

## Auditor change in line with business shift Hong Kong Conglomerates

SIIS (648 HK, HK\$0.149)

Not Rated

**Auditor change in line with business shift.** Following the listing of the announcement by SIIS on the HKEx regarding the retirement and change of auditors, we contacted the management to get an insight into the reasons behind the change. After the discussion with an Executive Director, we were convinced that SIIS' initiative not to reappoint PwC and plan to appoint Deloitte as the company's auditors is in line with its shift into the China healthcare business by way of the acquisition of China Renji.

**China Renji a positive light for SIIS.** In the past, SIIS has largely been an investment holding company. However, we believe that the management is making a concerted effort in becoming one of the leading healthcare plays in China through investment into China Renji and the divesture of non-core businesses. In our view, this should be viewed in a positive light and the need for change in auditors represents a part of this restructuring process.

**Without access to SBI E2-Capital, not cost efficient for PwC to be retained as SIIS' auditor.** Coinciding with the company's change of auditors, E2-Capital (378 HK, HK\$0.98, NR) (E2) also notified PwC not to offer themselves for reappointment as E2's auditors once their current term is completed on 10 May 2007. The retirement means that PwC are no longer auditing a significant proportion of SIIS' financial services business and subsidiaries given that SBI E2-Capital Ltd. is a joint venture between SIIS and E2. Therefore, it would be net cost inefficient for SIIS to retain PwC as auditors. In fact the retention of PwC will mean duplication of efforts and PwC seeking opinion from other auditors on SIIS' operations during the auditing process. The company also felt that PwC adopted a too conservative an approach based on purely historical trading record rather than prospective earnings on the valuation of some historical investments, which PwC's retirement letter referred to. Notwithstanding this, PwC issued an unqualified audit report for SIIS' accounts for the FY12/06 just completed, while the FY12/07 auditing process has yet to commence.

**Change of auditor issue over dramatized by the market.** In our view, this issue of auditor change appears to have been over dramatized by the market. It is a retirement of the auditor triggered by the company, not resignation of the auditor during financial year. We note that Deloitte will be more than qualified to be SIIS' new auditor. The auditing and advisory firm has a dedicated team focusing on the pharmaceutical and healthcare industry in both Hong Kong and China. The audit firm is the current auditors for many medical related stocks including Townhealth (8138 HK), Shineway (2877 HK) and Mingyuan (233 HK) and will assign a specialist medical team to SIIS which includes the auditing firm's partner who is overlooking Townhealth.

**Table 1: Deloitte medical related companies portfolio (selected)**

Ticker	Company name
2877 HK	China Shineway
233 HK	Mingyuan Medical
1093 HK	China Pharmaceutical
8199 HK	Shandong Weigao
1889 HK	Wuyi International

Source: Company data, Deloitte

**Disclosure of interests: SBI E2-Capital acted as the sole bookrunner and joint placing agent for the SIIS placement of 1,500m new shares (including an option for an additional placement of 200m new shares which was exercised in full) at HK\$0.125 per share on 25 April 2007.**

**An Executive Director of SBI E2-Capital Securities is also an Executive Director of SIIS. SBI E2-Capital is a joint venture between SIIS and E2-Capital (Holdings) Ltd. (387 HK).**