



IPO Execution



I. The Market Environment



What the Headlines Say... Investment Banks

- Insider Trading
- Research Independence
- Securities Distribution
- Principal vs. Advisor
- Product Suitability
- Risk Management



What the Headlines Say... Clients

- Accounting / Financial Manipulation
- Money laundering
- Bribery
- Collusion / price fixing
- Options backdating
- Executive compensation
- Board room spying
- Intellectual property
- Product safety
- Business practices
- Social issues



Key Issues for Investment Banks

- Proper use of information / Chinese Wall
- Managing conflicts of interest
- Due diligence



Issues of Business Ethics in Practice

- AML, Insider Trading, Bribery
- Research independence
- Misuse of confidential information
- Product suitability and pricing
- Acting as principal
- Client practices
- Internal behavior



Our Approach

- Strong Culture
- Clear Policies and Procedures
- Training and Education
- Rigorous Oversight
- Reward and Strict Enforcement



Our Business Principles

- #4. We take great pride in the professional quality of our work. We have an uncompromising determination to achieve excellence in everything we undertake...
- #6. We make an unusual effort to identify and recruit the very best person for every job. Although our activities are measured in the billions of dollars, we select our people one by one.
- #7. We offer our people the opportunity to move ahead more rapidly than is possible at most other places. Advancement depends on merit and we have yet to find the limits to the responsibility our best people are able to assume.
- #8. We stress teamwork in everything we do. While individual creativity is always encouraged, we have found that team effort often produces the best results. We have no room for those who put their personal interests ahead of the interests of the firm and its clients.



Our Business Principles

- #2. Our assets are our people, capital and reputation. If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard.
- #12. We regularly receive confidential information as part of our normal client relationships. To breach a confidence or to use confidential information improperly or carelessly would be unthinkable.
- #13. Our business is highly competitive, and we aggressively seek to expand our client relationships. However, we must always be fair competitors and must never denigrate other firms.
- #14. Integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives.



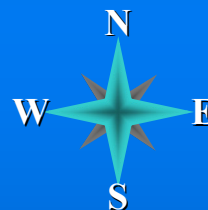
The Chairman's Forum: Compass for Excellence in Leadership & Accountability

Trust but Verify

- Have you developed adequate processes and procedures to monitor business practices?
- Do you know whether your people are performing their jobs to the highest ethical standards?
- Do you consistently follow-up on "yellow flags?"
- How well do you (and your people) know your clients?
- Do you verify that your people are communicating with clients and others in an open manner, particularly when there is room for misunderstanding or a potential problem?

Integrity

- Do you hold yourself and those who work with you to the highest of standards?
- Do you first ask yourself: "Is it right?", rather than "Will this be profitable" or "Is it legal"?
- Do you consistently seek help and a "second set of eyes" on ethical issues?
- Do you learn from your experience - and that of others - and modify your behavior accordingly?
- Do you respect the confidentiality of the information you receive?



Exercise Leadership

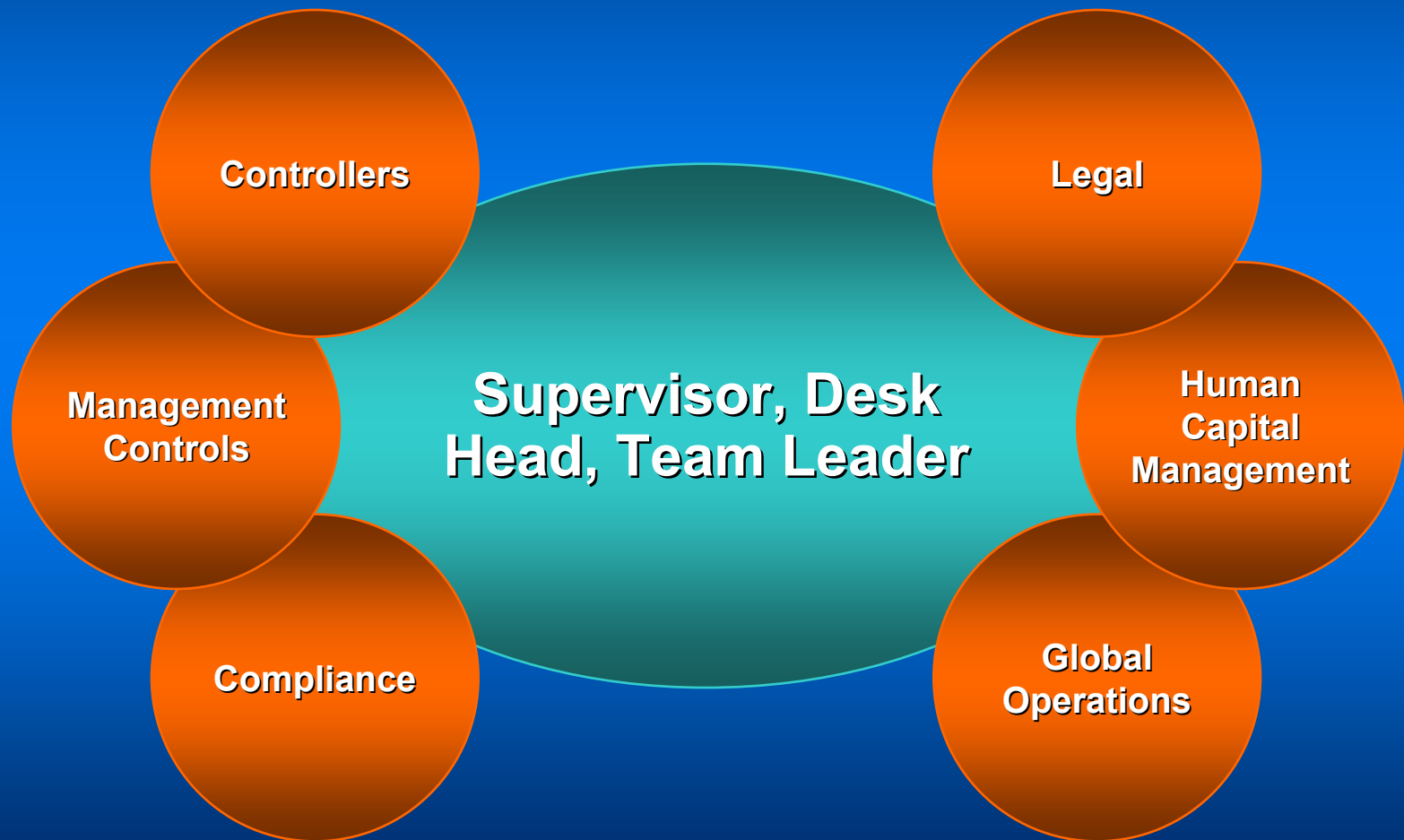
- What does it mean to act like a leader in the realm of business judgment?
- Do you actively welcome discussion of all issues / questions / concerns regarding business judgment?
- Do you look for tell-tale signs of poor judgment? What are the signs?
- Do you demonstrate the need to stay well within guidelines?
- When someone shows poor judgment or seems accident-prone, do you take decisive action?

Communicate

- Have you articulated clear, simple business practice guidelines to your people? Are your people clear on what exactly you expect of them?
- Do you encourage proactive and open communications with clients in which you transparently identify and discuss real or perceived conflicts, problems or sensitivities and discuss the risks/rewards of their choices?
- Do you include your people/your manager in business practice / business selection decisions?
- Do you tell your people how they are doing on a regular basis?



Integrated System of Support, Monitoring and Oversight

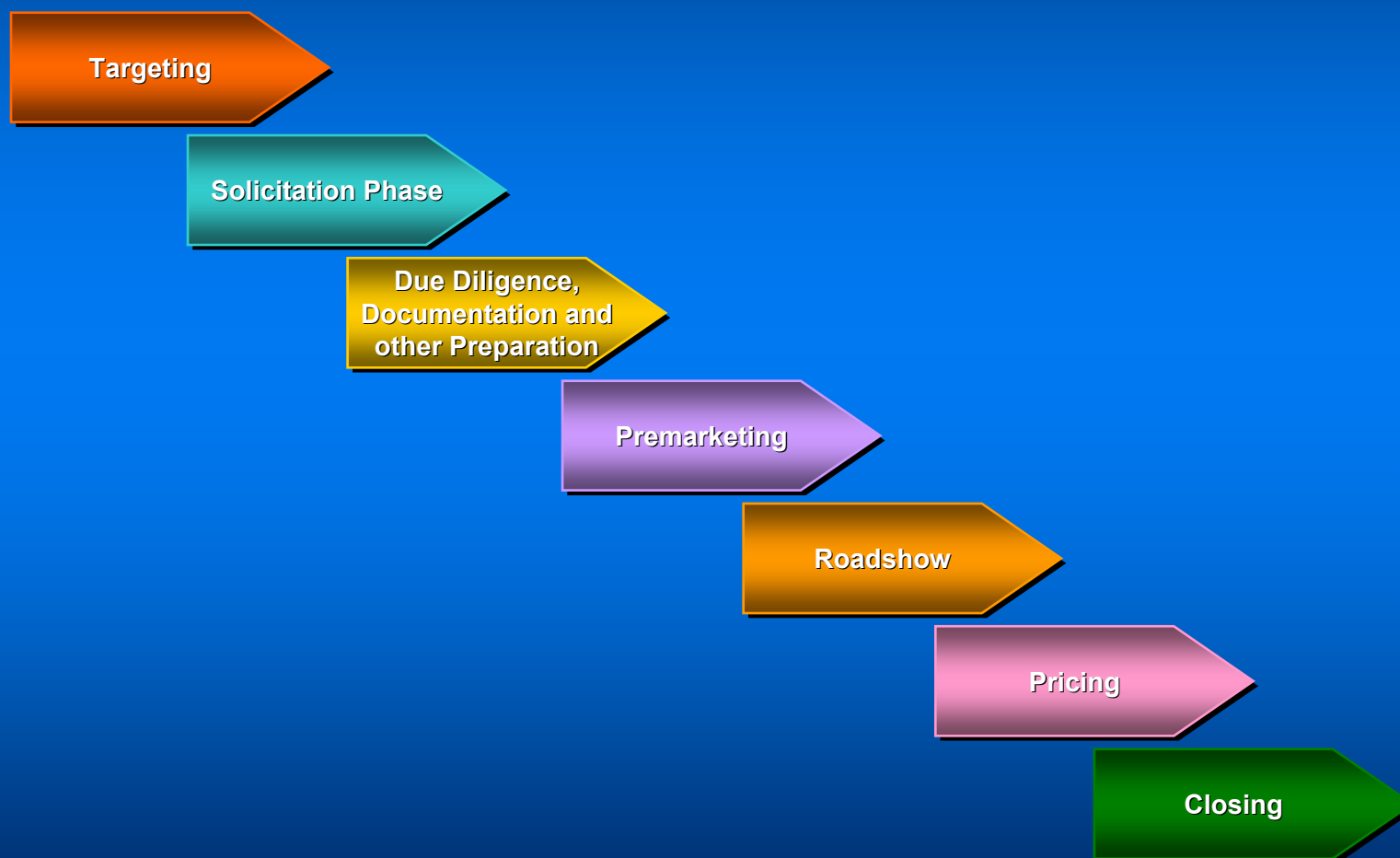




II. The IPO Process



The Equity Offering Process



Summary of Key Responsibilities

| Project Organisation/ Internal Tasks | External | | | |
|---|---|---|---|---|
| | Documentation | Due Diligence | Valuation | Offering Structure/ Marketing |
| <ul style="list-style-type: none"> Project Organisation Selection of Advisors Grey/Restricted List BIG Checking Commitments Committee Red Flash Sales Memo Sales Call Case Study Post Closing Matters (Advertising, Expenses) | <ul style="list-style-type: none"> Prospectuses Stock Exchange Filings Historical Financials Comfort Letters Legal Opinions Underwriting Agreement Agreement among Underwriters Agreement between Syndicates Closing Documentation | <ul style="list-style-type: none"> Legal Business Financial 3rd party Bring-downs | <ul style="list-style-type: none"> Review of Business Plan/Financial Projections Capital Structure Dividend Policy Valuation Price Range | <ul style="list-style-type: none"> Syndicate Structure Corporate Governance Management Incentives Employee Tranche Analyst Presentation Research Reports Red Flash Sales Memo Sales Call Pre-Marketing PR Campaigns Roadshows Pricing & Allocation Trading Settlement Greenshoe |



Going Public - Key Issues to Consider

Unique strategic event in the life cycle of a company with major strategic implications

Business Plan/Strategy

- Short Term/Medium Term
- Financial Targets

Use of Proceeds

- General Corporate vs. Specific Purposes

Corporate Governance

- Board Composition
- Executive vs. Non-executive Directors

Management Incentives

- Performance Based Compensation
- Stock vs. Cash

Financial Reporting

- Type of Accounts
- Timetable
- Level of Disclosure
- MIS



Going Public - Key Issues to Consider

Unique strategic event in the life cycle of a company with major strategic implications

Capital Structure

- Primary/Secondary Mix
- Leverage
- Free Float

Dividend Policy

- Dividend Yield
- Dividend Payout Ratio
- Semi-annual vs. Annual

Shareholder Base

- Institutional vs. Retail
- Domestic vs. International
- Employee Ownership

Investor Relations/ Public Relations

- Staff/Resources
- Senior Management Involvement



III. Why Do We Conduct Due Diligence?



Business Reasons

- Business selection
- To identify and understand business and financial risks involved in each transaction
- To enable us to describe and market the business to potential investors through the prospectus, information memorandum, roadshow and/or other marketing activities
- To enable us to perform valuations and give merger advice
- To enable us to deliver well-grounded fairness opinions
- To enhance commercial effectiveness in other assignments by furthering our understanding of and familiarity with industries
- To protect our reputation – our most important asset



Legal Reasons — Lawsuits

WorldCom Litigation of 2004

- Largest bankruptcy in history
- WorldCom treated “line” costs (transmission expenses) as capital expenditures in a massive fraud
- Investors’ claims that the prospectuses in two bond offerings contained material misstatements and omissions
- Motion for summary judgment based on a due diligence defense denied
- **14 underwriters settled for a total of \$6 billion (fees for the transactions were \$84 million)**



Due diligence in US Offerings

Due Diligence Defense

- Under US securities laws, underwriters have an affirmative defense from liability if they can prove they conducted a reasonable investigation and had reasonable grounds to believe that the disclosure contained no material misstatements or omissions.



Due diligence in HK IPOs

Sponsors' Duties

- Sponsors of HK IPOs have obligations under the Hong Kong Listing Rules with respect to due diligence:
 - A Sponsor must conduct reasonable due diligence inquiries to put itself in a position to be able to make the Sponsor's Declaration to the HKSE
 - A Sponsor must have regard to the due diligence practice note set out in Practice Note 21 (PN 21) of the Listing Rules
- A Sponsor's Declaration confirms certain matters relating to the issuer on the basis of reasonable due diligence inquiries made
- PN 21 sets out the HKSE's expectations of the due diligence that the Sponsors would typically perform. **PN 21 is not intended to be a set of prescribed minimum procedures that are applicable to all issuers.**



Due Diligence in A-Share Offerings

- Highly regulated Sponsor due diligence process:
 - Detailed due diligence requirements set forth in CSRC circular
 - Required to maintain detailed due diligence working notes – keep for 10 years
- Required to declare that Sponsor's representatives have discharged their due diligence duties



International Sanctions

Recent Developments

- Increasing focus on compliance with national and international sanctions programs by financial institutions and investment banks

Sanctions Programs

- US Treasury's Office of Foreign Assets Control (OFAC)
- United Nations
- European Community
- EU Member States



Environmental Policy

- Take the environmental impact and practices of our clients and potential clients into consideration as we make business selection decisions
- Encourage clients conducting industrial and agricultural activity in environmentally sensitive areas to do so with the appropriate safeguards
- Encourage issuer clients to make appropriate disclosure with respect to the environmental impact of their businesses, including greenhouse gas emissions, and the potential consequences to their businesses of changes in environmental regulation



AML & Anti-corruption Laws

- Anti-Money Laundering laws: PRC, Hong Kong, US and UK
- Anti-corruption laws: Prohibit direct and indirect payments to government officials in order to obtain or retain business, or gain an improper advantage
- US Foreign Corrupt Practices Act (FCPA)
 - Giving or promising anything of value, directly or indirectly, to a foreign government official (his/her relatives or nominees), political parties or party officials in exchange for getting or keeping business, or gaining any improper business advantage



What Can Go Wrong?

Examples include:

- Disappointing earnings results announced shortly after the IPO
- Accounting fraud revealed two months after the IPO
- Undisclosed liabilities / litigation
- Change in regulations impacting performance
- Unknown management reputational issues or business practices comes to light post commitment
- Issuers' legal rights or property rights to certain key business assets challenged shortly after the IPO



IV. How Do We Conduct Due Diligence?



Overview of Due Diligence

- Different types of due diligence.
 - Management due diligence
 - Business due diligence
 - Site visits
 - Customers due diligence
 - Financial due diligence
 - Documentary and legal due diligence
 - Accounting (internal controls) due diligence
 - Auditors due diligence
 - Environmental due diligence
 - Tax due diligence
- Purpose.
 - Cross checking and verification



Management Due Diligence

- Company Management. Identify the right group; meet with key members of management (alone and together), key marketing and operating personnel, consider background of each person in senior management

- Involve the right people.
 - Delegation of the entire process to junior team members is not adequate
 - Experienced bankers must also be involved in the due diligence investigation along with junior bankers, involve bankers who review offering documents in the drafting sessions, do not rely solely on our lawyers to conduct due diligence (but make sure they participate in each due diligence discussion)
 - Leverage existing knowledge through consultation with other resources within the firm



Management Due Diligence

- Have a plan.

- Team should develop a strategy, with input from outside counsel, for the overall due diligence process, linking documentary, business and management due diligence with the offering document preparation process
- Plan should allow triangulating on and double-checking of key information

- Cumulative versus issue specific.

- A checklist is not sufficient. Identify and focus on key issues, expect process to suggest new lines of inquiry and follow up



Management Due Diligence

- Formal meeting with management and auditors.
 - Prepare due diligence questions based on precedents (have our outside counsel comment) and knowledge gained to date on the Company and industry
 - Schedule meetings with the right executives and auditors (consider separate meetings with auditors) and include outside counsel
 - Be prepared (know the industry and the Company) and know the jargon, let senior team members take the lead, ask probing questions, listen to answers carefully and follow up, be polite and culturally sensitive
 - Include questions on Sarbanes-Oxley compliance, where applicable, including board and committee matters and corporate governance



Management Due Diligence

- Be the devil's advocate. Be skeptical, resolve inconsistencies, understand why former banks, advisors or auditors are no longer involved with the Company, why insiders have sold
- Drill down on important topics. Not enough to just ask questions — must follow up, listen for said and unsaid, trust your instincts
- Importance of risk factors. Comprehensive and specific risk disclosure protects everyone; ask yourself: “what could go wrong?”
- Bring-down meetings and conference calls. Companies can change quickly, due diligence is a continuous process – continue to update the investigation throughout the offering process (launch, pricing and closing) and tie the process to the offering document disclosure



Management Due Diligence: Pitfalls, Problems and Reality

- Uncooperative executives or auditors
- Sensitive questions and areas
- You don't think you've heard the whole truth
- Handling inconsistencies and resolving open questions
- Hindsight is 20/20. Courts are supposed to review the due diligence investigation under the circumstances that existed at the time of the investigation, but always act knowing your actions may be scrutinized with the benefit of hindsight



Business Due Diligence

Industry Due Diligence; Financial Due Diligence

How Do We Do It?

- Industry. Review industry information and consider competitors, key industry risks, market characteristics and trends, financial results for comparable companies, importance of technology, patents and other IP
- Company financials.
 - Review financial statements and other financial information to assess condition and trends
 - Review should include:
 - Audited annual and unaudited periodic financial statements including footnotes and MD&A (usually for past five full fiscal years)
 - Budgets and forecasts
 - Meetings with financial officers and auditors to discuss financial statements and review topics such as internal accounting controls, any change of auditors, control weaknesses and whistleblower complaints



Business Due Diligence

Financial Due Diligence; Auditors Due Diligence

Independent Verification.

- Discussions with Company's independent auditors.
 - Auditors increasingly seek to limit their participation in the due diligence process and the coverage of their comfort letters
 - The quality of information from the auditors must be carefully evaluated
 - Read the management letters issued by the auditors
- Equity and Fixed Income research coverage
- Ratings Agencies. Review of reports and direct contact
- Consultation with other areas of the Firm
- Checkings. Meetings and calls with customers, suppliers and potentially with regulators
- Media coverage. Review available press reports and other sources



Business Due Diligence

Documentary and Legal Due Diligence

- Document review. We and/or our counsel review board minutes, material contracts, litigation letters prepared by outside counsel, management letters prepared by Company's auditors, filings and correspondence with regulatory authorities, stockholder reports, press releases, newspaper and magazine articles, other PR materials and analysts' reports over an appropriate time period depending on the company and industry
- Structure. Our counsel evaluates legal structure; we and our counsel evaluate authorized and actual capital structure, securities issuances, securities terms, bank loans, shareholder agreements, dividend policies and payment history
- Follow up. We and our counsel coordinate to ask questions of the Company based on our document review; follow up on open items; read and comment on the prospectus to ensure disclosure of appropriate information gained in the course of our due diligence investigation



Business Due Diligence

Accounting & Internal Controls Due Diligence

Accounting and Internal Controls

- Internal organization and reporting lines
- Management reporting systems
- Timing and process for creating management accounts
- Evidence of material weaknesses and deficiencies

Communications from the Auditors to Management and the Audit Committee

Discussions with Auditors



Due Diligence Record-keeping

- Record-keeping process of due diligence procedures for specific transactions
 - Record dates of meetings and calls attended, including a list of attendees and general topics covered
 - Record a list of documents reviewed in the due diligence process
 - Consider a memo to files for any substantial due diligence issue recording the issue and subsequent resolution
 - Record list of internal inquiries made in the due diligence process
- Documenting key on-going interactions with management can also be critical to establishing our due diligence investigation



IBD Legal

- Advise on legal, policy and reputational issues
- Advise on transaction structure and execution
 - Actively involved in underwriting agreement negotiation
 - Actively involved in due diligence issues
 - Review offering documents, sales memos, opinions, comfort letters, certificates and other deal documentation
- Advise on banking/research issues
- Resource for standard form documents, including underwriting agreements, transaction timelines, *etc.*



IBD Compliance

- Advise on compliance, policy and reputational issues
- Responsible for policies and procedures in IBD
- Actively involved in compliance training programs
- Responsible for various initiatives driven by the IBD Business Practices Committee
- Manage regulatory and litigation inquiries, requests and investigations; manage and mitigate mistakes and incidents
- Responsible for surveillance in IBD, including email
- Oversee individual compliance matters, including personal trading, private investments, outside business activities and broker-dealer registrations



Compliance

Current Areas of Focus

- **Pace and Extent of Regulatory Change in Asia**
- **Email**
- **Publicity**
- **IPO Allocations**
- **Securities Distribution Policy**
- **Policies regarding Research**
- **Corporate Governance**
- **Anti-Trust**
- **Anti-Money Laundering**
- **Consultants Policy**
- **Copyrighted Materials**



V. The Role of Internal Committees



The Role of Internal Committees

- Review and assess various risks assumed by the Firm in financing transactions
 - Financial
 - Legal
 - Regulatory
 - Reputational
 - Structural
- Ensure consistent standards for financing transactions are applied across departments and geographic regions
 - Business selection
 - Standards of disclosure
 - Quality control of transaction execution processes
- Review and maintain Firm policies and precedents for financing transactions
- Develop new policies to anticipate or respond to changes in the competitive and regulatory environment



Key Trends in the Industry

- Continuing regulatory and media focus on underwriter's diligence and issuer's disclosure
- Cross-border transactions and listings attracting overlapping regulatory and media focus on capital markets transactions – must think locally *and* globally about potential issues
- The “speed of scandal” and enforcement actions – sometimes immediate, sometimes at glacial speed
- Expansion of business coverage to include less familiar and less transparent clients and markets
- Accounting issues
- Corporate governance issues
- Regulatory and litigation focus around familiar and emerging issues



Typical Committee Issues

- Financial disclosure
 - Timing of deal relative to latest financials and other corporate events
 - Implications for comfort letter (negative assurance)
 - Non-consolidated financials
 - Pro formas

- Factors to consider in financial disclosure
 - Company history: how long public, reputation, past financial issues, transparency, accuracy of guidance
 - Nature of business: predictability, recent developments, risk factors
 - Accounting: risk areas for manipulation or significant variation in policies
 - Reliance on management accounts
 - Recent M&A



Typical Committee Issues

- Financial profile
 - Balance sheet
 - Liquidity
 - Working capital
 - Recent performance / trends
 - Profit forecast
 - Loan covenants
 - Recent transactions / integration of acquisitions

- Business model
 - Competitive position
 - Barriers to entry
 - Cyclicalities
 - Technological obsolescence
 - Customer/supplier concentration



Typical Committee Issues

- Corporate Governance
 - Reputation and background of shareholders
 - Independence of management from shareholders
 - Quality and number of independent directors
 - Internal controls: audit committee, compliance officer
 - Age, reputation, transparency, track record of company
 - Board vs. controlling shareholder vs. public shareholder
- Connected (Related Party) Transactions
 - Magnitude, transparency, oversight
 - Ability to replace / degree of reliance
- Intellectual property
 - Protection of own IP
 - Infringement of others' IP



Typical Committee Issues

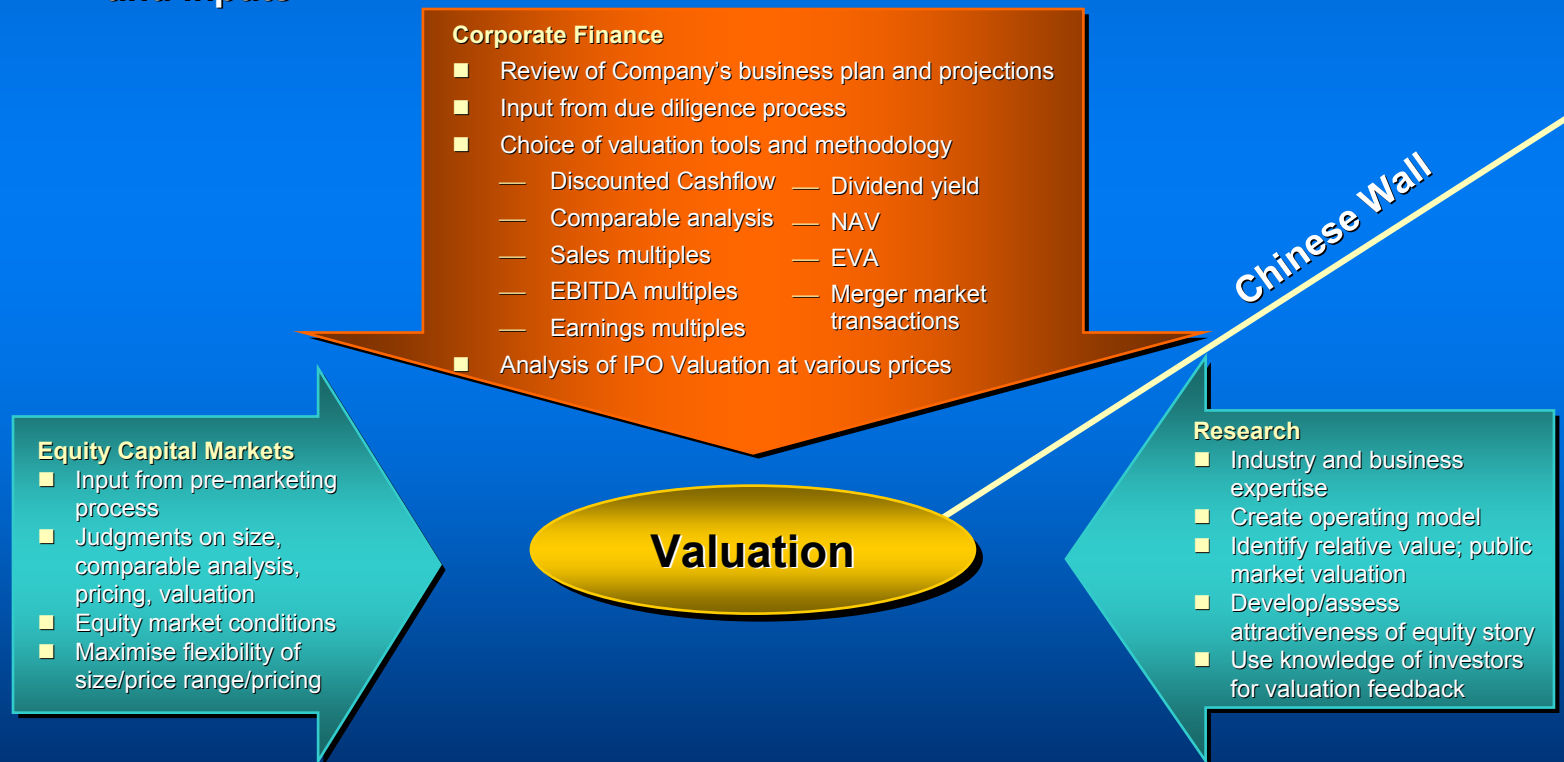
- Corporate structure
 - Control of subsidiaries / associates
 - Funding of non-wholly-owned entities
 - Shareholder / partner agreements
- Regulatory issues
 - Validity of licenses
 - Fines, penalties, etc.
 - Changes in regulatory body or governing law
- Litigation
- Foreign ownership laws
- Selling shareholders
- Material non-public information



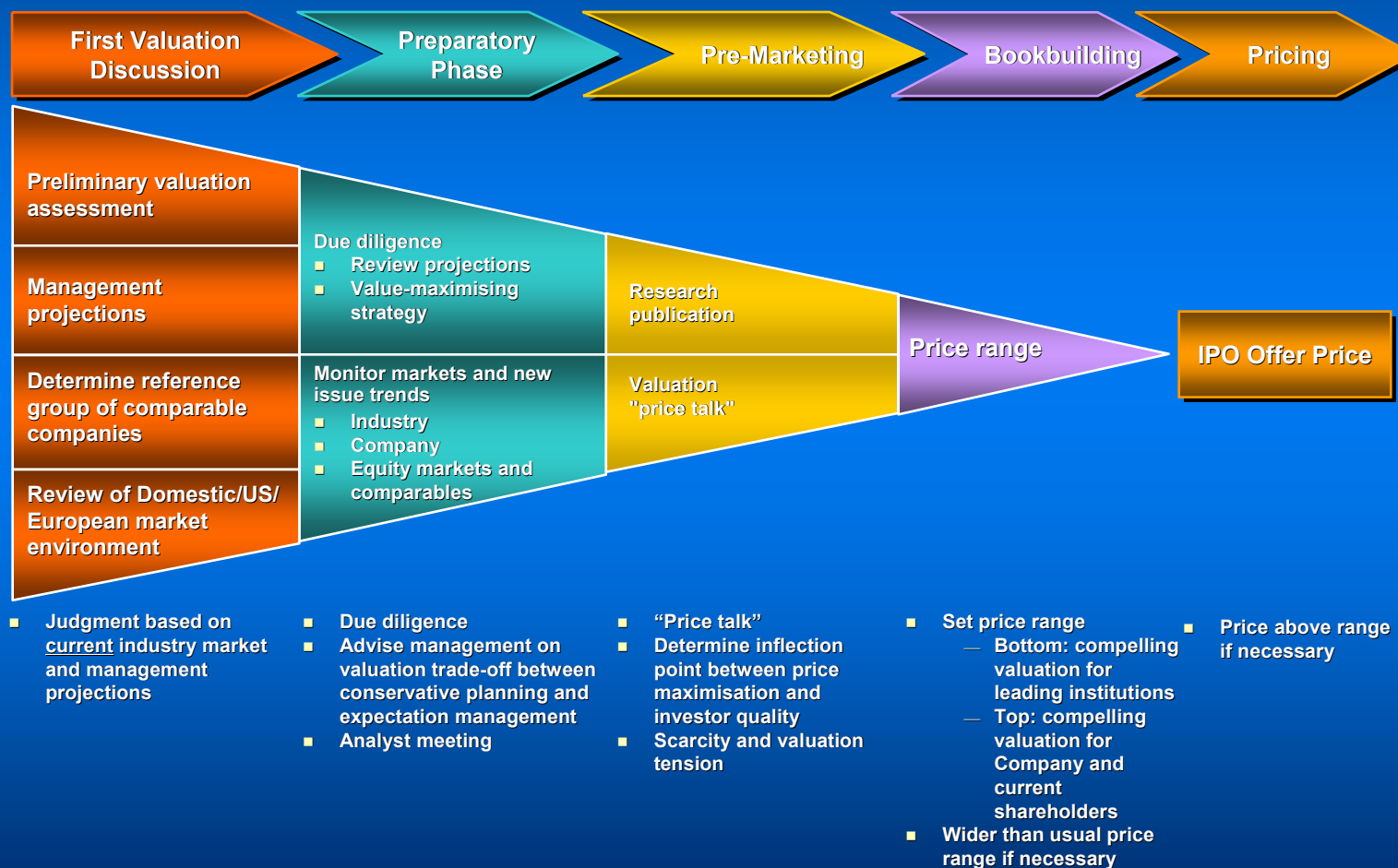
VI. Valuation and Marketing

Key Elements of Valuation

- Corporate Finance and ECM will drive the valuation process with input from Research
- Accurate and optimal valuation is the combination of numerous critical elements and inputs

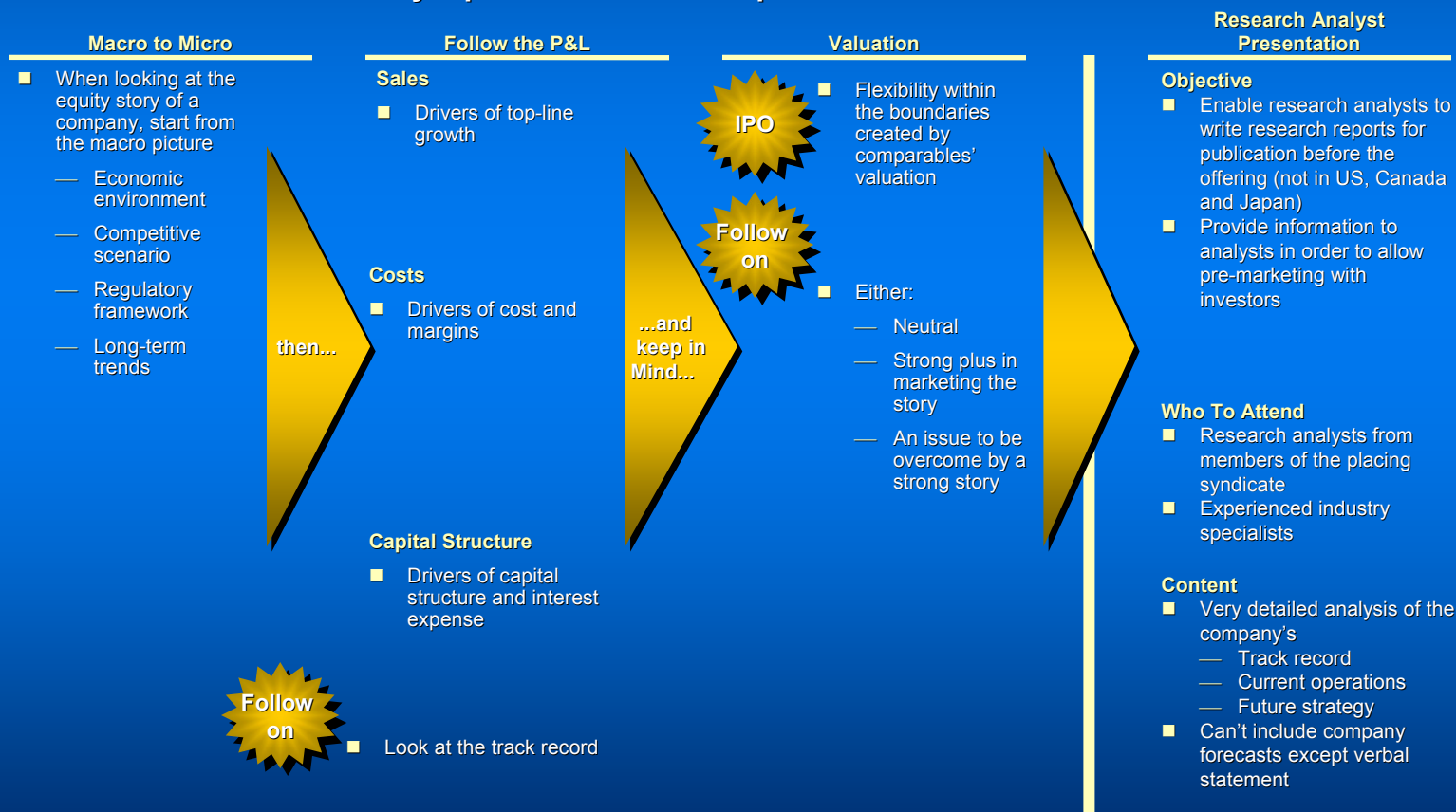


Valuation Process



Developing the Equity Story

Corporate Finance takes the lead in helping the Company to develop the equity story which will lead into the research analyst presentation before publication of research



Strict Chinese Wall between
Corporate Finance and Research



Marketing the Offering

Who Does What?

| IBD | ECM | Research | Salesforce |
|---|---|---|---|
| <ul style="list-style-type: none">■ Prospectus drafting■ Prepare Committee memo■ Prepare sales memo■ Prepare and organise analyst presentation■ Prepare roadshow presentation■ Support roadshow logistics■ Respond to investor/salesforce questions | <ul style="list-style-type: none">■ Develop sales captain strategy■ Organise sales call■ Organise pre-marketing■ Organise Roadshow■ Run the Book■ Coordinate with salesforce and syndicate■ Communicate bookbuilding status■ Price■ Allocate■ Exercise Greenshoe | <ul style="list-style-type: none">■ Prepare research report■ Help crafting of equity story■ Conduct sales-call■ Conduct pre-marketing (one-on-ones and group functions)■ Communicate investor feedback■ Assist salesforce in selling effort■ Cover the stock on ongoing basis | <ul style="list-style-type: none">■ Attend sales call■ Target Investors■ Set up pre-marketing meetings■ Provide investor feedback■ Set up roadshow/one-on-one meetings■ Sell the story to investing client (PMs and analysts)■ Take demand■ Update investors on status of book■ Generate after-market orders■ Communicate and confirm allocation |