives set by the Board and the day-to-day operations of the Group.

As at 31 December 2009, the Board comprises nine members, six of whom are executive directors, and three are independent non-executive directors. One-third of the Board is independent non-executive directors and more than one of them have appropriate professional qualifications or accounting or related financial management expertise. Each of the independent non-executive directors has made an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all independent non-executive directors to be independent under the guidelines set out in Rule 3.13 of the Listing Rules.

COMMUNICATIONS WITH SHAREHOLDERS AND INVESTORS

To promote effective communication, the Company maintains a website at www.pearloriental.com, where extensive information and updates on the Company's business developments and operations, financial information, corporate governance practices and other information are available for public access.

SHAREHOLDER RIGHTS

To safeguard shareholder interests and rights, separate resolutions are proposed at shareholder meetings on each substantial issue, including the election of individual Directors.

All resolutions put forward at a shareholder meeting will be taken by poll pursuant to the Listing Rules and the poll results will be posted on the websites of the Company and of the Stock Exchange after the shareholder meeting.

During the Year, 2 board meetings have been held, the attendance of each Director, on named basis and by category at Board meetings, Audit Committee meetings is set out below:

	Meetings attended/held	
	Board Meetings	Audit Committee Meetings
Executive Directors:		
Wong Kwan (<i>Chairman & Chief Executive</i>)	2/2	N/A
Dr. Lew Mong Hung (<i>Note 1</i>)	0/2	N/A
Cheung Kwok Yu	2/2	N/A
Zhou Li Yang	2/2	N/A
Zheng Yingsheng	1/2	N/A
Johnny Yuen	1/2	N/A
Chan Yiu Keung (<i>Note 2</i>)	N/A	N/A
Independent Non-executive Directors:		
Dong Zhixiong (<i>Note 3</i>)	2/2	2/2
Yu Jianmeng (<i>Member of Audit Committee</i>) (<i>Note 4</i>)	1/2	1/2
Fung Hing Chiu, Cyril (<i>Member of Audit Committee</i>)	2/2	2/2
Lai Ka Wai, Graham (<i>Chairman of Audit Committee</i>)	2/2	2/2

Notes:

- (1) Appointed on 3 December 2009
- (2) Resigned on 6 February 2009
- (3) Resigned on 1 October 2009
- (4) Appointed on 19 September 2009

To the best knowledge of the Board, there is no relationship (including financial, business, family or other relationship) among members of the Board as at 31 December 2009. All of them are free to exercise their individual judgments.

CHAIRMAN AND MANAGING DIRECTOR

For the Year, Mr. Wong Kwan, the Chairman, and Mr. Zhou Li Yang, the Managing Director, had segregated and clearly defined roles.

REMUNERATION OF DIRECTORS

The Remuneration Committee has 3 members, comprising Messrs. Yu Jianmeng, Fung Hing Chiu, Cyril and Lam Ka Wai, Graham, all independent non-executive directors. The Remuneration Committee is chaired by Lam Ka Wai, Graham.

The Remuneration Committee is responsible for making recommendations to the Board on the Company's policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration.

NOMINATION OF DIRECTORS

The Company does not have a Nomination Committee. The Board as a whole is responsible for the procedure of agreeing to the appointment of its members and for nominating appropriate person for election by shareholders at the annual general meeting, either to fill a casual vacancy or as an addition to the existing directors.

The notice of annual general meeting contains detailed information on election of directors including detailed biography of all directors standing for election or re-election to enable shareholders to make an informed decision on their election.

INTERNAL CONTROL

The Board acknowledges its responsibility to ensure that a sound and effective internal control system, which serves as an integral part of the Company's management system, is maintained. The Board is responsible for approving and reviewing internal control policy, while the responsibility of day-to-day management of operational risks and implementation of mitigation measures lies with the management. An internal control system is designed to provide reasonable, but not absolute, assurance that material misstatement or loss can be avoided, and to manage and minimise risks of failure in operational systems. Key control procedures include:

- establishing a structure with defined authority and proper segregation of duties
- monitoring the strategic plan and performance
- designing an effective accounting and information system
- encouraging internal reporting on serious concern about malpractice
- conducting internal independent review by internal audit function

The Company places great value upon creating an environment where employees maintain the highest standard of integrity. To this end, the Board encourages the raising of concerns by employees about internal malpractice directly to the Board which will review complaints and decide how the investigation should be conducted.

AUDITORS' REMUNERATION

For the year ended 31 December 2009, Ascenda Cachet CPA Limited (formerly Cachet Certified Public Accountants Limited), the existing external auditors provided the following services to the Group:

	<i>HK\$'000</i>
Annual audit services	850
Other assurance services	420
	<hr/>
	1,270
	<hr/>

AUDIT COMMITTEE

As at 31 December 2009, the Audit Committee currently comprises the three independent non-executive directors, namely Mr. Lai Ka Wai, Graham (Chairman of the Audit Committee), Mr. Yu Jianmeng and Mr. Fung Hing Chiu, Cyril. The Audit Committee held two meetings during the Year. The Audit Committee is provided with sufficient resources to discharge its duties. The term of reference of the Audit Committee follow the guidelines sset out in the CG Code. The principal duties of the Audit Committee include the review of the financial reporting and internal control system of the Group, review of half-yearly and annual reports and accounts review and monitor the appointment of the auditors and their independence.

The Audit Committee has reviewed the audited financial statements for the year ended 31 December 2009.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Directors acknowledge their responsibility for the preparation of the financial statements of the Company and ensure that they are prepared in accordance with statutory requirements and applicable accounting standards. The Directors also ensure the timely publication of such financial statements.

The statement of the external auditors of the Company, Ascenda Cachet CPA Limited, with regard to their reporting responsibilities on the Company's financial statements is set out in the Independent Auditor's Report on page 23.



Ascenda Cachet CPA Limited
天健德揚會計師事務所有限公司

To the shareholders of Pearl Oriental Innovation Limited

(Incorporated in Bermuda with limited liability)

We have audited the financial statements of Pearl Oriental Innovation Limited (the "Company") and with its subsidiaries (the "Group") set out on pages 25 to 115, which comprise the consolidated and Company statements of financial position as at 31 December 2009, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the disclosure requirements of Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, in accordance with Section 90 of the Bermuda Companies Act 1981, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the HKICPA. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2009 and of the Group's loss and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Ascenda Cachet CPA Limited
(Formerly Cachet Certified Public Accountants Limited)
Certified Public Accountants

Chan Yuk Tong
Practising Certificate Number P03723

Hong Kong
28 April 2010

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2009

	Notes	2009 HK\$'000	2008 HK\$'000
REVENUE	5	195,530	78,783
Cost of sales		(175,091)	(51,095)
Gross profit		20,439	27,688
Other income and gains	5	23,968	12,493
Selling and distribution costs		(5,345)	(17,609)
Administrative expenses		(78,242)	(43,171)
Finance costs	7	(5,597)	(6,494)
Impairment loss on available-for-sales investments		(922,318)	—
Share of losses of associates		(548)	(12,752)
LOSS BEFORE TAX	6	(967,643)	(39,845)
Income tax expense	10	(319)	(1,420)
LOSS FOR THE YEAR		(967,962)	(41,265)
Attributable to:			
Owners of the Company	12	(566,840)	(38,310)
Minority interests		(401,122)	(2,955)
		(967,962)	(41,265)
LOSS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY	13		
Basic		(87.6) cents	(8.5) cents
Diluted		(87.6) cents	(8.5) cents

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2009

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
LOSS FOR THE YEAR	(967,962)	(41,265)
OTHER COMPREHENSIVE INCOME		
Exchange differences on translation of foreign operations	1,949	5,742
Income tax effect	—	—
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	1,949	5,742
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	(966,013)	(35,523)
Attributable to:		
Owners of the Company	(564,911)	(33,778)
Minority interests	(401,102)	(1,745)
	(966,013)	(35,523)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2009

	<i>Notes</i>	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
NON-CURRENT ASSETS			
Property, plant and equipment	14	64,465	165,331
Prepaid land lease payments	15	—	18,868
Deposits paid		761	—
Goodwill	16	121,945	16,921
Interests in an associate	17	—	420,903
Available-for-sales investments	22	—	—
Total non-current assets		187,171	622,023
CURRENT ASSETS			
Inventories	19	8,707	9,083
Trade receivables	20	6,199	10,250
Prepayments, deposits and other receivables	21	47,521	11,195
Available-for-sales investments	22	—	—
Due from an associate	18	—	5,593
Cash and cash equivalents	24	224,314	15,787
Total current assets		286,741	51,908
CURRENT LIABILITIES			
Trade payables	25	5,700	8,767
Other payables and accruals	26	51,696	19,886
Interest-bearing bank borrowings, secured	27	—	8,382
Due to minority shareholders of subsidiaries	23	—	5,167
Tax payable		319	16,451
Loan from immediate parent and ultimate controlling party	28	4,910	—
Total current liabilities		62,625	58,653
NET CURRENT ASSETS/(LIABILITIES)		224,116	(6,745)
TOTAL ASSETS LESS CURRENT LIABILITIES		411,287	615,278
NON-CURRENT LIABILITIES			
Due to minority shareholders of subsidiaries	23	—	16,337
Interest-bearing bank borrowings, secured	27	—	51,998
Loan from immediate parent and ultimate controlling party	28	66,300	25,000
Total non-current liabilities		66,300	93,335
Net assets		344,987	521,943

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2009

	<i>Notes</i>	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
EQUITY			
Equity attributable to owners of the Company			
Issued capital	30	115,922	46,474
Reserves	32(a)	212,906	466,822
		328,828	513,296
Minority interests		16,159	8,647
Total equity		344,987	521,943

Zhou Li Yang
Director

Cheung Kwok Yu
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2009

	Attributable to the owners of the Company									
	Issued capital	Share premium	Treasury shares	Capital reserve	Exchange fluctuation reserve	Share option reserve	Accumulated losses	Total	Minority interests	Total equity
	HK\$'000	HK\$'000	HK\$'000 (note 32(a))	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2008	193,641	345,610	(10,556)	420,430	3,265	—	(482,442)	469,948	6,297	476,245
Total comprehensive income for the year	—	—	—	—	4,532	—	(38,310)	(33,778)	(1,745)	(35,523)
Issue of new shares	38,728	38,728	—	—	—	—	—	77,456	—	77,456
Share issue expenses	—	(330)	—	—	—	—	—	(330)	—	(330)
Capital reduction	(185,895)	—	—	—	—	—	185,895	—	—	—
Cancellation of share options	—	—	—	(16,579)	—	—	16,579	—	—	—
Increase in minority interests arising from acquisition of a subsidiary	—	—	—	—	—	—	—	—	4,095	4,095
At 31 December 2008 and 1 January 2009	46,474	384,008	(10,556)	403,851	7,797	—	(318,278)	513,296	8,647	521,943
Total comprehensive income for the year	—	—	—	—	1,929	—	(566,840)	(564,911)	(401,102)	(966,013)
Exchange fluctuation reserve realised upon disposal of a subsidiary (note 36)	—	—	—	—	(7,276)	—	—	(7,276)	—	(7,276)
Issue of new shares (note 30)	68,568	308,026	—	—	—	—	—	376,594	—	376,594
Share issue expenses	—	(530)	—	—	—	—	—	(530)	—	(530)
Equity-settled share options arrangements (note 31)	—	—	—	—	—	6,727	—	6,727	—	6,727
Share options exercised during the year	880	5,697	—	—	—	(1,649)	—	4,928	—	4,928
Share options lapsed during the year	—	—	—	—	—	(188)	188	—	—	—
Increase in minority interests arising from acquisition of a subsidiary (note 33)	—	—	—	—	—	—	—	—	399,094	399,094
Increase in minority interests arising from acquisition of a business (note 35)	—	—	—	—	—	—	—	—	5,039	5,039
Contribution from minority interests	—	—	—	—	—	—	—	—	7,000	7,000
Acquisition of minority interests (note 34)	—	—	—	—	—	—	—	—	(2,519)	(2,519)
At 31 December 2009	115,922	697,201*	(10,556)*	403,851*	2,450*	4,890*	(884,930)*	328,828	16,159	344,987

* These reserve accounts comprise the consolidated reserve of HK\$212,906,000 (2008: HK\$466,822,000) in the consolidated statement of financial position.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2009

	Notes	2009 HK\$'000	2008 HK\$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Loss before tax		(967,643)	(39,845)
Adjustments for:			
Finance costs		5,597	6,494
Gain on disposal of subsidiaries	36	(20,270)	—
Share of losses of associates		548	12,752
Interest income	5	(12)	(171)
Loss on disposal of property, plant and equipment		—	356
Depreciation of property, plant and equipment	14	9,160	5,664
Amortisation of prepaid land lease payments	15	459	473
Impairment loss on trade receivables	6	—	1,838
Impairment loss on available-for-sales investments	6	922,318	—
Write off of other receivables	6	955	1,206
Write back of other payables		—	(545)
Write-off of property, plant and equipment	14	5	7,716
Shortfall in profit of an associate guaranteed by an ex-joint venture partner	5	—	(9,800)
Equity-settled share option expenses	6,31	6,727	—
		(42,156)	(13,862)
Decrease/(increase) in inventories		376	(1,881)
(Increase)/decrease in trade receivables		(3,417)	5,112
Increase in prepayments, deposits and other receivables		(43,625)	(458)
Increase/(decrease) in trade payables		861	(10,395)
Increase/(decrease) in other payables and accruals		8,492	(24,468)
Cash used in operations		(79,469)	(45,952)
Income tax paid		—	(1,721)
Net cash flows used in operating activities		(79,469)	(47,673)
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest received		12	171
Purchases of items of property, plant and equipment	13	(4,673)	(3,699)
Net cash and cash equivalent inflow from acquisition of subsidiaries	33	9	2,029
Net cash and cash equivalent inflow from disposal of subsidiaries	36	54,987	—
Proceeds from disposal of items of property, plant and equipment		—	70
Advances (to) /from an associate		(275)	4,337
Net cash flows from investing activities		50,060	2,908

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2009

	<i>Notes</i>	2009 HK\$'000	2008 HK\$'000
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares	43	167,464	34,653
Repayment of bank loans		(7,100)	(4,036)
Net proceeds from the exercise of the share options	30(a)(ix)	4,928	—
Advance from minority shareholders of subsidiaries		—	4,008
Contribution from minority shareholders		7,000	—
Advance from an immediate parent and ultimate controlling party		71,210	3,570
Interest paid		(5,597)	(6,444)
Net cash flows from financing activities		237,905	31,751
NET INCREASE /(DECREASED) IN CASH AND CASH EQUIVALENTS			
Cash and cash equivalents at beginning of year		15,787	31,617
Effect of foreign exchange rate changes, net		31	(2,816)
CASH AND CASH EQUIVALENTS AT END OF YEAR		224,314	15,787
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances		224,314	15,787

STATEMENT OF FINANCIAL POSITION

31 December 2009

	<i>Notes</i>	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
NON-CURRENT ASSETS			
Interests in subsidiaries	17	212,420	527,076
CURRENT ASSETS			
Prepayments, deposits and other receivables	21	10,684	80
Cash and cash equivalents	24	206,624	8,882
Total current assets		217,308	8,962
CURRENT LIABILITIES			
Other payables and accruals	26	4,073	2,003
Loan from immediate parent and ultimate controlling party	28	3,112	—
Total current liabilities		7,185	2,003
NET CURRENT ASSETS		210,123	6,959
TOTAL ASSETS LESS CURRENT LIABILITIES		422,543	534,035
NON-CURRENT LIABILITIES			
Due to subsidiaries	17	(11,256)	(5,350)
Loan from immediate parent and ultimate controlling party	28	(66,300)	(25,000)
Total non-current liabilities		(77,556)	(30,350)
Net assets		344,987	503,685
EQUITY			
Issued capital	30	115,922	46,474
Reserves	32 (b)	229,065	457,211
Total equity		344,987	503,685

Zhou Li Yang
Director

Cheung Kwok Yu
Director

1. CORPORATE INFORMATION

Pearl Oriental Innovation Limited (the “Company”) is a limited liability company incorporated in Bermuda. The registered office of the Company is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda and its principal place of business in Hong Kong is situated at Suite 1908, 19/F., 9 Queen’s Road Central, Hong Kong.

In the opinion of the directors, the Company’s immediate parent and ultimate controlling party is Orient Day Developments Limited, a company incorporated in the British Virgin Islands with limited liabilities.

During the year, the Company is an investment holding company. The principal activities of the Company and its subsidiaries (the “Group”) have not changed during the year and were involved in:

- provision of logistics and related services; and
- processing and sales of plastic recycling materials.

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”) (which include all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”) and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities (the “Listing Rules”) on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) and the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for buildings, which are stated in the consolidated statement of financial position at valuation less accumulated depreciation and any impairment losses.

These financial statements are presented in Hong Kong dollars and all values are rounded to the nearest thousand except when otherwise indicated.

The Group has incurred a significant loss of approximately HK\$967,962,000 for the year ended 31 December 2009. Excluding the effect of impairment losses on available-for-sales investments incurred for the year of approximately HK\$922,318,000 the operating loss for the year is approximately HK\$45,644,000. Despite of the above, these financial statements have been prepared on the basis that the Group will continue to operate as a going concern because the Group has net current assets and net assets of approximately HK\$224,116,000 and HK\$ 344,987,000, respectively, as at 31 December 2009. Moreover, as disclosed in notes 42(b) and (c) to the financial statements, subsequent to the end of the reporting period, the Company has entered into arrangements to increase its issued share capital with an aggregate gross proceeds of approximately HK\$66.3 million already received and HK\$319 million to be received on the completion by the Company.

2.1 BASIS OF PREPARATION *(Continued)*

BASIS OF CONSOLIDATION

The consolidated financial statements include the financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2009. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All income, expenses and unrealised gains and losses resulting from inter-company transactions and inter-company balances within the Group are eliminated on consolidation in full.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Contingent consideration is recognised if the adjustment is probable and can be measured reliably. Subsequent measurement of the contingent consideration affects goodwill.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries. An acquisition of minority interests is accounted for using the parent entity extension method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as goodwill.

2.2 CHANGE IN ACCOUNTION POLICY AND DISCLOSURES

The Group has adopted the following new and revised HKFRSs for the first time for the current year's financial statements.

HKFRS 1 and HKAS 27 Amendments	Amendments to HKFRS 1 First-time Adoption of HKFRSs and HKAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate
HKFRS 2 Amendments	Amendments to HKFRS 2 Share-based Payment – Vesting Conditions and Cancellations
HKFRS 7 Amendments	Amendments to HKFRS 7 Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments
HKFRS 8	Operating Segments
HKAS 1 (Revised)	Presentation of Financial Statements
HKAS 18 Amendment*	Amendment to Appendix to HKAS 18 Revenue – Determining whether an entity is acting as a principal or as an agent
HKAS 23 (Revised)	Borrowing Costs
HKAS 32 and HKAS 1 Amendments	Amendments to HKAS 32 Financial Instruments: Presentation and HKAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation
HK(IFRIC)-Int 9 and HKAS 39 Amendments	Amendments to HK(IFRIC)-Int 9 Reassessment of Embedded Derivatives and HKAS 39 Financial Instruments: Recognition and Measurement – Embedded Derivatives
HK(IFRIC)-Int 13	Customer Loyalty Programmes
HK(IFRIC)-Int 15	Agreements for the Construction of Real Estate
HK(IFRIC)-Int 16	Hedges of a Net Investment in a Foreign Operation
HK(IFRIC)-Int 18	Transfers of Assets from Customers (adopted from 1 July 2009)
Improvements to HKFRSs (October 2008)*	Amendments to a number of HKFRSs except for Amendment to HKFRS 5

* Included in Improvements to HKFRSs 2009 (as issued in May 2009).

Other than as further explained below regarding the impact of HKAS 1 (Revised) and HKFRS 8, the adoption of these new and revised HKFRSs has had no significant financial effect on these financial statements.

(a) HKFRS 8 OPERATING SEGMENTS

HKFRS 8, which replaces HKAS 14 Segment Reporting, specifies how an entity should report information about its operating segments, based on information about the components of the entity that is available to the chief operating decision maker for the purposes of allocating resources to the segments and assessing their performance. The standard also requires the disclosure of information about the products and services provided by the segments, the geographical areas in which the Group operates, and revenue from the Group's major customers. The Group concluded that the operating segments determined in accordance with HKFRS 8 are the same as the business segments previously identified under HKAS 14. These revised disclosures, including the related revised comparative information, are shown in note 4 to the financial statements.

(b) HKAS 1 (REVISED) PRESENTATION OF FINANCIAL STATEMENTS

HKAS 1 (Revised) introduces changes in the presentation and disclosures of financial statements. The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, this standard introduces the statement of comprehensive income, with all items of income and expense recognised in profit or loss, together with all other items of recognised income and expense recognised directly in equity, either in one single statement, or in two linked statements. The Group has elected to present two statements.

2.3 ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements.

HKFRS 1 (Revised)	First-time Adoption of Hong Kong Financial Reporting Standards ¹
HKFRS 1 Amendments	Amendments to HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards – Additional Exemptions for First-time Adopters ²
HKFRS 2 Amendments	Amendments to HKFRS 2 Share-based Payment – Group Cash-settled Share-based Payment Transactions ²
HKFRS 3 (Revised)	Business Combinations ¹
HKFRS 9	Financial Instruments ⁶
HKAS 24 (Revised)	Related Party Disclosures ⁵
HKAS 27 (Revised)	Consolidated and Separate Financial Statements ¹
HKAS 32 Amendment	Amendment to HKAS 32 Financial Instruments: Presentation – Classification of Rights Issues ³
HKAS 39 Amendment	Amendment to HKAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items ¹
HK(IFRIC)-Int 14 Amendments	Amendments to HK(IFRIC)-Int 14 Prepayments of a Minimum Funding Requirement ⁵
HK(IFRIC)-Int 17	Distributions of Non-cash Assets to Owners ¹
HK(IFRIC)-Int 19	Extinguishing Financial Liabilities with Equity Instruments ⁴
Amendments to HKFRS 5 included in Improvements to HKFRSs issued in October 2008	Amendments to HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations – Plan to Sell the Controlling Interest in a Subsidiary ¹
HK Interpretation 4 (Revised in December 2009)	Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases ²

Apart from the above, the HKICPA has issued Improvements to HKFRSs 2009 which sets out amendments to a number of HKFRSs primarily with a view to removing inconsistencies and clarifying wording. The amendments to HKFRS 2, HKAS 38, HK(IFRIC)-Int 9 and HK(IFRIC)-Int 16 are effective for annual periods beginning on or after 1 July 2009 while the amendments to HKFRS 5, HKFRS 8, HKAS 1, HKAS 7, HKAS 17, HKAS 38 and HKAS 39 are effective for annual periods beginning on or after 1 January 2010 although there are separate transitional provisions for each standard or interpretation.

¹ Effective for annual periods beginning on or after 1 July 2009

² Effective for annual periods beginning on or after 1 January 2010

³ Effective for annual periods beginning on or after 1 February 2010

⁴ Effective for annual periods beginning on or after 1 July 2010

⁵ Effective for annual periods beginning on or after 1 January 2011

⁶ Effective for annual periods beginning on or after 1 January 2013

The Group is in the process of making an assessment of the impact of these new and revised HKFRSs upon initial application. So far, the Group considers that except for the adoption of these new and revised HKFRSs are unlikely to have a significant impact on the Group's results of operations and financial position.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

SUBSIDIARIES

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

JOINT VENTURES

A joint venture is an entity set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits or losses from the joint venture's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture is treated as:

- (a) a subsidiary, if the Group, has unilateral control, directly or indirectly, over the joint venture;
- (b) a jointly-controlled entity, if the Group does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;
- (c) an associate, if the Group does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or
- (d) an equity investment accounted for in accordance with HKAS 39, if the Group holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

ASSOCIATES

An associate is an entity, not being a subsidiary or a jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's interests in associates are stated in the consolidated statement of financial position at the Group's share of net assets under the equity method of accounting, less any impairment losses. The Group's share of the post-acquisition results and reserves of associates is included in the consolidated income statement and consolidated reserves, respectively. Unrealised gains and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interests in the associates, except where unrealised losses provide evidence of an impairment of the asset transferred. Goodwill arising from the acquisition of associates, which was not previously eliminated or recognised in the consolidated reserves, is included as part of the Group's interests in associates and is not individually tested for impairment. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in associates are treated as non-current assets and are stated at cost less any impairment losses.

GOODWILL

Goodwill arising on the acquisition of subsidiaries and associates represents the excess of the cost of the business combination over the Group's interest in the net fair value of the acquirees' identifiable assets acquired, and liabilities and contingent liabilities assumed as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated statement of financial position as an asset, initially measured at cost and subsequently at cost less any accumulated impairment losses. In the case of associates, goodwill is included in the carrying amount thereof, rather than as a separately identified asset in the consolidated statement of financial position.

The carrying amount of goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

EXCESS OVER THE COST OF BUSINESS COMBINATIONS

Any excess of the Group's interest in the net fair value of the acquirees' identifiable assets, liabilities and contingent liabilities over the cost of acquisition of subsidiaries, associates and jointly-controlled entities (previously referred to as negative goodwill), after reassessment, is recognised immediately in the income statement.

IMPAIRMENT OF NON-FINANCIAL ASSETS OTHER THAN GOODWILL

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, goodwill and financial assets), the asset's recoverable amount is estimated. An asset's recoverable amount is the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, in which case the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

An assessment is made at the end of each reporting period as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years.

A reversal of such an impairment loss is credited to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, in which case, the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

RELATED PARTIES

A party is considered to be related to the Group if:

- (a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;
- (b) the party is an associate;
- (c) the party is a jointly-controlled entity;
- (d) the party is a member of the key management personnel of the Group or its parent;
- (e) the party is a close member of the family of any individual referred to in (a) or (d); or
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, an individual referred to in (d) or (e); or
- (g) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

PROPERTY, PLANT AND EQUIPMENT AND DEPRECIATION

Property, plant and equipment other than buildings are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where the recognition criteria are satisfied, the expenditure for a major inspection is capitalised in the carrying amount of the asset as a replacement. Where significant parts of property, plant and equipment are required to be replaced at intervals, the Group recognises such parts as individual assets with specific useful lives and depreciation.

Buildings are stated at valuation less accumulated depreciation and any impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. Changes in the values of property, plant and equipment are dealt with as movements in the asset revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the income statement. Any subsequent revaluation surplus is credited to the income statement to the extent of the deficit previously charged. On disposal of a revalued asset, the relevant portion of the asset revaluation reserve realised in respect of previous valuations is transferred to retained profits as a movement in reserves.

Depreciation is calculated on the straight-line basis to write off the cost or valuation of each item of property, plant and equipment to its residual value over its estimated useful life. The principal annual rates used for this purpose are as follows:

Buildings	Over the shorter of the lease terms and their estimated useful lives
Leasehold improvements	Over the shorter of the lease terms and land use rights or 5 years
Furniture, fixtures and equipment	20% to 25%
Motor vehicles	16 ² / ₃ % to 33 ¹ / ₃ %

Where parts of an item of property, plant and equipment have different useful lives, the cost or valuation of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at least at each financial year.

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

LEASES

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

Prepaid land lease payments under operating leases are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

INVESTMENTS AND OTHER FINANCIAL ASSETS

INITIAL RECOGNITION AND MEASUREMENT

Financial assets within the scope of HKAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge as appropriate. The Group determines the classification of its financial assets at initial recognition. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

The Group's financial assets include cash and bank balances, trade and other receivables and amount due from associates.

SUBSEQUENT MEASUREMENT

The subsequent measurement of financial assets depends on their classification as follows:

LOANS AND RECEIVABLES

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such assets are subsequently measured at amortised cost using the effective interest rate method less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance income in the income statement. The loss arising from impairment is recognised in the income statement in finance cost or operating expenses.

AVAILABLE-FOR-SALE FINANCIAL INVESTMENTS

Available-for-sale financial investments are non-derivative financial assets in listed and unlisted equity and debt securities. Equity investments classified as available for sale are those which are neither classified as held for trading nor designated at fair value through profit or loss. The Group has investments in unlisted shares that are not traded in an active market but that are classified as available-for-sale investment.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

DERECOGNITION OF FINANCIAL ASSETS

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a “pass-through” arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group’s continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

IMPAIRMENT OF FINANCIAL ASSETS

The Group assesses at the end of each reporting period whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that a debtor or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

FINANCIAL ASSETS CARRIED AT AMORTISED COST

For financial assets carried at amortised cost, the Group first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

IMPAIRMENT OF FINANCIAL ASSETS *(Continued)*

FINANCIAL ASSETS CARRIED AT AMORTISED COST *(Continued)*

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to finance costs in the income statement.

ASSETS CARRIED AT COST

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

AVAILABLE-FOR-SALE FINANCIAL INVESTMENTS

For available-for-sale financial investments, the Group assesses at the end of each reporting period whether there is objective evidence that an investment or a group of investments is impaired.

If an available-for-sale asset is impaired, the amount of the loss measured as the difference between the assets's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial assets. Impairment losses on these assets are not reversed.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FINANCIAL LIABILITIES

INITIAL RECOGNITION AND MEASUREMENT

Financial liabilities within the scope of HKAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Group's financial liabilities include trade and other payables, bank borrowings and amount due to minority shareholders of subsidiaries.

SUBSEQUENT MEASUREMENT

The measurement of financial liabilities depends on their classification as follows:

LOANS AND BORROWINGS

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost, using the effective interest rate method unless the effect of discounting would be immaterial, in which case they are stated at cost. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the effective interest rate method amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance costs in the income statement.

CONVERTIBLE BONDS

The component of convertible bonds that exhibits characteristics of a liability is recognised as a liability in the statement of financial position, net of transaction costs. On issuance of convertible bonds, the fair value of the liability component is determined using a market interests rate for an equivalent non-convertible bond; and this amount is carried as a long term liability on the amortised cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option that is recognised and included in shareholders' equity, net of transaction costs. The carrying amount of the conversion option is not remeasured in subsequent years. Transaction costs are apportioned between the liability and equity components of the convertible bonds based on the allocation of proceeds to the liability and equity components when the instruments are first recognised.

DERECOGNITION OF FINANCIAL LIABILITIES

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in the income statement.

OFFSETTING OF FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if, and only if, there is currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

FINANCIAL LIABILITIES *(Continued)*

FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments that are traded in active markets is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. For financial instruments where there is no active market, the fair value is determined using appropriate valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; a discounted cash flow analysis; and option pricing models.

CASH AND CASH EQUIVALENTS

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments that are readily convertible into known amounts of cash, are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the statement of financial position, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

PROVISIONS

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the end of the reporting period of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the statement of comprehensive income.

INCOME TAX

Income tax comprises current and deferred tax. Income tax relating to items recognised outside profit or loss is recognised outside profit or loss, either in other comprehensive income or directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period, taking into consideration interpretations and practices prevailing in the countries in which the Group operates.

Deferred tax is provided, using the liability method, on all temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and associates, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

INCOME TAX *(Continued)*

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised, except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at the end of each reporting period and are recognised to the extent that it has become probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

REVENUE RECOGNITION

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (i) from the provision of logistic services, when the services are rendered;
- (ii) rental income, on a time proportion basis over the lease terms;
- (iii) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and
- (iv) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

EMPLOYEE BENEFITS

SHARE-BASED PAYMENT TRANSACTIONS

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees for grants after 7 November 2002 is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an external valuer using a binomial option pricing model, further details of which are given in note 32 to the financial statements.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the year in which the performance and/or service conditions are fulfilled. The cumulative expense recognised for equity-settled transactions at the end of the each reporting period until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the statement of comprehensive income for a year represents the movement in the cumulative expense recognised as at the beginning and end of that year.

No expense is recognised for awards that do not ultimately vest, except for equity-settled transactions where vesting is conditional upon a market or non-vesting condition, which are treated as vesting irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified, if the original terms of the award are met. In addition, an expense is recognised for any modification, that increases the total fair value of the share-based payment transaction, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. This includes any award where non-vesting conditions within the control of either the Group or the employee are not met. However, if a new award is substituted for the cancelled award, and is designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph. All cancellations of equity-settled transaction awards are treated equally.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

OTHER EMPLOYEE BENEFITS

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and are charged to the income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

EMPLOYEE BENEFITS *(Continued)*

OTHER EMPLOYEE BENEFITS *(Continued)*

The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme, except for the Group's employer voluntary contributions, which are refunded to the Group when the employee leaves employment prior to the contributions vesting fully, in accordance with the rules of the MPF Scheme.

The employees of the Group's subsidiary which operates in Mainland China are required to participate in a central pension scheme operated by the local municipal government. This subsidiary is required to contribute a percentage of its payroll costs to the central pension scheme. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

FOREIGN CURRENCIES

These financial statements are presented in Hong Kong dollars, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions recorded by the entities in the Group are initially recorded using their respective functional currency rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the end of the reporting period. All differences are taken to the income statement with the exception of all monetary items that provide an effective hedge for a net investment in a foreign operation. These are recognised in other comprehensive income until the disposal of the net investment, at which time they are recognised in the income statement. Tax charges and credits attributable to exchange differences on those monetary items are also recorded in equity. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of certain overseas subsidiaries are currencies other than the Hong Kong dollar. As at the end of the reporting period, the assets and liabilities of these entities are translated into the presentation currency of the Company at the exchange rates ruling at the end of the reporting period and their income statements are translated into Hong Kong dollars at the weighted average exchange rates for the year. The resulting exchange differences are recognised in other comprehensive income and accumulated in the exchange fluctuation reserve. On disposal of a foreign operation the component of other comprehensive income relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated statement of cash flows, the cash flows of overseas subsidiaries are translated into Hong Kong dollars at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into Hong Kong dollars at the weighted average exchange rates for the year.

TREASURY SHARES

Treasury shares are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to/from retained earnings.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

JUDGEMENTS

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

CONTINGENT LIABILITIES IN RESPECT OF LITIGATIONS AND CLAIMS

The Group has been engaged in a number of litigations and claims during the year. Contingent liabilities arising from these litigations and claims have been assessed by management with reference to legal advice. Provisions on the possible obligation, if appropriate, are made based on management's best estimates and judgements.

CONTROL OVER TAIYUAN SANXING COAL GASIFICATION (GROUP) CO., LIMITED ("TAIYUAN SANXING")

The Group assesses whether it has control over the financial and operating policies of Taiyuan Sanxing. As the Group was not provided with the financial and operating information of Taiyuan Sanxing, the Group is unable to exercise its power on the financial and operating matters of Taiyuan Sanxing. The investment in Taiyuan Sanxing is therefore classified as available-for-sale investments.

ESTIMATION UNCERTAINTY

The key assumptions concerning the future and other key sources of estimation uncertainty at the end of reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

IMPAIRMENT OF GOODWILL

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating units and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2009 was HK\$121,945,000 (2008: HK\$16,921,000). More details are set out in note 16 to the financial statements.

IMPAIRMENT OF NON-FINANCIAL ASSETS (OTHER THAN GOODWILL)

The Group assesses whether there are any indicators of impairment for all non-financial assets at the end of each reporting period. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. An impairment exists when the carrying value of an asset or a cash-generating units exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The calculation of the fair value less costs to sell is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES *(Continued)*

ESTIMATION UNCERTAINTY *(Continued)*

IMPAIRMENT OF AVAILABLE-FOR-SALE INVESTMENTS

The Group classifies certain assets as available-for-sale investments and stated at cost less impairment losses. The Group assesses at the end of each reporting period whether there is any objective evidence that the available-for-sale investments are impaired. At 31 December 2009, impairment losses of approximately HK\$922,318,000 (2008: Nil) have been recognised for available-for-sale assets. The net carrying amount of available-for-sale assets was Nil (2008: Nil). More details are set out in note 22 to the financial statements.

DEPRECIATION AND USEFUL LIVES

Items of property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technologies changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

4. OPERATING SEGMENT INFORMATION

For management purposes, the Group is organised into business units based on their products and services and has two reportable operating segments as follows:

- (a) the logistics and related services segment is the provision of logistic business and related services; and
- (b) the plastic recycling segment is procuring, processing and sales of plastic recycling materials.

Management monitors the results of its operating segments separately for the purpose of making decisions about resources allocation and performance assessment. Segment performance is evaluated based on reportable segment loss, which is a measure of adjusted loss before tax. The adjusted loss before tax is measured consistently with the Group's loss before tax except that interest income and finance costs are excluded from such measurement.

Segment assets exclude unallocated head office and corporate assets as these assets are managed on a group basis.

Segment liabilities exclude unallocated head office and corporate assets as these liabilities are managed on a group basis.

4. OPERATING SEGMENT INFORMATION (Continued)

Year ended 31 December 2009

	Provision of logistics and related services segment HK\$'000	Plastic recycling segment HK\$'000	Total HK\$'000
Segment revenue:			
Service income	28,266	—	28,266
Gross rental income	3,826	—	3,826
Sales of plastic recycling materials	—	163,438	163,438
	<u>32,092</u>	<u>163,438</u>	<u>195,530</u>
Segment results	<u>(8,822)</u>	<u>(16,686)</u>	<u>(25,508)</u>
Other income and gains			23,968
Unallocated expenses			(959,958)
Loss from operations			(961,498)
Finance costs			(5,597)
Share of losses of an an associate			(548)
Loss before tax			(967,643)
Income tax expense			(319)
Loss for the year			<u>(967,962)</u>
Segment assets	8,450	241,710	250,160
Unallocated assets			223,752
Total assets			<u>473,912</u>
Segment liabilities	8,082	17,541	25,623
Unallocated liabilities			103,302
Total liabilities			<u>128,925</u>
Capital expenditure	415	4,236	4,651
Unallocated capital expenditure			22
			<u>4,673</u>
Depreciation and amortisation	4,245	4,653	8,898
Unallocated depreciation and amortisation			262
			<u>9,160</u>
Impairment loss on available-for-sales investments			922,318
Write-off of other receivables			955

4. OPERATING SEGMENT INFORMATION (Continued)

Year ended 31 December 2008

	Provision of logistics and related services segment HK\$'000	Plastic recycling segment HK\$'000	Total HK\$'000
Segment revenue:			
Service income	66,928	—	66,928
Gross rental income	11,855	—	11,855
Sales of plastic recycling materials	—	—	—
	<u>78,783</u>	<u>—</u>	<u>78,783</u>
Segment results	<u>(9,398)</u>	<u>(968)</u>	<u>(10,366)</u>
Other income and gains			12,493
Unallocated expenses			<u>(22,726)</u>
Loss from operations			(20,599)
Finance costs			(6,494)
Share of losses of associates			<u>(12,752)</u>
Loss before tax			(39,845)
Income tax expense			<u>(1,420)</u>
Loss for the year			<u>(41,265)</u>
Segment assets	140,456	78,739	219,195
Unallocated assets			<u>454,736</u>
Total assets			<u>673,931</u>
Segment liabilities	95,644	8,060	103,704
Unallocated liabilities			<u>48,284</u>
Total liabilities			<u>151,988</u>
Capital expenditure*	2,012	65,520	67,532
Unallocated capital expenditure			<u>520</u>
			<u>68,052</u>
Depreciation and amortisation	5,296	143	5,439
Unallocated depreciation and amortisation			<u>698</u>
			<u>6,137</u>
Write-off of other receivables	1,178	28	<u>1,206</u>
Impairment loss on trade receivables			<u>1,838</u>

* Capital expenditure consist of additions to property, plant and equipment including assets from acquisition of subsidiaries (note 14 and 33).

4. OPERATING SEGMENT INFORMATION (Continued)**GEOGRAPHICAL INFORMATION****(a) REVENUE FROM EXTERNAL CUSTOMERS**

The revenue information is based on the location of the customers.

Year ended 31 December 2009	Hong Kong HK\$'000	The PRC HK\$'000	France HK\$'000	Total HK\$'000
Segment revenue:				
Service income	—	28,266	—	28,266
Gross rental income	—	3,826	—	3,826
Sales of plastic recycling materials	162,045	—	1,393	163,438
	<u>162,045</u>	<u>32,092</u>	<u>1,393</u>	<u>195,530</u>
Year ended 31 December 2008	Hong Kong HK\$'000	The PRC HK\$'000	France HK\$'000	Total HK\$'000
Segment revenue:				
Service income	—	66,928	—	66,928
Gross rental income	—	11,855	—	11,855
Sales of plastic recycling materials	—	—	—	—
	<u>—</u>	<u>78,783</u>	<u>—</u>	<u>78,783</u>

4. OPERATING SEGMENT INFORMATION *(Continued)***GEOGRAPHICAL INFORMATION** *(Continued)***(b) NON-CURRENT ASSETS**

Year ended 31 December 2009	Hong Kong HK\$'000	The PRC HK\$'000	France HK\$'000	Total HK\$'000
Non-current assets	<u>73,352</u>	<u>—</u>	<u>113,819</u>	<u>187,171</u>
Year ended 31 December 2008	Hong Kong HK\$'000	The PRC HK\$'000	France HK\$'000	Total HK\$'000
Non-current assets	<u>432,177</u>	<u>120,028</u>	<u>69,818</u>	<u>622,023</u>

INFORMATION ABOUT A MAJOR CUSTOMER

Revenue of approximately HK\$20,442,000 (2008: HK\$21,996,000) was derived from sales to a single customer during the year ended 31 December 2009.

5. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Group's turnover, represents service income from logistics and other services rendered, gross rental income and sales of plastic recycling materials during the year.

An analysis of revenue, other income and gains is as follows:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Revenue		
Service income	28,266	66,928
Gross rental income	3,826	11,855
Sales of plastic recycling materials	163,438	—
Total revenue	<u>195,530</u>	<u>78,783</u>
Other income and gains		
Bank interest income	12	171
Gain on disposal of subsidiaries (note 36)	20,270	—
Exchange gains, net	3,012	1,763
Write-back of other payables	—	545
Shortfall in profit of an associate guaranteed by an ex-joint venture partner	—	9,800
Others	674	214
Total other income and gains	<u>23,968</u>	<u>12,493</u>
Total revenue, other income and gains	<u>219,498</u>	<u>91,276</u>

6. LOSS BEFORE TAX

The Group's loss before tax is arrived at after charging/(crediting):

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Cost of services provided and goods sold*	175,091	51,095
Amortisation of prepaid land lease payments (note 15)	459	473
Depreciation of property, plant and equipment*(note 14)	9,160	5,664
Write-off of property, plant and equipment (note 14)	5	7,716
Minimum lease payments under operating leases: Land and buildings	4,298	4,606
Auditors' remuneration:		
Annual audit:		
Current year	850	750
Under-provision for the previous years	—	140
Other assurance services	420	—
	1,270	890
Impairment loss on trade receivables	—	1,838
Write-off of other receivables	955	1,206
Impairment loss on available-for-sales investments (note 22)	922,318	—
Staff costs (including directors' remuneration (note 8)):		
Wages and salaries	28,689	24,132
Equity-settled share option expenses (note 31)	6,727	—
Pension scheme contributions	168	179
	35,584	24,311
Exchange gains, net	(3,012)	(1,763)
Bank interest income	(12)	(171)

* The cost of services provided and goods sold included depreciation of property, plant and equipment of approximately HK\$2,480,000 (2008: HK\$2,552,000).

7. FINANCE COSTS

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Interest on bank advances and other borrowings wholly repayable within five years	3,570	5,359
Bank overdraft interest	4	3
Interest on other loans	1,738	882
Others	285	250
	<u>5,597</u>	<u>6,494</u>

8. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Fees	<u>1,272</u>	<u>1,051</u>
Other emoluments:		
Salaries, allowances and benefits in kind	10,536	3,896
Pension scheme contributions	49	60
Equity-settled share option expenses*	5,786	—
	<u>16,371</u>	<u>3,956</u>
	<u>17,643</u>	<u>5,007</u>

* During the year, the directors were granted share options in respect of their services to the Group under the share option scheme of the Company, further details of which are set out in note 31 to the financial statements. The fair value of such options which has been recognised in the income statement over the vesting period, was determined as at the date of grant and the amount included in the financial statements for the current year is included in the above directors' remuneration disclosures.

8. DIRECTORS' REMUNERATION (Continued)

Year ended 31 December 2009

	Directors' fees HK\$'000	Salaries, allowances and benefits in kind HK\$'000	Equity-settled share option expenses HK\$'000	Pension scheme contributions HK\$'000	Total HK\$'000
Executive directors					
Wong Kwan	—	1,800	562	12	2,374
Cheung Kwok Yu	—	1,216	562	12	1,790
Zheng Yingsheng	—	871	562	—	1,433
Zhou Li Yang	—	1,320	562	12	1,894
Johnny Yuen	—	300	562	12	874
Lew Mon Hung (appointed on 3 December 2009)	—	5,000	1,103	—	6,103
Chan Yiu Keung (resigned on 6 February 2009)	—	29	—	1	30
	—	10,536	3,913	49	14,498
Independent non-executive directors					
Fung Hing Chiu, Cyril	150	—	562	—	712
Lam Ka Wai, Graham	930	—	562	—	1,492
Yu Jian Meng (appointed on 19 September 2009)	67	—	187	—	254
Dong Zhixiong (resigned on 1 October 2009) [@]	125	—	562	—	687
	1,272	—	1,873	—	3,145
Total	1,272	10,536	5,786	49	17,643

8. DIRECTORS' REMUNERATION (Continued)

Year ended 31 December 2008

	Directors' fees HK\$'000	Salaries, allowances and benefits in kind HK\$'000	Equity-settled share option expenses HK\$'000	Pension scheme contributions HK\$'000	Total HK\$'000
Executive directors					
Wong Kwan	—	1,750	—	12	1,762
Cheung Kwok Yu	—	1,158	—	12	1,170
Zheng Yingsheng	—	412	—	—	412
Zhou Li Yang	—	576	—	12	588
Johnny Yuen	—	300	—	12	312
Chan Yiu Keung	—	300	—	12	312
	—	4,496	—	60	4,556
Independent non-executive directors					
Fung Hing Chiu, Cyril	150	—	—	—	150
Lam Ka Wai, Graham (appointed on 3 October 2008)	37	—	—	—	37
Dong Zhixiong	150	—	—	—	150
Lai Shi Hong, Edward (resigned on 3 October 2008)	114	—	—	—	114
	451	—	—	—	451
Total	451	4,496	—	60	5,007

There were no other emoluments payable to the independent non-executive directors during the year (2008: Nil).

There was no arrangement under which a director waived or agreed to waive any remuneration during the year (2008: Nil).

© Dong Zhixiong was a director of the Company during the year. He resigned as a director and became a consultant of the Company effective from 1 October 2009 for two years.

8. DIRECTORS' REMUNERATION *(Continued)*

The number of directors, whose remuneration fell within the following bands is as follows:

	Number of directors	
	2009	2008
Nil to HK\$1,000,000	5	8
HK\$1,000,001 to HK\$2,000,000	4	2
HK\$2,000,001 to HK\$5,000,000	1	—
Over HK\$5,000,000	1	—
	<u>11</u>	<u>10</u>

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included five (2008: three) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining two non-director, highest paid employees for the year ended 31 December 2008 are as follows:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Salaries, allowances and benefits in kind	—	1,104
Pension scheme contributions	—	24
	<u>—</u>	<u>1,128</u>

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2009	2008
Nil to HK\$1,000,000	<u>—</u>	<u>2</u>

10. INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 16.5% on the estimated assessable profits arising in Hong Kong during the year. No Hong Kong profits tax has been provided as the Group did not generate any assessable profits arising in Hong Kong during the year ended 31 December 2008. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates.

	2009 HK\$'000	2008 HK\$'000
Current tax:		
Hong Kong profits tax	319	—
PRC corporate income tax	—	1
Deferred tax: (note 29)		
Overprovision of deferred tax assets in prior years	—	1,419
Tax charge for the year	319	1,420

A reconciliation of the tax expense applicable to loss before tax using the statutory rates for the countries in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, are as follows:

	2009		2008	
	HK\$'000	%	HK\$'000	%
Loss before tax	(967,643)		(39,845)	
Tax at statutory tax rate	(162,815)	16.8	(9,724)	(24.4)
Tax effect of share of profit and losses of an associate	90	—	3,917	10.0
Income not subject to tax:				
Gain on disposal of subsidiaries	(3,344)	0.3	—	—
Others	(389)	—	(8,348)	(20.9)
Expenses not deductible for tax:				
Impairment loss on available-for-sales investments	152,182	(15.7)	—	—
Others	7,412	(0.7)	7,388	18.4
Tax losses not yet recognised	7,183	(0.7)	6,768	16.9
Overprovision for deferred tax assets in prior years	—	—	1,419	3.6
Tax charge at the Group's effective rate	319	—	1,420	3.6

11. DIVIDENDS

The Directors did not recommend a final dividend for the year ended 31 December 2009 (2008: Nil).

12. LOSS ATTRIBUTABLE TO OWNERS OF THE COMPANY

The consolidated loss attributable to owners of the Company for the year ended 31 December 2009 includes a loss of HK\$546,417,000 (2008: HK\$10,624,000) which has been dealt with in the financial statements of the Company.

13. LOSS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY

The calculation of basic loss per share is based on the loss for the year attributable to ordinary equity holders of the Company and the weighted average number of ordinary shares in issue during the year.

No adjustment has been made to the basic loss per share amounts presented for the years ended 31 December 2008 and 2009 in respect of a dilution as the impact of share options outstanding had an anti-dilutive effect on the basic loss per share amounts presented.

The calculations of basic loss per share are based on:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Earnings		
Loss attributable to equity holders of the Company, used in the basic loss per share calculation	<u>566,840</u>	<u>38,310</u>
	Number of shares (thousand)	
	2009	2008
Shares		
Weighted average number of ordinary shares in issue during the year used in basic loss per share calculation:		
Issued ordinary shares at 1 January	447,182	383,059
Effect of shares issued during the year	<u>199,763</u>	<u>64,123</u>
	<u>646,945</u>	<u>447,182</u>

14. PROPERTY, PLANT AND EQUIPMENT
Group

	Buildings HK\$'000	Freehold land HK\$'000	Leasehold improvements HK\$'000	Furniture fixtures and equipment HK\$'000	Motor vehicles HK\$'000	Total HK\$'000
31 December 2009						
At 1 January 2009:						
Cost or valuation	120,937	4,555	1,270	54,486	2,121	183,369
Accumulated depreciation and impairment	(2,597)	—	(845)	(13,840)	(756)	(18,038)
Net carrying amount	<u>118,340</u>	<u>4,555</u>	<u>425</u>	<u>40,646</u>	<u>1,365</u>	<u>165,331</u>
At 1 January 2009, net of accumulated depreciation and impairment	118,340	4,555	425	40,646	1,365	165,331
Additions	27	—	—	4,646	—	4,673
Disposal of subsidiaries (note 36)	(85,312)	—	(257)	(11,946)	(840)	(98,355)
Written off	—	—	—	(5)	—	(5)
Depreciation provided during the year	(3,571)	—	(119)	(5,154)	(316)	(9,160)
Exchange realignment	1,623	(61)	4	411	4	1,981
At 31 December 2009, net of accumulated depreciation and impairment	<u>31,107</u>	<u>4,494</u>	<u>53</u>	<u>28,598</u>	<u>213</u>	<u>64,465</u>
At 31 December 2009:						
Cost or valuation	32,278	4,494	85	31,006	446	68,309
Accumulated depreciation and impairment	(1,171)	—	(32)	(2,408)	(233)	(3,844)
Net carrying amount	<u>31,107</u>	<u>4,494</u>	<u>53</u>	<u>28,598</u>	<u>213</u>	<u>64,465</u>
Analysis of cost or valuation:						
At cost	32,278	4,494	85	31,006	446	68,309
At valuation	—	—	—	—	—	—
	<u>32,278</u>	<u>4,494</u>	<u>85</u>	<u>31,006</u>	<u>446</u>	<u>68,309</u>

14. PROPERTY, PLANT AND EQUIPMENT (Continued)**Group** (Continued)

	Buildings HK\$'000	Freehold land HK\$'000	Leasehold improvements HK\$'000	Furniture fixtures and equipment HK\$'000	Motor vehicles HK\$'000	Total HK\$'000
31 December 2008						
At 1 January 2008:						
Cost or valuation	85,121	—	1,471	27,227	1,449	115,268
Accumulated depreciation	—	—	(944)	(13,698)	(470)	(15,112)
Net carrying amount	85,121	—	527	13,529	979	100,156
At 1 January 2008, net of accumulated depreciation	85,121	—	527	13,529	979	100,156
Additions	1,148	—	132	1,529	890	3,699
Acquisition of subsidiaries (note 33(b))	27,312	4,117	—	32,924	—	64,353
Disposals	—	—	(57)	(237)	(132)	(426)
Written off	—	—	—	(7,716)	—	(7,716)
Depreciation provided during the year	(2,609)	—	(199)	(2,442)	(414)	(5,664)
Exchange realignment	7,368	438	22	3,059	42	10,929
At 31 December 2008, net of accumulated depreciation and impairment	118,340	4,555	425	40,646	1,365	165,331
At 31 December 2008:						
Cost or valuation	120,937	4,555	1,270	54,486	2,121	183,369
Accumulated depreciation and impairment	(2,597)	—	(845)	(13,840)	(756)	(18,038)
Net carrying amount	118,340	4,555	425	40,646	1,365	165,331
Analysis of cost or valuation:						
At cost	31,485	4,555	1,270	54,486	2,121	93,917
At valuation	89,452	—	—	—	—	89,452
	120,937	4,555	1,270	54,486	2,121	183,369

14. PROPERTY, PLANT AND EQUIPMENT *(Continued)***Group** *(Continued)*

Notes:

- (a) The Group's buildings located in the PRC had been disposed of through the disposal of subsidiaries (note 36) during the year.
- (b) The carrying amount of the Group's buildings at 31 December 2009 would have been HK\$Nil (2008: HK\$92,030,000) had they been stated at cost less accumulated depreciation.
- (c) At 31 December 2008, certain of the Group's buildings situated in the PRC with an aggregate carrying value of HK\$86,896,000 together with the Group's prepaid land lease payments of HK\$19,341,000 (note 15) were pledged to secure the bank loans granted to the Group (note 27). The pledged buildings and prepaid land lease payments were disposed of through the disposal of the related subsidiary during the year (note 36) and the pledge has therefore been released.
- (d) The Group's freehold land is located in France.

15. PREPAID LAND LEASE PAYMENTS

The Group's prepaid lease payments represented its interest in land use rights and their net carrying value is analysed as follows:

	Group	
	2009	2008
	HK\$'000	HK\$'000
Carrying amount at beginning of year	19,341	18,855
Amortisation during the year	(459)	(473)
Exchange realignment	200	959
Disposal of a subsidiary during the year (note 36)	(19,082)	—
Carrying amount at 31 December	—	19,341
Current portion included in prepayments, deposits and other receivables	—	(473)
Non-current portion	—	18,868
Analysed into:		
Situated in the PRC under a medium term lease	—	19,341

At 31 December 2008, certain of the Group's the prepaid land lease payments of HK\$19,341,000 together with the Group's buildings situated in the PRC with an aggregate carrying value of HK\$86,896,000 (note 14) were pledged to secure the bank loans granted to the Group (note 27). The pledged buildings and prepaid land lease payments were disposed of through the disposal of subsidiaries during the year (note 36) and the pledge has therefore been released.

16. GOODWILL**Group**

	<i>HK\$'000</i>
At 31 December 2008:	
Cost at 1 January 2008, net of accumulated impairment	—
Acquisition of a subsidiary (note 33(b))	16,921
At 31 December 2008	16,921
At 31 December 2008:	
Cost	16,921
Accumulated impairment	—
Net carrying amount	16,921
At 31 December 2009:	
Cost at 1 January 2009, net of accumulated impairment	16,921
Acquisition of minority interests (note 34)	42,985
Acquisition of a business (note 35)	62,039
Cost and carrying amount at 31 December 2009	121,945
At 31 December 2009:	
Cost	121,945
Accumulated impairment	—
Net carrying amount	121,945

IMPAIRMENT TESTING OF GOODWILL

Goodwill acquired through business combinations and acquisition of a business has been allocated to the relevant cash-generating units for impairment testing as follows:

	<i>HK\$'000</i>
Carrying amount of goodwill relevant to the processing and sales of plastic recycling material in the ERC Group	59,906
Carrying amount of goodwill relevant to the processing and sales of plastic recycling material in the IBE Group	62,039
	121,945

16. GOODWILL (Continued)

PROCESSING AND SALES OF PLASTIC RECYCLING MATERIALS IN THE ERC GROUP

The recoverable amount of the processing and sales of plastic recycling materials in the ERC Group cash-generating unit has been determined based on a value in use calculation using cash flow projections based on financial budgets covering a five-year period approved by senior management. The discount rate applied to the cash flow projections is 17% (2008:19%) and cash flows beyond the five-year period are extrapolated using a growth rate which does not exceed the long term average growth rate of the processing and sales of plastic recycling materials industry.

Key assumptions were used in the value in use calculation of the processing and sales of plastic recycling materials in the ERC Group cash-generating unit for 31 December 2008 and 2009. The following describes each key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill:

	2009 %	2008 %
Gross margin	40	40
Growth rate	43	43
Discount rate	17	19

Management determined the budgeted gross-margin based on past performance and its expectation for market development. The weighted average growth rates used are based on the industry research. The discount rates used are pre-tax that reflected current market assessments of the time value of money and the risks specific risks relating to the relevant segments.

PROCESSING AND SALES OF PLASTIC RECYCLING MATERIALS IN THE IBE GROUP

The recoverable amount of the processing and sales of plastic recycling materials in the IBE Group cash-generating unit has been determined based on a value in use calculation using cash flow projections based on financial budgets covering a five-year period approved by senior management. The discount rate applied to the cash flow projections is 12% (2008: N/A) and cash flows beyond the five-year period are extrapolated using a growth rate which does not exceed the long term average growth rate of the processing and sales of plastic recycling materials industry.

Key assumptions were used in the value in use calculation of the processing and sales of plastic recycling materials in the IBE cash-generating unit for 31 December 2009. The following describes each key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill:

	2009 %
Gross margin	7
Growth rate	5
Discount rate	12

Management determined the budgeted gross-margin based on past performance and its expectation for market development. The weighted average growth rates used are based on the industry research. The discount rates used are pre-tax that reflected current market assessments of the time value of money and the specific risks relating to the relevant segments.

17. INTERESTS IN SUBSIDIARIES

	Company	
	2009	2008
	HK\$'000	HK\$'000
Unlisted shares, at cost	—	—
Due from subsidiaries	726,156	527,076
	726,156	—
Less: Impairment	(513,736)	—
	212,420	527,076

The amounts due from/(to) subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

Particulars of the principal subsidiaries of the Company are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Champion Merry Investment Limited	The British Virgin Islands (the "BVI")	US\$1	—	100%	Investment holding
China Coal Energy Holdings Limited (note (a))	Hong Kong	HK\$100,000,000	—	55.11%	Coal gasification and coal mining
China Environmental Resources Limited	Hong Kong	HK\$10,000	—	60%	Investment holding
Exploitation Ressources Internationales, S.A. #	France	EURO153,800	—	60%	Plastic recycling
Euro Resources China Limited	Hong Kong	HK\$10,000	—	60%	Investment holding
Get Wealthy Investments Limited	BVI	US\$1	—	100%	Investment holding
Grand Huge International Limited	Hong Kong	HK\$10,000	—	100%	Provision of corporate services
IB Environmental Plastic Limited	Hong Kong	HK\$1	—	60%	Plastic recycling
Pearl Oriental International Assets Limited	Hong Kong	HK\$1	—	100%	Provision of corporate services

17. INTERESTS IN SUBSIDIARIES (Continued)

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
PO (SZ) Logistics Limited	BVI	US\$1	—	100%	Provision of logistics
Pearl Oriental Logistics (Shenzhen) Limited [#] (note (b))	The People's Republic of China (the "PRC")	US\$400,000	—	100%	Provision of logistics services
Pearl Oriental Logistics Sino Limited	Hong Kong	HK\$22,000,000	—	60%	Investment holding
Wuhan Pearl Oriental Logistics Limited (note (b))	The PRC	RMB4,007,157	—	60%	Provision of logistics services

Not audited by Ascenda Cachet CPA Limited (formerly Cachet Certified Public Accountants Limited)

Note a: This subsidiary was acquired by the Company during the year, details of which are set out in note 33(a) to the financial statements.

Note b: These subsidiaries are registered as a Sino-foreign investment enterprise under the PRC laws.

The above table lists the subsidiaries of the Company which in the opinion of the directors, principally affects the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particular of excessive length.

18. INTERESTS IN AN ASSOCIATE

	Group	
	2009	2008
	HK\$'000	HK\$'000
Share of net assets	—	365,012
Goodwill arising from acquisition	—	55,891
	—	420,903
Due from associates	—	5,593
	—	426,496

The amount due from the associate was unsecured, interest-free and had no fixed terms of repayment.

Particulars of the Group's interests in the associate are as follows:

Name	Place of incorporation/ registration and operations	Particular of issued shares held	Percentag of ownership interest attributable to the Group	Principal activities
China Coal Energy Holdings Limited ("China Coal")	Hong Kong	HK\$100,000,000	55.11% (2008: 39.93%)	Coal gasification and coal mining

During the year, the Company further acquired from independent third parties an aggregate of 15.18% equity interests in China Coal through the acquisition of the 100% equity interests in Get Wealthy Investments Limited ("Get Wealthy") (which holds 15% equity interests in China Coal) and the remaining 0.18% equity interests in China Coal. Upon the completion of which on 15 July 2009, China Coal became an indirect non-wholly-owned subsidiary of the Company. These interests in the associate have therefore formed part of the consideration of the acquisition of Get Wealthy/China Coal as set out in note 33(a) to the financial statements.

	HK\$'000
Balance of interests in an associate at 1 January 2009	420,903
Shares of losses of China Coal during the period from 1 January 2009 to 14 July 2009	(548)
	420,355
Transfer to form part of the consideration of the acquisition of Get Wealthy/China Coal (note 33(a))	(420,355)
Balance of interests in an associate at 31 December 2009	—

18. INTERESTS IN AN ASSOCIATE *(Continued)*

The following table illustrated the summarised financial information of China Coal extracted from their financial statements for the year ended 31 December 2008:

	2008 <i>HK\$'000</i>
Revenue	—
Loss for the year	(9,101)
Available-for-sale investments	944,312
Other assets	9
Total assets	944,321
Total liabilities	(31,907)
Net assets	912,414

19. INVENTORIES

	Group	
	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Raw materials	8,707	9,083

20. TRADE RECEIVABLES

	Group	
	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Trade receivables	9,142	13,130
Less: Impairments	(2,943)	(2,880)
	6,199	10,250

At 31 December 2008, included in the trade receivables were receivables of a then subsidiary of the Group in the amount of approximately RMB372,000 (equivalent to approximately HK\$420,000) (note 27(d)) pledged to a bank as securities for the bank loan granted to the then subsidiary of the Group, which was disposed of during the year (note 36).

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally two months, extending up to three months for major customers. For the plastics recycling business, the Group's trading terms with its customers are mainly in advance, except for the well acquainted customers, credit terms may be allowed. The credit period is generally one month. Each customer has a maximum credit limit as approved from the management from time to time. The Group seeks to maintain strict control over its outstanding receivables and has a credit control department to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned and the fact that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. Trade receivables are non-interest-bearing.

An aged analysis of the trade receivables as at the end of reporting period, based on the invoice date, is as follows:

	Group	
	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Less than 3 months	5,995	9,063
3 months to 6 months	96	194
6 months to 12 months	108	993
	6,199	10,250

20. TRADE RECEIVABLES *(Continued)*

The movements in the provision for impairment of trade receivables are as follows:

	Group	
	2009 HK\$'000	2008 HK\$'000
At beginning of year	2,880	1,042
Impairment loss recognised	—	1,838
Exchange realignment	63	—
At end of year	<u>2,943</u>	<u>2,880</u>

At 31 December 2009, the Group's trade receivables of HK\$1,838,000 (2008: HK\$1,838,000) were individually determined to be impaired with a carrying amount before provision of HK\$1,838,000 (2008: HK\$1,838,000). The Group does not hold any collateral over these balances.

The aged analysis of the trade receivables that are not considered to be impaired is as follows:

	Group	
	2009 HK\$'000	2008 HK\$'000
Neither past due nor impaired	5,995	9,063
3 to 6 months past due	96	194
6 to 12 months past due	108	993
	<u>6,199</u>	<u>10,250</u>

Receivables that were neither past due nor impaired relate to a large number of diversified customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Company. Based on past experience, the directors of the Company are of the opinion that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Company does not hold any collateral or other credit enhancements over these balances.

21. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2009 HK\$'000	2008 HK\$'000	2009 HK\$'000	2008 HK\$'000
Current portion of prepaid land lease payments (note 15)	—	473	—	—
Prepayments	948	3,277	—	—
Rental and other deposits paid (note (a))	2,756	4,519	—	—
Security deposits for the legal case (note (b))	10,446	—	10,446	—
Trade deposits (note (c))	32,702	—	—	—
Other receivables	669	2,926	238	80
	47,521	11,195	10,684	80

Notes:

- (a) Include in the rental and other deposits is a deposit of RMB1,650,000 (equivalent to approximately HK\$1,725,000) (2008: RMB1,500,000 (equivalent to approximately HK\$1,692,000)) paid in respect of a proposed acquisition undertaken by Euro Resources China Limited ("ERC"), which was a 60%-owned subsidiary as at 31 December 2009. On 14 July 2007, ERC entered into a conditional sale and purchase agreement with an independent third party, Mr. He Zhaorong ("Mr. He"), in relation to the acquisition of a 60% equity interest in Foshan Shunde Euro Resources Wanhai Manufacturing Limited ("Foshan") at a total consideration of RMB9,000,000 (equivalent to HK\$10,153,800).

On the same day, ERC further entered into a supplemental agreement with Mr. He, pursuant to which, ERC paid a deposit of RMB1,500,000 (equivalent to HK\$1,692,000) to Mr. He in respect of the proposed acquisition.

On 25 March 2009, ERC entered into a supplemental agreement with Mr. He, pursuant to which, the completion date of the proposed acquisition has been extended to 31 March 2011. During the year, a further amount of RMB150,000 (equivalent to approximately HK\$170,000) was paid by the Group.

As at 31 December 2009 and 2008, the Group had a capital commitment of RMB7,350,000 (equivalent to approximately HK\$8,352,000 (2008: RMB7,500,000 (equivalent to approximately HK\$8,461,000)) (note 39) in respect of the outstanding purchase consideration.

- (b) During the year, the Company paid a sum of HK\$10,446,000 to the Court as the security for payment of judgement debt and the plaintiffs' cost in respect of the legal claims with the ex-directors of a disposed subsidiary. Further details are set out in note 41(c) to the financial statements.
- (c) The trade deposits paid of HK\$32,702,000 as at 31 December 2009 represented the purchase deposits paid to the suppliers. The related goods were received by the Group subsequent to the end of reporting period in January 2010.

None of the above assets is either past due or impaired.

22. AVAILABLE-FOR-SALES INVESTMENTS

The available-for-sales investments grouped in current assets are as follows:

	Group		Company	
	2009 HK\$'000	2008 HK\$'000	2009 HK\$'000	2008 HK\$'000
Equity securities, at cost:				
Balance at 1 January	12,412	12,412	12,412	12,412
Written off during the year	(12,412)	—	(12,412)	—
Balance at 31 December	—	12,412	—	12,412
Impairments:				
Balance at 1 January	12,412	12,412	12,412	12,412
Written off during the year	(12,412)	—	(12,412)	—
Balance at 31 December	—	12,412	—	12,412
Net carrying value	—	—	—	—

The above investment represents certain equity securities of China Technology Global Corporation which were designated as available-for-sale financial assets on 1 January 2005. The securities have been fully impaired because China Technology Global Corporation was de-listed from the Over-The-Counter Bulletin Board of the United States of America in 2006. The above investment was written-off during the year as the directors were of the opinion that there is unlikely an recover of the investment.

The available-for-sales investments grouped in non-current assets are as follows:

	Group	
	2009 HK\$'000	2008 HK\$'000
Unlisted equity investment at cost (note 33)	922,318	—
Impairment	(922,318)	—
Net carrying value	—	—

The non-current available-for-sales investments represented an 100% equity interests in Taiyuan Sanxing Coal Gasification (Group) Co., Limited (太原市三興煤炭氣化有限公司) ("Taiyuan Sanxing") held by China Coal.

22. AVAILABLE-FOR-SALES INVESTMENTS (Continued)

As at 31 December 2008, the Group had 39.93% equity interest in China Coal and classified as “Interests in an associate” (note 18) and shared its results during that year. As detailed in note 33(a) to the financial statements, the Group has further acquired from independent third parties an aggregate of 15.18% equity interest in China Coal through the acquisition of the entire equity interests in Get Wealthy Investments Limited (which holds 15% equity interests in China Coal) and the remaining equity interest in China Coal at an aggregate consideration of HK\$58,000,000. Upon the completion of the acquisition, the Group’s equity interest in China Coal increased from 39.93% to 55.11% and the Group obtained control over the financial and operating policies of China Coal. China Coal became an indirect non-wholly-owned subsidiary of the Company which has an effective equity interest of 55.11%. China Coal’s results have been equity picked-up until 14 July 2009 and fully consolidated into the Group’s consolidated financial statements since 15 July 2009.

The principal activity of China Coal is investment holding and the principal asset of China Coal is an 100% equity interest in Taiyuan Sanxing. Taiyuan Sanxing was established in the PRC with limited liabilities and the Taiyuan Sanxing Group is principally engaged in the coal gasification and coal mining. The principal assets of Taiyuan Sanxing and its subsidiary Shanxi Sanxing Coal and Coke Limited (山西三興煤焦有限公司) (“Shanxi Sanxing”) (collectively, the “Taiyuan Sanxing Group”) are certain coal mines.

Pursuant to a conditional agreement dated 15 July 2006 between the Company and Mr. Zhang Jingyuen (formerly known as “Zhang Genyu”) (“Mr. Zhang”) (張景淵), Mr. Zhang has guaranteed the Company that the audited net profit of China Coal determined in accordance with HKFRSs for the three financial years ended 31 December 2009 should in aggregate be not less than HK\$600,000,000. Should the aggregate audited net profit of China Coal fall below HK\$600,000,000, Mr. Zhang will pay the shortfall to the Company on a dollar-to-dollar basis after the issuance of China Coal’s audit reports for the three financial years ended 31 December 2009. Mr. Zhang had pledged all his 44.89% equity interests in China Coal (the “Share Pledge”) as collateral for his performance under the Profit Guarantee in a the deed of charge dated 25 October 2006 (the “Deed of Charge”).

As announced by the Company on 12 August 2008, on 7 August 2008, Mr. Zhang issued and served a writ (the “Writ”) in the High Court of Hong Kong against, inter alia, the Company, Get Wealthy Investment Limited (“Get Wealthy”), Champion Merry Investment Limited (“Champion”, a subsidiary of the Company) and Mr. Wong Kwan, Chairman, Chief executive, executive director and also a major shareholder of the Company, in which Mr. Zhang claimed, inter alias, against the Company and Champion for damages for alleged breaches of a joint venture agreement dated 15 July 2006 (the “Joint Venture Agreement”), and Mr. Zhang also applied for an order that the Joint Venture Agreement and the Deed of Charge be rescinded.

After considering the opinion from the Company’s legal advisors in Hong Kong, the directors are of the opinion that all the claims in the Writ are of no substance and groundless, and the directors will strongly defend and has confidence to defeat such claims and the Company has issued counter claim against Mr. Zhang, including without limitation, the dividend from China Coal of HK\$80,000,000, damages for breaches of the Joint Venture Agreement and other relief.

The Group and the other defendants have made applications for striking out of Mr. Zhang’s claims against the Group and the other defendants and also a summary judgment for counterclaims against Mr. Zhang for dividend from China Coal of HK\$80,000,000 and other damages. The applications have been dismissed by the Court with costs, and the parties to the legal action would proceed to trial on dates to be fixed. After consultation with the Company’s legal advisors, the directors are confident that the Group’s rights and interests can be fully protected during the coming trial.

22. AVAILABLE-FOR-SALES INVESTMENTS (Continued)

In addition to the above:

- i) Zhang Xinyu obtained a judgment (the “Judgment”) on 10 November 2008 from the Taiyuan Intermediate People’s Court (太原市中級人民法院) against Taiyuan Sanxing, inter alia, that:
 1. an agreement (the “December 2006 Agreement”) entered into among Zhang Xinyu, Mr. Zhang and Taiyuan Sanxing on 28 December 2006 in relation to the capital injection and transfer of equity interests in Shanxi Sanxing from Mr. Zhang and Zhang Xinyu to Taiyuan Sanxing should be cancelled; and
 2. after the Judgment becomes effective, Shanxi Sanxing has to be restored to the original situation before the December 2006 Agreement, and all shares in Shanxi Sanxing have to be transferred back to Zhang Xinyu and Mr. Zhang.

Zhang Xinyu is the younger brother of Mr. Zhang and the chairman of board, a director and also the legal representative of Taiyuan Sanxing. Unknown to the Company, Zhang Xinyu has instituted the above legal proceedings (the “Legal Proceedings”) against Taiyuan Sanxing in the Taiyuan Intermediate People’s Court, and the Legal Proceedings have been wilfully concealed to the Company and China Coal. China Coal has made an application for an appeal to the judgement.

22. AVAILABLE-FOR-SALES INVESTMENTS (Continued)

- ii) Subsequent to the acquisition of the additional 15.18% equity interest in China Coal, it came to the attention of the Company's directors that there is a dispute over the title of the mining permit of a coal mine located at 山西省臨縣林家坪鎮白家峁村 (the "Coal Mine") owned by Shanxi Sanxing. In particular, (山西省臨縣林家坪鎮白家峁村民委員會) (the "Village") has sued the Department of Land and Resources, Shanxi Province (山西省國土資源廳) in the People's Intermediate Court of Taiyuan (太原市中級人民法院) and claimed that the Department of Land and Resources, Shanxi Province (山西省國土資源廳) has wrongfully transferred the title of the Coal Mine from the Village to Shanxi Sanxing and to obtain an administrative judgment of revoking such change. The Company understands that the Department of Land and Resources, Shanxi Province (山西省國土資源廳) has filed its appeal against the judgment but the appeal has been dismissed by the People's High Court of Shanxi Province (山西省高級人民法院) in October 2009. As a result of the judgment, the transfer of the title of the Coal Mine to Shanxi Sanxing in April 2002 has been confirmed as an illegal administrative action, and the mining permit of Shanxi Sanxing issued by the Department of Land and Resources, Shanxi Province (山西省國土資源廳) in December 2006 has been cancelled.

According to the legal advice of the Company's PRC lawyers, the Company and China Coal, as the controlling stakeholder of Taiyuan Sanxing and the Coal Mine, have paid genuine consideration as bona fide purchasers and the investments have been approved by the Department of Commerce, Shanxi Province (山西省商務廳), the Department of Land and Resources, Shanxi Province (山西省國土資源廳) and the Department of Industrial and Commercial Administration, Shanxi Province (山西省工商行政管理局), therefore the investments should be protected by the PRC laws. They have relied on the legality of Shanxi Sanxing as the registered owner of the title of the Coal Mine according to the records in the Department of Land and Resources, Shanxi Province (山西省國土資源廳), the Department of Commerce Shanxi Province (山西省商務廳) and the Department of Industrial and Commercial Administration, Shanxi Province (山西省工商行政管理局). The Company has already taken immediate steps and measures including but not limited to the reporting to the People's Government of Shanxi Province (山西省人民政府), the People's High Court of Shanxi Province (山西省高級人民法院), the Department of Commerce, Shanxi Province (山西省商務廳) and the Department of Land and Resources, Shanxi Province (山西省國土資源廳) to request suspension of execution of the administrative judgment made by the People's High Court of Shanxi Province (山西省高級人民法院) and also requesting the case be fairly handled in accordance with the laws and facts in order to protect its rights and interests in the Coal Mine. The Company also indicates that it will reserve its rights of taking necessary legal actions against the relevant government authorities of Shanxi Province for compensations should the Company incur any damages suffered from loss of the title of the Coal Mine as a result of the issue being not resolved reasonably and lawfully by the government of Shanxi Province.

22. AVAILABLE-FOR-SALES INVESTMENTS (Continued)

- iii) Since Zhang Xinyu, Mr. Zhang, Gao Shanhe, Zhang Zhenwu and Wang Jifeng (the directors of Taiyuan Sanxing) have refused to execute the resolutions of China Coal, the sole shareholder of Taiyuan Sanxing, refused to account for profits of Taiyuan Sanxing, obviously failed to perform their fiduciary duties as directors of Taiyuan Sanxing and also caused damages to lawful rights and interests of China Coal as a foreign investors, China Coal has therefore issued a writ against them in the People's High Court of Shanxi Province (山西省高級人民法院) to claim for damages against breaches of their fiduciary duties and their conducts amounted to wilful embezzling of assets of Taiyuan Sanxing which are clearly contrary to the laws of the PRC.

Because of the above legal claims between the Company and Mr. Zhang, China Coal had not been provided with the operating and financing information of Taiyuan Sanxing since 1 January 2008 and China Coal was unable to exercise its powers on the financial and operating matters of Taiyuan Sanxing. The loss of the operating and financing control over Taiyuan Sanxing had become apparent to China Coal's board of directors because the legal representative, directors and senior management of Taiyuan Sanxing were either appointed based on the recommendation of Mr. Zhang and/or ex-senior management of Taiyuan Sanxing prior to the Group's acquisition of the present equity interests in China Coal and therefore in Taiyuan Sanxing. Following all the shareholders of China Coal except Mr. Zhang had become aware of the loss of control over Taiyuan Sanxing, the board of directors of China Coal had passed certain key resolutions demanding structural reform to the board of directors of Taiyuan Sanxing. However, due to the above management structure unfavourable to the Group, those board resolutions of China Coal cannot be executed on or by Taiyuan Sanxing. As a result of the loss of control or significant influence over Taiyuan Sanxing, China Coal's equity interests in Taiyuan Sanxing were reclassified as an available-for-sales investment at its carrying value during the year ended 31 December 2008.

The Group, through China Coal, has taken the necessary legal actions to protect China Coal's investment in Taiyuan Sanxing. However, based on the legal advice, the directors of the Company may not be able to obtain a favourable judgement in the litigations.

In view of the above litigations and the inability of China Coal to deal with its interests in Taiyuan Xinsang as well as the significant deterioration of the Taiyuan Sanxing Group's operations and assets, particularly as evidenced by the cancellation of the title of the Coal Mine, a full provision of impairment loss of approximately HK\$922,318,000 on the available-for-sales-investment in Taiyuan Sanxing was made by the Group during the year ended 31 December 2009, in which an amount of approximately HK399,094,000 was attributable to its minority interests.

23. DUE TO MINORITY SHAREHOLDERS OF SUBSIDIARIES - GROUP

At 31 December 2008, the amounts due to certain then minority shareholders of subsidiaries were unsecured and interest-free and of which HK\$5,167,000 had no fixed repayment terms, and the remaining balance of HK\$16,337,000 which was not repayable within the one year after the end of the reporting period.

At 31 December 2009, the amounts due to minority shareholders of subsidiaries of approximately HK\$6,012,000 have been reclassified as other payables upon the acquisition of the minority interests of a subsidiary (note 26(a)(ii)). In addition, the amounts due to minority shareholders of subsidiaries of approximately HK\$11,496,000 has been acquired by the Group (note 34). The remaining balance of HK\$3,996,000 was derecognised from the Group upon the disposal of subsidiaries (note 36).

24. CASH AND CASH EQUIVALENTS

	Group		Company	
	2009 HK\$'000	2008 HK\$'000	2009 HK\$'000	2008 HK\$'000
Cash and bank balances	<u>224,314</u>	<u>15,787</u>	<u>206,624</u>	<u>8,882</u>

At the end of the reporting period, the cash and bank balances of the Group denominated in Renminbi ("RMB") amounted to approximately HK\$3,975,000 (2008: approximately HK\$3,298,000). The RMB is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

At the end of reporting period, certain bank deposits of the Group amounting to approximately HK\$1,127,000 (2008: approximately HK\$1,113,000) was frozen.

25. TRADE PAYABLES

An aged analysis of the trade payables as at the end of the reporting period, based on the invoice date, is as follows:

	Group	
	2009 HK\$'000	2008 HK\$'000
Current – 3 months	<u>3,622</u>	4,136
3 months – 6 months	—	548
6 – 12 months	—	3,270
Over 1 year	<u>2,078</u>	813
	<u>5,700</u>	<u>8,767</u>

The trade payables are non-interest-bearing and are normally settled on 60 day terms.

26. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2009 HK\$'000	2008 HK\$'000	2009 HK\$'000	2008 HK\$'000
Other payables	5,372	2,292	—	—
Accruals	13,815	17,579	4,073	2,003
Due to former shareholders of subsidiaries (note (a))	29,412	—	—	—
Trade deposit received (note (b))	3,007	—	—	—
Deposit received (note (b))	90	15	—	—
	51,696	19,886	4,073	2,003

Notes:

- (a) As at 31 December 2009, the amounts due to certain former shareholders of subsidiaries of HK\$29,411,000 represented:
- (i) approximately HK\$23,400,000 due to Favour Good Investments Limited, which was unsecured, bear interest rate at 6% per annum and repayable in December 2010; and
 - (ii) approximately HK\$6,012,000 due to Kong Rise Limited, which was unsecured, interest-free and has no fixed terms of repayments.
- (b) The trade deposits received of approximately HK\$3,007,000 as at 31 December 2009 represented sales deposits received from the customers. The related goods were delivered by the Group to the customers subsequent to the end of reporting period in January 2010.

27. INTEREST-BEARING BANK BORROWINGS, SECURED

	Effective interest rate (%)	Maturity	Group	
			2009 HK\$'000	2008 HK\$'000
Bank loans – secured	Prime rate	2014	—	60,370
Bank overdrafts – secured	Prime rate	On demand	—	10
			—	60,380
Analysed into:				
Bank loans repayable:				
Within one year or on demand			—	8,382
In the second year			—	8,922
In the third to fifth years, inclusive			—	31,099
Beyond five years			—	11,977
Total			—	60,380
Current portion			—	(8,382)
Non-current portion			—	51,998

The Company's banking facilities as at 31 December 2008 were secured by:

- a charge on the premises of the Group's leasehold building of HK\$86,896,000 (note 14), together with the prepaid land lease payments HK\$19,341,000 (note 15), which were situated in the PRC.
- corporate guarantees given by the Company and a subsidiary of the Company;
- the Group's banking facilities were subject to the fulfilment of covenants relating to certain capital requirements, as were commonly found in lending arrangements with financial institutions. If the Group breach the covenants, the drawn down facilities would become payable on demand. As at 31 December 2008, none of the covenants relating to the drawn down facilities had been breached.
- a charge on the trade receivables of Pearl Oriental Warehouse (Shenzhen) Limited, a wholly owned subsidiary of the Company, of approximately RMB372,000 (equivalents to HK\$420,000)).

Upon the disposal of subsidiaries during the year (note 36), the corporate guarantees given by the Company and a subsidiary of the Company were released by the bank.

28. LOAN FROM IMMEDIATE PARENT AND ULTIMATE CONTROLLING PARTY

	Group		Company	
	2009 HK\$'000	2008 HK\$'000	2009 HK\$'000	2008 HK\$'000
Current portion (note (i))	4,910	—	3,112	—
Non current portion (note (ii))	66,300	25,000	66,300	25,000
	<u>71,210</u>	<u>25,000</u>	<u>69,412</u>	<u>25,000</u>

On 5 September 2008, the Company entered into a loan facility agreement with Orient Day Development Limited (Orient Day"), the immediate parent and ultimate controlling party of the Company, for the grant of a loan facility of not exceeding HK\$25,000,000 by Orient Day to the Company.

The total amount of HK\$25,000,000 has been drawn down by the Company during the year ended 31 December 2008 and remained outstanding as at 31 December 2008. The loan was unsecured and bore interest at the Hong Kong Prime Rate as quoted by the Hong Kong and Shanghai Banking Corporation ("HSBC Prime rate") from time to time. On 4 March 2009, the Company entered into a conditional subscription agreement with Orient Day, pursuant to which, the loan was settled as part of the proceeds for the issue of convertible notes to Orient Day during the year (note 30(a)(iv)).

As at 31 December 2009, the loan from immediate parent and ultimate controlling party of HK\$71,210,000 represented:

- (i) a loan with an aggregate amount of approximately HK\$4,910,000 granted by Orient Day during the year with the following terms:
- approximately HK\$3,112,000 advanced to the Company, which was unsecured, bore interest at HSBC Prime Rate from time to time and had no fixed repayment terms, and;
 - approximately HK\$1,798,000 advanced to a subsidiary of the Group, which was unsecured, interest-free and had no fixed repayment terms.

These loans were fully settled subsequent to the end of the reporting period in February 2010.

- (ii) An amount of HK\$66,300,000 representing the amounts received for the subscription of the Company's shares by Orient Day. The subscription was completed subsequent to the end of the reporting period in January 2010, details of which are set out in note 42 to the financial statements.

29. DEFERRED TAX ASSETS

	Group	
	2009	2008
	HK\$'000	HK\$'000
At the beginning of year	—	1,419
Deferred tax charged to the income statement during the year (note 10)	—	(1,419)
Gross deferred tax assets at 31 December	—	—

At 31 December 2009, the Group had unused tax losses of approximately HK\$23,414,000 (2008: 36,018,000) available for offset against future profits for a period of five years. During the year, no unrecognised tax losses have expired. No deferred tax asset has been recognised in respect of such losses as they have arisen in subsidiaries that have been loss-making for some time and it is not considered probable that taxable profits will be available against which the tax losses can be utilised.

At 31 December 2009, the Group did not have any significant deductible temporary differences (2008: Nil).

No provision for deferred taxation has been recognised in the financial statements of the Company as the amount involved is insignificant.

30. SHARE CAPITAL

(a) SHARES

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Authorised:		
200,000,000,000 ordinary shares of HK\$0.10 each	<u>20,000,000</u>	<u>20,000,000</u>
Issued and fully paid:		
1,159,216,960 ordinary shares of HK\$0.10 each (2008: 464,737,960 shares of HK\$0.10)	<u>115,922</u>	<u>46,474</u>

A summary of the movements in the Company's authorised and issued share capital during the year is as follows:

	Authorised			
	Ordinary shares of HK\$0.10 each		Ordinary shares of HK\$0.5 each	
	Number of shares '000	<i>HK\$'000</i>	Number of shares '000	<i>HK\$'000</i>
At 1 January 2008	—	—	600,000	300,000
Increase in authorised share capital:				
Capital restructuring (note (i))	—	—	5,400,000	2,700,000
Capital reduction (note (ii))	6,000,000	600,000	(6,000,000)	(3,000,000)
Increase in authorised share capital (note (iii))	<u>194,000,000</u>	<u>19,400,000</u>	<u>—</u>	<u>—</u>
At 31 December 2008 and 2009	<u>200,000,000</u>	<u>20,000,000</u>	<u>—</u>	<u>—</u>

30. SHARE CAPITAL (Continued)**(a) SHARES** (Continued)

	Issued and fully paid					
	Ordinary shares of HK\$0.10 each		Ordinary shares of HK\$0.5 each		Share premium account	Total
	Number of shares '000	HK\$'000	Number of shares '000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2008	—	—	387,281	193,641	346,510	540,151
Issues of new shares (note(i))	—	—	77,456	38,728	38,728	77,456
Share issue expenses	—	—	—	—	(330)	(330)
Capital reduction (note (ii))	464,737	46,474	(464,737)	(232,369)	—	(185,895)
At 31 December 2008	464,737	46,474	—	—	384,908	431,382
At 1 January 2009	464,737	46,474	—	—	384,908	431,382
Issue of new shares						
In May 2009 (note (iv))	116,666	11,667	—	—	23,333	35,000
In July 2009 (note (vi))	145,000	14,500	—	—	55,100	69,600
In July 2009 (note (iv))	33,333	3,333	—	—	6,667	10,000
In October 2009 (note (v))	50,000	5,000	—	—	15,000	20,000
In October 2009 (note (vii))	200,000	20,000	—	—	94,000	114,000
In December 2009 (note (viii))	115,680	11,568	—	—	106,426	117,994
Share issue expenses	—	—	—	—	(530)	(530)
In December 2009 (note (v))	25,000	2,500	—	—	7,500	10,000
Share options exercised (note (ix))	8,800	880	—	—	5,697	6,577
At 31 December 2009	1,159,216	115,922	—	—	698,101	814,023

Notes:

- i. Pursuant to an ordinary resolution passed on 19 February 2008, the authorised share capital of the Company was increased from HK\$300,000,000, divided into 600,000,000 shares of HK\$0.50 each, to HK\$3,000,000,000, divided into 6,000,000,000 shares of HK\$0.50 each, by the creation of 5,400,000,000 additional shares of HK\$0.50 each. Pursuant to a share subscription agreement dated 31 December 2007, the Company has allotted 77,456,000 new ordinary shares of HK\$0.50 each to Orient Day Developments Limited at a price of HK\$1.00 per share, raising gross proceeds of approximately HK\$77,456,000 for working capital.
- ii. Pursuant to a special resolution passed on 12 November 2008, the issued share capital of the Company was reduced by cancelling the paid up capital to the extent of HK\$0.40 on each of the shares in issue such that the nominal value of all the issued shares was reduced (the "Issued Capital Reduction") from HK\$0.50 each to HK\$0.10 each; and (b) the nominal value of all shares in the authorised share capital of the Company was reduced from HK\$0.50 each to HK\$0.10 each, resulting in the reduction of the authorised share capital from HK\$3,000,000,000 to HK\$600,000,000 divided into 6,000,000,000 shares of HK\$0.10 each (the "Authorised Capital Reduction"). Upon the Issued Capital Reduction and the Authorised Capital Reduction becoming effective, the credit amount arising from the Issued Capital Reduction be applied to set off against the accumulated losses of the Company;
- iii. Pursuant to an ordinary resolution passed on 12 November 2008, upon the Issued Capital Reduction and the Authorised Capital Reduction becoming effective, the authorised share capital of the Company was increased from HK\$600,000,000, divided into 6,000,000,000 shares of HK\$0.10 each, to HK\$20,000,000,000, divided into 200,000,000,000 shares of HK\$0.10 each, by the creation of 194,000,000,000 new shares of HK\$0.10 each.

30. SHARE CAPITAL (Continued)

(a) SHARES (Continued)

Notes: (Continued)

- (iv) In March 2009, Orient Day and the Company entered into a subscription agreement (the "First Subscription Agreement") in relation to the proposed issue of convertible notes (the "First Convertible Notes") by the Company to Orient Day. The First Convertible Notes consist of two tranches and the total principal amount is up to HK\$45,000,000. The First Convertible Notes are convertible into new ordinary shares of the Company at a conversion price of HK\$0.30 per ordinary share, resulting in the issue of an aggregate of up to 150,000,000 new ordinary shares of the Company.

The First Convertible Notes shall be issued as follows:

- Orient Day shall subscribe for, and the Company shall issue, the convertible note due after 2 years from the date of issue with a principal amount up to HK\$30,000,000 (the "First Tranche Note");
- if Orient Day elects to subscribe for, the Company may at its sole discretion give a written notice to Orient Day on or before 31 December 2009 to invite for the subscription for the second tranche of the First Convertible Notes (the "Second Tranche Note") with a further principal amount of HK\$15,000,000.

The First Tranche Note and part of the Second Tranche Note of HK\$5,000,000 were converted by Orient Day on 22 May 2009, resulting in 116,666,000 new ordinary shares being issued to Orient Day for a total consideration of HK\$35,000,000, satisfied by Orient Day as to HK\$25,000,000 by offsetting a loan of HK\$25,000,000 due to Orient Day by the Company at the time (note 28) and as to the remaining balance of HK\$10,000,000 in cash for general working capital of the Company.

The remaining balance of the Second Tranche Note was exercised by Orient Day on 29 July 2009, resulting in 33,333,000 new ordinary shares being issued to Orient Day for a total consideration of HK\$10,000,000 in cash for general working capital of the Company.

At the end of the reporting period, there were no outstanding First Convertible Notes.

- (v) In May 2009, Orient Day and the Company entered into another subscription agreement (the "Second Subscription Agreement") in relation to the proposed issue of convertible notes (the "Second Convertible Notes") by the Company to Orient Day. The Second Convertible Notes consist of two tranches and the total principal amount is up to HK\$100,000,000. The Second Convertible Notes are convertible into new ordinary shares of the Company at an conversion price of HK\$0.40 per ordinary share, resulting in the issue of an aggregate of up to 250,000,000 new ordinary shares of the Company.

The Second Convertible Notes shall be issued as follows:

- Orient Day shall subscribe for, and the Company shall issue, the convertible note due after 2 years from the date of issue with a principal amount up to HK\$100,000,000;
- if Orient Day elects to subscribe for, the Company may at its sole discretion give a written notice to Orient Day on or before 30 June 2011 to invite for the subscription for the whole part of the Second Convertible Note by Orient Day provided that the principal amount of each of the convertible note notices shall be in the multiples of HK\$10,000,000.

A total of 50,000,000 and 25,000,000 new shares were issued on 20 October 2009 and 31 December 2009, respectively, and Orient Day exercised its right to convert the Second Convertible Notes into ordinary shares of the Company on the respective issue dates. The proceeds from the conversion of the Second Convertible Notes were of approximately HK\$30,000,000.

At the end of the reporting period, a total of HK\$70,000,000 of Second Convertible Notes remained outstanding, the full issue and conversion of which would result in the issue of a total of 175,000,000 new ordinary shares of the Company with an aggregate gross proceeds of HK\$70,000,000.

30. SHARE CAPITAL *(Continued)*

(a) SHARES *(Continued)*

Notes: *(Continued)*

- (vi) In July 2009, the Company issued 145,000,000 new ordinary shares at a price of HK\$0.40 per share as the consideration for the acquisition of the additional equity interests in China Coal (note 33(a)). At the issue date, the fair value of the consideration shares were approximately HK\$69,600,000.
- (vii) In October 2009, the Company issued 200,000,000 new ordinary at a price of HK\$0.5 per shares as the consideration for the acquisition of minority interests (note 34) in a then non-wholly-owned subsidiary and the acquisition of certain business (note 34). At the issue date, the fair value of the consideration shares were approximately HK\$114,000,000.
- (viii) In December 2009, the Company entered into several shares sales and subscription agreements with Orient Day and certain other purchasers. Pursuant to which, Orient Day agreed to sell an aggregate of 115,680,000 existing shares of the Company ("Sale Share(s)") beneficially owned by Orient Day to the purchasers at a price of HK\$1.02 per Sale Share (the "Sale"). In addition, Orient Day conditionally agreed to subscribe for an aggregate of 115,680,000 new ordinary shares of the Company (the "Subscription Share(s)") at a price of HK\$1.02 per Subscription Share (the "Subscription"). The Sale and Subscription was completed on 24 December 2009 with aggregate net proceeds of approximately HK\$117,464,000 received by the Company. The purpose of the Sale and Subscription was to raise capital for the Company while broadening the shareholder base and capital base of the Company.
- (ix) In December 2009, 8,800,000 share options have been exercised at an exercise price of HK\$0.56 per share, resulting into the issue of 8,800,000 new ordinary shares of the Company with an aggregate gross proceeds of HK\$6,577,000 (including the amount transferred from share option reserve of approximately HK\$1,649,000). The net proceeds from the exercise of the share options were HK\$4,928,000.

(b) SHARE OPTIONS

Details of the Company's share option scheme are included in note 31 to the financial statements.

31. SHARE OPTION SCHEME

The Company has a share option scheme (“the Old Scheme”) which was adopted on 21 June 2002 whereby, pursuant to a written resolution of the sole shareholder, was set up for the primary purpose of providing incentives to directors and eligible employees, and which will expire on 20 June 2012. Under the Scheme, the directors of the Company may grant options to eligible employees, including directors of any companies in the Group, to subscribe for shares in Company. However, the Old Scheme had cancelled during the year ended 31 December 2008.

The Company has a new share option scheme (“the New Scheme”) which was adopted on 5 August 2009 and 3 December 2009, respectively, whereby, pursuant to a written resolution of all the shareholders, was set up for the primary purpose of providing incentives to directors and eligible employees, and which will expire on 14 July 2019. Under the Scheme, the directors of the Company may grant options to eligible employees, including directors of any companies in the Group, to subscribe for shares in Company.

The total number of shares in respect of which options may be granted under the New Scheme is not permitted to exceed 10% of the issued share capital of the Company from time to time, without prior approval from shareholders of the Company. The number of shares in respect of which options may be granted to an individual in any one year is not permitted to exceed 1% of the Company’s issued share capital; otherwise it must be approved by the shareholders of the Company.

The options may be exercised at any time from the date of acceptance of the offer to the tenth anniversary of the date of grant. The exercise price is determined by the directors of the Company, and shall not be less than the higher of the closing price of the Company’s shares on the date of grant, the average closing price of the shares for the five business days immediately preceding the date of grant and the nominal value of the shares of the Company. Each option gives the holder the right to subscribe for one ordinary share in the Company.

31. SHARE OPTION SCHEME (Continued)

The following table discloses movements in the Company's share options establishing during the year:

Grantee	Date of grant	Exercise period	Outstanding as at 1 January 2009	Granted during the year	Exercise during the year	Lapse during the year	Outstanding as at 31 December 2009	Exercise price per share option HK\$
Directors								
Wong Yuk Kwan	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.56
Cheung Kwok Yu	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	(3,000,000)	—	—	0.56
Zhou Li Yang	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.56
Zheng Yingsheng	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	(2,000,000)	—	1,000,000	0.56
Johnny Yuen	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.56
Fung Hing Chiu	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.56
Lam Ka Wai Graham	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.56
Yu Jianmeng	5 August 2009	5 August 2009 - 14 July 2019	—	1,000,000	—	—	1,000,000	0.56
Lew Mon Hung	3 December 2009	3 December 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.83
			—	25,000,000	(5,000,000)	—	20,000,000	
Consultant								
Dong Zhixiong*	5 August 2009	5 August 2009 - 14 July 2019	—	3,000,000	—	—	3,000,000	0.56
Employees								
	5 August 2009	5 August 2009 - 14 July 2019	—	5,000,000	(3,800,000)	(1,000,000)	200,000	0.56
			—	33,000,000	(8,800,000)	(1,000,000)	23,200,000	

31. SHARE OPTION SCHEME *(Continued)*

The options granted during the year were measured using the Binomial Option Pricing Model which was performed by an independent valuer, BMI Appraisals Limited. The inputs into the model used are summarised as follows:

Date of grant	5 August 2009	3 December 2009
Spot price	HK\$0.56	HK\$0.83
Exercise price	HK\$0.56	HK\$0.83
Risk-free rate	2.43%	2.14%
Nature of the options	Call	Call
Expected life of the options	9.94 years	9.61 years
Expected volatility	75.33%	75.15%
Expected dividend yield	Nil	Nil
Early exercise behavior	150%	150%

The Company recognised total expenses of approximately HK\$6,727,000 for the year ended 31 December 2009 in relation to share options granted.

32. RESERVES**(a) GROUP**

The amounts of the Group's reserves and the movements therein for the current and prior year are presented in the consolidated statement of changes in equity on page 29 of the financial statements.

The capital reserve of the Group represents the difference between the nominal value of the share capital issued by the Company and the aggregate of the share capital and the share premium account of the subsidiaries acquired pursuant to the Group reorganisation in 1996.

At 31 December 2008 and 2009, 4,060,000 ordinary shares of the Company remained with Pearl Oriental Sino Limited, a subsidiary, which was accounted for as a reduction in the Company's equity.

32. RESERVES (Continued)**(b) COMPANY**

	Issued capital HK\$'000	Share premium HK\$'000	Contributed surplus HK\$'000	Share options reserve HK\$'000	Retained earnings/ accumulated losses) HK'000	Total HK'000
At 1 January 2008	193,641	346,510	45,348	16,579	(164,895)	437,183
Issue of shares (note 30(a)(i))	38,728	38,728	—	—	—	77,456
Share issue expenses	—	(330)	—	—	—	(330)
Capital reduction (note 30(a)(ii))	(185,895)	—	—	—	185,895	—
Cancellation of share options	—	—	—	(16,579)	16,579	—
Total comprehensive income for the year	—	—	—	—	(10,624)	(10,624)
At 31 December 2008	46,474	384,908	45,348	—	26,955	503,685
Issue of new shares (note 30)	68,568	308,026	—	—	—	376,594
Share issue expenses	—	(530)	—	—	—	(530)
Equity-settled share options arrangements (note 31)	—	—	—	6,727	—	6,727
Share options exercised during the year (note 30(a)(viii))	880	5,697	—	(1,649)	—	4,928
Share options lapsed during the year	—	—	—	(188)	188	—
Total comprehensive for the year	—	—	—	—	(546,417)	(546,417)
At 31 December 2009	115,922	698,101	45,348	4,890	(519,274)	344,987

Notes

(i) Contributed surplus

The contributed surplus of the Company represents the excess of the nominal value of the share capital issued by the Company and the aggregate net asset value of the subsidiaries acquired at the date of acquisition pursuant to the Group reorganisation in 1996. Under the Companies Act 1981 of Bermuda (as amended), the Company may make distributions to its members out of contributed surplus in certain circumstances.

Under the Companies Act 1981 Bermuda, the contributed surplus account of the Company is available for distribution. However, the Company cannot declare or pay a dividend, or make a distribution out of contributed surplus, if:

- (a) it is, or would after the payment be, unable to pay its liabilities as they become due; or
- (b) the realisable value of its assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium.

(ii) Share premium account

The share premium account is available for distribution to shareholders subject to the provisions of the Articles of Association of the Company and no distribution may be paid to shareholders out of the share premium account unless, immediately following the date on which the distribution or dividend is proposed to be paid, the Company shall be able to pay its debts as they fall due in the ordinary course of business.

32. RESERVES *(Continued)*

In the opinion of the directors, the Company's reserves available for distribution to shareholders are as follows:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Share premium	698,101	384,908
Contributed surplus	45,348	45,348
Retained (losses)/earnings	(519,274)	26,955
	<u>224,175</u>	<u>457,211</u>

33. ACQUISITION OF SUBSIDIARIES**(a) ACQUISITION OF ADDITIONAL EQUITY INTERESTS IN CHINA COAL ENERGY HOLDINGS LIMITED ("CHINA COAL")**

On 15 July 2009, the Group acquired from independent third parties an aggregate of 15.18% equity interests in China Coal through the acquisition of a 100% equity interest in Get Wealthy Investments Limited ("Get Wealthy") (which holds 15% equity interests in China Coal) and the remaining 0.18% equity interests in China Coal at an aggregate consideration of HK\$58,000,000. The consideration was satisfied by issuing 145,000,000 new ordinary shares (the "Consideration Shares") at a price of HK\$0.40 per ordinary share. Upon the completion, the Group's equity interest in China Coal increased from 39.93% (note 18) to 55.11% and China Coal has therefore become an indirect 55.11% owned subsidiary of the Company.

Get Wealthy is an investment holding company incorporated in the British Virgin Islands with limited liabilities. China Coal is an investment holding company incorporated in Hong Kong with limited liabilities. The principal asset of China Coal is a 100% equity interest in Taiyuan Sanxing Coal Gasification (Group) Co., Limited ("Taiyuan Sanxing"). Taiyuan Sanxing was established in the PRC with limited liability. Taiyuan Sanxing and its subsidiary are principally engaged in the coal gasification and coal mining.

33. ACQUISITION OF SUBSIDIARIES (Continued)**(a) ACQUISITION OF ADDITIONAL EQUITY INTERESTS IN CHINA COAL ENERGY HOLDINGS LIMITED (“CHINA COAL”)** (Continued)

As detailed in note 22 to the financial statements, China Coal has not been provided with the operating and financing information of Taiyuan Sanxing since 1 January 2008 and China Coal is unable to exercise its powers on the financial and operating matters of Taiyuan Sanxing. As a result of the loss of control or significant influence over Taiyuan Sanxing, China Coal's equity interests in Taiyuan Sanxing were reclassified as an available for sales investment at its carrying value of HK\$944,312,000 during the year ended 31 December 2008.

The acquisition of additional equity interests in China Coal (the “Acquisition”) is not accounted for as a business combination in the Group's consolidated financial statements for the year ended 31 December 2009 as the Group obtained control of Get Wealthy and China Coal through the Acquisition that are not businesses, the bringing together of those entities is not a business combination. Accordingly, the consideration of the Acquisition was allocated between the individual identifiable assets and liabilities of Get Wealthy and China Coal.

	Notes	Fair value recognised on acquisition HK\$'000	Previous carrying amount HK\$'000
Available-for-sales investments	22	922,318	944,312
Cash and bank balances		9	9
Other payables and accruals		(4,010)	(4,010)
Due to a former shareholder of China Coal		(23,400)	(23,400)
Due to the Group by China Coal	18	(5,868)	(5,868)
Net assets of Get Wealthy and China Coal		889,049	911,043
Minority interests of China Coal		(399,094)	
Net assets of Get Wealthy and China Coal attributable to the owners of the Company		489,955	
Satisfied by:			
Interests in an associate, China Coal	18	420,355	
Fair value of the Consideration Shares	30(a)(vi)	69,600	
		489,955	

33. ACQUISITION OF SUBSIDIARIES *(Continued)***(a) ACQUISITION OF ADDITIONAL EQUITY INTERESTS IN CHINA COAL ENERGY HOLDINGS LIMITED (“CHINA COAL”)** *(Continued)*

An analysis of the net inflow of cash and cash equivalents in respect of the acquisition of Get Wealthy and China Coal is as follows:

	<i>HK\$'000</i>
Cash consideration	—
Cash and bank balances acquired	9
Net inflow of cash and cash equivalents in respect of the acquisition of Get Wealthy and China Coal	9

Since its acquisition, China Coal has not contributed to the Group's consolidated revenue for the year ended 31 December 2009 but incurred a loss of approximately HK\$923,201,000 to the consolidated loss for the year ended 31 December 2009, of which approximately HK\$399,094,000 was attributable to its minority interests.

Had the acquisition taken place at 1 January 2009, the Group's consolidated revenue and loss for the year ended 31 December 2009 would have been HK\$195,530,000 and HK\$968,786,000, respectively.

(b) ACQUISITION OF ADDITIONAL EQUITY INTERESTS IN EURO RESOURCES CHINA LIMITED (“ERC”)

Euro Resources China Limited (“ERC”) was owned as to 50% by the Group and was classified as an associate in the consolidated balance sheet as at 31 December 2007. At the time of acquiring the 50% equity interests in ERC by the Group, the vendors (Mr. Laurent Kim, a former director and the founder of ERC) and Mr. Ung Phong (collectively, the “Guarantors”) have given a profit guarantee to Grand Ascend Investments Limited (“Grand Ascend”), a wholly-owned subsidiary of the Company, in respect of ERC's audited results for the three years ending 31 December 2009. Mr. Laurent Kim had pledged its 30% equity interests in ERC in favour of Grand Ascend under a share charge (the “Share Charge”) as collateral for the performance of the Guarantors under the profit guarantee.

As disclosed in the Company's circular dated 27 November 2008, the Guarantors had failed to honour and perform the profit guarantee due to their own personal reasons, and the Group had no other choice but to dispose of Mr. Laurent Kim's 30% equity interests in ERC under the Share Charge by way of a private tender. Private invitations to offer had been sent to a number of potential investors in the environmental and related sectors by an independent sale agent of the private tender appointed by the Group including all the existing shareholders of ERC. Legal advices have been obtained by the Company in respect of the enforceability of the Share Charge and of the results of the private tender.

Allfair Limited (“Allfair”), a wholly-owned subsidiary of the Group, had submitted an offer of HK\$9,800,000 to the sale agent of the private tender which was the only offer received by the sale agent. On 5 November 2008, Allfair entered into a sale and purchase agreement (the “Acquisition”) with Grand Ascend, to acquire the 30% equity interests in Euro Resources at a consideration of HK\$9,800,000.

As disclosed in the Company's circular dated 27 November 2008, the Group has reserved the right to claim against the Guarantors to recover the balance of the shortfall in the Profit Guarantee, i.e. approximately Euro 5.5 million (equivalent to approximately HK\$60,115,000) minus the sum of HK\$9,800,000 recovered by the Group as a result of enforcing the Share Charge. The Group may consider taking legal proceedings against the Guarantors after seeking legal advice if it is in the best interests of the Group. The amount of HK\$9,800,000 has been booked as other income and gains (note 5).

33. ACQUISITION OF SUBSIDIARIES (Continued)**(b) ACQUISITION OF ADDITIONAL EQUITY INTERESTS IN EURO RESOURCES CHINA LIMITED (“ERC”)**
(Continued)

Upon to the completion of the Acquisition, ERC became an 80% owned subsidiary of the Company. The fair values of the identifiable assets and liabilities of ERC as at the completion date of Acquisition and the corresponding carrying amounts immediately before the completion date of the Acquisition are as follows:

	Fair value recognised on acquisition HK\$'000	Previous carrying amount HK\$'000
Property, plant and equipment (Note 15)	64,353	64,353
Cash and bank balances	2,029	2,029
Inventories	7,202	7,202
Trade receivables	1,887	1,887
Prepayments and other receivables	4,253	4,253
Trade payables	(9,362)	(9,362)
Accruals and other payables	(30,669)	(30,669)
Due to minority shareholders	(17,507)	(17,507)
Tax payable	(1,707)	(1,707)
	<u>20,479</u>	<u>20,479</u>
Portion attributable to the 30% equity interests in ERC acquired	6,144	
Goodwill on acquisition of 30% equity interests	<u>3,656</u>	
Satisfied as:		
Other income - shortfall in profit of ERC guaranteed by an ex-joint venture partner (Note 5)	<u>9,800</u>	

The net inflow of cash and cash equivalents in respect of the Acquisition represents the cash and bank balances of ERC of approximately HK\$2,029,000 acquired.

The goodwill in association with the piece-meal acquisition of the 80% equity interests in ERC is as follows:

	<i>HK\$'000</i>
Goodwill recognised in the previous period, included in the interests in associates	13,265
Goodwill on acquisition of 30% equity interests	<u>3,656</u>
Total goodwill arising from acquisition of a subsidiary (Note 16)	<u>16,921</u>

33. ACQUISITION OF SUBSIDIARIES *(Continued)***(b) ACQUISITION OF ADDITIONAL EQUITY INTERESTS IN EURO RESOURCES CHINA LIMITED (“ERC”)**
(Continued)

Since the acquisition of the additional 30% equity interests by the Group, ERC has not contributed to the Group’s revenue and contributed a loss of HK\$965,000 to the consolidated loss for the year ended 31 December 2008.

34. ACQUISITION OF MINORITY INTEREST

On 30 July 2009, the Group entered into a sales and purchase agreement (the “ERC Sales and Purchase Agreement”) to acquire the entire issued share capital of Poly Keen Limited (“Poly Keen”) for an aggregate consideration of HK\$50,000,000, which was satisfied by the issue of 100,000,000 new ordinary shares (the “Consideration Share 1”) at the price of HK\$0.50 per ordinary share. Prior to the acquisition, the Group owned 80% equity interests in Euro Resources China Limited (“ERC”) and its subsidiaries and, Poly Keen owned 20% equity interests in ERC. Upon the completion of the acquisition on 21 October 2009, ERC became a wholly-owned subsidiary of the Company.

	<i>Notes</i>	<i>HK\$’000</i>
The carrying values of the identifiable assets and liabilities of Poly Keen and ERC Group as at the date of acquisition		12,597
Portion attributable to the remaining 20% equity interests In ERC held by Poly Keen		2,519
Elimination of amount due to Poly Keen the ERC Group		11,496
		14,015
Satisfied by:		
Fair value of the Consideration Share 1	30(a)(vii)	(57,000)
Goodwill on acquisition of the remaining 20% equity interest	16	42,985

An analysis of the net inflow of cash and cash equivalents in respect of the acquisition of Poly Keen and the ERC Group are as follows:

	<i>HK\$’000</i>
Cash consideration	—
Cash and bank balances acquired	—
Net outflow of cash and cash equivalents in respect of the acquisition of Poly Keen	—

35. ACQUISITION OF BUSINESS

In addition to the acquisition of minority interests as detailed in note 34 to the financial statements, on 30 July 2009, the Company further entered into a merger agreement (“Merger Agreement”) with Mr. Cheung Mo Kit (“Mr Cheung”), an independent third party and the sole shareholder of IB Group Trading Limited (“IBG”). Pursuant to which, a joint venture company, China Environmental Resources Limited (“CER”), has been established for the development of the business of plastic recycling (the “Business”). The registered capital of CER is HK\$50,000,000 comprising 50,000,000 shares of HK\$1 per share, HK\$30,000,000 was contributed by Group for 60% equity interests in CER while the remaining HK\$20,000,000 was contributed by Mr. Cheung for 40% equity interests in CER. CER became a 60% owned subsidiary of the Group. A new operating company, IB Environmental Plastic Limited (“IBE” and together with CER, hereby referred as the “IBE Group”), has been set up as a wholly-owned subsidiary CER to operate the Business in the plastic recycling industry in Europe, Japan, the PRC and other countries.

In addition, pursuant to the Merger Agreement, the Company issued 100,000,000 new ordinary shares (the “Consideration Share 2”) at the price of HK\$0.50 per ordinary share to Mr. Cheung as the consideration for Mr. Cheung’s agreeing to enter into the Merger Agreement. Mr. Cheung procured all the Business has been transferred from IBG to IBE.

The fair values of the identifiable assets and liabilities of the Business acquired under the Merger Agreement as at the date of acquisition and the corresponding goodwill arising from the completion of the Merger Agreement were as follows:

	<i>Notes</i>	<i>HK\$'000</i>
Assets and liabilities of the Business		—
Assets and liabilities of Poly Keen and the ERC Group		12,597
Assets and liabilities of the joint venture, net		12,597
The joint venture partner’s 40% share in the assets and liabilities of the IBE Group, net		5,039
Consideration for the Merger Agreement:		
Fair value of the Consideration Share 2	30(a)(vii)	57,000
Goodwill arising from the completion of the Merger Agreement*	16	62,039

* The goodwill arising from the acquisition of the Business of HK\$62,039,000 represented (i) the extensive suppliers and customers networks in Japan, Malaysia, Taiwan and Mainland China; (ii) the senior management team of IBG; and (iii) the good reputation and the operation in the plastic recycling industry in Europe, Japan, Mainland China and other countries. These intangible assets have not been recognised separately from the goodwill as the directors of the Company are of the opinion that these intangible assets cannot be measured reliably and cannot be recognised separately as an identifiable asset.

Since its acquisition by the Group, the Business contributed HK\$159,018,000 and HK\$1,652,000, respectively, to the Group’s consolidated revenue and the consolidated profit for the year ended 31 December 2009.

Had the acquisition taken place at 1 January 2009, the Group’s consolidated revenue of and consolidated loss for the year ended 31 December 2009 would have been HK\$195,530,000 and HK\$967,962,000, respectively.

36. DISPOSAL OF SUBSIDIARIES

DISPOSAL OF POEHL

On 22 January 2009, Pearl Oriental Logistics Holdings Limited, a wholly-owned subsidiary of the Company, entered into a sale and purchase agreement with Sunny Villa Investments Limited (“Sunny Villa”). Pursuant to which, the Company (i) has disposed of 60% equity interest in Pearl Oriental Express Holdings Limited (“POEHL”) and (ii) waived (the “Waiver”) of a shareholder’s loan of approximately HK\$15,043,000 in full owing from POEHL and its subsidiary, Guangzhou Pearl Oriental Logistics Limited (“GZPO”) to the Group for a consideration of HK\$3,000,000 which was satisfied by cash and HK\$9,000,000 which was satisfied by a convertible bond issued by POEHL with a maturity of two years from the date of issue and which can be convertible into 20% equity interests in POEHL or, GZPO or any other new holding company.

The disposal of POEHL was completed on 28 February 2009 and the Company received cash of HK\$3,000,000 and the convertible bond of HK\$9,000,000 as the consideration of the disposal of POEHL and the Waiver. In the opinion of the directors of the Company, the fair value of the convertible bond was minimal at the date of issue.

DISPOSAL OF GOOD VALUE GROUP

In prior years, the Group had 100% equity interest in Good Value Holdings Limited (“Good Value”) and its subsidiaries, Hong Kong Good Value Holdings Limited (“HKG VH”) and Pearl Oriental Warehouse (Shenzhen) Limited (“POW (SZ)”) (collectively referred to as the “Good Value Group”). The principal activities of POW (SZ) were provision of logistics services and warehousing services in the PRC and, POW(SZ) owned a bonded warehouse property (the “Warehouse”) in Futian, Shenzhen, the PRC. The Warehouse has been pledged to a bank for a bank loan granted to the Group (the “Bank Loan”).

On 27 November 2009, the Group entered into a sale and purchase agreement with Full Wealth International Investments Holdings Limited (“Full Wealth”), an independent third party. Pursuant to which, the Group had disposed of its 100% equity interests in Good Value at a consideration of RMB93,000,000 (equivalent to approximately HK\$105,520,000), in which (i) RMB46,500,000 (equivalent to approximately HK\$52,760,000) is satisfied by cash; and (ii) the remaining consideration of RMB46,500,000 (equivalent to approximately HK\$52,760,000) is offset against the outstanding bank loan of POW (SZ) of approximately RMB46,720,000 (equivalent to approximately HK\$53,280,000). The net proceeds after the deduction of the Bank Loan amounted to RMB46,500,000 (equivalent to approximately HK\$52,760,000).

36. DISPOSAL OF SUBSIDIARIES (Continued)**DISPOSAL OF GOOD VALUE GROUP** (Continued)

The major classes of assets and liabilities of the POEHL Group and the Good Value Group as at the respective disposal dates were as follows:

	<i>Notes</i>	POEHL Group <i>HK\$'000</i>	Good Value Group <i>HK\$'000</i>	Total <i>HK\$'000</i>
Net assets disposed of:				
Property, plant and equipment	14	3,419	94,936	98,355
Prepaid land lease payments	15	—	19,082	19,082
Cash and bank balances		286	487	773
Trade receivables		7,331	74	7,405
Prepayments and other receivables		5,036	74	5,110
Trade payables		(3,717)	(211)	(3,928)
Accruals and other payables		(8,465)	(1,639)	(10,104)
Interest bearing bank borrowings*		—	(53,280)	(53,280)
Tax payable		(14)	(16,637)	(16,651)
Due to minority interests		(3,996)	—	(3,996)
Due to immediate holding company		(15,043)	—	(15,043)
		(15,163)	42,886	27,723
Waiver of the amount due to immediate holding company		15,043	—	15,043
Net assets value		(120)	42,886	42,766
Exchange fluctuation reserve realised	5	(4,685)	(2,591)	(7,276)
		(4,805)	40,295	35,490
Gain on disposal of subsidiaries		7,805	12,465	20,270
		3,000	52,760	55,760
Satisfied by:				
Cash		3,000	52,760	55,760
Fair value of the convertible bond		—	—	—
		3,000	52,760	55,760

* The remaining consideration of RMB46,500,000 (equivalent to HK\$52,760,000) is offset against the outstanding Bank Loan of approximately RMB46,720,000 (equivalent to approximately HK\$53,280,000), the Group is not liable to the excess amount between the remaining consideration and the outstanding Bank Loan.

36. DISPOSAL OF SUBSIDIARIES *(Continued)***DISPOSAL OF GOOD VALUE GROUP** *(Continued)*

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of subsidiaries are as follows:

	POEHL Group <i>HK\$'000</i>	Good Value Group <i>HK\$'000</i>	Total <i>HK\$'000</i>
Cash consideration	3,000	52,760	55,760
Cash and bank balances disposed of	(286)	(487)	(773)
Net inflow of cash and cash equivalents in respect of the disposal of subsidiaries	<u>2,714</u>	<u>52,273</u>	<u>54,987</u>

37. CONTINGENT LIABILITIES

At the end of the reporting period, the Company's contingent liabilities not provided for in the financial statements were as follows:

	Company 2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Guarantees given to banks in connection with facilities granted to subsidiaries	<u>—</u>	<u>60,370</u>

As at 31 December 2008, corporate guarantees were given to the banks by the Company for the banking facilities granted to the subsidiary of the Company, which were utilised to the extent of approximately HK\$60,367,000. No financial liabilities were recorded for the above guarantees given to banks as, in the opinion of the directors, the fair values of the financial guarantee contracts were not material as at 31 December 2008.

The relevant corporate guarantees were released upon the disposal of subsidiaries during the year (notes 27 and 36).

Details of the Group's litigations and the related contingent liabilities (if any) are set out in note 41 to the financial statements.

38. OPERATING LEASE ARRANGEMENTS**AS LESSEE**

The Group leases certain of its office properties under operating lease arrangements. Leases for properties are negotiated for terms of one to four years.

At 31 December 2009, the Group had total future minimum lease payments under non-cancellable operating leases in respect of land and buildings falling due as follows:

	Group	
	2009	2008
	<i>HK\$'000</i>	<i>HK\$'000</i>
Within one year	3,303	7,612
In the second to fifth year, inclusive	3,719	733
After five years	—	—
	<u>7,022</u>	<u>8,345</u>

The Company did not have any significant operating lease arrangements as at 31 December 2009 (2008: Nil)

39. CAPITAL COMMITMENTS

In addition to the operating lease commitments detailed in note 38 above, the Group had the following capital commitments at the end of the reporting period:

	Group	
	2009	2008
	<i>HK\$'000</i>	<i>HK\$'000</i>
Authorised, but not contracted for:		
Proposed acquisition of a subsidiary (note 21(a))	8,352	8,461
Leasehold improvement	32	—
	<u>8,384</u>	<u>8,461</u>

The Company did not have any significant commitments as at 31 December 2009 (2008: Nil).

40. RELATED PARTY TRANSACTIONS AND BALANCES

- (i) In addition to the balances detailed in notes 18, 23 and 28 to the financial statements, the Group had the following transactions with the related party during the year:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Immediate and ultimate controlling party:		
Orient Day Developments Limited:		
Administrative fees paid	—	250
Loan interest paid	855	882
Ex-minority shareholder of a subsidiary		
Favour Good Investments Limited:		
Loan interest paid	1,256	—

The related party transactions were conducted on terms negotiated between the Company and the related company.

- (ii) Compensation of key management personnel of the Group:

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Short term employee benefits	5,580	3,932
Post-employment benefits	—	—
Equity-settled share option expenses	2,248	—
Total compensation paid to key management personnel	7,828	3,932

Further details of directors' emoluments are included in note 8 to the financial statements.

41. LITIGATIONS

Apart from the litigations detailed in note 22 to the financial statements, the Group had the following significant outstanding litigations at the end of the reporting period:

(a) LITIGATION WITH THE EX-DIRECTORS OF A DISPOSED SUBSIDIARY

The Group had three pending litigation claims with the ex-directors of a disposed subsidiary, Dransfield Holdings Limited (“DHL”), who claim against the Group for a total sum of not less than HK\$11.4 million. As disclosed in the Company’s announcement dated 23 August 2005, the Company’s interest in DHL was disposed of on 23 July 2005. It was alleged in these claims that by disposing of all its shares in DHL, the Company was evading liabilities and denying these claimants’ benefits of the debts owned by DHL. A judgment (the “Judgment”) was given in favour of Horace Yao Yee Cheong, Habile International Holdings Limited and Makdavy Holdings Limited (collectively, the “Plaintiffs”) against the Company on 22 May 2009 for the aggregate sum of approximately HK\$6.9 million together with interests thereon and legal costs. To pursue the appeal, the Company has paid a total sum of HK\$10,167,000 (note 21) to the Court being the security for payment of judgement debt and the Plaintiffs’ cost. The Company has filed an appeal against the Judgment and the appeal was allowed by the Court of Appeal and the Judgment was set aside on 13 April 2010. On the basis of the Court of Appeal’s judgement, the Group is not liable to pay to the Plaintiffs. The Board is of the view that the claims filed by the remaining two ex-directors, Ms. Cheung Kam Wah and Mr. Tse Tack Huen, Alexander, are without merit.

(b) LITIGATION WITH DiCHAIN HOLDINGS LIMITED

It is a term and condition in the subscription agreements entered into by, inter alios, the Company and DiChain Holdings Limited (“DiChain Holdings”), being a former majority shareholder of the Company, on 22 February 2006 and an obligation (the “Obligation”) for DiChain Holdings to pledge one billion Shares (or 20,000,000 Consolidated Shares of HK\$0.50 each) upon completion of the Subscription Agreements, as collateral to compensate the Company of any economic loss (if any) arising from any breach of warranties (if any) provided by DiChain Holdings under the Subscription Agreements. As DiChain Holdings has not yet performed the Obligations under the Subscription Agreements, the Company issued a writ of summons against DiChain Holdings on 31 October 2006, inter alia, in respect of the breach of warranties given by DiChain Holdings under the Subscription Agreements. The Company obtained a summary judgment against DiChain Holdings on 13 December 2007 in respect of its non-performance of obligations and breach of warranties under the Subscription Agreements. On 7 January 2008, China Minsheng Banking Corporation Limited (Shenzhen Branch) (“Minsheng Bank”) applied to the court to join as the intervener of this case and has applied to the court for appeal, and Minsheng Bank obtained an order on 15 April 2008 that the appeal against the summary judgment entered by the Company on 13 December 2007 be allowed. The Company has obtained legal advice to further appeal after reviewing the judgment from the court and may consider to petition to the court for a winding order of DiChain Holdings in order to protect the interests of the Company.

42. EVENTS AFTER THE REPORTING PERIOD

Subsequent to the reporting period, the Group has following events:

- (a) On 9 January 2010, the Group entered into an agreement with the vendors (the “Vendors”), pursuant to which, the Company will acquire (the “Acquisition”) the 100% equity interest in Festive Oasis Limited (“Oasis”) and its subsidiaries (collectively, the “Oasis Group”), the 100% ownership interest in respect of oil, gas and/or mineral leases, title and related rights in the certain natural gas and oilfield located in the Utah, the United States of America (the “Ownership Interest”) through 2 phases and the amount due by Oasis to one of its shareholders, Charcon, (a shareholder which owns a 35% interest in Oasis) (the “Sales Loan”). In phase 1, the Company will acquire the 100% equity interest in Oasis and the Sales Loan at a consideration of US\$200 million (equivalent to approximately HK\$1,560 million, the “Phase 1 Consideration”) which is to be satisfied by (i) as to US\$50 million (equivalent to approximately HK\$390 million) by cash; and (ii) as to US\$150 million (equivalent to approximately HK\$1,170 million) by the issue of up to 847,810,000 consideration shares in the Company at a price (the “Price”) of HK\$1.38 per Share. As a condition to the payment of the Phase 1 Consideration, the Vendors will transfer to the Oasis Group, by phases, a 70% Ownership Interest. In phase 2, the Company may, at its option, further acquire the remaining 30% Ownership Interest and transfer to the same to the Oasis Group at a consideration of US\$25 million (equivalent to approximately HK\$195 million) which is to be satisfied by (i) as to US\$25 million (equivalent to approximately HK\$195 million) by cash in full; or (ii) if the Vendors elect, as to US\$12.5 million (equivalent to approximately HK\$97.5 million) by cash and the remaining sum of US\$12.5 million (equivalent to approximately HK\$97.5 million) by the issue of 70,650,000 consideration shares in the Company at HK\$1.38 per Share.

The Acquisition constitutes a very substantial acquisition and a connected transaction of the Company under the Listing Rules. At the date of approving these audited financial statements, the acquisition is still subject to, inter alia, the approval of the independent shareholders of the Company.

- (b) The Company further entered into various share sale and subscription agreements with certain independent third parties (the “Purchasers”) and Orient Day, on 12 December 2009 and 13 December 2009. Pursuant to which, Orient Day agreed to sell an aggregate of 65,000,000 existing ordinary shares (the “Sale Share(s)”) of the Company to the Purchasers at a price of HK\$1.02 per Sale Share. In addition, Orient Day conditionally agreed to subscribe for an aggregate of 65,000,000 new shares (the “Subscription Share(s)”) of the Company at a price of HK\$1.02 per Subscription Share, resulting in an aggregate gross proceeds of HK\$66.3 million as additional working capital of the Company. The subscription was completed in January 2010.
- (c) During the period from 15 April 2010 to 20 April 2010, the Company has entered into several subscription agreements (the “Subscription Agreements”) with certain subscribers (the “Subscriptions”), pursuant to which, those subscribers have conditionally agreed to subscribe for an aggregate of 231,367,000 new shares (the “Subscription Share(s)”) at a price of HK\$1.38 per Subscription Share. The gross proceeds from the Subscription are approximately HK\$319,000,000, which is intended to be partially utilised for the proposed Acquisition mentioned in note 42(a) above, the remaining balance of the proceeds shall be utilised as costs for the exploitation and exploration of existing and new wells of the Utah Gas and Oil Field. At the date of approving these audited financial statements, the Subscriptions have not yet been completed.

43. NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS**MAJOR NON-CASH TRANSACTIONS**

Apart from details set out in notes 33 to 35 to the financial statements regarding the acquisition of subsidiaries, minority interest and the Business and note 36 regarding the disposal of subsidiaries, the Group had the following major non-cash transaction:

As set out in note 30(a)(iv) to the financial statements, the First Tranche Note of HK\$30,000,000 and part of the Second Tranche Note of HK\$5,000,000 of the First Convertible Notes was converted by Orient Day on 22 May 2009, resulting in 116,666,000 new ordinary shares being issued to Orient Day for a total consideration of HK\$35,000,000. The consideration was satisfied by Orient Day partly by offsetting a loan of HK\$25,000,000 due to Orient Day by the Company at that time (note 28).

44. FINANCIAL INSTRUMENTS BY CATEGORY

The carrying amounts of each of the categories of financial instruments as at the end of the reporting period are as follows:

31 December 2009**Financial assets****Group**

	Loans and receivables HK\$'000	Total HK\$'000
Trade receivables	6,199	6,199
Financial assets included in prepayments, deposits and other receivables	47,521	47,521
Cash and cash equivalents	224,314	224,314
	<u>278,034</u>	<u>278,034</u>

Financial liabilities

	Financial liabilities at amortised cost HK\$'000	Total HK\$'000
Trade payables	5,700	5,700
Financial liabilities included in other payables and accruals	51,696	51,696
Loan from immediate parent and ultimate controlling party	71,210	71,210
	<u>128,606</u>	<u>128,606</u>

44. FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

31 December 2008

Group

Financial assets

	Loans and receivables HK\$'000	Total HK\$'000
Trade receivables	10,250	10,250
Financial assets included in prepayments, deposits and other receivables	11,195	11,195
Due from an associate	5,593	5,593
Cash and cash equivalents	15,787	15,787
	<u>42,825</u>	<u>42,825</u>

Financial liabilities

	Financial liabilities at amortised cost HK\$'000	Total HK\$'000
Trade payables	8,767	8,767
Financial liabilities included in other payables and accruals	19,886	19,886
Loan from immediate parent and ultimate controlling party	25,000	25,000
Due to minority shareholders of subsidiaries	21,504	21,504
Interest-bearing bank borrowings, secured	60,380	60,380
	<u>135,537</u>	<u>135,537</u>

44. FINANCIAL INSTRUMENTS BY CATEGORY *(Continued)*

31 December 2009

Financial assets**Company**

	Loans and receivables	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>
Cash and cash equivalents	206,624	206,624
Other receivables	10,446	10,446
Due from subsidiaries	726,156	726,156
	<u>943,226</u>	<u>943,226</u>

Financial liabilities

	Financial liabilities at amortised cost	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>
Financial liabilities included in other payables and accruals	4,073	4,073
Loan from immediate parent and ultimate controlling party	69,412	69,412
Due to subsidiaries	11,256	11,256
	<u>84,741</u>	<u>84,741</u>

44. FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

31 December 2008

Financial assets

Company

	Loans and receivables HK\$'000	Total HK\$'000
Cash and cash equivalents	8,882	8,882
Other receivables	80	80
Due from subsidiaries	527,076	527,076
	<u>536,038</u>	<u>536,038</u>

Financial liabilities

	Financial liabilities at amortised cost HK\$'000	Total HK\$'000
Financial liabilities included in other payables and accruals	2,003	2,003
Loan from immediate parent and ultimate controlling party	25,000	25,000
Due to subsidiaries	5,350	5,350
	<u>32,353</u>	<u>32,353</u>

45. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, comprise interest-bearing bank borrowings, other payables and accruals, the amount due to a minority shareholders of subsidiaries and, loan from immediate parent and ultimate controlling party. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

The main risks arising from the Group's financial instruments are cash flow interest rate risk, foreign currency risk, credit risk and liquidity risk. The board reviews and agrees policies for managing each of these risks and they are summarised below. The Group's accounting policies in relation to derivatives are set out in note 2.4 to the financial statements.

INTEREST RATE RISK

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's interest bearing bank borrowings, secured, with a floating interest rate.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's loss before tax.

	Increase/ (decrease) in basis points	Increase/ (decrease) in profit before tax <i>HK\$'000</i>	Increase/ (decrease) in in equity* <i>HK\$'000</i>
31 December 2009			
Hong Kong dollars	1%	(31)	—
	(1%)	31	—
31 December 2008			
Hong Kong dollars	1%	(854)	—
	(1%)	854	—

* Excluding retained profits/accumulated losses.

45. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)**FOREIGN CURRENCY RISK**

The Group has minimal transactional currency exposures as the sales and purchases of the Group were mainly transacted in Chinese Renminbi ("RMB"), Euro ("Euro") and Hong Kong dollars (HKD). Approximately 17% (2008: 90%) of the Group's sales are denominated in currencies other than the functional currency of the operating units making the sale, while almost 10% of costs are denominated in the units' functional currency.

The exchange rate of RMB and EURO were comparatively volatile.

The following table demonstrates the sensitivity at the end of reporting period to a reasonably possible change in the exchange rate of RMB and EURO exchange rate, with all other variable held constant, of the Group's profit before tax.

	Increase/ (decrease) in exchange rate %	Increase/ (decrease) in profit before tax HK\$'000	Increase/ (decrease) in equity* HK\$'000
31 December 2009			
If HKD weakens against RMB	5%	122	—
If HKD strengthens against RMB	5%	(122)	—
If HKD weakens against EURO	5%	(20)	—
If HKD strengthens against EURO	5%	20	—
31 December 2008			
If HKD weakens against RMB	5%	(2,593)	—
If HKD strengthens against RMB	5%	2,593	—
If HKD weakens against EURO	5%	(221)	—
If HKD strengthens against EURO	5%	221	—

* Excluding retain profits/accumulated losses.

At 31 December 2008 and 2009, the Group had not hedged any foreign currency sales to reduce such foreign currency risk.

45. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

CREDIT RISK

The Group trades only with recognised and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant. For transactions that are not denominated in the functional currency of the relevant operating unit, the Group does not offer credit terms without the specific approval of the management.

The credit risk of the Group's other financial assets, which comprise cash and cash equivalents, amount due from an associate and other receivable, arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Since the Group trades only with recognised and creditworthy third parties, there is no requirement for collateral. Concentrations of credit risk are managed by customer, by geographical region and by industry sector. There are no significant concentrations of credit risk within the Group.

LIQUIDITY RISK

The Group monitors its risk to a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of both its financial instruments and financial assets (e.g. trade receivable) and projected cash flows from operations.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans, and other interest-bearing loans. The directors of the Company are currently exploring various options for providing additional equity funding to the Group. Provided that such additional equity funding can be secured, the directors are satisfied that the Group will be able to meet in full its financial obligations as they fall due for the foreseeable future. A shareholder and director of the Group has indicated his willingness to continue financing the operations of the Group and the Company and has agreed not to demand repayment of the amounts due to him of his controlled entity until the Group and the Company is in a position to do so.

45. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)**LIQUIDITY RISK** (Continued)

The maturity profile of the Group's financial liabilities as at the end of the reporting period, based on the contracted undiscounted payments, was as follows:

Group**31 December 2009**

	On demand HK\$'000	Less than 3 months HK\$'000	Held to 3 to less than 12 months HK\$'000	1 to 5 years HK\$'000	Total HK\$'000
Trade payables	—	5,700	—	—	5,700
Other payables and accruals	51,696	—	—	—	51,696
Due to immediate parent and ultimate controlling party	—	—	4,910	66,300	71,210
	51,696	5,700	4,910	66,300	128,606

31 December 2008

	On demand HK\$'000	Less than 3 months HK\$'000	Held to 3 to less than 12 months HK\$'000	1 to 5 years HK\$'000	Total HK\$'000
Trade payables	—	4,136	3,818	813	8,767
Other payables and accruals	19,886	—	—	—	19,886
Interest-bearing bank borrowings, secured	10	1,343	7,029	51,998	60,380
Due to immediate parent and ultimate controlling party	—	—	—	25,000	25,000
Due to minority shareholders of subsidiaries	5,167	—	—	16,337	21,504
	25,063	5,479	10,847	94,148	135,537

45. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)**LIQUIDITY RISK** (Continued)**Company**

31 December 2009

	On demand HK\$'000	Less than 3 months HK\$'000	Held to 3 to less than 12 months HK\$'000	1 to 5 years HK\$'000	Total HK\$'000
Other payables and accruals	4,073	—	—	—	4,073
Due to subsidiaries	11,256	—	—	—	11,256
Due to immediate parent and ultimate controlling party	—	—	3,112	66,300	69,412
	15,329	—	3,112	66,300	84,741

31 December 2008

	On demand HK\$'000	Less than 3 months HK\$'000	Held to 3 to less than 12 months HK\$'000	1 to 5 years HK\$'000	Total HK\$'000
Other payables and accruals	2,003	—	—	—	2,003
Due to subsidiaries	5,350	—	—	—	5,350
Due to immediate parent and ultimate controlling party	25,000	—	—	—	25,000
	32,353	—	—	—	32,353

45. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)***CAPITAL MANAGEMENT**

The primary objectives of the Group's capital management are to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes for managing capital during the years ended 31 December 2009 and 2008.

The Group monitors capital using a gearing ratio, which is net debt divided by the total capital plus net debt. Net debt includes trade payables, other payable and accruals, a loan from the immediate and ultimate controlling party, and amounts due to minority shareholders of subsidiaries and interest-bearing bank borrowings, less cash and cash equivalents. Capital includes equity attributable to owners of the Company. The gearing ratios as at the end of reporting periods were as follows:

Group

	2009 <i>HK\$'000</i>	2008 <i>HK\$'000</i>
Trade payables	5,700	8,767
Other payables and accruals	51,696	19,886
Loan from immediate parent and ultimate controlling party	71,210	25,000
Interests-bearing bank borrowings, secured	—	60,380
Due to minority shareholders of subsidiaries	—	21,504
Less: Cash and cash equivalents	(224,314)	(15,787)
Net debt	(95,708)	119,750
Total equity	344,987	521,943
Equity and net debt	249,279	641,693
Gearing ratio	(38%)	19%

46. COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified to conform with the current year's presentation.

47. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 28 April 2010.

A summary of the results and of the assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the published audited financial statements and restated/reclassified as appropriate, is set out below.

	Year ended 31 December 2009 HK\$'000	Year ended 31 December 2008 HK\$'000	Period from 1 April 2007 to 31 December 2007 HK\$'000	Year ended 31 March 2007 HK\$'000	Year ended 31 March 2006 HK\$'000
RESULTS					
CONTINUING OPERATIONS					
REVENUE	195,530	78,783	55,620	65,344	75,157
Cost of sales	(175,091)	(51,095)	(40,272)	(51,061)	(54,207)
Gross profit	20,439	27,688	15,348	14,283	20,950
Other income and gains	23,968	12,493	7,361	4,218	20,609
Selling and distribution costs	(5,345)	(17,609)	(7,175)	(4,912)	(4,732)
Administrative expenses	(71,515)	(43,171)	(34,939)	(39,539)	(107,202)
Equity-settled share-based payments expenses	(6,727)	—	(4,126)	(20,297)	—
Finance costs	(5,597)	(6,494)	(4,125)	(6,868)	(6,155)
Impairment losses on available-for-sales investments	(922,318)	—	—	—	—
Share of profits and losses of associates	(548)	(12,752)	61,884	(1,201)	—
PROFIT/(LOSS) BEFORE TAX	(967,643)	(39,845)	34,228	(54,316)	(76,530)
Tax	(319)	(1,420)	(1,103)	(1,168)	(1,039)
PROFIT/(LOSS) FOR THE YEAR/PERIOD	(967,962)	(41,265)	33,125	(55,484)	(77,569)
Attributable to:					
Owners of the Company	(566,840)	(38,310)	38,422	(53,278)	(78,276)
Minority interests	(401,122)	(2,955)	(5,297)	(2,206)	707
	(967,962)	(41,265)	33,125	(55,484)	(77,569)
ASSETS, LIABILITIES AND MINORITY INTERESTS					
TOTAL ASSETS	473,912	673,931	645,008	547,256	156,787
TOTAL LIABILITIES	(128,925)	(151,988)	(168,763)	(119,514)	(103,080)
MINORITY INTERESTS	(16,159)	(8,647)	(6,297)	(1,818)	(4,024)
	328,828	513,296	469,948	425,924	49,683

This summary does not form part of the audited financial statements.

Press Releases

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Senior executives of listed company and two others charged with fraud and money laundering

7 October 2013

Four persons, including a chairman and a former deputy chairman of a listed company, were today (Monday) charged by the ICAC with conspiracy to defraud in relation to the acquisition of natural gas and oil fields in the United States of America (USA) and laundering crime proceeds.

The defendants are Wong Yuk-kwan, alias Wong Kwan, 65, chairman and executive director of Pearl Oriental Oil Limited (POOL), formerly known as Pearl Oriental Innovation Limited (POIL); Lew Mon-hung, 64, former deputy chairman and executive director of POOL; Yik Siu-hung, 44, housewife; and Yip Sui-kuen Kitty, 44, vice financial officer and administrative manager of POOL.

All defendants face two counts of conspiracy to defraud, contrary to Common Law. Yik further faces three counts of dealing with property known or believed to represent proceeds of an indictable offence, contrary to Section 25(1) of the Organised and Serious Crimes Ordinance (OSCO), while Yip has been charged with one count of similar offence under the OSCO.

The defendants will appear in the Eastern Magistracy at 9:30 am tomorrow (Tuesday) for mention.

In February 2012, the ICAC commenced an investigation into the case in relation to suspected offences under the Prevention of Bribery Ordinance. During the course of the investigation, the defendants were arrested in January 2013. As a result of the investigation, the defendants were charged today with the above alleged offences.

One of the charges alleges that between December 1, 2009 and May 17, 2011, the defendants conspired together to defraud the Stock Exchange of Hong Kong Limited (SEHK) by falsely representing that:

- * before the investment opportunity was first introduced to POIL by Marvel Sunlight Limited (MSL) and Charcon Assets Limited (CAL) for the acquisition of certain natural gas and oil fields in Utah, USA, MSL had already reached an agreement for its investment with the owner of the natural gas and oil fields;
- * MSL, being one of the vendors in POIL's acquisition of the entire issued share capital of Festive Oasis Limited (FOL), and its beneficial owners were third parties independent of POIL and its connected persons; and
- * the original acquisition cost incurred by CAL, a company solely owned by Wong, on 35 per cent interest of FOL was US\$70 million.

It was alleged that as a result, the SEHK was caused to allow the publication by POIL of an announcement and a circular in relation to the acquisition of the entire issued share capital of FOL.

The defendants also face a similar charge alleging them of conspiring together to defraud POIL, its then shareholders and potential investors between December 1, 2009 and May 17, 2011, thus causing POIL to approve the agreement for the acquisition of the entire issued share capital of FOL and the allotment and issue of new shares for its payment.

Yik faces three counts of dealing with two properties worth HK\$390 million in total and 282,600,000 shares of POIL between March 9, 2010 and May 17, 2011, knowing or having reasonable grounds to believe that the properties and shares represented proceeds of an indictable offence.

The remaining charge alleges that Yip dealt with HK\$3 million between January 26 and 27, 2011, knowing or having reasonable grounds to believe that the money represented proceeds of an indictable offence.

The SEHK had rendered full assistance to the ICAC during its investigation.

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Appendix E:

Corporate governance scores of different countries in the study of S. Johnson et al. (2000)

This table presents the seven different measurements of macro-level governance scores of 25 countries used by the study of S. Johnson et al.

	Corporate governance variables						
	Judicial efficiency	Corruption	Rule of Law	Enforceable minority shareholder rights	Anti-directors rights	Creditors rights	Accounting standards 1990
Argentina	6.0	6.0	5.4	3.0	4	1	45
Brazil	5.8	6.3	6.3	3.0	3	1	54
Chile	7.3	5.3	7.0	3.5	5	2	52
China	n.a.	6.5	6.0	n.a.	n.a.	n.a.	n.a.
Colombia	7.3	5.0	2.1	n.a.	3	0	50
Czech	n.a.	n.a.	n.a.	2.0	n.a.	n.a.	n.a.
Greece	7.0	7.3	6.2	n.a.	2	1	55
Hong Kong	10.0	8.5	8.2	3.0	5	4	69
Hungary	n.a.	7.5	8.5	3.0	n.a.	n.a.	n.a.
India	8.0	4.6	4.2	2.0	5	4	57
Indonesia	2.5	2.1	4.0	1.0	2	4	n.a.
Israel	10.0	8.3	4.8	3.0	3	4	64
Korea	6.0	5.3	5.4	1.0	2	3	62
Mexico	6.0	4.8	5.4	3.0	1	0	60
Malaysia	9.0	7.4	6.8	2.0	4	4	76
Philippines	4.8	2.9	2.7	3.0	3	0	65
Poland	n.a.	7.4	7.7	4.0	n.a.	n.a.	n.a.
Portugal	5.5	7.4	8.7	n.a.	3	1	36
Russia	n.a.	n.a.	n.a.	2.0	n.a.	n.a.	n.a.
Singapore	10.0	8.2	8.6	4.0	4	4	78
Thailand	3.3	5.2	6.3	2.0	2	3	64
Turkey	4.0	5.2	5.2	2.0	2	2	51
Taiwan	6.8	6.9	8.5	3.0	3	2	65
Venezuela	6.5	4.7	6.4	n.a.	1	n.a.	40
South Africa	6.0	8.9	4.4	2.5	5	3	70
Sample size	20	23	23	20	20	19	19

Judicial efficiency is the assessment and integrity of the legal environment as it affects business, particularly foreign firms produced by the country-risk rating agency Business International Corporation. It may be taken to represent investors' assessments of conditions in the country in question. Scale from 0 to 10, with lower scores meaning lower efficiency levels.

Corruption is the assessment of the corruption in government. Lower scores indicate that high government officials are likely to demand special payments and illegal payments are generally expected throughout lower levels of government in the form of bribes connected with import and export licenses, exchange

Table 1 Foot note (continued)

controls, tax assessment, policy protection, or loans. Scale from 0 to 10, with lower scores for higher levels of corruption.

Rule of law is the assessment of the law and order tradition in the country produced by the country risk rating agency International Country Risk. Scale from 0 to 10, with lower scores for less tradition for law and order.

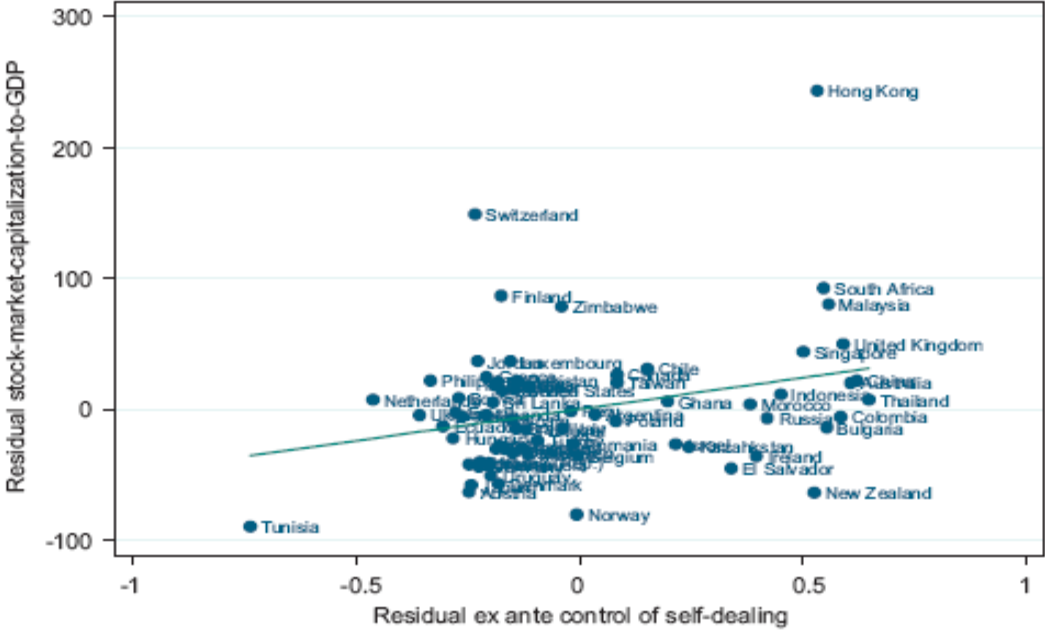
Anti-director rights index is formed by adding 1 when (1) the country allows shareholders to mail their proxy vote to the firm; (2) shareholders are not required to deposit their shares prior to the general shareholders' meeting; (3) cumulative voting or proportional representation of minorities in the board of directors is allowed; (4) an oppressed minorities mechanism is in place; (5) the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholders' meeting is less than or equal to 10%; or (6) shareholders have preemptive rights that can only be waived by a shareholder's vote. The index ranges from 0 to 6.

Creditor rights is an index formed by adding 1 when (1) the country imposes restrictions, such as creditors' consent or minimum dividends to file for reorganization; (2) secured creditors are able to gain possession of their security once the reorganization petition has been approved; (3) secured creditors are ranked first in the distribution of the proceeds that result from the disposition of the assets of a bankrupt firm; and (4) the debtor does not retain the administration of its property pending the resolution of the reorganization. The index ranges from 0 to 4.

Accounting standards are making use of examining and rating firms' 1990 annual reports on their inclusion or omission of 90 items. These items fall into seven categories. A minimum of three firms in each country were studied. The firms represent a cross section of various industry groups; industrial firms represented 70%, and financial firms represented the remaining 30%.

Appendix F: Stock market capitalization-to-GDP against anti-self-dealing index

This figure presents the partial-regression plot of stock market capitalization-to-GDP against the anti-self-dealing index in regressions that control for income per capita.



Appendix G

Eight-country comparison in the study of Lemmon and Lins (2003)

This table presents the mean value of summary statistics by country in the comparison study.

	Hong Kong	Indonesia	Malaysia	Philippines	Singapore	S.Korea	Taiwan	Thailand	All
Cumulative stock returns during the crisis	-0.566	-0.207	-0.712	-0.485	-0.559	-0.661	-0.033	-0.276	-0.492
Management group control rights ownership %	40	34	27	44	31	16	18	19	26
Management group cash flow rights leverage	1.49	1.52	2.48	2.62	3.11	2.37	2.32	1.53	2.17
Market value of equity	1014	800	854	606	713	465	608	286	675
Beta	0.62	0.64	1.18	0.72	0.64	1.02	0.63	0.74	0.83
Country "Rule of Law" score	8.22	3.98	6.78	2.73	8.57	5.35	8.52	6.25	6.97

Cumulative stock returns represent the total return over the crisis period from July 1, 1997 to August 1, 1998.

Management ownership refers to all stakes held by a firm's officers and directors and their families. Management control rights and cash-flow-ownership rights of a firm include direct ownership as well as the effect of those stakes obtained indirectly via management ownership and control of blockholders in the firm.

Cash flow rights leverage is computed as management control rights divided by the cash flow rights associated with those control rights.

Market value of equity is using the fiscal year-end that precedes July 1, 1997 and is reported in million of US dollars.

Betas are computed using stock returns and the corresponding MSCI country index returns for a minimum data range of 12 months (maximum of 36 months) prior to July 1, 1997.

The rule of law variable is obtained from La Porta et al. (1998). It ranges from 0 to 10 with lower scores corresponding to less tradition for law and order.

Chapter 14A

EQUITY SECURITIES

CONNECTED TRANSACTIONS

Preliminary

- 14A.01 The connected transactions rules are intended to ensure that the interests of shareholders as a whole are taken into account by a listed issuer when the listed issuer enters into connected transactions. The rules set out in this Chapter also provide certain safeguards against listed issuers' directors, chief executives or substantial shareholders (or their associates) taking advantage of their positions.
- 14A.02 This is achieved through the general requirement for connected transactions to be disclosed and subject to independent shareholders' approval. Accordingly, where any connected transaction is proposed, the transaction must be announced publicly by means of an announcement published in accordance with rule 2.07C and a circular must be sent to shareholders giving information about the transaction. Prior approval of the shareholders in general meeting will be required before the transaction can proceed. A connected person with a material interest in the transaction will not be permitted to vote at the meeting on the resolution approving the transaction.
- 14A.03 Certain categories of transaction are exempt from the disclosure and independent shareholders' approval requirements and certain transactions are subject only to disclosure requirements.
- 14A.04 Connected transactions may be either one-off transactions (in the case of listed issuers) or continuing transactions (in the case of both listed issuers and new applicants). Different rules apply in each case. A listed issuer must, in respect of all connected transactions, enter into a written agreement with the relevant parties.
- 14A.05 If a listed issuer proposes to enter into a transaction which could be a connected transaction, it is essential that the listed issuer consult the Exchange at an early stage so that, in cases of doubt, the listed issuer can ascertain whether and to what extent the provisions of this Chapter apply. The relevant contract(s) or, if applicable, draft contract(s) must be supplied to the Exchange, if requested.
- 14A.06 The Exchange has the specific power to deem a person to be connected (see rule 14A.11(4)) and to specify that certain exemptions will not apply to particular transactions (see rule 14A.30).

- 14A.07 The Exchange may grant a waiver from all or any of the requirements in this Chapter where the Exchange deems it appropriate on such terms and conditions as the Exchange may determine (see rule 14A.42).
- 14A.08 A connected transaction may also be a reverse takeover, very substantial acquisition, very substantial disposal, major transaction, discloseable transaction, or share transaction and listed issuers should also refer to Chapter 14 of the Exchange Listing Rules.
- 14A.09 Listed issuers must complete and submit any checklist(s) in such form as may be prescribed by the Exchange from time to time in respect of any connected transactions or continuing connected transactions.

General matters concerning definitions and interpretation

14A.10 In this Chapter:

- (1) a “banking company” means a bank, a restricted licence bank or a deposit taking company as defined in the Banking Ordinance or a bank constituted under appropriate overseas legislation or authority;
- (2) “consideration” is calculated as set out in rule 14.15;
- (3) “controller” means a director, chief executive or controlling shareholder of the listed issuer;
- (4) “financial assistance” includes granting credit, lending money, providing security for, or guaranteeing a loan;

Note: see also the definition of “ordinary and usual course of business” in rule 14A.10(9).

- (5) “independent shareholder” means any shareholder of the listed issuer that is not required to abstain from voting at a general meeting to approve a connected transaction;
- (6) an “issuer” means a listed issuer or company or other legal person whose securities are the subject of an application for listing on the Main Board and its subsidiaries and includes a company whose shares are represented by depositary receipts that are the subject of an application for listing;

- (7) a “listed issuer” shall have the meaning set out in rule 14.04(6);
- (8) “normal commercial terms” are terms which a party could obtain if the transaction were on an arm’s length basis or on terms no less favourable to the listed issuer than terms available to or from independent third parties;
- (9) “ordinary and usual course of business” of an entity means the existing principal activities of the entity or an activity wholly necessary for the principal activities of the entity. In the context of financial assistance provided in the ordinary and usual course of business, this means financial assistance provided by a banking company only and, in the context of financial assistance not provided in the ordinary and usual course of business, it means financial assistance not provided by a banking company;
- (10) “percentage ratios” shall have the meaning set out in rule 14.04(9);
- (10A) “Qualified Connected Person” means any person that is a connected person of the Qualified Issuer, solely because it is a substantial shareholder (or its associate) with or without representation on the board in one or more non-wholly-owned subsidiaries of the Qualified Issuer formed to participate in property projects, each of which is single purpose and project specific;
- (10B) “Qualified Issuer” has the meaning in rule 14.04(10B);
- (10C) “Qualified Property Acquisition” has the meaning in rule 14.04(10C);
- (11) “recognised stock exchange” means a regulated, regularly operating, open stock market recognised for this purpose by the Exchange;
- (12) “total assets” shall have the meaning set out in rule 14.04(12); and
- (13) a “transaction” by an issuer, whether or not it is of a revenue nature in the ordinary and usual course of business as defined in rule 14.04(1)(g), includes:
 - (a) the acquisition or disposal of assets including deemed disposals set out in rule 14.29;
 - (b) any transaction involving a listed issuer writing, accepting, transferring, exercising or terminating (in the manner described in rule 14A.68) an option to acquire or dispose of assets or to subscribe for securities;
 - (c) entering into or terminating finance leases;

- (d) entering into or terminating operating leases or sub-leases, including those of properties;
- (e) granting an indemnity or a guarantee or providing financial assistance;
- (f) entering into any arrangement or agreement involving the formation of a joint venture entity in any form, such as a partnership or a company, or any other form of joint arrangement;
- (g) issuing new securities;
- (h) the provision of or receipt of services;
- (i) sharing of services; and
- (j) providing or acquiring raw materials, intermediate products and finished goods.

Definition of connected person

14A.11 Rule 1.01 contains a general definition of “connected person”. In this Chapter, the definition of “connected person” includes:

- (1) a director, chief executive or substantial shareholder of the listed issuer;
- (2) any person who was a director of the listed issuer within the preceding 12 months;
- (3) a supervisor of a PRC issuer;
- (4) any associate of a person referred to in rules 14A.11(1), (2) or (3). The definitions of “associate” (in the context of non-PRC issuers and PRC issuers) are contained in rules 1.01 and 19A.04, respectively. In this Chapter, an “associate” of a person referred to in rules 14A.11(1), (2) or (3) includes the following additional persons:
 - (a) any person or entity with whom a person referred to in rules 14A.11(1), (2) or (3) has entered, or proposes to enter, into any agreement, arrangement, understanding or undertaking, whether formal or informal and whether express or implied, with respect to the transaction which is such that, in the opinion of the Exchange, that person or entity should be considered a connected person;
 - (b) (i) any person cohabiting as a spouse with, and any child, step-child, parent, step-parent, brother, sister, step-brother and step-sister of, a person referred to in rules 14A.11(1), (2) or (3); and

- (ii) a company which the party referred to in rule 14A.11(4)(b)(i) can exercise or control the exercise of more than 50% of the voting power at general meetings or control the composition of a majority of the board of directors; and
- (c) (i) a father-in-law, mother-in-law, son-in-law, daughter-in-law, grandparent, grandchild, uncle, aunt, cousin, brother-in-law, sister-in-law, nephew and niece of a person referred to in rules 14A.11(1), (2) or (3); and
- (ii) a company which the party referred to in rule 14A.11(4)(c)(i) can exercise or control the exercise of more than 50% of the voting power at general meetings or control the composition of a majority of the board of directors,

whose association with the person referred to in rules 14A.11(1), (2) or (3) is such that, in the opinion of the Exchange, the proposed transaction should be subject to the requirements of this Chapter. Listed issuers must notify the Exchange of any proposed transaction with these parties unless the transaction is exempt under rules 14A.31 or 14A.33. Listed issuers must also provide information to the Exchange to demonstrate whether or not these parties should be regarded as associates of the person referred to in rules 14A.11(1), (2) or (3);

- Notes:*
1. *A company which is an "associate" of a person referred to in rules 14A.11(1), (2) or (3) only because that person has an indirect interest in the company through its shareholding in the listed issuer is not a connected person.*
 2. *[Repealed 3 June 2010]*
 3. *For the purpose of rules 14A.11(4)(b)(ii) and 14A.11(4)(c)(ii), the Exchange may aggregate the interests of a person referred to in rule 14A.11(1), (2) or (3) and his relatives in a company to determine whether they together have a majority control over the company.*

- (5) any non wholly-owned subsidiary of the listed issuer where any connected person(s) of the listed issuer (other than at the level of its subsidiaries) as defined under rules 14A.11(1) to (4) is/are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of such non wholly-owned subsidiary; and

Notes: 1 [Repealed 3 June 2010]

- 2 An interest of a connected person of the listed issuer (other than at the level of its subsidiaries) in the subsidiary which is held through the listed issuer is to be excluded from the 10% referred to in this rule.*

- (6) any subsidiary of a non wholly-owned subsidiary referred to in rule 14A.11(5).

14A.12 The definition of “connected person” in rule 14A.11 does not include any wholly-owned subsidiaries of the company whose securities are listed on the Exchange, whether directly or indirectly held.

14A.12A For the purpose of this Chapter,

- (1) a non wholly-owned subsidiary will not be regarded as a connected person by virtue of being:
- (a) a substantial shareholder of another subsidiary; or
 - (b) an associate of any connected persons (at the level of the issuer’s subsidiaries only) as defined in rules 14A.11(1) to (3); and
- (2) the Exchange will not normally treat a PRC Governmental Body (see definition in rule 19A.04) as a connected person of a listed issuer. If requested by the Exchange the issuer must make written representations to the Exchange explaining its legal, commercial or other relationships with the PRC Governmental Body and must satisfy the Exchange that it should not be treated as a connected person, or if the Exchange determines that it should be treated as a connected person, the issuer must agree to comply with any additional obligations arising from such treatment as may be requested by the Exchange.

Definition of connected transaction

14A.13 A connected transaction is:

- (1) (a) any transaction between a listed issuer and a connected person; or

Acquisition or disposal of interest in a company

- (b) (i) any transaction between a listed issuer and a person who is not a connected person and the transaction involves the listed issuer acquiring or disposing of an interest in a company where a substantial shareholder of that company is, or is proposed to be, a controller or is (or will become as a result of the transaction) an associate of a controller. The Exchange may aggregate the interests of any person and his associates (as defined in rule 14A.11(4)) in determining whether together they are a “substantial shareholder” of any company. Where assets (as opposed to businesses) account for 90% or more of such a company’s net assets or total assets, the Exchange will treat the acquisition or disposal of such assets as a connected transaction and an acquisition or disposal of an interest in that company; or

Notes: 1 A listed issuer itself will not be considered an “associate” of a controller when the listed issuer is acquiring or disposing of an interest in a company of which it is already a substantial shareholder.

2 A controller whose only interest in a company is through its interest in the listed issuer will not be taken to be a “substantial shareholder” of that company.

3 This rule does not apply where all the following conditions are met:

- (i) the listed issuer acquires an interest in a company;*

- (ii) the substantial shareholder of the company being acquired is a director, chief executive or controlling shareholder of the company being acquired (or an associate of such director, chief executive or controlling shareholder) immediately prior to the acquisition;*
- (iii) it is proposed that the substantial shareholder will remain a director, chief executive or controlling shareholder of the company being acquired (or an associate of such director, chief executive or controlling shareholder) following the acquisition; and*
- (iv) following the acquisition, the only reason why he is still a controller is that he remains a director, chief executive or controlling shareholder of the company being acquired (or an associate of such director, chief executive or controlling shareholder), as the case may be. Where he remains a controlling shareholder, there must not be any increase in his interest in such company as a result of the acquisition.*

4 For a disposal of interest in a company, this rule does not apply if (i) the disposal falls within this rule only because the substantial shareholder of the company being disposed of is a director, chief executive or controlling shareholder of this company (or an associate of such director, chief executive or controlling shareholder) immediately prior to the disposal; and (ii) there is no change in the substantial shareholder's interest in such company as a result of the disposal or any related arrangement.

- (ii) any transaction between a listed issuer and a person who is not a connected person and the transaction involves the listed issuer acquiring an interest in a company (or an option to acquire such interest) of which a controller (or an associate of a controller) is, or will become, a shareholder where the interest being acquired is:*

- (A) of a fixed income nature;*

- (B) shares to be acquired on less favourable terms than those granted to the controller or its associate; or
- (C) shares which are of a different class from those held by, or to be granted to, the controller or its associate.

Note: This rule does not apply where the acquisition is pursuant to the terms of a subscription of shares in the company by the listed issuer and the controller (or its associate) and the subscription upon such terms has previously been approved by shareholders in accordance with the requirements of this Chapter.

Subscription on favourable terms

- (iii) any transaction between a listed issuer and a person who is not a connected person and the transaction involves a controller (or an associate of a controller) subscribing on specially favourable terms shares in a company in which the listed issuer is a shareholder; or

Note: This rule does not apply where the subscription is pursuant to the terms of a subscription of shares in the company by the listed issuer and the controller (or its associate) and the subscription upon such terms has previously been approved by shareholders in accordance with the requirements of this Chapter.

Subscription of different class of shares

- (iv) any transaction between a listed issuer and a person who is not a connected person and the transaction involves a controller (or an associate of a controller) subscribing shares in a company in which the listed issuer is a shareholder but which are of a different class from those held by the listed issuer.

Note: This rule does not apply where the subscription is pursuant to the terms of a subscription of shares in the company by the listed issuer and the controller (or its associate) and the subscription upon such terms has previously been approved by shareholders in accordance with the requirements of this Chapter.

Financial assistance

(2) the provision of financial assistance:

(a) by a listed issuer to:

- (i) a connected person; or
- (ii) a company in which both the listed issuer and a connected person are shareholders and where any connected person(s) of the listed issuer (other than at the level of its subsidiaries) as defined under rules 14A.11(1) to (4) is/are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of such company; or

Note: An interest of a connected person of the listed issuer (other than at the level of its subsidiaries) in the company which is held through the listed issuer is to be excluded from the 10% referred to in this rule.

(b) to a listed issuer by;

- (i) a connected person; or
- (ii) a company in which both the listed issuer and a connected person are shareholders and where any connected person(s) of the listed issuer (other than at the level of its subsidiaries) as defined under rules 14A.11(1) to (4) is/are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of such company.

Note: An interest of a connected person of the listed issuer (other than at the level of its subsidiaries) in the company which is held through the listed issuer is to be excluded from the 10% referred to in this rule.

(3) a listed issuer granting an indemnity or guarantee or providing financial assistance to and/or for the benefit of a connected person or any company falling under rule 14A.13(2)(a)(ii);

(4) the granting of security over the assets of a listed issuer in respect of any financial assistance made to the listed issuer by a connected person or any company falling under rule 14A.13(2)(b)(ii).

Financial assistance transactions are governed by rules 14A.63 to 14A.66;

Options

- (5) the writing, acceptance, transfer, exercise or non-exercise of an option (as defined in rule 14.72) involving a listed issuer and a connected person. Options are governed by rules 14A.67 to 14A.71; and

Joint ventures

- (6) the entering into of any arrangement or agreement involving the formation of a joint venture entity in any form, such as a partnership or a company, or any other form of joint arrangement by a listed issuer and a connected person (see rule 14A.10(13)(f)). Qualified Property Acquisition undertaken on a joint venture basis with a Qualified Connected Person is governed by rules 14A.72 to 14A.79. In this case, the size of a listed issuer's financial commitment will be calculated in the manner set out in rule 14.15(2).

Definition of continuing connected transaction

14A.14 Continuing connected transactions are connected transactions involving the provision of goods or services or financial assistance, which are carried out on a continuing or recurring business and are expected to extend over a period of time. They are usually transactions in the ordinary and usual course of business of the issuer.

14A.15 Continuing connected transactions are governed by rules 14A.33 to 14A.41.

General rules

Categories

14A.16 The categories of connected transactions are:

- (1) connected transactions exempt from the reporting, announcement and independent shareholders' approval requirements (see rule 14A.31);
- (2) connected transactions exempt from the independent shareholders' approval requirements (see rule 14A.32);
- (3) continuing connected transactions exempt from the reporting, annual review, announcement and independent shareholders' approval requirements (see rule 14A.33);
- (4) continuing connected transactions exempt from the independent shareholders' approval requirements (see rule 14A.34); and
- (5) connected transactions, including continuing connected transactions, not falling under any of the categories set out in rules 14A.16(1) to (4).

14A.17 Transactions falling under rule 14A.16(5) are subject to the reporting, announcement and independent shareholders' approval requirements, and in the case of continuing connected transactions, the annual review requirements of this Chapter.

Independent shareholders' approval

14A.18 The Exchange will require that connected transactions and continuing connected transactions are made conditional on prior approval by the shareholders of the listed issuer in general meeting. The listed issuer must ensure that the following parties abstain from voting at the relevant meeting on resolution(s) approving the relevant transactions:

- (1) any connected person with a material interest in the transaction; and
- (2) any person falling within rules 14A.13(1)(b)(i) to (iv) that has a material interest in the transaction and its associates,

and a statement that such persons will not vote must be included in the relevant circular to shareholders.

14A.19 The listed issuer must comply with the independent shareholders' approval requirements set out in rules 14A.52 to 14A.54 and the contents requirements for the announcement and circular set out in rules 14A.56 and 14A.58 to 14A.60 respectively.

14A.20 [Repealed 3 June 2010]

Independent financial advice

14A.21 In relation to a connected transaction that is subject to independent shareholders' approval under this Chapter, the listed issuer must comply with the requirements set out in rules 13.39(6) and 13.39(7).

14A.22 The separate letter from the independent financial adviser required under rule 13.39(7)(b) must set out:

- (1) the reasons for the opinion;
- (2) the key assumptions made;
- (3) the factors taken into consideration in forming that opinion;
- (4) a statement as to whether the transaction is on normal commercial terms, in the ordinary and usual course of business, fair and reasonable and in the interests of the listed issuer and its shareholders as a whole; and

- (5) advice from the independent financial adviser to the independent board committee and independent shareholders (or, if applicable, to the independent shareholders only) on whether independent shareholders should vote in favour of the transaction.

14A.23 The agreement referred to in rule 14A.04 will be the basis on which the independent financial adviser will give its opinion to independent shareholders.

Methods of calculating the consideration

14A.24 The methods of calculating the consideration as set out in rule 14.15 also apply to connected and continuing connected transactions.

Aggregation of transactions

14A.25 The Exchange will aggregate a series of connected transactions and treat them as if they were one transaction if they were all completed within a 12-month period or are otherwise related. In such cases, the listed issuer must comply with the requirements for the relevant classification of the connected transactions when aggregated. Where a series of acquisitions of assets over a longer period is being aggregated under rule 14.06(6)(b) (i.e. they constitute a reverse takeover), the aggregation period under this rule 14A.25 for such acquisitions shall cover 24 rather than 12 months.

14A.26 Factors which the Exchange may take into account in determining whether connected transactions will be aggregated include whether the transactions:

- (1) are entered into by the listed issuer with the same party or with parties connected or otherwise associated with one another;
- (2) involve the acquisition or disposal of securities or an interest in one particular company or group of companies;
- (3) involve the acquisition or disposal of parts of one asset; or
- (4) together lead to substantial involvement by the listed issuer in a business activity which did not previously form a part of the listed issuer's principal business activities.

14A.27 The Exchange may consider aggregating all continuing connected transactions with a single connected person to determine in which category the aggregated transaction falls.

14A.27A For the purposes of aggregating connected transactions under rule 14A.25, a listed issuer must consult the Exchange before it enters into any proposed connected transaction(s) if:

- (1) any circumstances described in rule 14A.26 or rule 14A.27 exist in respect of such proposed connected transaction(s) and any other connected transaction(s) entered into by the listed issuer in the preceding 12-month period; or
- (2) the proposed connected transaction(s) and any other transaction(s) entered into by the listed issuer involve acquisitions of assets from a person or group of persons or any of his/their associates within 24 months of such person or group of persons gaining control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries).

The listed issuer must provide details of the transactions to the Exchange to enable it to determine whether the transactions will be aggregated.

Note: This rule serves to set out certain specific circumstances where the listed issuer must seek guidance from the Exchange before it enters into any proposed connected transaction(s). The Exchange may nevertheless aggregate connected transactions pursuant to rule 14A.25 where no prior consultation was made by the listed issuer under rule 14A.27A.

Exceptions

14A.28 Certain types of connected transactions, described in rule 14A.31, are exempt from all disclosure and independent shareholders' approval requirements. The connected transactions described in rule 14A.32 are not required to be approved by independent shareholders but must in every case be disclosed by way of an announcement published in accordance with rule 2.07C and must be reported on in the listed issuer's next published annual report and accounts.

14A.29 Certain types of continuing connected transactions, described in rule 14A.33, are exempt from all disclosure, annual review and independent shareholders' approval requirements. The continuing connected transactions described in rule 14A.34 are not required to be approved by independent shareholders but must in every case be disclosed by way of an announcement published in accordance with rule 2.07C when the listed issuer enters into the transaction. The transaction must also be reported on in the listed issuer's subsequent published annual report and accounts for the financial years during which the listed issuer undertakes the transaction pursuant to the relevant written agreement.

Exchange discretion

14A.30 The Exchange reserves the power to specify that an exemption will not apply to a particular transaction. The Exchange may also require, at its discretion, that any other connected transaction be made conditional on independent shareholders' approval and that the same requirements in rules 14A.18 to 14A.23 will apply.

**Connected transactions
exempt from the reporting, announcement and
independent shareholders' approval requirements**

14A.31 The following connected transactions will be exempt from all the reporting, announcement and independent shareholders' approval requirements contained in this Chapter:

Intra-group transactions

- (1) a transaction between a listed issuer and a non wholly-owned subsidiary or between its non wholly-owned subsidiaries where no connected person(s) of the listed issuer (other than at the level of its subsidiaries) as defined under rules 14A.11(1) to (4), is/are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of any of the subsidiaries concerned and none of the subsidiaries concerned is itself a connected person under rule 14A.11 or rule 1.01;

Note: An interest of a connected person of the listed issuer (other than at the level of its subsidiaries) in the subsidiary which is held through the listed issuer is to be excluded from the 10% referred to in this rule.

- (1A) a transaction between a listed issuer's non wholly-owned subsidiary referred to in rule 14A.11(5) and any of its subsidiaries which are connected persons only by virtue of being the subsidiaries of the non wholly-owned subsidiary; or a transaction between any of these subsidiaries;

De minimis transactions

- (2) a connected transaction on normal commercial terms where each or all of the percentage ratios (other than the profits ratio) is/are:
 - (a) less than 0.1%;
 - (b) less than 1% and the transaction is a connected transaction only because it involves a person who is a connected person of the listed issuer by virtue of its/his relationship(s) with the issuer's subsidiary or subsidiaries; or

- (c) less than 5% and the total consideration is less than HK\$1,000,000;

Note: This exemption does not apply to the issue of new securities by a listed issuer (other than its subsidiaries) to a connected person, which is governed by rule 14A.31(3).

Issue of new securities

- (3) where a listed issuer issues new securities to a connected person and:
- (a) the connected person receives a pro rata entitlement to securities in its capacity as shareholder; or
 - (b) securities are issued under a share option scheme which complies with Chapter 17 or securities that are issued under a share option scheme in existence before the securities of the listed issuer first commenced dealing on the Exchange for which approval for listing was granted at the time such dealing first commenced; or
 - (c) the connected person is acting as underwriter or sub-underwriter of an issue of securities by the listed issuer, provided that rules 7.21(2) and 7.26A(2) have been complied with; or

Notes: 1 The entity whose issue of securities is being underwritten or sub-underwritten by a connected person must make full disclosure of the terms and conditions of the underwriting in the listing document.

2 Excess application and the taking up of pro rata entitlements in respect of a rights issue or open offer are not connected transactions. Rules 7.21(1) and 7.26A(1) provide that, where securities not subscribed by allottees are to be disposed of by means of excess application forms, such securities must be available for subscription by all shareholders and allocated on a fair basis. An intention to so offer such securities must be fully disclosed in the rights issue or open offer announcement, listing document and any circular.

3 If a listed issuer which is a holding company acts as underwriter or sub-underwriter of an issue of securities by its subsidiary that is also a listed issuer, such transaction is also connected for the listed holding company if the listed subsidiary is a connected person under rules 14A.11(5) or 14A.11(6). In this case, the listed issuer which is a holding company is subject to connected

transaction requirements unless exempted under rules 14A.31(1) or 14A.31(2). The exemption under this rule is applicable to the listed subsidiary but not the listed holding company.

- (d) securities are issued to a connected person within 14 days after such connected person has executed an agreement to reduce its holding in that class of securities by placing securities to a third person who is not its associate. The securities must be issued at a price not less than the placing price. The placing price may be adjusted for the expenses of the placing. The number of securities issued to the connected person must not exceed the number of securities placed by it;

Note: Under rule 13.28, the listed issuer is required to make an announcement in accordance with rule 2.07C containing details of the placing and subscription of shares by the connected person.

Stock Exchange dealings

- (4) a transaction falling within rule 14A.13(1)(b)(i), which comprises a dealing in securities listed on the Exchange or a recognised stock exchange by a listed issuer in the ordinary and usual course of its business. If the transaction is not carried out on the Exchange or a recognised stock exchange, this exemption will still apply if no consideration passes to or from a connected person. This exemption will not apply if the purpose is to confer a direct or indirect benefit upon a controller(s) or associate of a controller who is also a substantial shareholder in the relevant company;

Purchase of own securities

- (5) any purchase by a listed issuer of its own securities from a connected person on the Exchange or a recognised stock exchange or under a general offer made in accordance with the Code on Share Repurchases. Where the purchase is on the Exchange or a recognised stock exchange, this exemption will not apply if the connected person knowingly sells its securities to the listed issuer;

Directors' service contracts

- (6) the entering into of a service contract by a director of the listed issuer with the listed issuer;

Note: A director's service contract to which rule 13.68 applies is subject to independent shareholders' approval under that provision.

Consumer goods or consumer services

- (7) the acquisition as consumer or realisation in the ordinary and usual course of business of consumer goods or consumer services by a listed issuer from or to a connected person of the listed issuer on normal commercial terms. Such goods and services:—
- (a) must be of a type ordinarily supplied for private use or consumption;
 - (b) must be for the acquirer's own consumption or use, and not be
 - (i) processed into products of the acquirer or for resale; or
 - (ii) otherwise for the purpose of or in connection with any business or contemplated business of the acquirer (whether for consideration or otherwise), except for the case where the issuer is the acquirer and there is an open market and transparency in the pricing of these goods or services;

Note: Examples include utilities provided by a listed issuer to a connected person, meals consumed by a connected person at a restaurant owned by the listed issuer, the acquisition of groceries for its own use by a connected person from a listed issuer involved in the retailing of groceries, and utilities provided by a connected person to a listed issuer where the prices are published or publicly quoted and apply to other independent consumers.

- (c) must be consumed or used by the acquirer in the same state as when they were acquired;
- (d) must be of a total consideration or value that is or represents less than 1% of the total revenue or total purchases, as the case may be, of the listed issuer as shown in its latest published audited accounts or, where consolidated accounts have been prepared, its latest published audited consolidated accounts; and
- (e) the transactions concerned must be on terms no more favourable to the connected person than those available to independent third parties or no less favourable to the listed issuer than those available from independent third parties (as the case may be);

Note: Listed issuers are encouraged to consult the Exchange at an early stage to determine whether a transaction falls within the scope of this rule.

Sharing of administrative services

- (8) the sharing of administrative services between a listed issuer and a connected person on a cost basis. The cost of the services must be identifiable and allocated to

the parties involved on a fair and equitable basis. Examples include company secretarial services, legal services and staff training services.

Transactions with persons connected at the level of subsidiaries

- (9) a connected transaction on normal commercial terms where
 - (a) the transaction is a connected transaction only because it involves a person who is a connected person of the listed issuer by virtue of its/his relationship(s) with the issuer's subsidiary or subsidiaries;
 - (b) the value of the relevant subsidiary's total assets, profits and revenue (or the aggregate value of the relevant subsidiaries' total assets, profits and revenue) represents:
 - (i) less than 10% under the relevant percentage ratios as defined under rule 14.04(9) for each of the latest three financial years (or if less, the period since the incorporation or establishment of the subsidiary or subsidiaries); or
 - (ii) less than 5% under the relevant percentage ratios as defined under rule 14.04(9) for the latest financial year.

For this purpose, 100% of the subsidiary's or subsidiaries' total assets, profits and revenue will be used to calculate the relevant percentage ratios. Where any of the calculations of the percentage ratios produces an anomalous result, the Exchange may disregard the calculation and the listed issuer must provide alternative tests which it considers appropriate to the Exchange for consideration; and

- (c) if any relevant subsidiary (or any of its subsidiaries) is a party to the transaction or if the securities or assets of the relevant subsidiary (or any of its subsidiaries) are the subject of the transaction, the consideration ratio is less than 10%. This requirement will not apply if the transaction is of a revenue nature in the issuer's ordinary and usual course of business; and

Transactions with associates of a passive investor

- (10) a connected transaction of a revenue nature in the ordinary and usual course of the listed issuer's business and on normal commercial terms where
 - (a) the transaction is a connected transaction only because it involves an associate (the "Relevant Associate") of a substantial shareholder of the listed issuer; and

- (b) the substantial shareholder is a passive investor in the listed issuer and meets the following criteria:
- (i) it is a sovereign fund, or a unit trust or mutual fund authorised by the Commission or an appropriate overseas authority;
 - (ii) it has a wide spread of investments other than the securities of the listed issuer and the Relevant Associate;
 - (iii) it and the Relevant Associate are connected persons only because it is a substantial shareholder of the listed issuer;
 - (iv) it is not a controlling shareholder of the listed issuer;
 - (v) it does not have any representative on the board of directors of the listed issuer, and is not involved in the management of the listed issuer (including any influence over the listed issuer's management through negative control (e.g. its veto rights) on material matters of the listed issuer); and
 - (vi) it is independent of the directors, chief executive, controlling shareholder(s) and any other substantial shareholder(s) of the listed issuer.

**Connected transactions exempt from
the independent shareholders' approval requirements**

14A.32 A connected transaction on normal commercial terms where each or all of the percentage ratios (other than the profits ratio) is/are:

- (1) less than 5%; or
- (2) less than 25% and the total consideration is less than HK\$10,000,000

is only subject to the reporting and announcement requirements set out in rules 14A.45 to 14A.47 and is exempt from the independent shareholders' approval requirements of this Chapter.

Note: This exemption does not apply to the issue of new securities by a listed issuer (other than its subsidiaries) to a connected person, which is governed by rule 14A.31(3).

**Continuing connected transactions
exempt from the reporting, annual review, announcement and
independent shareholders' approval requirements**

14A.33 The following continuing connected transactions will be exempt from the reporting, annual review, announcement and independent shareholders' approval requirements of this Chapter:

Consumer goods or consumer services

- (1) the provision of consumer goods or consumer services as set out in rule 14A.31(7);

Sharing of administrative services

- (2) the sharing of administrative services as set out in rule 14A.31(8);

De minimis transactions

- (3) a continuing connected transaction on normal commercial terms where each or all of the percentage ratios (other than the profits ratio) is/are on an annual basis:
- (a) less than 0.1%;
 - (b) less than 1% and the transaction is a connected transaction only because it involves a person who is a connected person of the issuer by virtue of its/his relationship(s) with the issuer's subsidiary or subsidiaries; or
 - (c) less than 5% and the annual consideration is less than HK\$1,000,000;

Transactions with persons connected at the level of subsidiaries

- (4) a continuing connected transaction that meets the requirements in rule 14A.31(9); and

Transactions with associates of a passive investor

- (5) a continuing connected transaction that meets the requirements in rule 14A.31(10).

Notes: 1. When a connected person no longer meets the conditions under rule 14A.33(4) or 14A.33(5), the issuer must, subject to Note 2 to rule 14A.33, comply with all applicable reporting, annual review, announcement and independent shareholders' approval requirements for its subsequent continuing connected transactions with the connected person.

2. *If the connected person no longer meets the conditions under rule 14A.33(4) or 14A.33(5) during the term of an agreement for continuing connected transactions, the issuer is only required to comply with the applicable reporting, annual review and announcement requirements if:*

- (a) *the agreement is for a fixed period with fixed terms; and*
- (b) *the exemption under rule 14A.33(4) or 14A.33(5) applies at the time of the agreement.*

Issuers are encouraged to consult the Exchange on the application of this Note.

Continuing connected transactions exempt from the independent shareholders' approval requirements

14A.34 A continuing connected transaction on normal commercial terms where each or all of the percentage ratios (other than the profits ratio) is/are on an annual basis:

- (1) less than 5%; or
- (2) less than 25% and the annual consideration is less than HK\$10,000,000

is only subject to the reporting and announcement requirements set out in rules 14A.45 to 14A.47, the annual review requirements set out in rules 14A.37 to 14A.40 and the requirements set out in rules 14A.35(1) and 14A.35(2). It is exempt from the independent shareholders' approval requirements of this Chapter.

Non-exempt continuing connected transactions

14A.35 When an issuer enters into a continuing connected transaction not falling under rule 14A.33, it must:

- (1) in respect of each connected transaction, enter into written agreement(s) with the connected person. The agreement must set out the basis of the calculation of the payments to be made. The period for the agreement must be fixed and reflect normal commercial terms and, except in special circumstances, must not exceed 3 years. Special circumstances are limited to cases where the nature of the transaction requires the contract to be of a duration longer than 3 years. In such cases, the independent financial adviser will need to explain why a longer period for the agreement is required and to confirm that it is normal business practice for contracts of this type to be of such duration;

Note: Examples of bases of calculation of the payments to be made include the sharing of costs, price per unit for on-going purchases, annual rental for a lease, and percentage of total construction cost for a management fee.

- (2) in respect of each connected transaction, set a maximum aggregate annual value ("cap"), the basis of which must be disclosed. This annual cap must be expressed in terms of monetary value rather than a percentage of the issuer's annual revenue as derived from its latest published audited accounts or, where consolidated accounts have been prepared, its latest published audited consolidated accounts. The cap must be determined by reference to previous transactions and figures which are readily ascertainable from published information of the issuer. If there are no previous transactions, the cap must be made based on reasonable assumptions, details of which must be disclosed;

Note: Reference to annual revenue and other bases may help to determine the monetary value of the cap.

- (3) comply with the reporting and announcement requirements described in rules 14A.45 to 14A.47;
- (4) comply with the independent shareholders' approval requirements described in rule 14A.48 for transactions not falling under rule 14A.34; and
- (5) comply with the annual review requirements described in rules 14A.37 to 14A.40.

14A.36 The listed issuer must re-comply with rules 14A.35(3) and (4) in the following circumstances:—

- (1) if the cap in rule 14A.35(2) is exceeded; or
- (2) when the relevant agreement is renewed or there is a material change to the terms of the agreement.

Annual review of continuing connected transactions

14A.37 When an issuer enters into a continuing connected transaction not falling under rule 14A.33, each year the independent non-executive directors of the listed issuer must review the continuing connected transactions and confirm in the annual report and accounts that the transactions have been entered into:

- (1) in the ordinary and usual course of business of the listed issuer;
- (2) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the listed issuer than terms available to or from (as appropriate) independent third parties; and

- (3) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the listed issuer as a whole.

14A.38 When an issuer enters into a continuing connected transaction not falling under rule 14A.33, each year the auditors must provide a letter to the listed issuer's board of directors (with a copy provided to the Exchange at least 10 business days prior to the bulk printing of the listed issuer's annual report), confirming that the continuing connected transactions:

- (1) have received the approval of the listed issuer's board of directors;
- (2) are in accordance with the pricing policies of the listed issuer if the transactions involve provision of goods or services by the listed issuer;
- (3) have been entered into in accordance with the relevant agreement governing the transactions; and
- (4) have not exceeded the cap disclosed in previous announcement(s).

14A.39 The listed issuer shall allow, and shall procure that the counterparty to the continuing connected transactions shall allow, the auditors sufficient access to their records for the purpose of reporting on the transactions as set out in this rule. The listed issuer's board of directors must state in the annual report whether its auditors have confirmed the matters stated in rule 14A.38.

14A.40 A listed issuer shall promptly notify the Exchange and publish an announcement in accordance with rule 2.07C if it knows or has reason to believe that the independent non-executive directors and/or the auditors will not be able to confirm the matters set out in rules 14A.37 and/or 14A.38 respectively. The listed issuer may have to re-comply with rules 14A.35(3) and (4) and any other conditions the Exchange considers appropriate.

14A.41 Where a listed issuer has entered into an agreement involving continuing transactions and such transactions subsequently become continuing connected transactions for whatever reason (e.g. due to a party becoming a director of the listed issuer), the listed issuer must, immediately upon it becoming aware of this fact, comply with all applicable reporting, annual review and disclosure requirements of this Chapter in respect of all such continuing connected transactions. Upon any variation or renewal of the agreement, the listed issuer must comply in full with all applicable reporting, annual review, disclosure and independent shareholders' approval requirements of this Chapter in respect of all continuing connected transactions effected after such variation or renewal.

Waivers

Exchange discretion

14A.42 The Exchange may consider granting waivers from all or any of the requirements of this Chapter. In particular, the Exchange will consider granting waivers for the following transactions:

- (1) a transaction which is connected only because of the interest of a non-executive director of the listed issuer where the Exchange is satisfied that:
 - (a) such director does not control the listed issuer; and
 - (b) his principal business interest is not the listed issuer.

Where a waiver is given from the requirement to obtain independent shareholders' approval pursuant to this rule 14A.42(1), the Exchange may require a letter from the listed issuer's auditor or a financial adviser acceptable to the Exchange stating that in their opinion the transaction is fair and reasonable so far as the shareholders of the listed issuer are concerned. The Exchange will normally also require that:

- (i) an announcement containing brief details of the transaction be published in accordance with rule 2.07C as soon as possible thereafter; and
 - (ii) details of the transaction be included in the listed issuer's next published annual report and accounts;
- (2) where the listed issuer guarantees (or gives an indemnity in respect of) the obligations of (i) a non wholly-owned subsidiary described in rule 14A.11(5) or any of its subsidiaries described in rule 14A.11(6) or (ii) a company falling under rule 14A.13(2)(a)(ii), to a third party creditor and the guarantee or indemnity is joint and several, if:
 - (a) the guarantee is required in connection with a government or public sector contract awarded by tender;
 - (b) each of the shareholders of the non wholly-owned subsidiary or company has given a similar joint and several guarantee or indemnity to the third party; and
 - (c) each of the other shareholders of the non wholly-owned subsidiary or company has agreed to indemnify the listed issuer for a percentage of the liability guaranteed or indemnified at least in proportion to its percentage equity interest in the subsidiary or company and the Exchange is satisfied that such shareholder indemnity is of sufficient substance; or

- (3) upon an application by a new applicant, specific continuing connected transactions. Such waivers will be from the announcement and independent shareholders' approval requirements of this Chapter. General waivers will not be granted. The applicant's sponsor is required to state in the listing document whether the continuing connected transactions for which the waivers are sought are in the ordinary and usual course of business of the listed issuer, on normal commercial terms, are fair and reasonable and in the interests of the shareholders as a whole. In addition, the issuer is required to comply with rules 14A.35(1), 14A.35(2), 14A.36, 14A.37, 14A.38, 14A.39 and 14A.40.

Shareholders' meeting waiver

14A.43 Where independent shareholders' approval of a connected transaction is required, such approval shall be given by a majority vote at a general meeting of the shareholders of the listed issuer unless the following conditions are met, in which case a written independent shareholders' approval may be accepted in lieu of holding a general meeting: -

- (1) no shareholder of the listed issuer is required to abstain from voting if the listed issuer were to convene a general meeting for the approval of the connected transaction; and
- (2) the written independent shareholders' approval has been obtained from a shareholder or closely allied group of shareholders who (together) hold more than 50% in nominal value of the securities giving the right to attend and vote at that general meeting to approve the connected transaction.

Notes: 1 The Exchange will take into account the factors set out in rule 14.45 in determining whether a group of shareholders constitutes a "closely allied group of shareholders".

- 2 *Where a listed issuer discloses price sensitive information to any shareholder in confidence to solicit the written independent shareholders' approval, the listed issuer must be satisfied that such shareholder is aware that he must not deal in the listed issuer's securities before such information has been made available to the public.*

Waiver conditions

14A.44 In granting any waiver, the Exchange may impose conditions whenever it considers appropriate.

Reporting requirements

14A.45 The following details of the connected transaction must be included in the listed issuer's next published annual report and accounts:

- (1) the transaction date;
- (2) the parties to the transaction and a description of their connected relationship;
- (3) a brief description of the transaction and its purpose;
- (4) the total consideration and terms (including, where relevant, interest rates, length of repayment and security); and
- (5) the nature and extent of the connected person's interest in the transaction.

14A.46 An issuer which has entered into a continuing connected transaction not falling under rule 14A.33, must disclose the information set out in rule 14A.45 in its subsequent published annual report and accounts for the financial years during which the issuer undertakes the transaction under the written agreement entered into pursuant to rule 14A.35(1).

Announcement requirements

14A.47 Issuers proposing to enter into a connected transaction or a continuing connected transaction which is subject to announcement requirements must:—

- (1) notify the Exchange as soon as possible after the terms of the transaction have been agreed;

Note: Under rule 13.09, a listed issuer's notification obligations in respect of information expected to be price-sensitive arise as soon as that information is the subject of a decision.

- (2) publish an announcement in accordance with rule 2.07C as soon as possible; and

Note: Where the connected transaction is also a share transaction, major transaction, very substantial disposal, very substantial acquisition or reverse takeover, rule 14.37 (requirement for short suspension of dealings) also applies.

- (3) comply with rules 14A.45 or 14A.46 (the reporting requirements).

14A.47A Where there is expected to be delay in despatch of the circular by the date previously announced under rule 14A.56(10) or this rule, the listed issuer must as soon as practicable disclose this fact by way of an announcement stating the reason for the delay and the new expected date of despatch of the circular.

Independent shareholders' approval requirements

14A.48 Listed issuers proposing to enter into a connected transaction or a continuing connected transaction which is subject to independent shareholders' approval must:

- (1) comply with rules 14A.45 or 14A.46 (the reporting requirements) and 14A.47 (the announcement requirements); and
- (2) comply with the requirements set out in rules 14A.49 to 14A.54 (the circular and independent shareholders' approval requirements).

Shareholders' circular

14A.49 The listed issuer must also send a circular, which complies with rules 14A.58 to 14A.62, to the shareholders and arrange for its publication in accordance with the provisions of Chapter 2 of the Exchange Listing Rules:

- (a) if the transaction is approved or is to be approved by way of written shareholders' approval from a shareholder or a closely allied group of shareholders under rule 14A.43, within 15 business days after publication of the announcement; or
- (b) if the transaction is to be approved by shareholders at a general meeting, at the same time as or before the listed issuer gives notice of the general meeting to approve the transaction.

A listed issuer shall despatch to its shareholders any revised or supplementary circular and/or provide any material information that has come to the attention of the directors after the issue of the circular (by way of announcement published in accordance with rule 2.07C) on the transaction to be considered at a general meeting not less than 10 business days before the date of the relevant general meeting. The meeting must be adjourned before considering the relevant resolution to ensure compliance with the 10 business day requirement under this rule by the chairman or, if that is not permitted by the issuer's constitutional documents, by resolution to that effect (see also rule 13.41).

Note: The listed issuer must assess the scale of revisions or updating required and materiality of the new information, revisions or updating required that has come to its attention after publication of the circular, when deciding whether to issue a revised or supplementary circular or publish an announcement in accordance with rule 2.07C. Where the revisions or updating required are significant, the listed issuer must

consider carefully whether it would be better to publish a revised or supplementary circular rather than provide particulars of the changes in an announcement. The listed issuer should not overwhelm or confuse investors with lengthy announcements describing changes to information contained in the original circular.

14A.50 [Repealed 1 January 2009]

14A.51 The circular must (subject to rule 14.87) be in English and Chinese.

Independent shareholders' approval

14A.52 The transaction and, in the case of a continuing connected transaction, the cap, must be made conditional on approval by independent shareholders at the time when the listed issuer enters into the transaction.

14A.53 The Exchange will consider waiving the requirement to hold a shareholders' meeting and permitting independent shareholders' approval to be given in writing in the circumstances set out in rule 14A.43.

14A.54 The Exchange will require any connected person with a material interest in a proposed transaction, and any shareholder with a material interest in such transaction and its associate(s), to abstain from voting at the relevant general meeting on the relevant resolution(s).

14A.55 [Repealed 3 June 2010]

Contents of announcements

14A.56 The announcement for connected transactions and continuing connected transactions must contain at least the following:

- (1) the information set out in rules 14.58 to 14.60 (contents of announcements - share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition and reverse takeover) and the views of the independent non-executive directors on the transaction if no independent shareholders' approval is required for the transaction;
- (2) a description of the connected relationship between the parties to the transaction and the nature and extent of the connected person's interest in the transaction;
- (3) a statement that the transaction is subject to independent shareholders' approval, if applicable;
- (4) in the case of continuing connected transactions, the amount of the cap for the purpose of rule 14A.35(2);

- (5) where the transaction involves the purchase of assets by the listed issuer, the original purchase cost of the asset to the connected person;
- (6) where appropriate, the original acquisition cost of the assets which will be sold to connected persons where the listed issuer has held such assets for a period of 12 months or less;
- (7) where the transaction is a connected transaction approved or to be approved by way of written independent shareholders' approval from a shareholder or a closely allied group of shareholders pursuant to rule 14A.43, details of the shareholder or the closely allied group of shareholders (as the case may be), including the name of the shareholder(s), the number of securities held by each such shareholder and the relationship between the shareholders;
- (8) where applicable, the information required in rule 14.62 if the announcement contains a profit forecast in respect of the listed issuer or a company which is, or is proposed to become, one of its subsidiaries;
- (9) if no circular is required under this Chapter, a statement on whether any directors have a material interest in the transaction and, if so, whether they have abstained from voting on the board resolution; and
- (10) where independent shareholders' approval is required, the expected date of despatch of the circular and if this is more than 15 business days after the publication of the announcement, the reasons why this is so.

Note: If there is expected to be delay in despatch of the circular, the listed issuer must as soon as practicable publish a further announcement in accordance with rule 14A.47A.

Guaranteed profits or net tangible assets

14A.57 Where a listed issuer acquires a company or business from a connected person and the profits or net tangible assets or other matters regarding the financial performance of that company or business are guaranteed by the connected person, the listed issuer must (unless expressly exempted by the Exchange) publish an announcement in accordance with rule 2.07C if the profits or net tangible assets or other matters regarding the financial performance are less than the amount guaranteed. Any such announcement must include details of:

- (1) the shortfall and the adjustment, if any, of the consideration for the transaction;
- (2) whether the connected person has fulfilled its obligations under the guarantee;

- (3) whether or not the listed issuer has exercised any option to sell the company or business back to the connected person or other rights it held under the terms of the guarantee, and the reasons for its decision; and
- (4) the opinion of the independent non-executive directors as to whether:
 - (a) the connected person has fulfilled its obligations; and
 - (b) the decision to exercise or not to exercise any option to sell the company or business back to the connected person or other rights under the guarantee is fair and reasonable and in the interests of the shareholders as a whole.

Note: An option under the terms of the guarantee is also subject to the requirements of rules 14A.67 to 14A.71.

Contents of circular

General principles

14A.58 All circulars sent by a listed issuer to holders of its listed securities must:

- (1) provide a clear and adequate explanation of its subject matter and demonstrate the advantages and disadvantages of the transaction for the listed issuer;
- (2) where practicable, include an arithmetical evaluation in the circular; and
- (3) where independent shareholders' approval is required, contain:
 - (a) all information necessary to allow the holders of securities to make a properly informed decision;
 - (b) a heading drawing attention to the importance of the document and advising holders of securities, who are in any doubt as to what action to take to consult appropriate independent advisers;
 - (c) a separate letter from the independent board committee, if applicable (see rule 14A.21); and
 - (d) a separate letter from the independent financial adviser (see rule 14A.22).

Note: If all the independent non-executive directors have a material interest in the relevant transactions or arrangements, no independent board committee can be formed. In that event, the independent financial adviser shall make its recommendation to the independent shareholders only in its letter set out in the circular to shareholders.

Specific disclosure in circular

14A.59 The circular must contain at least:

- (1) a prominent and legible disclaimer on its front cover or inside front cover in the form set out in rule 14.88;
- (2) full details of the transaction including:
 - (a) the date of the transaction and the identity and activities of the parties to the transaction including the identity and activities of the ultimate beneficial owner of the disposing or acquiring party;
 - (b) a general description of the nature and the value (being the book value and valuation, if any) of any assets concerned. If any of the assets are securities, the circular must include the name of the company in which the shares are or were held and a general description of its activities;
 - (c) a description of the terms and conditions of the consideration and a statement of the total consideration, explaining how this is being or is to be satisfied;
 - (d) the name of the connected person concerned;
 - (e) a statement of the nature of the connected person's relationship with any controller and the name and office held by that controller; and
 - (f) the nature and extent of the interest of the connected person in the transaction;
- (3) the information regarding the listed issuer specified in the following paragraphs of Appendix 1, Part B:
 - 1 — name
 - 2 — directors' responsibility
 - 5 — expert statements
 - 10 — securities to be issued (if applicable)
 - 29(2) — requirements if there is a profit forecast (see rule 14.61 for the definition of "profit forecast")
 - 32 — no material adverse change
 - 39 — directors' service contracts
 - 40 — directors' interests in assets
 - 43(2)(a) & (c) — documents on display

- (4) information regarding interests of directors and chief executive in the listed issuer required under paragraphs 34 and 38 of Appendix 1, Part B, and Practice Note 5;
- (5) where independent shareholders' approval is required, a statement that any connected person with a material interest in the transaction, and any shareholder with a material interest in the transaction and its associates, will not vote and the information required under rule 2.17;
- (6) information on the property interests (as defined in rule 5.01(3)) under rule 5.03 and an independent valuation if the primary significance of the asset (except for property interests) being acquired or disposed of is its capital value;
- (7) where independent shareholders' approval is required, a letter from the independent board committee as required under rule 14A.58(3)(c) and its recommendation to the independent shareholders as required under rule 14A.21;
- (8) a copy of the independent financial adviser's opinion letter referred to in rule 14A.22;
- (9) in the case of a continuing connected transaction, details of the cap for the purpose of rule 14A.35(2) and an explanation of how and the basis upon which it was calculated;
- (10) where a listed issuer acquires a company or business from a connected person who provides a guarantee of the profits or net tangible assets or other matters regarding the financial performance of that company or business,
 - (a) a statement that:—
 - (i) the listed issuer will publish an announcement in accordance with rule 2.07C if the profits or net tangible assets or other matters regarding the financial performance are less than the amount guaranteed and will include details in its next published annual report and accounts; and
 - (ii) the independent non-executive directors of the listed issuer will provide an opinion in the listed issuer's next published annual report and accounts as to whether the connected person has fulfilled its obligations under the guarantee; and
 - (b) details of any option granted to the listed issuer to sell the company or business back to the connected person and/or other rights granted to the listed issuer;

Note: An option under the terms of the guarantee is also subject to the requirements of rules 14A.67 to 14A.71.

- (11) information as to the competing interests (if any) of each of the directors and any proposed director of the issuer and his/her respective associates (as if each of them were treated as a controlling shareholder under rule 8.10);
- (12) where appropriate, details of any guarantee and/or other security given and required as part of the transaction;
- (13) reasons for entering into the transaction and the benefits which are expected to accrue to the listed issuer as a result of the transaction;
- (14) where the transaction involves the purchase of assets by the listed issuer, the original purchase cost of the asset to the connected person;
- (15) where appropriate, the original acquisition cost of the assets which will be sold to connected persons where the listed issuer has held such assets for a period of 12 months or less;
- (16) if the transaction involves a disposal of an interest in a subsidiary by a listed issuer, a declaration as to whether the subsidiary will continue to be a subsidiary of the listed issuer following the transaction;
- (17)
 - (a) where appropriate, a business valuation report on a business or company being acquired or disposed of and/or traffic study report in respect of any infrastructure project or infrastructure or project company. Such report(s) must clearly set out:
 - (i) all fundamental underlying assumptions including discount rate or growth rate used; and
 - (ii) a sensitivity analysis based on the various discount rates and growth rates;
 - (b) where any business valuation is based on a profit forecast, the accounting policies and calculations for the underlying forecasts must be examined and reported on by the auditors or reporting accountants. Any financial adviser mentioned in the circular must also report on the underlying forecasts;
- (18) a statement on whether any directors have a material interest in the transaction and, if so, whether they have abstained from voting on the board resolution; and
- (19) any additional information requested by the Exchange.

**Additional information to be included in circular
where connected transaction is also a Chapter 14 transaction**

- 14A.60 Where a connected transaction is also a share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition or reverse takeover, the circular must also contain the information required by Chapter 14 for that type of transaction.
- 14A.61 Where a notice of meeting to approve any proposed transaction has been sent to shareholders and subsequently the transaction becomes a connected transaction, the listed issuer shall publish a further announcement in accordance with rule 2.07C. The listed issuer must ensure that the following parties abstain from voting at that meeting on resolution(s) approving the transaction:
- (1) any connected person with a material interest in the transaction; and
 - (2) any shareholder with a material interest in the transaction and its associates.
- 14A.62 The listed issuer shall also send a supplementary circular to its shareholders. Both the announcement and the circular shall state that the transaction has become a connected transaction and identify the parties that are required to abstain from voting. The listed issuer must also include in the circular the opinion of the independent board committee and an independent financial adviser (in the form of a separate letter) on the transaction and the other information mentioned in rules 14A.58 and 14A.59.

Financial assistance

General

- 14A.63 Any transaction involving a connected person, or any company falling under rule 14A.13(2)(a)(ii) or 14A.13(2)(b)(ii), and financial assistance which is not exempted under rules 14A.65 or 14A.66 is subject to the reporting, announcement and independent shareholders' approval requirements of this Chapter.

Treatment of attributable interest in calculating proportionate financial assistance

- 14A.64 In calculating proportionate financial assistance to any company falling under rule 14A.13(2)(a)(ii), the Exchange will not consider the listed issuer's attributable interest in the company receiving the financial assistance. For example, where a principal purpose or effect of the transaction is for the granting by a non wholly-owned subsidiary of the listed issuer of financial assistance on normal commercial terms (or better to the listed issuer) to a company falling under rule 14A.13(2)(a)(ii), the Exchange will calculate the proportionate financial assistance from the listed issuer's point of view by reference to the equity interest of the group company which directly holds the interest in the company receiving the financial assistance.

Exempt from reporting, announcement and independent shareholders' approval requirements

14A.65 The following connected transactions are exempt from the reporting, announcement and independent shareholders' approval requirements of this Chapter:—

- (1) financial assistance provided by a listed issuer in its ordinary and usual course of business for the benefit of a connected person, or any company falling under rule 14A.13(2)(a)(ii), on normal commercial terms (or better to the listed issuer);
- (2) financial assistance provided by a listed issuer for the benefit of a connected person or a company falling under rule 14A.13(2)(a)(ii):
 - (a) in the ordinary and usual course of business of the listed issuer but not on normal commercial terms (or better to the listed issuer); or
 - (b) not in the ordinary and usual course of business but on normal commercial terms (or better to the listed issuer),

and where each or all of the percentage ratios (other than the profits ratio) is/are: (i) less than 0.1%; (ii) less than 1% and the transaction is a connected transaction only because it involves a person who is a connected person of the issuer by virtue of its/his relationship(s) with the issuer's subsidiary or subsidiaries; or (iii) less than 5% and the total value of the assistance plus any preferential benefit to the connected person, or a company falling under rule 14A.13(2)(a)(ii), is less than HK\$1,000,000;

- (3) financial assistance provided by a listed issuer for the benefit of a connected person in which the listed issuer is a shareholder, or any company falling under rule 14A.13(2)(a)(ii), not in the ordinary and usual course of business but on normal commercial terms (or better to the listed issuer), provided that the assistance being provided is in proportion to the listed issuer's equity interest in the connected person or the company falling under rule 14A.13(2)(a)(ii). In addition, any guarantees given by the listed issuer must be on a several (and not a joint and several) basis; or
- (4) financial assistance provided by a connected person, or any company falling under rule 14A.13(2)(b)(ii), for the benefit of a listed issuer on normal commercial terms (or better to the listed issuer) where no security over the assets of the listed issuer is granted in respect of the financial assistance.

Exempt from independent shareholders' approval requirements

14A.66 The following connected transactions are only subject to the reporting and announcement requirements set out in rules 14A.45 and 14A.46 and rule 14A.47 respectively:

- (1) financial assistance provided by the listed issuer in the ordinary and usual course of business for the benefit of a connected person, or any company falling under rule 14A.13(2)(a)(ii), not on normal commercial terms (or better to the listed issuer), where each or all of the percentage ratios (other than the profits ratio) is/are: (i) less than 5%; or (ii) less than 25% and the total value of the assistance plus any preferential benefit to the connected person or the relevant company is less than HK\$10,000,000; or
- (2) financial assistance provided by the listed issuer not in the ordinary and usual course of business but on normal commercial terms (or better to the listed issuer) for the benefit of:
 - (a) a connected person; or
 - (b) any company falling under rule 14A.13(2)(a)(ii) if the assistance being provided is not in proportion to the listed issuer's equity interest in the relevant company or any guarantees given by the listed issuer are not on a several basis, and each or all of the percentage ratios (other than the profits ratio) is/are: (i) less than 5%; or (ii) less than 25% and the total value of the assistance plus any preferential benefit to the connected person or the relevant company is less than HK\$10,000,000.

Options

14A.67 The definitions set out in rule 14.72 also apply to this Chapter.

14A.68 The grant, acquisition, transfer, or exercise of an option involving a listed issuer and its connected person will be treated as a connected transaction and classified by reference to the percentage ratios (other than the profits ratio). The termination of an option by a listed issuer will be treated as a transaction and classified by reference to the percentage ratio (other than the profits ratio), unless the termination is in accordance with the terms of the original agreement entered into by the listed issuer and does not involve payment of any amounts by way of penalty, damages or other compensation. The de minimis ratios under rules 14A.31(2) and 14A.32 apply to such connected transactions. The listed issuer must comply with the connected transaction requirements of the relevant classification and other specific requirements of rules 14A.69 to 14A.71.

14A.69 The following apply to an option involving a listed issuer and a connected person, the exercise of which is not at the listed issuer's discretion:

- (1) on the grant of the option, the transaction will be classified as if the option had been exercised. For the purpose of the percentage ratios, the consideration includes the premium and the exercise price of the option;
- (2) on the exercise or transfer of such option, such exercise or transfer must be announced by means of an announcement which is published in accordance with rule 2.07C as soon as reasonably practicable if the grant of the option has previously been announced pursuant to the requirements of this Chapter; and
- (3) if the grant of the option has previously been announced pursuant to the requirements of this Chapter, the listed issuer must as soon as reasonably practicable upon:
 - (a) the expiry of the option;
 - (b) the option holder notifying the grantor that the option will not be exercised; or
 - (c) the transfer by the option holder of the option to a third party

(whichever is the earliest) announce such fact by means of an announcement which is published in accordance with rule 2.07C.

14A.70 The following apply to an option involving a listed issuer and a connected person, the exercise of which is at the listed issuer's discretion:

- (1) on the acquisition by, or grant of the option to, the listed issuer, only the premium will be taken into consideration for the purpose of classification of the transaction. Where the premium represents 10% or more of the sum of the premium and the exercise price, the value of the underlying assets, the revenue attributable to such assets and the sum of the premium and the exercise price will be used for the purpose of the percentage ratios;
- (2) on the exercise of such option by the listed issuer, the exercise price, the value of the underlying assets and the revenue attributable to such assets will be used for the purpose of the percentage ratios. Where an option is exercised in stages, the Exchange may at any stage require the listed issuer to aggregate each partial exercise of the option and treat them as if they were one transaction; and
- (3) non-exercise of the option or transfer of the option to a third party will be treated as if the option was exercised. The exercise price, the value of the underlying assets, the revenue attributable to such assets and (if applicable) the premium for transferring the option will be used for the purpose of the percentage ratios.

14A.71 For the purpose of rules 14A.69(1) and 14A.70(1), where, on the grant of the option, the actual monetary value of the premium, the exercise price, the value of the underlying assets and the revenue attributable to such assets have not been determined, the listed issuer must demonstrate to the satisfaction of the Exchange the highest possible monetary value, which will then be used for the purpose of classification of the transaction. Failure to do so may result in the transaction being subject to all connected transaction requirements under this Chapter. The listed issuer must inform the Exchange of the actual monetary value of each of the premium, the exercise price, the value of the underlying assets and the revenue attributable to such assets as soon as it has been determined. If the actual monetary value results in the transaction falling within a higher classification of the transaction as a result, the listed issuer must publish an announcement in accordance with rule 2.07C stating this fact as soon as reasonably practicable and comply with the additional requirements of such higher classification.

Exemption for Qualified Property Acquisitions

14A.72 A Qualified Property Acquisition undertaken on a joint venture basis with a Qualified Connected Person is exempt from the independent shareholders' approval requirements if:

- (1) it satisfies the requirements in rule 14.33A(2)(a) to (d); and
- (2) the independent board committee and the independent financial adviser have confirmed that the Qualified Property Acquisition is in the Qualified Issuer's ordinary and usual course of business; and that the Qualified Property Acquisition and the joint venture, including its financing and profit distribution arrangements, are on normal commercial terms, fair and reasonable and in the interests of the Qualified Issuer and its shareholders as a whole.

14A.73 (1) A Qualified Issuer must publish an announcement as soon as possible after notification of the success of a bid by a joint venture for a Qualified Property Acquisition falling under rule 14A.72 and send a circular to its shareholders.

- (2) The announcement and circular must contain:
 - (a) information required in rules 14.33B(2)(a) and (b); and
 - (b) information to demonstrate that the conditions in rule 14A.72 were met.

Note: If any of these details are not available when the issuer publishes the initial announcement, it must publish subsequent announcement(s) to disclose the details as soon as possible after they have been agreed or finalised.

- (3) The announcement, circular and reporting requirements under chapter 14A apply to the acquisition and the joint venture according to the transaction classification, except that the information circular need not contain a valuation report on the property under the Qualified Property Acquisition.

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect about this circular or as to the action to be taken, you should consult a stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or otherwise transferred all your shares in Titan (Holdings) Limited, you should at once hand this circular to the purchaser(s) or the transferee(s) or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser(s) or the transferee(s).

The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this circular, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this circular.



TITAN (HOLDINGS) LIMITED

(incorporated in Bermuda with limited liability)

CONNECTED TRANSACTION AND DISCLOSEABLE TRANSACTION

**Independent financial adviser
to the Independent Board Committee**



DBS ASIA CAPITAL LTD

9th April, 2003

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DEFINITIONS

In this circular, the following expressions have the following meanings unless the context requires otherwise:

Expressions	Meanings
“Acquisition”	the acquisition of the Assets pursuant to the Agreement;
“Agreement”	the conditional agreement dated 4th March, 2003 entered into between the Vendors and the Purchasers in relation to the Acquisition;
“Assets”	the FSUs and the Licenses;
“Board”	the board of Directors of the Company;
“Business Day”	a day (other than a Saturday or a Sunday) on which banks are open for business in Hong Kong;
“Company”	means Titan (Holdings) Limited, a limited company incorporated in Bermuda with limited liability, whose shares are listed on the main board of the Stock Exchange;
“Completion”	completion of the sale and purchase of the Assets;
“Completion Date”	the date, being a business day, on which all the conditions for the sale and purchase of the Assets have been satisfied (or such other day as the parties to the Agreement may agree in writing);
“Consideration”	the total consideration payable by the Purchasers to the Vendors pursuant to the Agreement;
“Consideration Shares”	397,042,509 new shares of par value of HK\$0.01 each, to be allotted and issued by the Company in the name of Great Logistics (as directed by Vendor A, Vendor B and Vendor C) at HK\$0.35 per Share pursuant to the Agreement in satisfaction of the Consideration. Such Consideration Shares shall rank pari passu in all respect with the existing ordinary shares of the Company including the rights to receive all dividends and distributions declared made or distributed after the date of issue and shall be free from all charges, mortgages, liens, equities, encumbrances, claims, third party rights or restrictions of any nature whatsoever;

DEFINITIONS

“DBS Asia”	DBS Asia Capital Limited, an investment adviser registered under the Securities Ordinance (Chapter 333 of the Laws of Hong Kong) and the independent financial adviser to the Independent Board Committee in respect of the Acquisition;
“Directors”	means the directors of the Company;
“East License”	the license issued by the Ministry of Transport of Malaysia under which Vendor C has the right to undertake floating storage operations within the Johor port limits of Pasir Gudang and all ancillary documentation relating thereto;
“Encumbrances”	all pledges, charges, liens, mortgages, security interests, pre-emption rights, options and any other encumbrances or third party rights or claims of any kind (other than liens arising or incurred in the ordinary course of business and securing obligations not material in amount and provisions constituting reservation and retention of title clauses entered into in the ordinary course of business);
“FSU Mars”	the floating storage unit named “Titan Mars” with official number 0176008 and registered under the laws and flag of Cambodia;
“FSU Mercury”	the floating storage unit named “Titan Mercury” with official number 389176 and registered under the laws and flag of Singapore;
“FSU Valuation”	means the independent valuations on the FSUs prepared by independent valuer, Grant Sherman;
“FSUs”	FSU Mercury and FSU Mars;
“Great Logistics”	Great Logistics Holdings Limited, a company incorporated in the British Virgin Islands with limited liability on 2nd January, 2002;
“Group”	means the Company and its subsidiaries, which are principally engaged in the businesses of design, manufacture and sale of apparel, oil trading and oil transportation;

DEFINITIONS

“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China;
“Independent Board Committee”	an independent board committee constituted by the two independent non-executive directors of the Company, comprising Mr. Liu Hongru and Wong Kong Hon, formed to advise the Independent Shareholders in respect of the Acquisition;
“Independent Shareholders”	Shareholders other than Great Logistics and its associates;
“Last Trading Date”	4th March, 2003, being the last trading date of the Shares prior to date of the Company’s announcement dated 5th March, 2003;
“Latest Practicable Date”	4th April, 2003, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained in this circular;
“Licenses”	all right, title, benefit and interest of Vendor C in and to each of the East License and the West License, in each case including (but not limited to) all rights enjoyed by Vendor C and all rights of use in respect of the foregoing;
“Licenses Valuation”	means the independent valuations on the Licenses prepared by independent valuer, Grant Sherman;
“Listing Rules”	means The Rules Governing the Listing of Securities on the Stock Exchange;
“Malaysian Company A”	a third party independent of the Company and its subsidiaries, any director, chief executive or substantial shareholder of such companies or any of their respective associates (as defined in the Listing Rules);
“Malaysian Company B”	a third party independent of the Company and its subsidiaries, any director, chief executive or substantial shareholder of such companies or any of their respective associates (as defined in the Listing Rules);
“Purchaser A”	means Titan Mars Limited, an indirect wholly owned subsidiary of the Company and incorporated under the laws of the British Virgin Islands and whose registered office is at Beaufort House, P.O. Box 438, Road Town, Tortola, British Virgin Islands;

DEFINITIONS

“Purchaser B”	means Titan Solar Pte. Ltd., an indirect wholly owned subsidiary of the Company and incorporated under the laws of Singapore and whose registered office is at 6 Temasek Boulevard, #20-02 Suntec Tower Four, Singapore 038986;
“Purchasers”	collectively, Purchaser A and Purchaser B;
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong);
“Shareholder(s)”	means the shareholder(s) of the Company;
“Special General Meeting”	the special general meeting of the Company to be held at Room 3002, 30/F., Far East Finance Centre, 16 Harcourt Road, Hong Kong on 25th April, 2003 at 10:30 a.m. or any adjourned meeting thereof, notice of which is set out on pages 50 to 51 of this circular;
“Stock Exchange”	means The Stock Exchange of Hong Kong Limited;
“Vendor A”	means Titan Mars Pte. Ltd., a company incorporated under the laws of Singapore and whose registered office is at 8 Temasek Boulevard Suntec Tower Three #29-02, Singapore 038988;
“Vendor B”	means Titan Oil Tank Pte. Ltd., a company incorporated under the laws of Singapore and whose registered office is at 8 Temasek Boulevard Suntec Tower Three #29-02, Singapore 038988;
“Vendor C”	means Titan Oil Pte. Ltd., a company incorporated under the laws of Singapore and whose registered office is at 8 Temasek Boulevard Suntec Tower Three #29-02, Singapore 038988;
“Vendors”	collectively, Vendor A, Vendor B and Vendor C;
“West License”	the license issued by the Ministry of Transport of Malaysia under which Vendor C has the right to undertake floating storage operations within the port limits of Pelabuhan Tanjung Pelepas, Gelang Patah, Johor Malaysia and all ancillary documentation relating thereto.

LETTER FROM THE BOARD OF DIRECTORS



TITAN (HOLDINGS) LIMITED

(incorporated in Bermuda with limited liability)

Executive Directors:

Mr. Tsoi Tin Chun,
Chairman and Managing Director
Mr. Zheng Dun Xun
Mr. Tsoi Kwing Ming
Mr. Lu Ping Lang

Non-Executive Director:

Mr. Cheong Soo Kiong

Independent Non-Executive Directors:

Mr. Liu Hongru
Mr. Wong Kong Hon

Registered Office:

Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

Hong Kong Principal Office:

Room 3002, 30/F.
Far East Finance Centre
16 Harcourt Road
Hong Kong

9th April, 2003

To the Shareholders

Dear Sir or Madam,

CONNECTED TRANSACTION AND DISCLOSEABLE TRANSACTION

INTRODUCTION

On 5th March, 2003, the Directors announced that the Purchasers (both of which are indirect wholly owned subsidiaries of the Company), entered into the Agreement whereby Vendor A, Vendor B and Vendor C have agreed to sell and the Purchasers have agreed to purchase the FSUs and the Licenses (as the case may be). The Consideration will be satisfied at Completion by the issue of 397,042,509 Consideration Shares to Great Logistics (as directed by Vendor A, Vendor B and Vendor C), at the price of HK\$0.35 per Consideration Share.

Both Vendor A and Vendor B are wholly and beneficially owned by Ms. Tsoi Yuk Yi, the spouse of Mr. Tsoi Tin Chun. Vendor C is held as to 95% by Mr. Tsoi Tin Chun and as to 5% by Ms. Tsoi Yuk Yi. Great Logistics (which is wholly owned by Vendor C) is holding 1,800,500,000 shares, which amount to approximately 50.9% of the issued share capital of the Company. Mr. Tsoi Tin Chun is also the chairman and a director of the Company. Mr. Tsoi Tin Chun is not a direct shareholder of the Company but is a controlling shareholder of the

LETTER FROM THE BOARD OF DIRECTORS

Company as a result of his shareholding in Vendor C and Great Logistics. Ms. Tsoi Yuk Yi, as the spouse of Mr. Tsoi Tin Chun, is a connected person of the Company under Chapter 14 of the Listing Rules. After completion of the Acquisition, Mr. Tsoi Tin Chun's indirect shareholding will increase from 50.9% to 55.9% and Great Logistics' direct shareholding will also increase from approximately 50.9% to 55.9%.

The Acquisition constitutes a connected transaction for the Company under Chapter 14 of the Listing Rules because Ms. Tsoi Yuk Yi, as a controlling shareholder of each of Vendor A and Vendor B, is an associate of Mr. Tsoi Tin Chun, who is a substantial shareholder and director of the Company; and Vendor C is also a connected person by virtue of its indirect controlling shareholding in the Company and its ownership by Mr. Tsoi Tin Chun and Ms. Tsoi Yuk Yi. The Acquisition also constitutes a discloseable transaction of the Company under the Listing Rules. The Acquisition is subject to the Independent Shareholders' approval at the Special General Meeting, at which Great Logistics and its associates will abstain from voting.

The purpose of this circular is to provide you with information relating to the Acquisition and seek your approval of the Acquisition at the Special General Meeting. This circular also contains information in compliance with the Listing Rules.

THE AGREEMENT

Date : 4th March, 2003

Parties : (1) Titan Mars Pte. Ltd., a company incorporated under the laws of Singapore and whose registered office is at 8 Temasek Boulevard Suntec Tower Three #29-02, Singapore 038988 ("Vendor A"). Vendor A is wholly and beneficially owned by Ms. Tsoi Yuk Yi, the spouse of Mr. Tsoi Tin Chun. Mr. Tsoi Tin Chun is the chairman and a director of the Company;

(2) Titan Oil Tank Pte. Ltd., a company incorporated under the laws of Singapore and whose registered office is at 8 Temasek Boulevard Suntec Tower Three #29-02, Singapore 038988 ("Vendor B"). Vendor B is also wholly and beneficially owned by Ms. Tsoi Yuk Yi;

(3) Titan Oil Pte. Ltd., a company incorporated under the laws of Singapore and whose registered office is at 8 Temasek Boulevard Suntec Tower Three #29-02, Singapore 038988 ("Vendor C"). Vendor C is held as to 95% by Mr. Tsoi Tin Chun and as to 5% by Ms. Tsoi Yuk Yi. Vendor C wholly owns Great Logistics. Great

LETTER FROM THE BOARD OF DIRECTORS

Logistics is holding 1,800,500,000 shares in the capital of the Company, amounting to approximately 50.9% of the issued share capital of the Company as at the Latest Practicable Date;

- (4) Titan Mars Limited, an indirect wholly owned subsidiary of the Company and incorporated under the laws of the British Virgin Islands and whose registered office is at Beaufort House, P.O. Box 438, Road Town, Tortola, British Virgin Islands (“Purchaser A”);
- (5) Titan Solar Pte. Ltd., an indirect wholly owned subsidiary of the Company and incorporated under the laws of Singapore and whose registered office is at 6 Temasek Boulevard, #20-02 Suntec Tower Four, Singapore 038986 (“Purchaser B”); and
- (6) The Company.

Assets to be acquired : *FSU Mars*

Vendor A shall sell as beneficial owner, and Purchaser A shall purchase, FSU Mars free from all Encumbrances.

FSU Mercury

Vendor B shall sell as beneficial owner, and Purchaser B shall purchase, FSU Mercury free from all Encumbrances.

West License

Vendor C shall sell as beneficial owner, and Purchaser A shall purchase, the West License free from all Encumbrances. The West License is issued in the name of Malaysian Company A and not Vendor C, but it gives Vendor C the right to undertake floating storage operations within the port limits of Tanjung Pelepas, Gelang Patah, Johor Malaysia without a specified tenure. According to the Group’s Malaysian lawyers, this arrangement complies with the relevant rules and regulations in Malaysia. To effect the transfer of the West License, Vendor C will procure the Malaysian authority to reissue the West License in the name of the Malaysian Company A but give Purchaser A (instead of Vendor C) the right to undertake floating storage operations within the port limits of Tanjung Pelepas, Gelang Patah, Johor Malaysia.

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East License

Vendor C shall sell as beneficial owner, and Purchaser B shall purchase, the East License free from all Encumbrances. The East License is issued in the name of Malaysian Company B and not Vendor C, but it gives Vendor C the right to undertake floating storage operations within the port limits of Pasir Gudang, Johor Malaysia without a specified tenure. According to the Group's Malaysian lawyers, this arrangement complies with the relevant rules and regulations in Malaysia. To effect the transfer of the East License, Vendor C will procure the Malaysian authority to reissue the East License in the name of the Malaysian Company B but give Purchaser B (instead of Vendor C) the right to undertake floating storage operations within the port limits of Pasir Gudang, Johor Malaysia.

The West License grants the right to undertake floating storage within the port limits of Tanjung Pelepas, Gelang Patah, Johor Malaysia. FSU Mars is the floating storage unit operating within that designated port limits. The West License does not prohibit replacement of FSU Mars by another floating storage unit when FSU Mars retires from service in the future. Although the West License does not preclude the possibility of operating more than one FSU, the Group currently only intends to operate one FSU under the West License. The East License grants the right to undertake floating storage within the port limits of Pasir Gudang, Johor Malaysia. FSU Mercury is the floating storage unit operating within that designated port limits. The East License does not prohibit replacement of FSU Mercury by another floating storage unit when FSU Mercury retires from service in the future. Although the East License does not preclude the possibility of operating more than one FSU, the Group currently only intends to operate one FSU under the East License.

The port limits of Tanjung Pelepas, Johor Malaysia in which the West License grants right to undertake floating storage operation is situated in Malaysian waters [E103 degree 33.3' N1 degree 14.2'] near the western zone of Singapore. The port limits of Pasir Gudang, Johor Malaysia in which the East License grants right to undertake floating storage operation is situated in Malaysian waters [E104 degree 8.55' N1 degree 18.3'] near the eastern zone of Singapore. The Company

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considers port limits of Pasir Gudang, Johor Malaysia to be strategically located and are within close proximity for many ships that travel to/from the South China seas to Singapore and the port limits of Tanjung Pelepas, Johor Malaysia to be strategically located and are within close proximity for many ships that travel to/from the strait of Mallaca to Singapore.

Please see a rough map at page 25 of this circular (attachment 1) which illustrate the strategic locations of the two FSUs.

To the Company's knowledge the Malaysia Ministry of Transport has not made any public statement as to how many licences it can issue in the relevant port limits of the Licences. However, it is the Company's understanding that the Malaysia Ministry of Transport intends to issue only one license for each relevant port limits. Further, the Company was advised by the Vendors and understand that each port limit can only practically allow one FSU to operate due to limited space. Further, the valuer has not based the valuation on any assumption regarding the exclusivity of the Licences.

The Agreement provides that the transaction is to acquire all FSU Mars, FSU Mercury, West License and East License together. Each of the FSU Mars and FSU Mercury is also needed to be acquired together with the respective West License and East License to realise its commercial value. It is intended that after the Acquisition the FSUs will remain at their present location.

The FSUs provide services such as oil storage, blending and transshipment. FSU Mars and FSU Mercury are beneficially wholly owned by Vendor A and Vendor B respectively. FSU Mars commenced operations in May, 2002 and FSU Mercury commenced operations in June, 2001. The capacities of FSU Mars and FSU Mercury are 155,000 cubic meters and 70,000 cubic meters respectively. They are in good conditions and FSU Mars is expected to operate for another 4 years and FSU Mercury is expected to operate for another 5 years. The economic life of the vessel and FSU is approximately 30 years. After deducting the "used" economic life period as a vessel, the remaining economic life of FSU Mars and FSU Mercury is 4 and 5 years respectively. The valuation of the FSUs by the valuer is done base upon the remaining economic life of 4 and

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5 years respectively. The FSUs were formed by modifying two vessels bought by the Vendors in February, 2001 and December, 2000. After modification, the FSUs could still carry oil to serve the purpose of essential operations such as loading and unloading oil. The differences between the FSUs and the vessels before modification are the vessels were used for transporting freight from one destination to another whereas the FSUs are located at a fixed area for storage, blending and transshipment purposes. The FSUs are normally firmly anchored when the storage, blending and transshipment activities are carried out. Only in exceptional cases that the FSUs need to move around within the designated area when carrying out the above activities. The FSUs could still be used to transport oil. However, the Company intends to use the FSUs only for storage, blending and transshipment purposes and not as vessels to transport oil and the Company intends to have the FSUs firmly anchored most of the time to carry out storage, blending and transshipment activities and in exceptional cases to move around within the designated area to carry out the above activities. Further, the Company does not consider it efficient to use them to transport oil in view of their old age and the consequential repair costs resulting from their old age.

The Group intends to employ most of the employees currently working on the FSUs and this will help to ensure the smooth operation of the FSUs upon the Acquisition.

FSU Mars and FSU Mercury are registered under the laws and flag of Cambodia and Singapore respectively. Vendor A (who owns FSU Mars) and Vendor B (who owns FSU Mercury) are incorporated in Singapore. Because they are companies incorporated to own shipping vessels, no profit taxes are payable in Singapore. No profit tax is also payable by registering the FSUs under the Singapore and Cambodia flags. Hence Vendors are not subject to profits tax in Singapore, Cambodia and Malaysia. The Company does not consider there will be significant consequences and impacts on the operations of the FSUs by registering the FSUs in these countries. The Company understands that there are some general regulatory requirements that the FSU owner needs to comply, for example, safety and crew manning requirements (such as how many engineer, officer or technician are required to operate the FSU).

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The following are the fees, taxes and dues payable in relation to registration of vessels under the Singapore and Cambodia flag:

Singapore flag — FSU Mercury

Registration fee — Singapore Dollar (“S\$”) (one S\$ is equivalent to approximately HK\$4.37) 2.50 per net ton; subject to a minimum of S\$1,250 and a maximum of S\$50,000.

- Other taxes/fees —
- (i) Annual tonnage tax: This is payable at the rate of S\$0.20 per ton subject to a minimum of S\$100 and a maximum of S\$10,000.
 - (ii) Minimum Safe Manning Certificate: The amount of S\$35 is payable.
 - (iii) Carving and Marking Note: The amount of S\$150 is payable.
 - (iv) Vessel station licence: The amount payable is S\$50 per year.

Apart from the above, the Company is not aware of any other fees which are payable by registering a vessel under Singapore flag.

Cambodia flag — FSU Mars

Registration fee — US\$0.05 per net ton, subject to a minimum of US\$15 and a maximum of US\$2,500.

- Other taxes/fees —
- (i) Provisional Certificate of Registry: the amount payable is US\$200.
 - (ii) Permanent Certificate of Registry: the amount payable is US\$500.

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- (iii) Annual taxes: This is payable at the rate of US\$0.10 per net ton subject to a minimum of US\$30.
- (iv) Temporary Safe Manning Certificate: The amount payable is US\$50.
- (v) Permanent Safe Manning Certificate: The amount payable is US\$100.
- (vi) Temporary Vessel Station License: The amount payable is US\$100.
- (vii) Permanent Vessel Station License: The amount payable is US\$200.
- (viii) Radio Tax: The amount payable is US\$50 per year.

Apart from the above, the Company is not aware of any other fees which are payable by registering a vessel under Cambodia flag.

Advantages/Disadvantages of registering a vessel under Singapore flag

Advantages — The Singapore registry of vessels has good international reputation and the Singapore flag is the preferred choice of many international shipowners. It also offers an easy registration procedure for owners. A vessel can be registered within two hours upon the complete submission of all relevant documents.

Disadvantages — The fees and charges are relatively expensive compare with many other shipping registry like Panama and Cambodia.

According to the Vendors, the reasons for registering FSU Mercury in Singapore are its established reputation and its close proximity with the place of operations of FSU Mercury.

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Advantages/Disadvantages of registering a vessel under Cambodia flag

Advantages — The low cost of registration. The fees and taxes of the Cambodia Ship Registry are amongst the lowest in the world. The application for registration is simple and the processing is quite short.

Disadvantages — Cambodia Shipping Registry does not have the established international reputation like the registries in Singapore and Hong Kong.

According to the Vendors, the primary reason for registering FSU Mars in Cambodia is the low fees and taxes payable.

The FSUs were formed by modifying two vessels bought by the Vendors in February, 2001 and December, 2000. The historical investment costs of the vessels before they were turned into the FSUs, incurred by the Vendors, were approximately US\$8.9 million (for the vessel that was turned into FSU Mars) and approximately US\$5.9 million (for the vessel that was turned into FSU Mercury). The historical investment costs include money spent on purchasing the vessels and purchasing vessel equipments. They do not include the modification costs of the vessels set out below.

The modifications include addition of a laboratory, blending piping systems, a heater and other construction works in each of the vessels that were necessary for blending, storage and transshipment of oil. The modification costs for FSU Mercury and FSU Mars were approximately US\$1.1 million and approximately US\$0.57 million respectively.

Consideration : The Consideration is US\$17,816,010 (equivalent to HK\$138,964,878) which will be settled at Completion by the issue of 397,042,509 Consideration Shares by the Company to Great Logistics (as directed by Vendor A, Vendor B and Vendor C), at the price of HK\$0.35 per Consideration Share. The Consideration is payable by Consideration Shares only. No consideration will be paid by the Purchasers to Malaysian Company A and Malaysian Company B. The Consideration shall be and shall be deemed to be fully paid by the Purchasers to the Vendors by the issuance of 397,042,509 Consideration Shares by the Company to Great Logistics. The consideration

LETTER FROM THE BOARD OF DIRECTORS

of US\$17,816,010 (equivalent to HK\$138,964,878) represents a discount of approximately 7% to the valuation of US\$19,157,000 (equivalent to HK\$149,424,600) by Grant Sherman Appraisal Limited. The Directors believe that the Consideration, which was determined after arm's length negotiation, is fair and reasonable so far as the Company and the Shareholders are concerned.

The sale and purchase of the Assets is conditional upon the successful issuance of the Consideration Shares. If the Consideration Shares are not issued, completion of the sale and purchase of the Assets will not take place.

- Conditions of the Sale and Purchase : The sale and purchase of the Assets is conditional upon:
- (a) Purchaser A having received all the documents relating to transfer of ownership of FSU Mars as more particularly set out in the Agreement;
 - (b) Purchaser B having received all the documents relating to transfer of ownership of FSU Mercury as more particularly set out in the Agreement;
 - (c) the passing of resolutions at the Special General Meeting by Shareholders of the Company approving, inter alia, the Agreement and the transactions contemplated therein (at which any connected person (as defined in the Listing Rules) of the Company who is interested in the transactions shall abstain from voting);
 - (d) the approval for the listing of and permission to deal in the Consideration Shares being granted by the Stock Exchange;
 - (e) the granting of a specific mandate to the directors of the Company to issue 397,042,509 new shares by ordinary resolution of the Shareholders of the Company at the Special General Meeting;
 - (f) the receipt by each of Purchaser A and Purchaser B of evidence reasonably satisfactory to it that it will be entitled to have the benefit of the use of the Licenses, such evidence to be in the form of legal advice to be provided by a Malaysian law firm or such other evidence

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as Purchaser A and Purchaser B (as the case may be) may reasonably request; and

- (g) original valuations to the satisfaction of the Purchasers having been obtained by the Purchasers from Grant Sherman Appraisal Limited in respect of the Assets.

The Vendor shall use its best endeavours to procure the fulfilment of the above conditions on or before 30th May, 2003. Completion shall take place on a business day when all the conditions have been satisfied or such other day as the parties to the Agreement may agree in writing. **If the Agreement is terminated or there are significant changes in the conditions of the Agreement, the Company will make appropriate announcement pursuant to the Listing Rules.** The above conditions are inserted for the sole benefit of the Purchasers and may be waived in whole or in part (and with or without conditions) by the Purchasers (except conditions (c), (d), (e) and (f)) without prejudicing the rights of the Purchasers to require the performance, fulfilment or satisfaction of such conditions in whole or in part at a later date. Conditions (a) and (b) sets out a long list of documents that the Purchasers need to receive for completion of the transaction. To cater for the situation where one or more of such documents might not be available, the Purchasers can demand substitute documents which would satisfy the requirements of the Purchasers. If the Purchasers can't waive such condition, completion of the transaction may be prejudiced. Therefore the Agreement provides the right to waive conditions (a) and (b). Subject to the Purchasers' right of waiver stated in the paragraph above, in the event that any of the above conditions shall not have been fulfilled on or before 30th May, 2003 then the Purchasers shall not be bound to proceed with the Acquisition and, save in respect of any antecedent breach of the Agreement, all rights and liabilities of the parties shall cease and no party shall have any claim against any other party except that the Vendors shall indemnify the Purchasers against all fees, expenses and out of pocket costs incurred in connection with the negotiation and preparation of the Agreement.

If the Vendors do not proceed with the sale before 30th May, 2003 for any reasons other than as provided in the Agreement, they would be in breach of the Agreement. The Purchasers shall have the right to seek remedy under the law including to

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cancel the Agreement and they shall be entitled to claim compensation for their losses and for all expenses incurred together with interest.

Completion

Subject to the fulfilment of all the conditions mentioned above, Completion shall take place on the Completion Date when all (but not some only) of the following events shall occur:-

- (a) Vendor A shall deliver FSU Mars to Purchaser A and Vendor A and Purchaser A shall sign and deliver to each other a protocol of delivery and acceptance confirming the date and time of delivery of FSU Mars from Vendor A to Purchaser A;
- (b) Vendor B shall deliver FSU Mercury to Purchaser B and Vendor B and Purchaser B shall sign and deliver to each other a protocol of delivery and acceptance confirming the date and time of delivery of FSU Mercury from Vendor B to Purchaser B;
- (c) Vendor C shall deliver to Purchaser A the original of the West License reissued for the benefit of Purchaser A and all documents ancillary thereto;
- (d) Vendor C shall deliver to Purchaser B the original of the East License reissued for the benefit of Purchaser B and all documents ancillary thereto; and
- (e) the delivery by the Company of the original share certificates for 397,042,509 Consideration Shares in the name of Great Logistics (as directed by Vendor A, Vendor B and Vendor C).

The Purchasers have been advised by their Malaysian lawyers that all rights, title, benefit and interest of Vendor C in the Licenses are, subject to the approval of the Malaysian authority, transferable. The Purchasers have also been advised that upon the reissue of the Licenses by the Malaysian authority in the name of Malaysian Company A and Malaysian Company B for the benefit of Purchaser A and Purchaser B respectively, there are no other regulatory approvals that need to be obtained in Malaysia in respect of Purchaser A's and Purchaser B's acquisition of the Licenses.

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Purchasers A and B have inspected the FSUs. The Agreement provides that each FSU shall be delivered and taken over in substantially the same condition as she was at the time of inspection, fair wear and tear excepted.

CONSIDERATION SHARES

The Consideration for the Acquisition is US\$17,816,010 (equivalent to HK\$138,964,878) which will be settled at Completion by the issue of 397,042,509 Consideration Shares by the Company to Great Logistics (as directed by Vendor A, Vendor B and Vendor C), at the price of HK\$0.35 per Consideration Share. The Consideration of US\$17,816,010 (equivalent to HK\$138,964,878) amount to approximately 49.6% of the adjusted net tangible assets of the Company (based on the unaudited consolidated net tangible assets as at 30th June, 2002, and adjusting for the placing of 515,000,000 Shares by the Company completed on 12th July, 2002), which is HK\$280,077,000.

The Consideration Shares represent approximately 11.23% of the existing issued share capital of the Company of 3,536,500,000 Shares and approximately 10.09% of the issued share capital of the Company of 3,933,542,509 Shares as enlarged by the Consideration Shares.

The Consideration Shares upon allotment and issue will rank *pari passu* in all respects with the existing issued shares of the Company. The Directors will allot and issue the Consideration Shares in the share capital of the Company pursuant to a specific mandate to be sought in the Special General Meeting.

The Consideration Share is issued at HK\$0.35 per Share. Based on the unaudited consolidated net asset value per Share as at 30th June, 2002 of HK\$0.047, the price of HK\$0.35 per Consideration Share (“Consideration price”) represents 7.45 times of the net asset value per Share of HK\$0.047. Taking into account the placing of 515,000,000 Shares by the Company completed on 12th July, 2002, the adjusted consolidated net asset value (which is HK\$280,077,000) per Share is HK\$0.079, and the Consideration price of HK\$0.35 represents 4.43 times of the adjusted net asset value per Share of HK\$0.079. Upon completion of the Acquisition, the adjusted consolidated net asset value (which is HK\$419,041,878) per Share would be HK\$0.107.

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The price of HK\$0.35 per Consideration Share represents:

Date/Period	Price per Share	Approximate % of Premium/(discount)
As at 4th March, 2003, being the Last Trading Date	0.3650	(4.11%)
5-days average (prior to and including the Last Trading Date)	0.3640	(3.85%)
10-days average (prior to and including the Last Trading Date)	0.3610	(3.05%)
30-days average (prior to and including the Last Trading Date)	0.3556	(1.57%)
90 days average (prior to and including the Last Trading Date)	0.3474	0.75%
The Latest Practicable Date	0.3850	(9.09%)
5-days average (prior to and including the Latest Practicable Date)	0.3830	(8.62%)
10-days average (prior to and including the Latest Practicable Date)	0.3825	(8.50%)

The Consideration of the Acquisition was determined after arm's length negotiation between the Vendors and Purchasers with reference to a valuation report dated 15th January, 2003 from Grant Sherman Appraisal Limited in respect of the Assets. Grant Sherman Appraisal Limited is an independent third party not connected with the directors, chief executive, substantial shareholders of all the parties to the Agreement or their subsidiaries or any of their respective associates. To value the FSUs, the valuer adopts the cost and market approaches in arriving at its opinion of values. To arrive at the valuation, the valuer also made reference to the survey report prepared by a marine engineering consultant firm named Ritchie & Bisset (Far East) Pte. Ltd. (an independent third party not connected with the directors, chief executive, substantial shareholders of all the parties to the Agreement or their subsidiaries or any of their respective associates) by including modification costs and related charges to be incurred for modifying the two vessels into a FSU. DBS Asia in its letter to the Independent Board Committee states that it considers the FSU valuation forms a fair and reasonable basis for determining the consideration for the FSUs and is fair and reasonable so far as the Company and the Independent Shareholders are concerned. To value the Licenses (which are issued in the names of Malaysian Company A and Malaysian Company B but give Vendor C rights to

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undertake floating storage operations within the relevant port limits), the valuer apply the income approach technique known as the discounted cash flow method. The valuation represents the present value of all future Licenses fees to be received under the Licenses. **Grant Sherman Appraisal Limited has not taken into account in its discounted cash flow model historic costs incurred for obtaining the Licenses. The aggregate application costs for obtaining the Licenses amounted to approximately HK\$200,000.** The Directors also understand from the Vendors, notwithstanding the HK\$200,000 application costs, the granting of the Licenses to the Vendors represents the Malaysian Government's recognition of Vendors' valuable contribution to the local economy. At present, the Company understands that the Vendors are the only ones permitted to undertake the FSU operations in the two ports in the subject district. Given this and the fact that the Group currently has no substantial business operations in Malaysia, the Directors consider that there can be no guarantee for the Company obtaining the Licenses should it make similar application to the Malaysian Government direct. Thus the Company chose to effect the Acquisition in lieu of making its own application for the Licenses.

In the valuation report from Grant Sherman Appraisal Limited attached at pages 34 to 44 of this circular, the valuer make valuation on the Licences after considering, inter alia, the historical financial information and the financial projections for operating the FSUs ("the Projections"). **The Projections were prepared by the Company based on information given by the Vendors.** FSU Mars commenced operations in May, 2002 and FSU Mercury commenced operations in June, 2001. In the second half of 2002 the revenue and earnings for FSU Mercury were approximately US\$1.8 million and approximately US\$0.56 million (after depreciation, finance charge and tax) respectively (unaudited). For the fourth quarter of 2002 the revenue and earnings for FSU Mars were approximately US\$1.6 million and approximately US\$0.67million (after depreciation, finance charge and tax) respectively (unaudited).

The Shareholders should be aware that the Projections were prepared by the Company based on information and figures from Vendors who are connected persons. The Directors consider the Projections were prepared by the Company on careful and fair estimation, and the Projections were arrived after making appropriate adjustment with the historical financial information provided with reference to the current market situation of the FSUs. The Projections were not based on industry statistics and data as there are no available comparable statistics and data due to the fact that the FSUs are the only ones undertaking the FSU operations in the subject district. **The Shareholders should also be aware that the valuation by the valuer is based on a lot of assumptions and also figures provided by Vendors who are connected persons. Such assumptions might not materialise.**

The valuer considers that, due to the uniqueness of the business of the FSUs and the Licenses, market valuation approach is inappropriate as there is no readily available market transaction for comparison purposes. In valuing the Licenses, the valuer also made certain assumptions including, inter alia, that there will be no major changes in the existing political, legal and economic conditions in Singapore, Malaysia and other countries in the region and competent management, key personnel, and technical staff will be recruited to support the ongoing operation of the FSUs (for the details of the full list of assumptions made by the

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valuer, please see the section under “the East License and the West License” within the valuation report at pages 37 to 39 of this circular). **The Directors consider the above assumptions made by the valuer are fair and reasonable and the valuer has appropriately qualify the assumptions in the section “Risk Factors” at page 43 of this circular.** DBS Asia in its letter to the Independent Board Committee also states it has no reasons to doubt the fairness and reasonableness of the bases and assumptions underlying the Licenses valuation. It also considers the methodology used in arriving at the Licenses valuation to be appropriate and it is fair and reasonable, so far as the Company and the Independent Shareholders are concerned, that the consideration for the Licenses is determined with reference to the Licenses valuation.

Grant Sherman Appraisal Limited valued the East License at US\$2,051,000 (equivalent to HK\$15,997,800), the West License at US\$4,978,000 (equivalent to HK\$38,828,400), FSU Mercury at US\$3,802,000 (equivalent to HK\$29,655,600) and FSU Mars at US\$8,326,000 (equivalent to HK\$64,942,800) respectively. The total valuation of the East License, West License, FSU Mercury and FSU Mars is therefore US\$19,157,000 (equivalent to HK\$149,424,600). The consideration of US\$17,816,010 (equivalent to HK\$138,964,878) represents a discount of approximately 7% to the valuation of US\$19,157,000 (equivalent to HK\$149,424,600) by Grant Sherman Appraisal Limited. The discount of 7% was given after arm’s length negotiation with the Vendors. The Directors believe that the Consideration, which was determined after arm’s length negotiation, is fair and reasonable so far as the Company and the Shareholders are concerned.

REASONS FOR THE ACQUISITION

The FSUs are strategically located in Malaysian waters for replenishing oil supply for vessels travelling between Indian Ocean and Pacific Ocean. These two FSUs serve to provide storage and transshipment services as well as blending services for its customers. FSU Mercury and FSU Mars have a storage capacity of 70,000 cubic metres and 155,000 cubic metres, respectively. The FSUs possess a number of competitive advantages compared to storage facilities on land, including (1) low capital investment, (2) low operating cost and (3) high flexibility.

The FSUs with the Licenses granted by the Malaysian government to operate in Malaysian waters are valuable assets. The FSUs provide oil storage, blending and transshipment services to customers and are expected to bring positive earnings stream to the Company and enhance the Company’s profitability and shareholders’ value. The shareholders’ value will be enhanced as the Acquisition will increase the net asset value per Share of the Company, from HK\$0.079 to HK\$0.107 per Share. **Apart from obtaining the relevant approval from the Malaysian Government, the Malaysian lawyers of the Group are not aware of any other requirements in law for an entity to carry out floating storage operations within the relevant Malaysian waters.**

LETTER FROM THE BOARD OF DIRECTORS

The FSUs are an important addition to further strengthen the Group's business in oil trading, storage and distribution. As stated in the Group's 2001 Annual Report, the interim report for the six months ended 30th June, 2002 and in the circular dated 19th November, 2002 regarding the acquisition by the Group from Karvounis Shipping Company Limited, an independent third party of the shipping vessel named M/T "Karvounis" (now re-named to "Oriental Tiger"), the Group has been engaged in the business of oil trading since October 2001. The facilities on the FSUs will supplement the Group's oil trading business, as the Group can fully integrate downstream business for petroleum products (basically fuel oil) and provides services such as storage, blending and transshipment. The Company intends to use the FSUs for storage, blending and transshipment services only.

The Directors expect positive cashflow and income will be generated by the two FSUs and the Licenses based on the following factors: (i) the market conditions; (ii) the strategic location of the FSUs in the relevant port limits; the (iii) Company's understanding that the Vendors, and after the Acquisition, the Group, are the only ones permitted to undertake the FSU operations in the two ports in the subject district; and (iv) the Projections, as stated above the Directors consider the Projections were made on prudent estimation. The Acquisition will enhance the net asset value per Share of the Company, from HK\$0.079 to HK\$0.107 per Share.

Apart from the acquisition of Oriental Tiger from Karvounis Shipping Company Limited, in early August, 2002, the Group acquired from, Pyxis Transport Limited, an independent third party a shipping vessel named Asian Tiger. The acquisition of Asian Tiger was announced on 26th July, 2002 and a circular dated 15th August, 2002 was sent to Shareholders. The source of funds of the acquisition of Oriental Tiger and Asian Tiger (collectively "the Shipping Vessels") was the net proceeds of approximately HK\$137,570,000 from the placing of 515,000,000 Shares by the Company completed on 12th July, 2002. The Shipping Vessels are solely used for the business of oil transportation. The Company plans to use the Shipping Vessels primarily for the purpose of transporting crude oil for Chinese importers.

The primary difference between a FSU and a shipping vessel is their functions. A shipping vessel is used for transporting freight from one destination to another. A FSU is located at a fixed area for storage, blending and transshipment purposes.

The terms of the Agreement were negotiated on an arm's length basis taking into consideration of the valuation by the Valuer and were made on normal commercial terms. The Directors consider that the terms of the Agreement are fair and reasonable to the Company and in the interests of the Shareholders and the Company.

LETTER FROM THE BOARD OF DIRECTORS

THE GROUP'S BUSINESS

The Group is principally engaged in the businesses of design, manufacture and sale of apparel, oil trading and oil transportation. The Group commenced its oil trading business since October 2001 as referred to in the audited consolidated financial statements of the Company for the year ended 31st December, 2001. The Group commenced its oil transportation business since August 2002 as disclosed in the circular dated 19th November, 2002 regarding the acquisition of Oriental Tiger by the Group. The intention to develop a fully-integrated downstream business for oil and petrochemical products, including storage, transshipment, distribution and others, was also disclosed in the interim report of the Company for the six months ended 30th June, 2002 and in the circular mentioned above dated 19th November, 2002. The Group currently intends to maintain and manage its garment business. Going forward, the Group seeks opportunities of further expansion in the above-mentioned oil related business lines as well as other businesses associated with the oil and gas industries.

SPECIAL GENERAL MEETING

A notice convening the Special General Meeting to be held at Room 3002, 30/F., Far East Finance Centre, 16 Harcourt Road, Hong Kong on 25th April, 2003 at 10:30 a.m. is set out on pages 50 to 51 of this circular for the purpose of considering and, if thought fit, passing the ordinary resolutions in respect of the Acquisition, the transactions contemplated therein and the specific mandate for the allotment and issue of the Consideration Shares.

Any connected person (as defined in the Listing Rules) in relation to the Company who is interested in the Acquisition shall be abstained from voting at the Special General Meeting. Great Logistics and its associates (as connected person under the Listing Rules) will abstain from voting at the Special General Meeting.

A form of proxy for use by the Shareholders at the Special General Meeting is enclosed. Whether or not you intend to attend and vote at the Special General Meeting, you are requested to complete the enclosed form of proxy in accordance with the instructions printed thereon and deposit at the head office and principal place of business of the Company at Room 3002, 30/F., Far East Finance Centre, 16 Harcourt Road, Hong Kong, as soon as possible but in any event, not less than 48 hours before the time appointed for holding the Special General Meeting or any adjourned meeting thereof (as the case may be). Completion and return of the form of proxy will not preclude you from attending and voting in person at the Special General Meeting or any adjourned meeting thereof (as the case may be) should you so wish.

The Acquisition constitutes a connected transaction for the Company under Chapter 14 of the Listing Rules because Ms. Tsoi Yuk Yi, as a controlling shareholder of each of Vendor A and Vendor B, is an associate of Mr. Tsoi Tin Chun, who is a substantial shareholder and director of the Company; and Vendor C is also a connected person by virtue of its indirect controlling shareholding in the Company and its ownership by Mr. Tsoi Tin Chun and Ms.

LETTER FROM THE BOARD OF DIRECTORS

Tsoi Yuk Yi. Therefore, the Acquisition is subject to the Independent Shareholders' approval at the Special General Meeting, at which Great Logistics and its associates will abstain from voting. The Acquisition also constitutes a discloseable transaction of the Company under the Listing Rules.

GENERAL

The Independent Board Committee comprising two independent non-executive directors of the Company has been formed to advise the Independent Shareholders on whether the Acquisition is fair and reasonable so far as the Independent Shareholders are concerned. DBS Asia, a third party independent financial adviser independent of the Company and its subsidiaries, any director, chief executive or substantial shareholder of such companies or any of their respective associates (as defined in the Listing Rules), has been appointed by the Company to advise the Independent Board Committee in respect of the Acquisition.

Application will be made to the Stock Exchange for the listing of, and permission to deal, in the Consideration Shares to be allotted and issued pursuant to the Agreement.

The issue of the Consideration Shares is conditional upon the granting of a specific mandate to the Directors to issue 397,042,509 new shares by ordinary resolution of the Shareholders of the Company at the Special General Meeting and the approval for the listing of and permission to deal in the Consideration Shares being granted by the Stock Exchange.

ADDITIONAL INFORMATION

Your attention is also drawn to (a) the letters from DBS Asia and Grant Sherman Appraisal Limited which contain their advice to the Independent Board Committee in relation to the Acquisition, and the principal factors and reasons considered by DBS Asia and Grant Sherman Appraisal Limited in arriving at their advice and (b) the general information, as set out in the appendices to this circular.

RECOMMENDATION

Having regard to the information described above, the Board considers that the terms of the Acquisition are fair and reasonable insofar as the Independent Shareholders are concerned and that the terms of the Acquisition are in the best interest of the Company and the Shareholders as a whole. The Board also considers the grant of the specific mandate is in the best interest of the Company and the Shareholders as a whole. Accordingly, the Board recommends the Independent Shareholders to vote in favour of the ordinary resolutions to approve the Acquisition and the grant of the specific mandate for the allotment and issue of the Consideration Shares as set out in the notice of the Special General Meeting.

LETTER FROM THE BOARD OF DIRECTORS

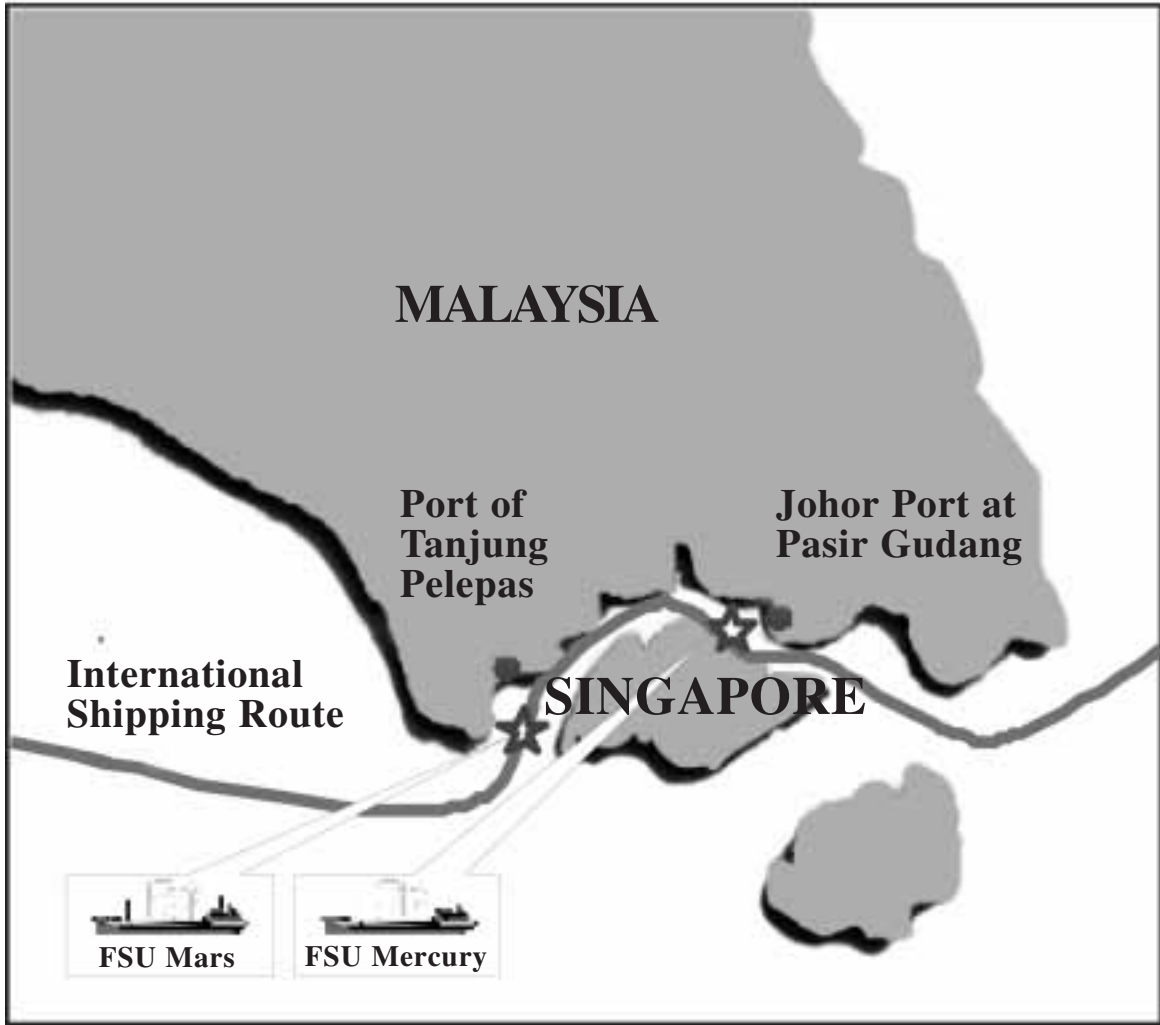
Your attention is also drawn to the letter from the Independent Board Committee set out in the section headed “Letter from the Independent Board Committee” of this circular which contains the recommendations of the Independent Board Committee to the Independent Shareholders concerning the Acquisition.

The Independent Board Committee considers that having taking into account the advice from DBS Asia, the financial adviser to the Independent Board Committee, the terms of the Acquisition are fair and reasonable so far as the Independent Shareholders are concerned and that the Acquisition are in the interests of the Company and the Independent Shareholders. Accordingly, the Independent Board Committee recommends the Independent Shareholders to vote in favour of the ordinary resolutions to be proposed at the Special General Meeting to approve the Acquisition.

Yours faithfully,
By order of the Board
Titan (Holdings) Limited
Tsoi Tin Chun
Chairman and Managing Director

LETTER FROM THE BOARD OF DIRECTORS

ATTACHMENT 1





TITAN (HOLDINGS) LIMITED

(incorporated in Bermuda with limited liability)

Registered Office:
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

Hong Kong Principal Office:
Room 3002, 30/F.
Far East Finance Centre
16 Harcourt Road
Hong Kong

9th April, 2003

To the Independent Shareholders

Dear Sir or Madam,

CONNECTED TRANSACTION AND DISCLOSEABLE TRANSACTION

We have been appointed as members of the Independent Board Committee to the Independent Shareholders in respect of the Acquisition, details of which are set out in the circular of the Company dated 9th April, 2003 (the "Circular") to the Shareholders. Unless the context otherwise requires, terms defined in the Circular shall have the same meanings when used in this letter.

Your attention is drawn to the advice of DBS Asia in respect of the Acquisition as set out in the Circular as well as other information set out in the appendices to the Circular.

Having taken into account the advice of DBS Asia, we consider that the Acquisition is in the interests of the Company and the Independent Shareholders and that the terms thereof are fair and reasonable so far as the Company and the Independent Shareholders are concerned. We therefore recommend that you vote in favour of the ordinary resolution to be proposed at the SGM to approve the Agreement.

Yours faithfully,

Independent Board Committee

Liu Hong Ru

Independent non-executive director

Wong Kong Hon

Independent non-executive director

LETTER FROM DBS ASIA



DBS ASIA CAPITAL LTD

16th Floor, Man Yee Building, 68 Des Voeux Road Central, Hong Kong

9th April, 2003

*The Independent Board Committee
Titan (Holdings) Limited*

Dear Sirs,

CONNECTED TRANSACTION AND DISCLOSEABLE TRANSACTION

We refer to our engagement as the independent financial adviser to the Independent Board Committee in relation to the Acquisition, details of which are contained in a circular (the "Circular") to the Shareholders dated 9th April, 2003, of which this letter forms part. Expressions used in this letter have the same meanings as defined in the Circular.

In formulating our recommendation, we have relied on the information and facts contained or referred to in the Circular. We have also assumed that the information and representations contained or referred to in the Circular were true and accurate at the time they were made and continue to be so at the date of the dispatch of the Circular. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors. We have also been advised by the Directors and believe that no material facts have been omitted from the Circular. We have also assumed the valuation report of Grant Sherman contained in the Circular remains to be true and accurate.

We consider that we have reviewed sufficient information to reach an informed view, to justify reliance on the accuracy of the information contained in the Circular and to provide a reasonable basis for our recommendation. We have not, however, conducted an independent verification of the information nor have we conducted any form of in-depth investigation into the businesses and affairs or the prospects of the Company or any of its respective subsidiaries or associates or of any of the FSUs or the legality of the Licenses.

LETTER FROM DBS ASIA

PRINCIPAL FACTORS CONSIDERED

In arriving at our opinion in respect of the Acquisition, we have considered the following principal factors and reasons:

Background and rationale

The Group is principally engaged in the design, manufacture and sale of apparel and oil transportation and oil trading. We noted that as means to create value for the Shareholders, the Company has in recent years continued to identify new business opportunities including the oil trading and transportation businesses. The Company has since October 2001 been engaged in the oil trading business. Further, in August and November 2002, the Group took advantage of the relatively low market price of shipping vessels and acquired two shipping vessels from independent third parties who are not connected or otherwise associated with each other or with the Company, the Directors or the substantial shareholder of the Company or any of its subsidiaries or any of their associates. Based on information provided to us by the Directors, we noted that the market prices of shipping vessels were relatively low in the second half of 2002 as compared to those in the previous periods.

As stated in the interim report for the six months ended 30 June 2002 and in the circular of the Company for the acquisition of the shipping vessel in November 2002, the Group stated its intention to develop a fully integrated downstream business for oil and petroleum products. We noted that the FSUs possess competitive edges given its strategic geographical locations for vessels travelling between the Indian Ocean and the Pacific Ocean. We have been advised by the Company that the Malaysia Ministry of Transport has made no public statement as to how many licenses it can issue, however, the Company understands that the Malaysia Ministry of Transport intends to issue only one license for each relevant port limits. Furthermore, we understand from the Directors that the major principal factor affecting the performance of the FSU business is the oil price, whereby in general, any decrease in oil prices would favourably lead to an increase in the FSU business and vice versa, any increase in oil prices would have an adverse impact on the business performance of the FSUs. Notwithstanding this inherited business risks, we noted that Grant Sherman has taken into account relevant business risks pertaining to the Licenses, including the non-exclusivity of the Licenses, in arriving at the Licenses Valuation.

Having considered the above, we concur with the views of the Directors that the Licenses are considerable assets and that the Acquisition provides the Company with a reasonable business opportunity to enhancing its recurrent stream of income as well as to have a downstream off-shore storage facilities for oil and petrochemical products, which is in line with the stated business diversification plan of the Company.

LETTER FROM DBS ASIA

Basis of determination

The total consideration for the Acquisition of approximately US\$17.82 million (approximately HK\$138.96 million) has been arrived at after arm's length negotiations between the Company and the Vendors with reference to the independent valuations on the FSUs (the "FSU Valuation") and the Licenses (the "Licenses Valuation") prepared by independent valuers, Grant Sherman. The total consideration represents a discount of approximately 7% to the aggregate sum of the FSU Valuation and the Licenses Valuation. Grant Sherman has arrived at the FSU Valuation and the Licenses Valuation based on the Projections prepared by the Company, which in turn were arrived at based on information provided by the Vendors. In assessing the fairness and reasonableness of the FSU Valuation and the Licenses Valuation, we have reviewed and discussed with Grant Sherman as to the methodologies, bases and assumptions used in their valuations of these assets.

FSU Valuation

We noted that Grant Sherman adopts the market method in arriving at the FSU Valuation. With reference to the survey report prepared by a marine engineering consultant firm, Grant Sherman has also included modification costs and related charges to be incurred for modifying the two vessels into a FSU to arrive at the FSU Valuation as at 31 December 2002, which represents the fair market value of the FSUs. We have been advised by the Directors that the FSU valuation is below the historic investment costs incurred by the Vendors for the FSUs. However, given the adoption of the market method, we understand that Grant Sherman has not taken into account the historic investment costs of the Vendors when conducting the FSU Valuation.

On this basis, we have no reason to doubt the bases and assumptions of the FSU Valuation and consider the FSU Valuation forms a fair and reasonable basis for determining the consideration for the FSUs. Having considered the above, we regard the FSU Valuation to be fair and reasonable so far as the Company and the Independent Shareholders are concerned.

Licenses Valuation

We noted that Grant Sherman has adopted the income approach technique known as the discounted cash flow (the "DCF") method in arriving at the Licenses Valuation. We further noted that Grant Sherman has not based on any assumption relating to the exclusivity of the Licenses to arrive at the Licences Valuation. The Licenses Valuation represents the present value of all future Licenses fees to be receivable under the Licenses. Given this, we noted that Grant Sherman has not taken into account in its DCF model historic costs incurred for obtaining the Licenses. We have been advised by the Directors that the aggregate application costs for obtaining the Licenses amounted to approximately HK\$200,000 and the Licenses were granted by the Malaysian

LETTER FROM DBS ASIA

Government in June 2001 and May 2002 respectively. We have further been advised by the Directors that, notwithstanding the application costs for the Licenses incurred by the Vendors as aforesaid, the granting of the Licenses to the Vendors by the Malaysian Government represents the Malaysian Government's recognition of the Vendors' valuable contribution made to the local economy including the enhancement of the flow of vessels to use the Johor port facilities, hence directly increased the revenues port charges levied by the local government; and to provide additional logistic services to vessels using the ports, since the Vendors' operations of the FSUs in the Johor district. The Company further understands that the Vendors are the only ones permitted to undertake the FSU operations in the two ports in the subject district and that each port can only practically allow one FSU to operate due to limited space. Given the above and the fact that the Group currently has no substantial business operations in Malaysia, the Directors consider that there can be no guarantee for the Company obtaining the Licenses should it make similar application to the Malaysian Government direct. Thus the Company chose to effect the Acquisition (for a consideration of approximately US\$6.54 million (equivalent to approximately HK\$51 million) in respect of the Licenses) in lieu of making its own application for the Licenses, which, based on the above understanding and circumstances is considered fair and reasonable.

We were advised by Grant Sherman that given the uniqueness of the business of the FSUs and the Licenses, market valuation approach is inapplicable as there is no readily available market transaction for comparison purposes. Further, given that the business of FSUs has yet to establish a track record and the appropriate market Licenses fees also has yet to be established, Grant Sherman considers it common practice to use the DCF model in assessing the Licenses Valuation.

We noted that under the DCF model, the Licenses fees are determined whereby a reasonable rate of return of 15%, which represents the discount rate used in the DCF model, could be generated from the business of the FSUs after taking into account such level of the Licenses fees as part of the operating costs. With such Licenses fees, which represents the future income stream to be generated from the Licenses, Grant Sherman then further used another DCF model to arrive at the Licenses Valuation.

In reviewing the DCF models for the business of the FSUs and the Licenses Valuation, we noted that Grant Sherman has taken into consideration relevant and pertinent factors including the historical and current operations, financial projections of the FSUs, assumptions and risks related to the underlying business and assets. We have reviewed and discussed with Grant Sherman, on a limited scope basis, the principal bases and assumptions underlying the determination of the Licenses fees such as the related throughput volume projections of the FSUs, their fee charges (i.e. the throughput fees) as well as other operating expenses of the business of the FSUs. We were advised by Grant Sherman that they consider these projections, which were based on historic

LETTER FROM DBS ASIA

performance, have been prepared by the Directors after due care and consideration, and believes that the information and Projections provided to them are fair and reasonable. With reference to the historic financial information on the FSU business as stated in the “Letter from the Board” of the Circular, we noted that the Projections form a fair base of the DCF model for the determination of the Licenses Valuation. Furthermore, we were advised by Grant Sherman that the assumptions adopted in the Licenses Valuation are common and general assumptions. Given our review and discussions with Grant Sherman, we have no reasons to doubt the fairness and reasonableness of the bases and assumptions underlying the Licenses Valuation.

As for the rate of return (which is equivalent to a discount rate) used in the DCF model, Grant Sherman has adopted a discount rate of 18% to arrive at the Licenses Valuation, which is equivalent to the rate of return a reasonable investor on an arms length basis would demand for when investing in similar type of investment. The discount rate was derived at using the Capital Asset Pricing Model plus a 3% premium to reflect the risks associated with the intangible asset nature of the Licenses. Grant Sherman has taken into account the market-derived rate of investment return for similar business, return on risk free investment, the specific risks pertaining to the Licenses, the rate of return to reflect the country risks of which the FSUs are going to operate in and the intangible asset nature of the Licenses. Having taken into account these factors, Grant Sherman considers that the discount rate of 18% used in the Licenses Valuation is fair and reasonable. Grant Sherman then arrived at the terminal values of the Licenses using the same discount rate and on the basis that the Licenses are to be held perpetually as no specified tenure has been stipulated in the Licenses. Furthermore, Grant Sherman, having taken account of the lack of marketability of the Licenses, applied a further 30% discount to its model to arrive at the Licenses Valuation. Based on our review of the analysis and market references prepared by Grant Sherman in determining the discount rate and the terminal value for the Licenses, we have no reason to doubt the fairness and reasonableness of using such discount rate and the basis of determination of such terminal values.

Having taken into account the above, we consider the methodology used in arriving at the Licenses Valuation to be appropriate and it is fair and reasonable, so far as the Company and the Independent Shareholders are concerned, that the consideration for the Licenses is determined with reference to the Licenses Valuation.

LETTER FROM DBS ASIA

Consideration and payment terms

The Company will satisfy the total consideration of approximately US\$17.82 million (HK\$138.96 million) by issue of 397,042,509 Consideration Shares to Great Logistics (as directed by Vendor A, Vendor B and Vendor C). The Consideration Shares represent approximately 11.23% of the existing issued share capital of the Company and approximately 10.09% of the issued share capital of the Company as enlarged by the issue of the Consideration Shares.

The issue price of HK\$0.35 per Consideration Share represents:

Period (Note)	As at the Last Trading Day		As at the Latest Practicable Date	
	Approximate Price per Share (HK\$)	Approximate Premium/ (discount)	Approximate Price per Share (HK\$)	Approximate Premium/ (discount)
	0.3650	(4.11%)	0.3850	(9.09%)
5-day average	0.3640	(3.85%)	0.3830	(8.62%)
10-day average	0.3610	(3.05%)	0.3825	(8.50%)
One-month average	0.3556	(1.57%)	0.3765	(7.04%)
Three-month average	0.3474	0.75%	0.3630	(3.58%)

Note: Counting from the date of the Last Trading Day or the Latest Practicable Date as the case maybe.

Notwithstanding the discount between the issue price of the Consideration Shares to the historic Share price stated above, we noted that the issue price already represents a premium of approximately 343% to the unaudited consolidated net asset value per Share (as adjusted by the net proceeds of the share placement completed in July 2002) of approximately HK\$0.079 as at 30 June 2002. Further, given that the Consideration represents a discount of approximately 7% to the aggregate of the FSU Valuation and the Licenses Valuation, we consider that despite the slight discount of the issue price of the Consideration Shares to the prevailing Share price, the issue price of the Consideration Shares is still fair and reasonable. We also consider that despite the shareholding dilution of approximately 10.09% to be arisen from the issue of the Consideration Shares in satisfaction of the Consideration, this payment method would minimize the impact on the Groups' working capital requirement and is in the interests of the Company and the Shareholders as a whole.

LETTER FROM DBS ASIA

PRO FORMA FINANCIAL EFFECTS

Earnings

The Group recorded a net loss for the year ended 31 December 2001 of approximately HK\$11.22 million. With the expected cashflow to be generated from the operations of the FSUs, we concur with the views of the Directors that the Acquisition would have a positive impact on the earnings performance of the Group.

Net tangible asset

Assuming that the Completion had been effected as at 30 June 2002, the Group's pro forma unaudited consolidated net tangible value would have adjusted from approximately HK\$280.1 million (taking into account the share placement completed in July 2002) to approximately HK\$368.1 million following Completion. Such increase is mainly attributable to the issue of the Consideration Shares.

Working capital and gearing

As the Acquisition is to acquire the two FSUs and the Licenses, and that the Consideration will be satisfied by issue of the Consideration Shares, the Group's gearing and working capital position should not be materially affected as a result of the Acquisition.

RECOMMENDATION

Having considered the principal factors and reasons referred to the above, we consider that the Acquisition is in the interests of the Company and the Independent Shareholders and that the terms thereof are fair and reasonable so far as the Company and the Independent Shareholders are concerned. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote for the ordinary resolutions to be proposed at the SGM to approve the Agreement.

Yours faithfully,

For and on behalf of

DBS ASIA CAPITAL LIMITED

Alex Lau

Flavia Hung

Managing Director

Director

LETTER FROM THE INDEPENDENT VALUER



GRANT SHERMAN APPRAISAL LIMITED

15 January 2003

Our Ref.: B08102

The Board of Directors
Titan (Holdings) Limited
Room 3002, 30/F, Far East Finance Centre
16 Harcourt Road, Admiralty
Hong Kong

Dear Sirs or Madams:

In accordance with your instructions, we have made an appraisal of the fair market values of the following assets:

1. The license issued by the Ministry of Transport of Malaysia under which Titan Oil Pte. Ltd. has the right to undertake floating storage operations within the port limits of Pasir Gudang, Johor Malaysia (“the East License”).
2. The license issued by the Ministry of Transport of Malaysia under which Titan Oil Pte. Ltd. has the right to undertake floating storage operations within the port limits of Tanjung Pelepas, Gelang Patah, Johor Malaysia (“the West License”).
3. The floating storage unit (“FSU”) named “Titan Mercury” with official number 389176 and registered under the laws and flag of Singapore (“FSU Mercury”).
4. The FSU named “Titan Mars” with official number 0176008 and registered under the laws and flag of Cambodia (“FSU Mars”).

This letter identifies the assets appraised; describes the scope and character of our investigation, the premise of the value adopted and the basis of valuation and assumptions; explains the valuation methodology utilized; and presents our conclusion of value.

Excluded from this appraisal are all real estate property, machinery and equipment (except FSU Mercury and FSU Mars), spare parts, supplies, stocks, materials on hand, inventories, computer software, current assets, current liabilities or any intangible assets that may exist (except the East License and the West License).

We confirm that we have made relevant inquiries and obtained such further information as we consider necessary for the purpose of providing you with our opinion of the fair market values on the premise of continued use for FSU Mercury and FSU Mars.

LETTER FROM THE INDEPENDENT VALUER

The purpose of this appraisal is to express an independent opinion of the fair market values of the East License, the West License, FSU Mercury and FSU Mars respectively as of 31 December 2002. It is our understanding that this appraisal will be used for acquisition purposes and our report will be incorporated in a circular to be issued to the shareholders of Titan (Holdings) Limited (“the Company”).

INTRODUCTION

The East License

The East License was issued by the Ministry of Transport of Malaysia under which Titan Oil Pte. Ltd. has the right to undertake floating storage operations within the port limits of Pasir Gudang, Johor Malaysia. The license allows the owner to carry out storage and transshipment operation of liquid break bulk cargoes comprising of marine diesel oil, fuel oil and gas oil only within a designated area in Malaysian water. The designated area is bounded by imaginary lines drawn from the following points:

A	Lat	01°	18.50’N
	Long	104°	12.50’E
B	Lat	01°	19.50’N
	Long	104°	12.50’E
C	Lat	01°	19.50’N
	Long	104°	13.50’E
D	Lat	01°	18.50’N
	Long	104°	13.50’E

The West License

The West License was issued by the Ministry of Transport of Malaysia under which Titan Oil Pte. Ltd. has the right to undertake floating storage operations within the port limits of Tanjung Pelepas, Gelang Patah, Johor Malaysia. The license allows the owner to carry out storage and transshipment operation of liquid break bulk cargoes comprising of marine diesel oil, fuel oil and gas oil only within a designated area in Malaysian water. The boundary of the designated area as the following:

Lat	01°	14.20’N
Long	103°	33.30’E

LETTER FROM THE INDEPENDENT VALUER

FSU Mercury

FSU Mercury is a floating storage unit with a capacity of about 70,000 m³. The FSU was transformed from an oil tanker which was built in 1977 by Cammell Laird & Co. Ltd. of United Kingdom. The original tanker was a single screw motor tanker of all steel welded construction with cargo tanks forward and accommodation, navigation and engine space aft. The tanker was modified into a FSU for storage and transshipment operation before it was put into its current usage. The modifications include addition of a laboratory, blending piping systems, a heater and other construction works that were necessary for storage and transshipment of oil.

After modification, FSU Mercury could still carry oil to serve the purpose of essential operations such as loading and unloading oil. The differences between the FSU and the vessel before modification are the vessel was used for transporting freight from one destination to another whereas the FSU is located at a fixed area for storage, blending and transshipment purposes.

FSU Mars

FSU Mars is a floating storage unit with a capacity of about 155,000 m³. The FSU was transformed from an oil tanker which was built in 1976 by Eriksbergs Mek Verkstads of Sweden. The original tanker was a single screw single hull and bottom oil tanker of all steel welded construction with cargo tanks forward and accommodation, navigation and engine space aft. The tanker was modified into a FSU for storage and transshipment operation before it was put into its current usage. The modifications include addition of a laboratory, blending piping systems, a heater and other construction works that were necessary for storage and transshipment of oil.

After modification, FSU Mars could still carry oil to serve the purpose of essential operations such as loading and unloading oil. The differences between the FSU and the vessel before modification are the vessel was used for transporting freight from one destination to another whereas the FSU is located at a fixed area for storage, blending and transshipment purposes.

PREMISE OF VALUE

The premise of value is fair market value in continued use which is defined as the following:

Fair market value is defined as the estimated amount at which a property might be expected to exchange between a willing buyer and a willing seller, neither being under compulsion, each having reasonable knowledge of all relevant facts.

LETTER FROM THE INDEPENDENT VALUER

Fair market value in the premise of continued use is defined as the fair market value of a property based on continuation of its existing use, assuming the asset could be sold in the open market for its existing use, and otherwise in keeping with the market value definition regardless of whether or not the existing use represents the highest and best use of the property.

Fair market value in the premise of continued use does not represent the amount that might be realised in the event of piecemeal disposition of the property in the open market or from any alternative use to which it may be put. Fair market value in the premise of continued use is based on the assumption that the property will continue in their present existing use.

INVESTIGATION AND ASSUMPTIONS

FSU Mercury and FSU Mars

In the course of our investigation, we accepted property records furnished by the Company as properly describing FSU Mercury and FSU Mars (collectively “the FSUs”). We met with the management of Titan Oil Pte. Ltd. to gather information relating to the condition and utility of the FSUs. The balance of the information provided by the Company, although not subject to a detailed verification, was accepted as reasonably representing the facts.

In this appraisal, we have used the opinions of a marine engineering consultant firm named Ritchie & Bisset (Far East) Pte. Ltd. as our reference. According to their survey reports dated 21 September 2001 and 18 November 2002 respectively for “Titan Mercury” and “Titan Mars”, the vessels’ hull and machinery were in apparent sound condition and satisfactorily maintained. The valuation of the FSUs is based upon the assumption that the FSUs have complete legal title.

The East License and the West License

The valuation of the Licenses is based upon the assumption that the Licenses owners will have the legal right to operate the FSUs as stated on the Licenses. Our investigation included a physical inspection of the FSUs, discussions with the management of the Company in relation to the history and nature of the business related to the East License and the West License (collectively “the Licenses”), a study of the historical financial information and the financial projections for operating the FSUs (“the Projections”) and the business plan provided by the management of the Company. We have no reason to doubt the truth and accuracy of such information, opinions and representation provided to us. Before arriving at our opinions of values, we have considered the following principal factors:

- the nature and the prospect of the business of floating storage for diesel oil, fuel oil and gas oil in the target market of the Company;

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- the regional economic outlook in general and the specific economic and competitive elements affecting the business, industry and market of floating storage for diesel oil, fuel oil and gas oil;
- the market-derived investment returns of entities engaged in floating storage business;
- the business risks of the floating storage business; and
- the Projections.

Due to the changing environment in which the FSUs are operating, a number of assumptions have to be established in order to sufficiently support our concluded values of the Licenses. The major assumptions adopted in this appraisal are:

- there will be no major changes in the existing political, legal, and economic conditions in Singapore, Malaysia and other countries in the region;
- there will be no major changes in the current taxation laws in Malaysia and Singapore, that the rates of tax payable remain unchanged and that all applicable laws and regulations will be complied with;
- exchange rates and interest rates will not differ materially from those presently prevailing;
- the Projections have been prepared on a reasonable basis, reflecting estimates which have been arrived at after due and careful consideration by the management of the Company (according to the Company the Projections was made based upon the information provided by the Vendors);
- the Licenses will be renewed upon their expiration (if applicable);
- FSU Mercury and FSU Mars have economic life of five years and four years respectively;
- the corporate income tax of the FSUs' operation will be exempted continuously;
- the inflation rate is assumed to be 3% per year;
- the perpetual growth rate of the FSU business is assumed to be 1% per year;
- competent management, key personnel, and technical staff will be recruited to support the ongoing operation of the FSUs; and

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- industry trends and market conditions for related industries around the world will not deviate significantly from economic forecasts.

VALUATION METHODOLOGY

Valuation of the FSUs

To develop our opinions of values, we considered the three generally accepted approaches to value: cost, market and income capitalization. The theory of these approaches is outlined as follows:

The cost approach

The cost approach establishes value based on the cost of reproducing or replacing the property, less depreciation from physical deterioration, and functional and economic/external obsolescence.

Cost of Reproduction New is defined as the estimated amount required to reproduce the appraised property at one time in like kind and materials in accordance with current market prices for materials, labour, and manufactured equipment, contractors' overhead and profit, and fees, but without provision for overtime, bonuses for labour, or premiums for materials or equipment.

Cost of Replacement New is defined as the estimated amount required to replace the entire property at one time with a modern new unit using the most current technology and construction materials that will duplicate the production capacity and utility of an existing unit at current market prices for materials, labour, and manufactured equipment, contractors' overhead and profit, and fees, but without provision for overtime, bonuses for labour, or premiums for materials or equipment.

Physical Deterioration is the loss in value resulting from wear and tear in operation and exposure to the elements.

Functional Obsolescence is the loss in value caused by conditions within the property such as changes in design, materials, or process that result in inadequacy, overcapacity, lack of utility, or excess operating costs.

Economic/External Obsolescence is an incurable loss in value caused by unfavorable conditions external to the property such as the local economy, economics of the industry, availability of financing, encroachment of objectionable enterprises, loss of material and labour sources, lack of efficient transportation, shifting of business centers, passage of new legislation, and changes in ordinances.

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The cost approach generally provides a meaningful indication of the value of land improvements, special buildings, special structures, and special machinery and equipment associated with a viable business or justified by economic demand.

When market transactions of comparable property are not available, when data cannot be extrapolated from larger transactions, or when transactions are non-existent, under premise of continued use, assuming adequate earnings the cost approach is the preferred valuation procedure.

The market approach

In the market approach, the value of the appraised property is estimated through analysis of recent sales of comparable items of the property. It is employed in the valuation of the property for which there is a known used market. Under the premise of continued use assuming adequate earnings, consideration is given to the cost to acquire similar items in the used-equipment market; an allowance then is made to reflect the costs for freight and installation.

A variant of the direct market approach is the use of market relationship. Recent market prices for property in an asset classification are determined with respect to age and are compared with a benchmark price, such as the cost of reproduction new. The ratio is applied to similar property in the classification when the secondary market for the subject equipment is too sparse to exhibit appropriate comparables.

The income capitalization approach

In the income capitalization approach, value is developed on the basis of capitalization of the net earnings that would be generated if a specific stream of income can be attributed to an asset or a group of assets. This approach is most applicable to investment and general-use properties where there is an established and identifiable rental market.

In any appraisal study, all three approaches to value must be considered, as one or more may be applicable to the subject appraised. In some situations, elements of two or three approaches may be combined to reach a value conclusion. For this appraisal, since the income generated by the FSUs could not be separately identified, therefore, the income capitalization approach was not applied. According to the valuation principle, the market method is always the preferred method in valuation if there is an active market and the details of the market transactions are available. The next preferred method is the income method which is applicable when future economic benefit to be generated by the subject asset can reasonably be estimated. The cost method is the least preferred method which is used only when the market and income method cannot not be applied. Therefore the subject asset, the FSUs, are appraised by the market method in this valuation. The modification costs are then considered to arrive at our opinions of values.

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Valuation of the Licenses

The fair market values of the Licenses were developed through the application of the income approach technique known as the discounted cash flow method. In this method, value depends on the present worth of future economic benefits to be derived from ownership of the Licenses. Thus, indications of value were developed by discounting future free cash flows available for distribution to the Licenses' owners to their present worth at market-derived rates of return appropriate for the risks and hazards of investing in the Licenses. The valuation model comprises two parts. In the first part, discounted cash flow method was used to determine the appropriate level of the licensing fees. Then in the second part, the licensing fees were discounted to their present values to obtain the fair market values of the Licenses after taking into consideration of the lack of marketability discount.

In order to establish the cash flows available for distribution to the owners of the Licenses, we assumed that the Licenses can be licensed to third parties. The Licenses' owners will receive periodical licensing fees which are the amount the licensees can afford after a normal return is earned. In this appraisal, we considered the cost of equity for a floating storage business derived from Capital Asset Pricing Model ("CAPM") is the appropriate indicator of the normal return that the licensees can earn. CAPM states that an investor requires excess returns to compensate for any risk that is correlated to the risk in the return from the stock market as a whole but requires no excess return for other risks. Risks that are correlated with the return from the stock market are referred to as systematic; other risks are referred to as nonsystematic. Under CAPM, the cost of equity is equal to the return on risk-free securities, plus the comparative companies' average systematic risk (beta) multiplied by the market risk premium, adjusted for increments for risk differentials of the business being valued versus those of the comparative companies, which include risk adjustments for size and other risk factors in relation to the comparative companies. A discussion of the derivation of cost of equity is provided in the following:

The CAPM – Cost of Equity

$$K_e = R_{rf} + MRP \times \beta$$

Where:

K_e = Cost of equity

R_{rf} = Risk-free rate

MRP = Market risk premium, which is the return the market portfolio is expected to generate in excess of the risk-free rate

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β = The “beta coefficient” that measures the relative risk of the asset being valued as compared to the risk of the market portfolio. It is computed by regressing returns on a comparable security on returns for the market index. It is a measure of the systematic risk of the asset.

For our analysis, we conclude that a cost of equity of 15% is deemed to be reasonable rate of return for a floating storage business. The licensing fees are determined whereby a return of 15%, which represents the discount rate used in this discount cash flow model, could be generated from the floating storage business after taking into account such level of the licensing fees as part of the operating costs of the licensees.

The fair market values of the Licenses were derived by discounting the licensing fees determined above to their present values. The licensing fees are the future economic income streams attributable to the owners of the Licenses. When developing the discount rate to apply to the licensing fees, it is the cost of equity for a floating storage business plus a premium for the intangible nature of the Licenses. The cost of equity was developed using CAPM. The cost of equity determined by CAPM is appropriate for a business enterprise that carries out a similar business as the comparable companies. However, the Licenses are intangible assets which are considered more risky than a business enterprise as a whole. Therefore, a 3% premium was added to the cost of equity determined by CAPM to arrive at the appropriate discount rate for the Licenses. For our analysis, we concluded that a discount rate of 18% was deemed to be reasonable and justifiable for valuing the equity interest of the Licenses. The fair market values of the Licenses were determined after a lack of marketability discount was applied to the resulted present values of the licensing fees. Terminal value was considered that accounts for 48% and 55% of the fair market values of the East License and West License respectively. The terminal values were estimated base upon the discount rate and the assumed perpetual growth rate.

Discount for Lack of Marketability

The concept of marketability deals with the liquidity of an ownership interest, that is, how quickly and easily it can be converted to cash if the owner chooses to sell. The lack of marketability discount reflects the fact that there is no ready market for shares in a closely held corporation. Ownership interests in closely held companies are typically not readily marketable compared to similar interests in public companies. Therefore, a share of stock in a privately held company is usually worth less than an otherwise comparable share in a publicly held company.

A number of studies were conducted in the U.S. in an attempt to determine average levels of discounts for lack of marketability. These studies all fall into one of two basic categories, depending on the type of market transaction data on which they are based:

- Restricted (“letter”) stock studies.

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- Studies of transactions in closely held stocks prior to initial public offerings (IPOs).

RISK FACTORS

Readers of this report should note that this valuation is based on many assumptions that could not be easily assessed due to the limited operating history of the FSUs. The valuations of the Licenses are based on many assumptions, such as the projected revenues to be generated from operating the FSUs (based upon the Projections and the historical data provided to the Company by the Vendors), the potential growth and size of the target markets (based upon the business plan and the data from public sources such as Bloomberg and the website of the Singapore Port Authority), the projected operating costs of the FSUs (based upon the Projections and the historical data) and the estimated licensing fees (obtained from the valuation model) that operators of the FSUs can afford, which form the basis of the projected cash flows available to distribute to the Licenses' owners. However, there is no guarantee that the projected cash flows would come true, in part or as a whole. Uncertainties result from limited operating history, implementation risks, qualities of services to be provided, competition and other risks that may not currently be contemplated. This valuation is based on the hypothesis that the Licenses' users will operate the FSUs in accordance with the Projections.

CONCLUSION OF VALUE

Based upon the investigation and analysis outlined above and on the appraisal method employed, it is our opinion that as of 31 December 2002, the fair market values under the premise of continued use for the appraised assets are reasonably stated in the following:

1.	The East License	USD2,051,000
2.	The West License	USD4,978,000
3.	FSU Mercury	USD3,802,000
4.	FSU Mars	USD8,326,000
	Total	<u>USD19,157,000</u>

This conclusion of value was based on generally accepted valuation procedures and practices that rely extensively on the use of numerous assumptions and the consideration of many uncertainties, not all of which can be easily quantified or ascertained. And for the purpose of the appraisal of the FSUs and the Licenses, we have reviewed the survey reports of Ritchie & Bisset (Far East) Pte. Ltd., the legal opinion issued by J.S. Pillay & Mohd Haaziq regarding the floating storage operations within designated areas in Malaysian water and the Certificate of Registry of FSU Mercury and FSU Mars supplied to us by the Company. We have relied on such reports, specifications and documents in arriving at our opinions of values.

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We have not investigated the title to or any liabilities against the property appraised. We hereby certify that we have neither present nor prospective interests in the Licenses, the FSUs, the Company, or the values reported.

Respectfully submitted,
For and on behalf of
GRANT SHERMAN APPRAISAL LIMITED
Keith C.C. Yan, ASA
Managing Director

Note: Mr. Keith C.C. Yan is an Accredited Senior Appraisal (Business Valuation) and he has been conducting business valuation in the Greater China region for various purposes since 1988.

Analysis and report by:
Keith C.C. Yan, *ASA*
Stanley S.C. Sieh, *CFA, CPA*

1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

2. SHARE CAPITAL

Authorised and issued share capital

The authorised and issued share capital of the Company as at the Latest Practicable Date:

	<i>HK\$</i>
<i>Authorised</i>	
10,000,000,000 shares (shares of HK\$0.01 each)	100,000,000
<i>Issued:</i>	
3,536,500,000 shares (shares of HK\$0.01 each)	35,365,000

All the existing issued shares rank *pari passu* in all respects including all rights as to dividends, voting and interests in capital.

No part of the share capital or debt securities of the Company are listed on or dealt in any stock exchange other than the Stock Exchange and no application is being made or is currently proposed to be sought for the shares or debt securities of the Company to be listed or dealt in on any other stock exchange.

3. DISCLOSURE OF INTERESTS

As at the Latest Practicable Date, the interests of the Directors and chief executives of the Company in the share capital of the Company or any of its associated corporations (within the meaning of the SFO), which require notification to the Company and the Stock Exchange pursuant to Section 347 of the SFO (including interests which they are deemed or taken to

have under Sections 344 and 345 of the SFO), or pursuant to the Model Code for Securities Transactions by Directors of Listed companies in the Listing Rules, or which were recorded in the required to be kept under section 352 of the SFO, were as follows:

Name of Director	Number of Shares			
	Personal interests	Corporate interests	Family interests	Other interests
Mr. Tsoi Tin Chun	–	1,800,500,000	–	–
		(Note)		

Note: These shares are owned by Great Logistics. Mr. Tsoi Tin Chun is deemed to be interested in the voting shares of Great Logistics as a result of his holdings in Titan Oil Pte. Ltd. (“Titan Oil”), the ultimate holding company of Great Logistics. Great Logistics’ issued share capital is beneficially wholly owned by Titan Oil which is in turn owned as to 95% by Mr. Tsoi Tin Chun and as to 5% by Ms. Tsoi Yuk Yi, the wife of Mr. Tsoi Tin Chun.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors or their associates had any personal, family, corporate or other interest in the equity securities or debentures of, or has a short position in shares in the relevant shares capital of the Company or any of its associated corporations (as defined in the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to section 347 of the SFO (including the interests which they were deemed or taken to have under section 344 and 345 of the SFO) or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules or which are required, pursuant to section 352 of the SFO, to be entered in the register referred to herein.

As at the Latest Practicable Date, none of the Directors had any direct or indirect interests in any assets which have since 31st December, 2001 (being the date to which the latest published audited consolidated accounts of the Group were made up) been acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group.

As at the Latest Practicable Date, none of the Directors was materially interested in any contract or arrangement entered into by the Company or any of its subsidiaries, which was subsisting and was significant in relation to the business of the Group.

4. SUBSTANTIAL SHAREHOLDER

As at the Latest Practicable Date, according to the register of interests in shares and short positions kept by the Company pursuant to section 336 of the SFO and so far as is known to, or can be ascertained after reasonable enquiries by the Directors, the following company was directly or indirectly interested in 5 per cent. or more of the issued share capital of the Company is as follows:

Name	Number of shares held	Percentage of holding
Great Logistics (<i>Note 1</i>)	1,800,500,000	50.91%
Titan Oil. (<i>Note 1</i>)	1,800,500,000	50.91%

Note 1: Great Logistics is beneficially wholly owned by Titan Oil. Titan Oil is beneficially owned as to 95% by Mr. Tsoi Tin Chun and as to 5% by Ms. Tsoi Yuk Yi, the wife of Mr. Tsoi Tin Chun.

Save as disclosed herein, according to the above-mentioned register, there were no persons (not being a Director or chief executive of the Company) known to the Directors or chief executives of the Company who, as at the Latest Practicable Date, were directly or indirectly interested in 5% or more of the issued share capital of any member of the Group or had any option in respect of such capital.

5. LITIGATION

Neither the Company nor any of its subsidiaries is engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened by or against the Company nor any of its subsidiaries.

6. DIRECTORS' SERVICE CONTRACTS

None of the Directors has any existing or proposed service contract with any member of the Group excluding contracts expiring or determinable by the Group within one year without payment of compensation other than statutory compensation.

7. CONSENT

DBS Asia, Grant Sherman Appraisal Limited, Ritchie & Bisset (Far East) Pte. Ltd. and the Malaysian lawyers have given and have not withdrawn their written consents to the issue of this circular with the inclusion of their letters and references to their name in the form and context in which they respectively appear in this circular.

8. EXPERTS

The following is the qualifications of the expert which have given its opinion or advice which are contained in this circular:

Name	Qualification	Date of opinion	Nature of opinion or advice
DBS Asia	Investment adviser and dealer registered under the Securities Ordinance (Cap. 333 of the Laws of Hong Kong)	9th April, 2003	set out on pages 27 to 33 of the Circular
Grant Sherman Appraisal Limited	Independent Valuer	15 January 2003	gives opinion on the fair market values of the Assets
J.S Pillay & Mohd Haaziq (Malaysian Lawyers)	Advocates & Solicitors of High Court of Malaya	4 March 2003	gives opinion on matters related to the Licenses
Ritchie & Bisset (Far East) Pte. Ltd.	Marine Surveyors and Consultants	21 September 2001 & 18 November 2002	set out on page 37 of the Circular

All of DBS Asia, Grant Sherman Appraisal Limited, Ritchie & Bisset (Far East) Pte. Ltd. and J.S Pillay & Mohd Haaziq do not have any shareholding interest in any member of the Group or any rights, whether legally enforceable or not, to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

All of DBS Asia, Grant Sherman Appraisal Limited, Ritchie & Bisset (Far East) Pte. Ltd. and J.S Pillay & Mohd Haaziq do not have any direct or indirect interest in any assets which have been, since 31 December 2001 (being the date to which the latest published audited consolidated financial statements of the Company were made up), acquired or disposed of by or leased to any member of the Group, or which are proposed to be acquired or disposed of by or leased to any member of the Group.

9. MISCELLANEOUS

- (i) The company secretary of the Company is Tu Chung To, Allen. He holds a bachelor's degree in commerce from the University of Toronto. He is also a fellow member of The Hong Kong Society of Accountants and a member of American Institute of Certified Public Accountants.

- (ii) The registered office of the Company is Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. The head office and principal place of business of the Company is at Room 3002, 30/F., Far East Finance Centre, 16 Harcourt Road, Hong Kong.
- (iii) The English text of this circular shall prevail over the Chinese text for the purpose of interpretation.

10. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection by the Shareholders at the Company's principal place of business in Hong Kong during normal office hours from 9.00 a.m. to 6.00 p.m. from the date of this Circular (being 9th April, 2003) up to and including 25th April, 2003:

- (i) the Agreement;
- (ii) the written consents referred to in this Appendix;
- (iii) the letter of advice from DBS Asia, the text of which is set out in the section headed "Letter from DBS Asia" of this circular;
- (iv) the letter of advice from Grant Sherman Appraisal Limited, the text of which is set out in the section headed "Letter from Grant Sherman Appraisal Limited" of this circular;
- (v) the Malaysian legal opinion from J.S Pillay & Mohd Haaziq;
- (vi) the letter from the Independent Board Committee; and
- (vii) The reports by Ritchie & Bisset (Far East) Pte. Ltd. dated 21 September 2001 and 18 November 2002



TITAN (HOLDINGS) LIMITED

(incorporated in Bermuda with limited liability)

NOTICE IS HEREBY GIVEN that a special general meeting (the “SGM”) of the shareholders of Titan (Holdings) Limited (the “**Company**”) will be held at Room 3002, 30/F., Far East Finance Centre, 16 Harcourt Road, Hong Kong on 25th April, 2003 at 10:30 a.m., for the purpose of considering and, if thought fit, passing (with or without modifications) the ordinary resolutions set out below. Unless stated otherwise, the capitalized terms used herein shall have the same meaning as ascribed to them in the circular of the Company dated 9th April, 2003 in respect of the connected transaction:

ORDINARY RESOLUTIONS

“THAT:

- (a) the Acquisition (as defined in the circular of the Company dated 9th April, 2003 (the “Circular”), a copy of which has been produced to the SGM marked “A” and signed by the chairman of the meeting for the purpose of identification) pursuant to the Agreement (as defined in the Circular), a copy of which has been produced to the SGM marked “B” and signed by the chairman of the meeting for the purpose of identification, be and is hereby approved, ratified and confirmed;
- (b) the Agreement be and is hereby approved, ratified and confirmed;
- (c) the grant of a specific mandate for the allotment and issue of Consideration Shares (as defined in the Circular) pursuant to the Agreement of an issue price of HK\$0.35 per Consideration Share for a total consideration of US\$17,816,010 (equivalent to HK\$138,964,878) be approved; and
- (d) the directors of the Company be and are hereby authorised to allot and issue the Consideration Shares pursuant to the specific mandate granted in paragraph (c) above and to do all acts, deeds and things which they may in their absolute discretion consider necessary, expedient or desirable to give effect to and implement the Acquisition pursuant to the Agreement, and to waive compliance

from or make and agree such variations of a non-material nature to any of the terms thereof as they may in their discretion consider to be desirable and in the interest of the Company.”

By order of the Board
Titan (Holdings) Limited
Tsoi Tin Chun
Chairman and Managing Director

Hong Kong, 9th April, 2003

Head Office and Principal Place of Business:

Room 3002, 30/F.
Far East Finance Centre
16 Harcourt Road
Hong Kong

Notes:

1. A form of proxy for use at the meeting is enclosed herewith.
2. The instrument appointing a proxy shall be in writing under the hand of the appointor or of his/her attorney duly authorised in writing or, if the appointor is a corporation, either under its seal or under the hand of any officer, attorney or other person authorised to sign the same.
3. Any member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him/her. A proxy need not be a member of the Company.
4. In order to be valid, the form of proxy, together with the power of attorney or other authority (if any) under which it is signed, or a notarially certified copy of such power or authority, must be lodged at the Company's share registrar, Tengis Limited, at G/F, BEA Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong not less than 48 hours before the time appointed for holding the meeting or any adjourned meeting (as the case may be)
5. Completion and return of the form of proxy will not preclude members from attending and voting in person at the meeting or at any adjourned meeting (as the case may be) should they so wish, and in such event, the form of proxy shall be deemed to be revoked.
6. Where there are joint registered holders of any Share, any one of such joint holders may vote, either in person or by proxy, in respect of such Share as if he/she were solely entitled thereto, but if more than one of such joint holders are present at the meeting, the most senior shall alone be entitled to vote, whether in person or by proxy. For this purpose, seniority shall be determined by the order in which the names stand in the register of members of the Company in respect of the joint holding.

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