Corporate Visit

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Concepta: To benefit from Chinese capital influx

Recommendation: Not Rated | **Hong Kong Industrials**

Price	**HK$2.60**	**Yield (3/07A)**	NA
12 mth range	HK$0.25-3.15	**ROE (3/07A)**	14.1%
Market cap.	US$234.8m	**Net gearing (3/07A)**	cash
No. shares o/s	700.0m	**Net cash/sh. (3/07A)**	HK$0.31
Daily t/o, 3 mth	US$0.07m	**BV/sh. (3/07A)**	HK$0.61
Free float %	48.6%	**Consensus EPS**	
Major shareholder	OPFSGL/connected parties – 51.4%	**- 3/08F**	NA
Ticker	1140.HK/ 1140 HK	**- 3/09F**	NA

Key points:

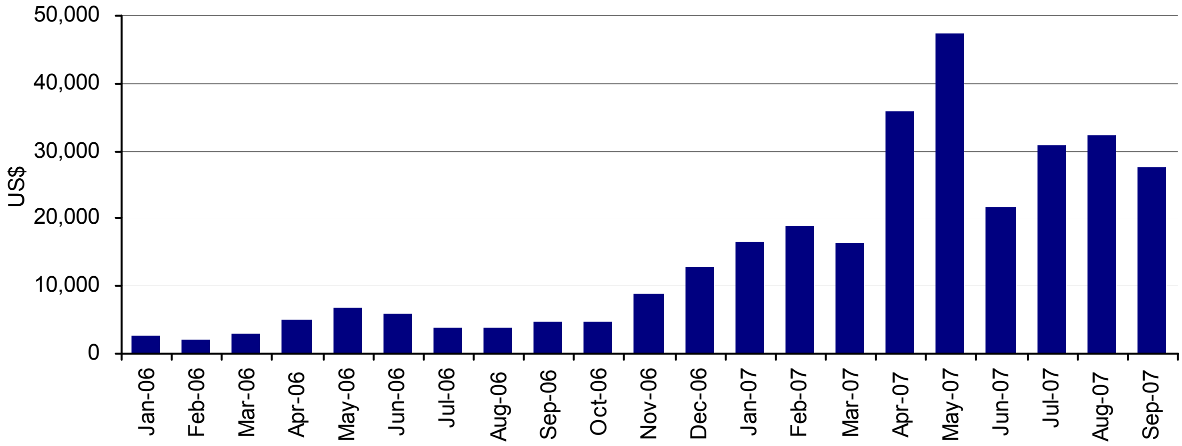
- China's Individual Investment Scheme and Qualified Domestic Institutional Investor scheme present a millennium opportunity for Hong Kong's securities industry.
- Concepta to benefit from the influx of Chinese capital as a cross-border investor and coordinator.
- Plans to invest in Hong Kong and China-based brokerages and asset management companies.
- Strong management team and an extensive network in the securities industry in Greater China.
- Management's extensive involvement implies strong commitment and confidence in prospects.

Millennium opportunity. In another bid to find an outlet for China's excess of foreign exchange, the State Administration of Foreign Exchange (SAFE) announced on 20 August a scheme to allow individuals in the country to invest in overseas securities. The "Individual Investment Scheme", or so-called "Individual QDII" (Qualified Domestic Institutional Investor), originally to be launched on 27 August, has yet to be approved by a number of authorities but the local investment community expects a nationwide introduction soon. Hong Kong, selected as the main market for the scheme's trial run, has been presented with a unique opportunity, which will significantly boost turnover on its stock exchange and help to diversify its investment philosophy and behavior.

Cross-border coordinator. Hong Kong-based Concepta Investments Ltd focuses its efforts to maximize earnings for shareholders via medium to long-term capital appreciation on the Greater China region. As an investment company, it is prohibited from holding more than 30.0% in a single investment project and from allocating more than 20.0% of its net asset value (NAV) to a single project. It cannot manage projects it has invested in. To capture opportunities arising from the Individual QDII scheme, it has repositioned itself as an investor and coordinator of the cross-border securities industry, focusing on the development of a cross-border platform for the securities industry in Hong Kong and China. To better reflect its investment philosophy, the company will be renamed as OP Financial Investment Limited.

Influx of funds from China. The average daily turnover on China's stock markets (including Shanghai and Shenzhen A and B-share markets) was about RMB37.6b in 2006 and RMB204.7b in the first nine months of 2007, up 513.5%. It increased from RMB127.8b in January to RMB231.4b in September. Shanghai's A-share Index surged from 376.6 points in January 2007 to 776.4 points in September. At the end of August, China had about 51.6m stock trading accounts, compared with 29.0m at end-2006. Assuming that 10.0% of the average daily turnover of RMB204.7b on China stock markets flows into the Hong Kong market, we estimate that local brokers will get an additional HK$13.0b/annum in brokerage fees, if the brokerage rate is 0.25%. If 10.0% of China's foreign exchange reserves are invested in Hong Kong-listed equity products via QDIIs and the management fee is 10.0% of the asset value, the territory's asset management industry will receive US$1.4b in management fees.

Chart 1: Aggregate monthly turnover of the China stock markets



Source: Bloomberg

Mainland brokers want seats on HKEX. China-focused brokerage houses with offices in Hong Kong will benefit the most from the new scheme. Under the Closer Economic Partnership Agreement (CEPA) between Hong Kong and China, qualified securities, futures and asset management companies from China are allowed to set up subsidiaries in Hong Kong but currently the number is limited. Most of the mainland's brokerages and asset management companies have no branches in Hong Kong and lack expertise in operating in the local market. Concepta, with its financial resources, profound knowledge of both markets and extensive network straddling the border, is well positioned to capitalize on helping Chinese brokers get a foothold in Hong Kong.

Matchmaking. Concepta Investment plans to acquire minority stakes (less than 30.0%) in brokerage houses in China and Hong Kong and act as a matchmaker, pairing them based on their portfolio. The company also plans to team up with mainland-based brokers and jointly acquire Hong Kong brokers (30:70), in return offering all the relevant licenses and a ready operation platform. Regardless of the approach, the company will share profits generated from its brokerage investment. Ultimately, the company will assist some of its brokerage investments to go public. It will contribute capital, local expertise and network to its mainland and Hong Kong partners. Mainland brokers will provide clientele to local brokers and local brokers an operation platform and relevant licenses to mainland brokers. As of end-August, the Shenzhen Stock Exchange has 136 members and Shanghai Stock Exchange 145.

Asset management partnerships. In order to capitalize on the opportunities emerged from the QDII expansion, the company will take minority stakes in mainland asset management companies (not the vehicles, or the assets under management) and help them set up offices in Hong Kong. After the China Banking Regulatory Commission (CBRC) eased restrictions on equity investments by QDII in May, demand for money managers in China with local expertise to invest in China-related stocks listed on the HKEX has increased. With branches or offices in Hong Kong, China-based asset management companies can launch products with focus on Hong Kong-listed China concept stocks. Such products should be well received by QDIIs. Should the qualified foreign investor (QFII) scheme expand to mid-tier asset management companies, China-based asset management companies with offices in Hong Kong are likely to be eligible for the status. Since money managers of Chinese asset management companies possess profound expertise in the China market, their QFII products should be well received. Funding will also be easy to obtain thanks to Hong Kong's position as a financial hub and the gateway into the Greater China region. The territory's well-developed communication and information technology infrastructure allows money managers to operate efficiently in China and Hong Kong. The valuation gap between H and A-shares also presents arbitrage opportunities for Chinese money managers who can trade on both sides of the border. According to the China Securities Regulatory Commission (CSRC), China had 58 asset management companies at end-May 2007.

Move above ground. Concepta aims to take minority stakes in China-based private equity firms and help them to set up in Hong Kong. The firms will raise funds in Hong Kong/ China on their own. The company may also invest some capital into the funds they set up in Hong Kong. Many private equity firms in China are unlicensed and by setting up funds in Hong Kong, they will be able to move above ground and raise funds easily. Should the QFII scheme be expanded, with their legal status, they will be eligible to become QFIIs or the investment targets of QDIIs.

Regional financial services platform. The company intends to select partners with research capabilities and consolidate their products into a single database to create a financial information provider. Subscription fees and sales of research reports will be main revenue sources. The operation will also create cross-selling opportunities. Ultimately, the company will consolidate the strengths of its partners into a financial services platform in the

Greater China region to provide brokerage, settlement/custody, asset management, financial advisory, research/information and investment banking services.

Resources. As of end-March 2007, Concepta Investment had HK$30.6m in cash and HK$31.5m in highly liquid assets (listed equities). The company plans to raise HK$700.0m through a placement of 600.0m shares at HK$1.20 each by early November. The placing shares are attached with warrants (one warrant for five placing shares), implying that 120.0m warrants, with an exercise price of HK$1.20 each, will be issued and allotted to the subscribers of new shares. Should the warrants be exercised in full, the company will issue an additional 120.0m shares and raise HK$144.0m.

Committed management. Concepta's management owns 28.3% of the company through Oriental Patron Holdings. The company's two directors, Mr. Zhang Zhiping and Mr. Zhang Gaobo will together subscribe to 330.0m of the new shares, implying that they will inject HK$396.0m into the company, boosting their stake to 51.4%, based on the issued share capital of 700.0m shares. They are also entitled to 66.0m warrants. Should they exercise their warrants, they will inject an additional HK$79.2m cash into the company, expanding their holdings to 51.7%, based on the issued share capital of 820.0m shares. This extensive involvement implies strong management commitment and confidence in the company's and the industry's prospects.

Key strengths: expertise and networking. The company's senior executives have strong backgrounds in China's securities industry. Chairman Zhang Zhiping was a deputy division chief in the Financial Administration Department of the People's Bank of China (PBOC) and the inaugural director of the Intermediary Supervision Department of CSRC. Mr. Zhang Gaobo was the deputy chief of the Financial Markets Administration Committee of the PBOC's Hainan Branch, as well as chairman of the Hainan Stock Exchange Centre. Both have developed extensive networks in China and as former regulators, they possess profound knowledge of China's securities and finance industries. Involved in the management of Oriental Patron Financial Services Group Limited since the 1990's, they are also familiar with the Hong Kong market.

Management background: Zhang Zhiping - appointed executive director and chairman in February 2003, responsible for formulating investment strategies, monitoring performance and approving investment decisions. Obtained a bachelor's degree in Arts from Heilongjiang University in 1982 and graduated from 中國人民銀行研究生部 (Graduate School of the People's Bank of China with a master's degree in Economics. Possesses more than 20 years of experience in China's and international financial markets. From December 1984 to February 1989, was a deputy division chief in 金融管理司 (Financial Administration Department) of the PBOC responsible for the supervision of financial markets in China. From February 1989 to March 1993, was chairman and general manager of Hainan Provincial Securities Company. Since the inception of CSRC in April 1993, was the inaugural director of 證券機構監管部 (Department of Intermediary Supervision) until May 1996. Between May 1992 and March 1993 and June 1996 and February 2001, was chairman of the investment committee of Hainan Fudao Investment Management Company, which manages Hainan Fudao Investment Fund. Since 1996, is executive chairman of Oriental Patron Financial Services Group Limited.

Zhang Gaobo - appointed executive director and chief executive officer in February 2003. Responsible for formulating investment strategies, monitoring performance and approving investment decisions. Obtained a bachelor' s degree in Science from Henan University in 1985 and graduated from the Beijing University with a master's degree in Economics in 1987. From February 1988 to February 1991, deputy chief of the 海南省政府政策處 (Policy Division of Hainan Provincial Government), responsible for drafting economic policies for the Hainan Provincial Government. From March 1991 to 1993, was deputy chief of 金融市場管理委員會 (Financial Markets Administration Committee) of the PBOC's Hainan Branch, responsible for the regulation of financial markets in Hainan Province. From January 1992 to 1994, chairman of 海南證券交易中心 (Hainan Stock Exchange Centre), responsible for its operations. Managing director of Oriental Patron Financial Services Group Limited since 1993.

Measures to drain forex. One of the most effective but drastic solutions to drain China's abundant forex reserves would be to allow the RMB to appreciate substantially or let it be a free-flow currency. But this would grossly undermine China's exports. A more practical solution is to increase foreign currency demand. So far, the Chinese government has tended to increase foreign exchange demand in the private sector, transferring some of its foreign exchange holdings to the private sector. In 2H 2003, it launched the "Individual Traveler Scheme", easing restrictions on individual foreign travel and boosting foreign currency demand. But this is not the most effective way to drain China's excess liquidity.

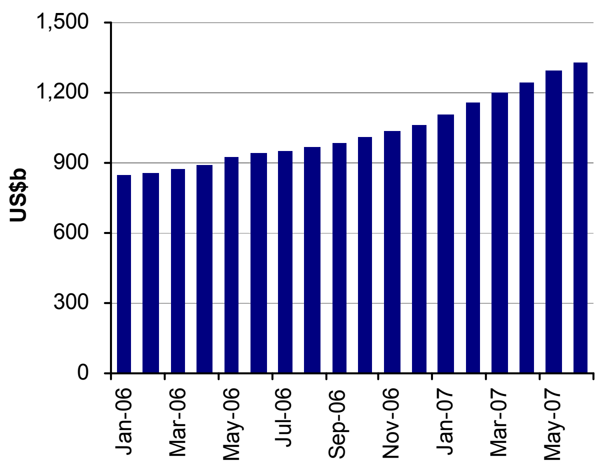
The most effective way. Relaxing restrictions on overseas investment is the most effective way to drain excess forex in the country. However, if the government allows the domestic money flow freely, it will lose its control over foreign exchange reserves. Fortunately, China has Hong Kong, with Asia-Pacific's third largest stock exchange (in terms of market capitalization, according to the World Federation of Exchange). HKEX appeals to mainland investors, given its relatively cheap valuation compared with China's A-share markets, strong liquidity and well-developed financial infrastructure. Since many major state-owned enterprises and renowned private enterprises have listed on HKEX, many investors in China are familiar with the bourse. Most of the H-shares in Hong Kong are trading at steep discounts to their A-share counterparts. Since Hong Kong is a part of China, it will be easier for the Chinese government to monitor and control funds flowing from China. Allowing mainland residents to invest in Hong Kong will facilitate the future merger of HKEX and China's exchanges and narrow the valuation gap between the H-share and A-share market.

Core reason of excessive liquidity. Forex purchase positions are formed when banks use local currency to purchase foreign currency. Money supply and foreign exchange reserves increase when banks use local currency to absorb foreign currency circulating in the market. When the central bank purchases foreign currency in the inter-bank market, it injects liquidity into the banking system by releasing local currency (printing money). If local banks (central bank included) purchase foreign currency in the OTC (over-the-counter) market and inter-bank foreign exchange market, money supply (supply of local currency) increases accordingly. When the central bank purchases foreign currency in the inter-bank foreign exchange market, its forex purchase position will be reflected in its balance sheet under the account of foreign exchange. If the whole banking system records net purchases (purchase minus disposal) of foreign currency, the country's forex purchase position and the use of credit funds of financial institutions will increase. The effect of an increase in foreign exchange is demonstrated as follows:

Increase in surplus of balance of payment → increase in foreign exchange reserves (and/or foreign assets) → position for forex purchase increase → base currency increase → money supply increase.

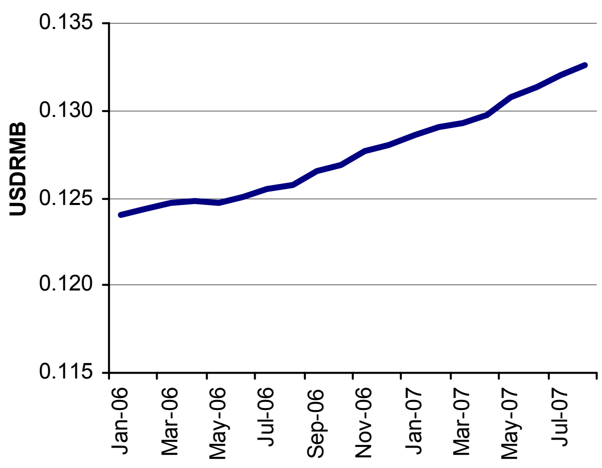
Influx of hot money. China's trade surplus surged 74.0% YoY to US$177.5b in 2006. In the first eight month of 2007, it reached US$161.8b, representing an annual growth rate of 71.3%. The RMB appreciated 9.8% from January 2005 to September 2007, due to the country's strong economy and pressure from other governments such as the US. Due to the rapid trade surplus increase and the mounting speculation about RMB appreciation, hot money has been flowing into China. In the first eight months of 2007, foreign direct investment measured as foreign capital utilized surged 11.9% YoY. China's FDI increased at an annul rate of 12.2% in June, 12.9% in July and 12.8% in August. Demand for foreign exchange in China is low because Chinese residents cannot invest overseas without government approval and are unwilling to hold foreign currency in anticipation of RMB appreciation. As a result, the PBOC has to step into the market and purchase foreign currency by printing more RMB, which increases the country's position for forex purchase and ultimately increases money supply in the market and foreign exchange reserves. Between January 2005 and September 2007, the average annual growth rate of M2 (currency in circulation + time deposits + saving deposits + other deposits) in China was 17.1%. It rose at an annual rate of 18.5% in July and 18.1% in August. Between January 2006 and June 2007, China's foreign exchange reserves surged 57.6% YoY to US$1,332.6b. Although the PBOC and the central government have launched austerity measures to cool down the overheated economy, economic growth has been accelerating and inflation pressure mounting.

Chart 2: China foreign exchange reserves



Source: Bloomberg

Chart 3: Valuation of RMB against USD

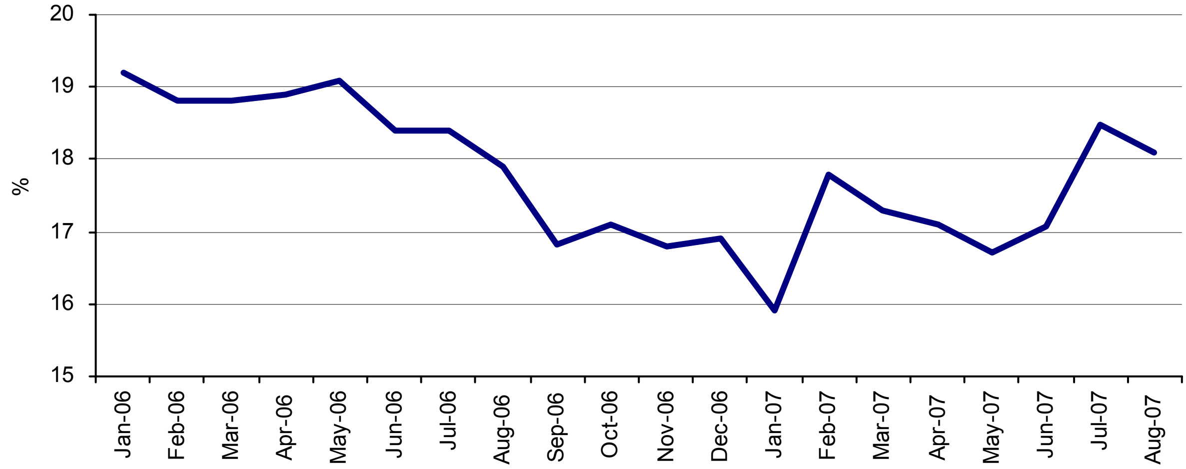


Source: Bloomberg

Challenge for PBOC. China's excessive foreign exchange reserves and the inflow of hot money from overseas presented a series of challenges for the Chinese government. First of all, the PBOC lost its monetary policy autonomy. Theoretically, as a central bank, PBOC formulates its monetary policy in accordance with the country's economy. But the foreign exchange inflow into the country forced it to increase RMB supply. Also, excessive foreign exchange reserves, especially in the USD and USD-denominated assets will undermine its financial position and the central government's treasury, should they depreciate. Excessive liquidity in the market also fuels inflation, excessive investment and the asset bubble. China's headline inflation rate measured as an annual growth rate of the CPI in urban areas reached 6.5% YoY. Besides, fixed asset investment in China surged 34.2% YoY in 1H 2007.

Negative interest rate creates bubble in the asset market. Headline inflation at 6.5% in August and the current PBOC benchmark one-year deposit rate of 3.87% imply that the real interest rate in China is negative 2.63%. Prohibited from overseas investment, the private sector has been chasing domestic assets, including real estate and equity, to hedge against deteriorating purchasing power and take advantage of cheap real borrowing costs.

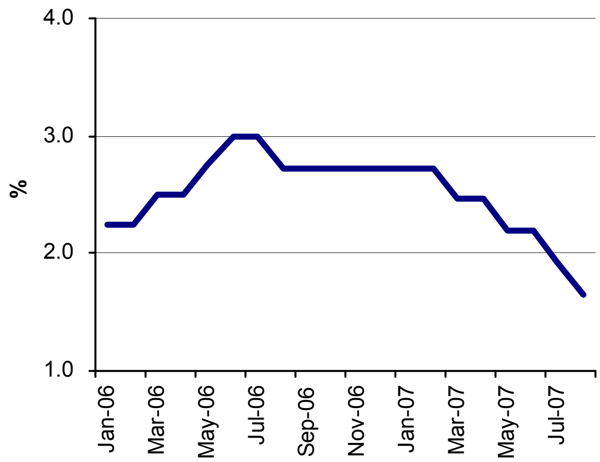
Chart 4: Growth in M2 in China



Source: Bloomberg

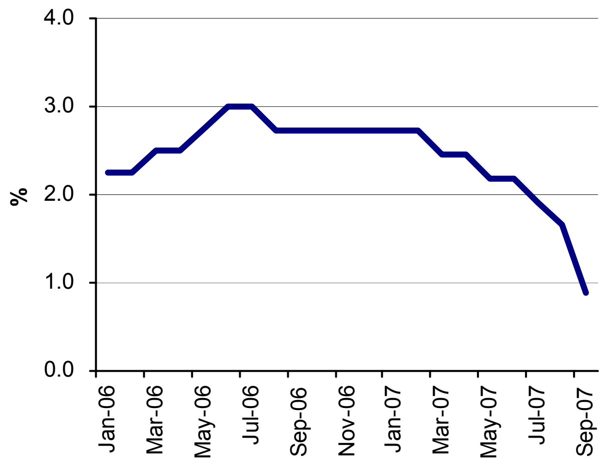
Future problems. To tackle the credit crunch in the aftermath of the meltdown of the sub-prime mortgage market, the US Federal Reserve is expected to slash interest rates further, after its one-off 0.50pcp cut in September. To cool down China's overheated economy and curb inflation pressure, PBOC has lifted interest rates six times (0.27pcp each) between January 2006 and September 2007. During the period, the benchmark one-year deposit rate increased from 2.25% to 3.87%. The interest margin between the Federal Fund Rate and the headline PBOC benchmark one-year deposit rate narrowed from 2.25% in January 2006 to 0.88% in September 2007. The narrowing interest margin between the Federal Fund Rate and the PBOC headline rate will accelerate the influx of foreign hot money. This implies that China's money supply will increase further and the country will have to drain the excess immediately.

Chart 5:Real interest rate in China



Source: Bloomberg

Chart 6: Interest margin of RMB and USD



Source: Bloomberg

QDII scheme. The scheme allows financial institutions to invest in offshore markets such as securities and bonds, on behalf of individuals and institutions. The Chinese government announced its QDII scheme in April 2006, opening up a channel for domestic institutional investors to invest overseas and relaxing restrictions on purchases of foreign exchange by domestic firms and individuals. In May 2007, after allotting a QDII quota of about

US$14.0b to 17 domestic banks and funds, CBRC expanded the QDII scope to equities. In the past, the QDIIs of domestic commercial banks (overseas wealth management divisions) were not allowed to invest in equity and derivatives directly, in commodity-based derivatives and instruments with ratings below BBB, as ranked by international rating agencies. This made QDII products unappealing to domestic investors, due to the bull run in the A-share market and the low return of high-grade fixed income products. CBRC's notice issued in May stipulates that banks' QDIIs are not allowed to invest in hedge funds, commodity-based derivatives and instruments with ratings below BBB but can invest in equities directly if the flowing conditions are meet:

- securities are listed on overseas exchanges,
- investment does not exceed 50.0% of the net asset value of the overseas wealth management product. Investment in a single equity security should not exceed 5.0% of the net asset value of the overseas wealth management product.
- minimum investment by a single client is not less than RMB300,000.0
- client has experience in and knowledge of equity investment.
- banks' QDIIs are approved by overseas authorities, with overseas wealth management MOUs with CBRC.
- commercial banks operate in markets regulated by the authorities that have overseas wealth management MOUs with CBRC.

The expanded QDII scheme will enhance the attractiveness of QDII products, offering more exposure to overseas stock markets, especially Hong Kong's H-share market. It is estimated that 19 financial institutions, including commercial banks and funds, have been allotted an aggregate quota of US$29.1b. Technically, 50.0% of this quota can be invested in stocks, especially H-shares listed on HKEX.

Table 1: QDII

Name of QDII	Quota (US$m)
Harvest Fund Management	5,000
China AMC	2,500
China Southern Fund Management	4,000
Agricultural Bank of China	500
Shanghai Pudong Development Bank	500
China Everbright Bank	500
Industrial Bank	500
Standard & Chartered Bank	500
Hang Seng Bank	300
Citibank	500
China CITIC Bank	500
China Merchant Bank	1,000
Hua An Fund Management	500
Bank of Communication	1,500
China Construction Bank	2,000
Bank of China	2,500
Industrial and Commercial Bank	2,000
Bank of East Asia	300
Harvest Fund Management	4,000

Source: SAFE, The Standard

CEPA on securities industry. Under the CEPA, Hong Kong professionals in the securities and futures industry are exempt from professional knowledge exams in China, they are just required to pass the examination on China's laws and regulation. Hong Kong's futures brokerages are allowed to hold stakes of up to 49.0% in their joint ventures with China-based counterparts. Qualified securities and futures companies in China are allowed to set up subsidiaries in Hong Kong. China's securities companies have to complete their registration in Hong Kong within one year. Mainland fund management companies approved by CSRC are allowed to establish subsidiaries in Hong Kong.

P & L (HK$m)	05A	06A	07A
Year to Mar			
Turnover	**127.6**	**50.4**	**48.2**
% chg	*(57.6)*	*(60.5)*	*(4.4)*
Gross profit	4.8	10.2	5.6
EBITDA	2.1	7.0	1.7
Depre./amort.	(0.0)	(0.0)	(0.0)
EBIT	2.1	7.0	1.7
Net int. income/(exp.)	0.0	0.4	1.0
Exceptionals	(7.5)	0.8	6.8
Associates	-	-	-
Jointly-controlled entit.	-	-	-
Pre-tax profit	**(5.4)**	**8.2**	**9.5**
Tax	0.0	(0.3)	(1.4)
Minority interests	-	-	-
Net profit	**(5.4)**	**7.9**	**8.1**
% chg	-	-	*2.2*
Dividends	-	-	(5.0)
Retained earnings	(5.4)	7.9	3.1
EPS (HK$) - Basic	(0.054)	0.079	0.081
EPS (HK$) - F.D.	(0.054)	0.079	0.081
DPS (HK$)	-	-	0.050
No. sh.s o/s (m) - W.A.	100.0	100.0	100.0
No. sh.s o/s (m) - Y.E.	100.0	100.0	100.0
No. sh.s o/s (m) - F.D.	100.0	100.0	100.0
Margins (%)			
Gross	*3.8*	*20.3*	*11.5*
EBITDA	*1.7*	*13.8*	*3.5*
EBIT	*1.6*	*13.8*	*3.5*
Pre-tax	*(4.3)*	*16.2*	*19.6*
Net	*(4.3)*	*15.6*	*16.7*

Balance Sheet (HK$m)	05A	06A	07A
Year to Mar			
Fixed assets	0.8	0.8	0.8
Intangible assets	-	-	-
Other LT assets	-	-	-
Cash	29.0	34.8	30.6
Accounts receivable	-	-	-
Other receivables	0.1	0.1	0.1
Inventories	-	-	-
Due from related co.s	-	-	-
Other current assets	18.1	18.6	31.5
Total assets	**48.0**	**54.2**	**63.0**
Accounts payable	(2.1)	(0.7)	(1.3)
Other payable	-	-	-
Tax payable	(0.6)	(0.3)	(0.4)
Due to related co.s	-	-	-
ST debts	-	-	-
Other current liab.	-	-	-
LT debts	-	-	-
Other LT liabilities	(0.0)	(0.0)	-
Total liabilities	**(2.7)**	**(1.1)**	**(1.8)**
Share capital	10.0	10.0	10.0
Reserves	35.3	43.2	51.2
Shareholders' funds	**45.3**	**53.2**	**61.2**
Minority interest	-	-	-
Total	**45.3**	**53.2**	**61.2**
Capital employed	45.3	53.2	61.2
Net (debt)/cash	29.0	34.8	30.6

Cash Flow (HK$m)	05A	06A	07A
Year to Mar			
EBIT	2.1	7.0	1.7
Depre./amort.	0.0	0.0	0.0
Net int. paid	0.0	0.4	1.0
Tax paid	(2.2)	(0.6)	(1.3)
Dividends received	-	-	-
Gross cashflow	**(0.1)**	**6.8**	**1.4**
Chgs. in working cap.	(2.4)	(1.1)	(5.6)
Operating cashflow	**(2.5)**	**5.7**	**(4.2)**
Capex	-	-	-
Free cashflow	**(2.5)**	**5.7**	**(4.2)**
Dividends paid	(10.0)	-	-
Net distribution to MI	-	-	-
Investments	-	-	-
Disposals	-	-	-
New shares	-	-	-
Others			
Net cashflow	**(12.5)**	**5.7**	**(4.2)**
Net (debt)/cash - Beg.	41.6	29.0	34.8
Net (debt)/cash - End.	29.0	34.8	30.6

Interim Results (HK$m)	05A	06A
Six months to Sep		
Turnover	**18.9**	**17.8**
% chg	*8,592.7*	*(5.8)*
Profit from operations	5.7	0.1
Interest expenses	-	
Associates	-	
Jointly-controlled entit.	-	
Pre-tax profit	**5.7**	**0.1**
Tax	-	-
Minority interests	-	-
Net profit	**5.7**	**0.1**
% chg	-	*(97.7)*
EPS (HK$) - Basic	0.057	0.001
DPS (HK$)	-	-

Shareholding Structure	Shares o/s (m)	%
Connected parties/mamagement	359.8	51.4
Xiao Wei	16.8	2.4
Wang Wencang	14.1	2.0
Independent Placees	270.0	38.6
Public	39.3	5.6
Total	**700.0**	**100.0**

Background

Hong Kong-based Concepta Investment focuses its efforts to maximize earnings for shareholders via medium to long-term capital appreciation on the Greater China region. To capture opportunities arising from the Individual QDII scheme, it has repositioned itself as an investor and coordinator of the cross-border securities industry, focusing on the development of a cross-border platform for the securities industry in Hong Kong and China.

Key Ratios	05A	06A	07A
Net gearing (%)	Cash	Cash	Cash
Net ROE (%)	(24.0)	16.0	14.1
EBIT ROCE (%)	9.3	14.1	2.9
Dividend payout (%)	-	-	62.1
Effective tax rate (%)	0.0	3.8	14.8
Net interest coverage (x)	na	na	na
A/R turnover (days)	-	-	-
A/P turnover (days)	6.1	10.4	7.9
Stock turnover (days)	-	-	-