



CHINA

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Chinese ADRs – new risk Education Edge: Paul Gillis

Could the US really force a de-listing of all Chinese ADRs?

Few would dispute that China is in the midst of an accounting crisis. We first wrote about this a year ago in [Corporate Governance Meltdown](#). Now, it appears the crisis may be at risk of entering a new stage, a stage that would have major implications on virtually every US-listed Chinese company. Professor Paul Gillis spoke at our Emerging Leaders Conference in HK this Wednesday. He estimates there is a 20% chance that the US could force a delisting from US stock exchanges virtually ALL Chinese (American Depository Receipts) ADRs. Perhaps more concerning to investors is his estimation that there is a 70% chance that the growing dispute will not be resolved, but rather extended well into 2013 or beyond, potentially leaving a lingering overhang on valuations on all US-listed PRC companies. The imminent restructuring of the Big 4 China JVs has profound implications for investors in HK-listed Chinese companies as well.

Consensus clearly views the risk of a mass de-listing as a very low probability – to the point of being able to safely ignore. However, we strongly encourage investors to read through Professor Gillis's arguments below and consider whether issues of national sovereignty and politics may outweigh the interests of investors in China ADRs. *The below commentary is a summary of the views of Dr. Gillis and not necessarily the views of Macquarie Securities.*

Five factors make thinkable what was unthinkable

How did we arrive at a point where the forced de-listing of blue chip China ADRs – perhaps as early as the end of this year - is thinkable?

The first factor to appreciate is that any company listed on a US stock exchange needs to be audited by an auditor who is registered with the PCAOB (Public Company Accounting Oversight Board). The PCAOB was created with the Sarbanes Oxley Act to increase government supervision of the accounting industry (which pre-Enron had been mostly self-regulating).

The second factor is that Chinese companies who use Big 4 auditors are actually audited by the Big 4's Chinese JVs (usually based in Shanghai, Beijing and, increasingly smaller cities). These JVs are legally distinct and must be independently registered with the PCAOB. Three of the Big 4 JVs end in the next 8 months (PwC does not end until 2018) as they were 20-year JVs created in 1992 in the wake of Deng Xiao Ping's Southern tour. These JVs are in the process of being converted into limited partnerships that may need to re-register with the PCAOB.

The third factor is that the PCAOB exercises its oversight by inspecting the audit papers of the audit firms. However, since 2009, China has prohibited the China JVs of the Big 4 from handing over their audit papers – effectively preventing the PCAOB from exercising its normal oversight. Why? From China's viewpoint, the idea of a foreign government body exercising regulatory oversight over Chinese nationals on Chinese soil is anathema. In 2009, the PCAOB effectively postponed the showdown – till the end of 2012.

The fourth factor is the eruption of the China accounting scandals over the past few years. The last time the issue was postponed was before the scandals erupted. This time, they have been headline news for a year and many US investors have lost money. The specific flashpoint is the Longtop case.

Recall that Longtop was a US-listed Chinese financial software services company that collapsed in a clear fraud last year. Deloitte's Chinese JV had been the auditor and the PCAOB has subpoenaed the JV for access to the audit work papers for their investigation. However, the PRC government has made clear to Deloitte's China JV that the handing over of such papers to the PCAOB would be regarded as a serious crime – a violation of the State Secrets Act – punishable by up to life in prison. To date, Deloitte's JV has refused to hand over the Longtop audit papers to the PCAOB. In another unnamed case, Deloitte refused to turn over work papers and the SEC has charged them with securities law violations. Other Big 4 JVs face similar requests.

The fifth factor is the US political environment, which threatens to escalate a knotty problem into a political storm. With the economy still weak and in the midst of an election cycle, there is intense pressure on politicians to be seen as protecting US voters' interests. China-bashing is often a vote winner and, from a US point of view, the issue is clear-cut: 'If you wish to trade on US stock exchanges and sell your shares to US investors, you must be subject to US regulations. Full stop.' The fact that there has been a wave of high-profile frauds simply intensifies this view.

Indeed, New York's Chuck Schumer, third-ranking Democrat in the Senate (serves on both the Committee on Finance and the Subcommittee of Financial Institutions and the Subcommittee on Securities, Insurance and Investment), has taken up the issue aggressively and has publicly notified the PCAOB that 'In the case of Chinese auditing firms, the board is failing to do its 'job' (it is of interest that the largest industry campaign contributor to Senator Schumer's campaigns over his Senate career has been the banking and securities industry).

It is in this environment that the PCAOB needs to find a way to convince Congress that it is not failing in its duty to protect US investors. Clearly, Chinese ADRs are audited by firms that the PCAOB is not currently able to exercise oversight over. And individual US investors are buying these ADRs today.

The worst-case outcome – every China ADR is forced to de-list

If the PCAOB fails to register the three new Big 4 JVs that need to re-register in the next eight months (and/or de-registers the PwC JV), all companies audited by those JVs would need new auditors or face delisting from US stock exchanges. The PCAOB may decide against extending the 2012 inspection deadline and instead deregister all auditors of China ADRs. Shareholders would still have legal rights to those shares, but those shares could not be traded in the US. The obvious market to re-list would be HK and there are unlikely to be any structural barriers to them doing so (although the HKSE would likely require new prospectuses etc and the process could take months if not years to process through, say, the top 50 China ADRs). Relisting on the PRC exchanges would seem unlikely, as forex and foreign investment rules would need to be completely revamped in order to execute this – a process that will likely take years.

US funds (and indeed individuals) would have no problem investing in HK-listed companies, same as the status quo. But the risk for investors is clearly a prolonged period of no liquidity if a de-listing is forced before a re-listing elsewhere can be achieved.

Paul Gillis assigns a 10% chance that the issue is successfully resolved by the deadline at the end of 2012, a 70% chance of the issue being given another extension such as what occurred in 2009, and a 20% chance of negotiations breaking down and a forced de-listing of all US-listed Chinese ADRs.

Surely, someone would have to bend? Perhaps not

The consensus reaction to the five factors outlined above is ‘Surely someone will figure out a solution to avoid an event that would harm investors, the US stock exchanges, Chinese private companies looking to raise capital, and even US & China relations.’

China may not mind de-listing of its US ADRs: While certainly there will be interest groups fighting hard for a resolution, they may be less powerful and less effective than consensus would have. On the Chinese side, the PRC government (in particular the China Securities Regulatory Commission CSRC) is not mandated to exercise oversight over foreign incorporated entities. This is important, as virtually all US-listed Chinese companies are actually offshore (typically Cayman Island, etc) entities that hold China operating companies. It is in China’s national interest for its best private companies to list in the PRC, although China has not to date actively discouraged private companies from seeking an overseas listing. But from the China’s point of view, there may be few tears shed over forcing Chinese companies to come home (whether to mainland exchanges or HK). The inconvenience of foreign investors may seem a small concern.

China’s hard stance has deep roots. In threatening severe punishments (up to life in prison) to the partners of the Big 4 JVs, China is invoking the State Secrets Law – arguing that the working papers could reveal state secrets. But behind this is the deeper principle that foreign governments should not be able to come onto Chinese soil and regulate Chinese citizens. This stance would seem hard to compromise on, given China’s history with imperialist powers.

The US stance is equally hard: From the point of view of the US Congress, the principle is equally clear and hard – if you list in the US and sell shares to US citizens, we have a duty to exercise oversight. Exercising oversight over auditors is not possible without access to auditors’ working papers. If they cannot be provided, the auditors cannot be registered.

One would think that Wall Street would be exerting political pressure to prevent a mass de-listing. Large mutual and pension funds would find their Chinese ADR holdings illiquid for a period of time that would likely be months at a minimum. The stock exchanges’ reputation would be harmed amongst foreign companies deciding where to list. The investment banks would see the end of their pipeline of lucrative NYSE IPOs (where IPO fees are substantially higher than in HK).

Nonetheless, the issue is more complex. Firstly, Wall Street’s power in Washington is not what it was pre-GFC. Secondly, the investment banks may well eye the potential fees from re-listing in HK and decide the immediate re-listing fees gained would outweigh the loss of future US IPO fees.

This is a problem largely unique to China

Some may point out that the US exchanges host a large number of ADRs from many countries around the world. Are they also at risk of retaliation from the PCAOB? The reality is that the PCAOB has not been able to directly access audit papers in many other countries. But the scale of the problem is much greater for China because so many Chinese companies have used the US capital markets.

The second factor to consider is that the vast majority of ADRs listed in the US are secondary – not primary – listings. E.g. Petrobrazil’s primary listing is in Sao Paulo. Thus, Petrobrazil would be actively monitored by the Brazilian securities regulator. The difference with China is that China has a large number of ADRs (many of them blue-chip representatives of their industries) that are ONLY listed in the US. Thus they are not actively monitored by the CSRC.

The fallout of a breakdown is also more serious for a Chinese ADR than for other ADRs. Again, using PetroBrazil as an example, a delisting of Petrobrazil’s ADR might be an annoying event for fund managers, but investors would have continued liquidity in some market.

However, in the case of most Chinese ADRs, a delisting would eliminate all liquidity (unless a listing in an alternative market could be achieved prior to the de-listing).

The new Chinese Big 4 JVs are going to be very different animals

Regardless of the outcome of the negotiations between China and PCAOB, investors should note that the new JVs of the Big 4 are going to be substantially different from the existing entities. When the JVs were established in 1992, China gave them the right to staff with expatriates who did not have to pass the Chinese CPA exam (which is only given in Chinese).

Going forward, they will have to be headed by Chinese nationals within three years. This could subject the JVs to political pressure above what may now exist. Aside from the heads, expat partners (most often from Hong Kong or Taiwan) will be limited to 40% starting next year and 20% by 2017. Investors in both HK and US listed Chinese shares will need to consider if this represents higher risk to the integrity of accounts. KPMG's deadline for restructuring is August 17, 2012, Ernst & Young's is in September 2012, Deloitte is in February 2013 and PwC has until 2018 (due to the re-registration in 1998 after the merger of PriceWaterhouse and Coopers).

Macquarie analysis: How much market cap are we talking about?

Below, Macquarie quantifies the scope of the problem:

If you take the 200 largest Chinese ADRs, they represent a market cap of US\$951bn and Average Daily Turnover of US\$1.4bn. However, much of this is made up of dual-listed ADRs such as China Mobile, which have their primary listing in HK. While a delisting of these ADRs may be a problem, the problem pales in the face of ADRs that have no other listing.

If we strip out dual-listed ADRs, we are left with 185 companies that have a collective market cap of US\$101bn and ADTV of US\$1.2bn. Of the top 200, 61% are audited by Big 4 JVs in China.

Fig 1 US-listed China ADRs – top 200

Ticker	Name	Market Cap	3M ADTV	Auditor
Dual listed China ADRs				
PTR US Equity	PetroChina Co. Ltd. (ADS)	257,649	22.5	PwC ZhongTian
CHL US Equity	China Mobile Ltd. (ADS)	214,329	46.8	KPMG HuaZhen
CEO US Equity	CNOOC Ltd. (ADS)	85,792	28.8	E&Y HuaMing
SNP US Equity	China Petroleum & Chemical Corp.	84,235	13.7	KPMG HuaZhen
LFC US Equity	China Life Insurance Co. Ltd. (ADS)	79,085	15.2	PwC ZhongTian
CHA US Equity	China Telecom Corp. Ltd. (ADS)	35,061	4.3	KPMG HuaZhen
CHU US Equity	China Unicom Ltd. (ADS)	28,891	16.6	PwC ZhongTian
HNP US Equity	Huaneng Power Int'l Inc. (ADS)	13,323	3.0	PwC ZhongTian
YZC US Equity	Yanzhou Coal Mining Co. Ltd. (ADS)	11,874	4.1	SHINewing
ACH US Equity	Aluminium Corp. of China Ltd. (ADS)	10,973	2.6	PwC ZhongTian
LNVGY US	Lenovo Group Ltd. (ADS)	8,581	0.3	PwC ZhongTian
ZNH US Equity	China Southern Airlines (ADS)	6,312	0.8	KPMG HuaZhen
CEA US Equity	China Eastern Airlines Corp. Ltd.	6,222	0.9	PwC ZhongTian
SHI US Equity	SINOPEC Shanghai Petrochemical	5,117	0.6	KPMG HuaZhen
GSH US Equity	Guangshen Railway Co. Ltd. (ADS)	3,039	0.5	PwC ZhongTian
Total		850,484	161	
China ADRs only listed in the US				
BIDU US Equity	BAIDU INC-SP ADR	37,938	559.9	E&Y HuaMing
NTES US Equity	NETEASE INC-ADR	7,590	41.9	PwC ZhongTian
EDU US Equity	NEW ORIENTAL-ADR	3,966	25.0	Deloitte HuaYong
MR US Equity	MINDRAY MEDI-ADR	3,444	13.9	PwC ZhongTian
SINA US Equity	SINA CORP	3,315	166.7	PwC ZhongTian
FMCN US Equity	Focus Media Holding Ltd. (ADS)	2,919	49.5	Deloitte HuaYong
YOKU US Equity	YOUKU INC-ADR	2,406	32.3	E&Y HuaMing
CTRP US Equity	CTRIP.COM-ADR	2,389	49.7	PwC ZhongTian
QIHU US Equity	QIHOO 360 TE-ADR	2,053	35.2	Deloitte HuaYong
RENN US Equity	RENREN INC-ADR	1,784	57.8	Deloitte HuaYong
SOHU US Equity	SOHU.COM INC	1,588	35.9	PwC ZhongTian
JOBS US Equity	51JOB INC-ADR	1,266	4.1	PwC ZhongTian
SFUN US Equity	SOUFUN HOLDI-ADR	1,235	3.1	E&Y HuaMing
TUDO US Equity	TUDOU HOLDINGS L	1,134	4.7	PwC ZhongTian
CYOU US Equity	CHANGYOU.COM-ADR	1,095	4.3	PwC ZhongTian
GA US Equity	GIANT INTERA-ADR	1,087	3.0	E&Y HuaMing
GAME US Equity	SHANDA GAMES-ADR	1,073	1.4	PwC ZhongTian
WX US Equity	WUXI PHARMAT-ADR	1,005	3.4	Deloitte HuaYong
HMIN US Equity	HOME INNS & -ADR	971	9.7	PwC ZhongTian
ASIA US Equity	ASIAINFO-LINKAGE	878	3.7	Deloitte HuaYong
SPRD US Equity	SPREADTRUM-ADR	802	18.5	PwC ZhongTian
XRS US Equity	TAL EDUCATIO-ADR	771	0.2	Deloitte HuaYong
HTHT US Equity	CHINA LODGIN-ADS	686	1.5	Deloitte HuaYong
AMAP US Equity	AutoNavi-ADS	646	1.8	Deloitte HuaYong
EJ US Equity	E-HOUSE CHIN-ADS	643	1.8	Deloitte HuaYong
VNET US Equity	21VIANET-ADR	635	3.7	E&Y HuaMing
DANG US Equity	E-COMMERCE C-ADR	519	24.2	E&Y HuaMing
SVN US Equity	7 DAYS GROUP-ADR	510	0.9	KPMG HuaZhen
TSL US Equity	TRINA SOLAR-ADR	503	15.2	Deloitte HuaYong
SCR US Equity	SIMCERE PHAR-ADR	476	0.3	KPMG HuaZhen
RDA US Equity	RDA MICROELE-ADR	459	0.5	PwC ZhongTian
KH US Equity	CHINA KANGHU-ADR	459	0.5	E&Y HuaMing
HOLI US Equity	HOLLYSYS AUTOMAT	457	2.0	BDO
PWRD US Equity	PERFECT WORL-ADR	452	9.0	PwC ZhongTian
YGE US Equity	YINGLI GREEN-ADR	413	5.4	KPMG HuaZhen
VIT US Equity	VANCEINFO TE-ADR	390	3.0	Deloitte HuaYong
LONG US Equity	ELONG INC-SP ADR	385	0.2	E&Y HuaMing
NQ US Equity	NQ MOBILE INC- A	368	4.2	PwC ZhongTian
FENG US Equity	PHOENIX NEW -ADR	365	0.4	PwC ZhongTian
STP US Equity	SUNTECH POWE-ADR	357	3.6	Deloitte HuaYong
AMBO US Equity	AMBOW EDUCAT-ADR	351	0.8	PwC ZhongTian
BONA US Equity	BONA FILM GR-ADR	348	0.3	Deloitte HuaYong
HOGS US Equity	ZHONGPIN INC	343	2.4	BDO
CISG US Equity	CNINSURE INC-ADR	333	0.7	Deloitte HuaYong
KONG US Equity	KONGZHONG-ADR	331	0.7	Deloitte HuaYong
FSIN US Equity	FUSHI COPPERWELD	301	4.7	KPMG HuaZhen
SSRX US Equity	3SBIO INC-ADR	300	0.9	E&Y HuaMing
VIPS US Equity	VIPSHOP HOLDINGS	297	0.6	Deloitte HuaYong
NOAH US Equity	NOAH HOLDING-ADS	279	0.5	Deloitte HuaYong
XUE US Equity	XUEDA EDU GP-ADR	263	0.1	Deloitte HuaYong
LDK US Equity	LDK SOLAR CO-ADR	259	4.2	KPMG HuaZhen
NTE US Equity	NAM TAI ELECTR	253	0.5	MOORE STEPHES
CBPO US Equity	CHINA BIOLOGIC P	243	0.1	KPMG HuaZhen
NPD US Equity	CHINA NEPSTA-ADR	230	0.3	KPMG HuaZhen
XIN US Equity	XINYUAN REAL-ADR	222	1.3	E&Y HuaMing
CXDC US Equity	CHINA XD PLASTIC	219	0.5	KPMG HuaZhen
UTSI US Equity	UTSTARCOM HOLDIN	183	0.4	PwC ZhongTian

Fig 1 US-listed China ADRs – top 200

Ticker	Name	Market Cap	3M ADTV	Auditor
CCSC US Equity	COUNTRY-SPON ADR	181	0.3	Deloitte HuaYong
STV US Equity	CHINA DIGITA-ADR	172	0.2	Deloitte HuaYong
JASO US Equity	JA SOLAR HOL-ADR	168	2.6	PwC ZhongTian
AMCN US Equity	AIRMEDIA-ADR	168	0.1	Deloitte HuaYong
BITA US Equity	BITAUTO HOLD-ADR	167	0.1	E&Y HuaMing
LIWA US Equity	LIHUA INTERNATIO	166	0.5	AGCA INC
CHOP US Equity	CHINA GERUI ADV	165	0.3	UHY VOCATION
TAOM US Equity	TAOMEE HOLDI-ADR	159	0.1	Deloitte HuaYong
YONG US Equity	YONGYE INTERNATI	154	0.9	KPMG HuaZhen
DATE US Equity	JIAYUAN.COM INTE	145	0.3	PwC ZhongTian
MY US Equity	CHINA MING Y-ADS	144	0.2	KPMG HuaZhen
NCTY US Equity	THE9 LTD-ADR	142	0.1	Deloitte HuaYong
CTFO US Equity	CHINA TRANSINFO	140	0.3	BDO CHINA
CCM US Equity	CONCORD MED-ADR	135	0.1	E&Y HuaMing
JST US Equity	JINPAN INTL LTD	130	0.2	GRANT THORNT
ADY US Equity	FEIHE INTERNATIO	130	2.2	GRANT THORNT
ZX US Equity	CHINA ZENIX -ADR	124	0.1	Deloitte HuaYong
LPH US Equity	LONGWEI PETROLEU	123	0.2	CHILD, VAN
SHP US Equity	SHANGPHARMA-ADR	123	0.1	PWC ZhongTian
CCIH US Equity	CHINACACHE-ADR	121	0.2	E&Y HuaMing
ACTS US Equity	ACTIONS SEMI-ADR	116	0.1	Deloitte HuaYong
CAAS US Equity	CHINA AUTOMOTIVE	116	0.3	PwC ZhongTian
SVA US Equity	SINOVAC BIOTECH	112	0.2	E&Y HuaMing
DL US Equity	CHINA DISTAN-ADR	111	0.0	Deloitte HuaYong
CEDU US Equity	CHINAEDU COR-ADR	106	0.0	Deloitte HuaYong
CIS US Equity	CAMELOT INFO-ADR	103	0.4	Deloitte HuaYong
SOL US Equity	RENESOLA LTD-ADR	100	1.2	Deloitte HuaYong
ZA US Equity	ZUOAN FASHIO-ADR	99	0.1	GHP HORWATH
NKBP US Equity	CHINA NUOK-ADR	99	0.1	E&Y HuaMing
WWIN US Equity	WINNER MEDICAL G	95	0.1	BDO
DEER US Equity	DEER CONSUMER PR	93	0.4	GOLDMAN PARKS
HSOL US Equity	HANWHA SOLAR-ADR	93	0.4	E&Y HuaMing
CGA US Equity	CHINA GREEN AGRI	92	0.3	KABANI & CO
VISN US Equity	VISIONCHINA -ADR	92	0.2	Deloitte HuaYong
ATAI US Equity	ATA INC-ADR	92	0.0	KPMG HuaZhen
KNDI US Equity	KANDI TECHNOLOGIE	91	0.2	ALBERT WONG &
ATV US Equity	ACORN INTERN-ADR	88	0.0	Deloitte HuaYong
BCDS US Equity	BCD SEMICONDR-ADR	86	0.2	Deloitte HuaYong
SYSW US Equity	SYSWIN INC-ADS	77	0.0	PwC ZhongTian
XNY US Equity	CHINA XINIYA-ADR	76	0.1	GHP HORWATH
JKS US Equity	JINKOSOLAR-ADR	74	1.1	PwC ZhongTian
KGJI US Equity	KINGOLD JEWELRY	71	1.0	FRIEDMAN LLP
MOBI US Equity	SKY-MOBI LTD-ADR	69	0.4	Deloitte HuaYong
YTEC US Equity	YUCHENG TECHNOLO	68	0.1	BDO
CHLN US Equity	CHINA HOUSING &	67	0.1	MSCM LLP
KUTV US Equity	KU6 MEDIA-ADR	64	0.1	PwC ZhongTian
LTON US Equity	LINKTONE LTD-ADR	62	0.1	E&Y HuaMing
CGEIU US	CHINA GROWTH EQU	62	0.1	CROWE HORWAT
CNTF US Equity	CHINA TECHFA-ADR	59	0.2	Deloitte HuaYong
MCOX US Equity	MCCOX LANE-ADR	58	0.0	Deloitte HuaYong
CCCL US Equity	CHINA CERAMICS C	56	0.1	GRANT THORNT
GRO US Equity	AGRIA CORP - ADR	56	0.1	E&Y HuaMing
COGO US Equity	COGO GROUP INC	55	0.2	KPMG HuaZhen
LAS US Equity	LENTUO INTER-ADR	53	0.1	E&Y HuaMing
CREG US Equity	CHINA RECYCLING	53	0.2	GOLDMAN PARKS
BORN US Equity	CHINA NEW BO-ADR	52	0.3	NA
NED US Equity	NOAH EDUCATI-ADR	51	0.0	Deloitte HuaYong
SORL US Equity	SORL AUTO PARTS	49	0.3	ROTENBERG
ONP US Equity	ORIENT PAPER INC	48	0.1	BDO
PACQ US Equity	PRIME ACQUISITIO	47	0.0	NA
TBOW US Equity	TRUNKBOW INTERNA	44	0.1	BERNSTEIN & PIN
GSI US Equity	GENERAL STEEL HO	44	0.1	FRAZER FROST
SCOK US Equity	SINOCOKING COAL	43	0.1	NA
NINE US Equity	NINETOWNS IN-ADS	42	0.0	GHP HORWATH
CVVT US Equity	CHINA VALVES TEC	40	0.1	FRAZER FROST
GURE US Equity	GULF RESOURCES I	40	0.2	MORISON COGEN
ALN US Equity	AMERICAN LORAIN	39	0.0	SAMUEL H WONG
SPU US Equity	SKYPEOPLE FRUIT	39	0.1	PARITZ & CO
SUTR US Equity	SUTOR TECHNOLOG	39	0.0	HANSEN BARNETT
CBAK US Equity	CHINA BAK BATTER	38	0.1	PKF
IDI US Equity	SEARCHMEDIA HLDS	37	0.0	MARCUM LLP
CHC US Equity	CHINA HYDRO-ADS	37	0.1	E&Y HuaMing
VIMC US Equity	VIMICRO INTE-ADR	37	0.1	E&Y HuaMing
THTI US Equity	THT HEAT TRANSFE	36	0.3	PKF
CSUN US Equity	CHINA SUNERG-ADR	34	0.1	Deloitte HuaYong
TRIT US Equity	TRI-TECH HOLDING	33	0.2	2&2 AUDIT
SEED US Equity	ORIGIN AGRITECH	31	0.4	BDO MCCABE

Fig 1 US-listed China ADRs – top 200

Ticker	Name	Market Cap	3M ADTV	Auditor
JRJC US Equity	CHINA FINANC-ADR	31	0.1	Deloitte HuaYong
CADC US Equity	CHINA ADVANCED C	30	0.1	FRIEDMAN LLP
CPGI US Equity	CHINA SHENGDA PA	28	0.0	BERNSTEIN & PIN
DQ US Equity	DAQO NEW ENE-ADR	27	0.1	Deloitte HuaYong
CNIT US Equity	CHINA INFORMATIO	27	0.2	GHP HORWATH
WH US Equity	WSP HOLDINGS-ADR	27	0.0	Deloitte HuaYong
SHZ US Equity	CHINA SHEN ZHOU	26	0.2	SHERB & CO
SGOC US Equity	SGOCO GROUP	26	1.1	FRAZER FROST
ZOOM US Equity	ZOOM TECHNOLOGIE	25	0.4	GOLDMAN PARKS
SCEI US Equity	SINO CLEAN ENERG	24	1.1	WEINBERG & CO
CBP US Equity	CHINA BOTANIC PH	24	0.0	WINDES &
EVK US Equity	EVER-GLORY INTER	23	0.0	GHP HORWATH
HGSH US Equity	CHINA HGS REAL E	23	0.0	FRIEDMAN LLP
CMFO US Equity	CHINA MARINE FOO	22	0.0	BDO CHINA
PSOF US Equity	PANSOFT CO LTD	21	0.0	CROWE HORWAT
TSTC US Equity	TELESTONE TECHNO	21	0.1	MAZARS CPA LTD
OSN US Equity	OSSEN INNOVA-ADR	20	0.0	BDO CHINA
GPRC US Equity	GUANWEI RECYCLIN	17	0.6	FRIEDMAN LLP
FFHL US Equity	FUWEI FILMS HOLD	17	0.0	KABANI & CO
QKLS US Equity	QKL STORES INC	16	0.0	ALBERT WONG &
CJJD US Equity	CHINA JO-JO DRUG	16	0.0	FRAZER FROST
AMCF US Equity	ANDATEE CHINA	16	0.0	DASZKAL BOLTON
SKBI US Equity	SKYSTAR BIO-PHAR	16	0.0	CROWE HORWAT
HEAT US Equity	SMARHEAT INC	16	5.8	GOLDMAN PARKS
GU US Equity	GUSHAN ENVIR-ADR	15	0.0	KPMG HuaZhen
CNET US Equity	CHINANET ONLINE	15	0.0	BERNSTEIN & PIN
CTC US Equity	IFM INVESTM-ADS	15	0.1	PwC ZhongTian
HPJ US Equity	HIGHPOWER INTL	15	0.0	DOMINIC KF CHAN
CPHI US Equity	CHINA PHARMA HOL	14	0.0	HANSEN BARNETT
TPI US Equity	TIANYIN PHARMACE	13	0.0	PATRIZIO & ZHAO
BSPM US Equity	BIOSTAR PHARMACE	13	0.2	MAZARS
CHGS US Equity	CHINA GENGSHENG	13	0.0	PKF
VALV US Equity	SHENGKAI INNOVAT	13	0.6	ALBERT WONG &
EFUT US Equity	EFUTURE INFORMAT	12	0.1	GRANT THORNT
CNYD US Equity	CHINA YIDA HOLDI	12	0.0	FRIEDMAN LLP
OINK US Equity	TIANLI AGRITECH	12	0.0	SHERB & CO
SIHI US Equity	SINOHUB INC	10	0.0	Baker Tilly
CALI US Equity	CHINA AUTO LOGIS	8	0.0	MARCUM
DHRM US Equity	DEHAIER MED SYS	8	0.0	FRIEDMAN
RCON US Equity	RECON TECHNOLOGY	7	0.5	BERNSTEIN & PIN
CLNT US Equity	CLEANTECH SOLUTI	6	2.7	SHERB & CO LLP
BEST US Equity	SHINER INTL INC	6	0.0	GOLDMAN PARKS
NFEC US Equity	NF ENERGY SAVING	6	0.4	NA
KONE US Equity	KINGTONE WIR-ADR	5	0.0	BERNSTEIN & PIN
LZEN US Equity	LIZHAN ENVIRONME	3	0.0	UHY VOCATION
BWOW US	WOWJOINT HOLDING	3	0.1	SHERB & CO

Source: Bloomberg, Macquarie Research, July 2012

Fig 2 Macquarie covered US-listed China stocks, as of close 28 Jun, 2012

Name	Ticker	Rating	Price	Target Price (LC)	Upside to target (%)	Mkt Cap (US\$M)	FY12 EPS growth (%)	FY09-12 CAGR (%)	FY12 PER (x)	FY11F ROE (%)	FY11F P/B (x)	FY11F Gearing/ Cash	Auditor
AutoNavi Holdings	AMAP US	Out	12.91	21.50	66.5	642	19.2	nmf	13.1	17.4	2.4	-74.0	Deloitte Hua Yong
Home Inns	HMIN US	Neutral	20.85	24.00	15.1	945	-16.0	-2.9	26.3	8.4	1.6	21.1	PwC Zhong Tian
China Lodging Group	HTHT US	Out	11.36	18.00	58.5	689	43.2	nmf	27.8	5.1	1.9	-34.6	Deloitte Hua Yong
7 Days Group	SVN US	Out	10.10	16.00	58.4	505	23.9	nmf	16.3	11.1	2.1	-10.4	KPMG Hua Zhen
Ambow Education	AMBO US	Out	4.47	10.00	123.7	335	20.0	32.7	6.1	10.5	0.7	-10.5	PwC Zhong Tian
New Oriental	EDU US	Out	25.58	31.50	23.1	4,051	28.9	24.7	26.1	23.6	7.0	-82.4	Deloitte Hua Yong
Baidu	BIDU US	Out	111.40	160.00	43.6	38,909	53.5	89.6	24.4	55.9	16.2	-24.4	Ernst & Young Hua Ming
China Dangdang	DANG US	Out	6.44	10.00	55.3	515	-97.4	nmf	nmf	-16.9	2.8	-105.5	Ernst & Young Hua Ming
Focus Media (ADR)	FMCN US	Out	22.47	43.00	91.4	2,905	24.5	33.6	8.8	22.8	2.3	-27.4	Deloitte Hua Yong
Qihoo 360 Technology	QIHU US	Out	17.54	33.00	88.1	2,093	75.1	163.2	18.9	28.7	5.7	-92.5	Deloitte Hua Yong
Renren	RENN US	Under	4.72	4.00	-15.3	1,863	-552.1	nmf	nmf	-0.1	1.6	-81.6	Deloitte Hua Yong
SINA Corporation	SINA US	Out	51.48	130.00	152.5	3,393	-56.9	-30.4	129.5	5.4	3.2	-48.2	PwC Zhong Tian
Sohu.com	SOHU US	Out	42.40	65.00	53.3	1,611	-48.6	-13.7	16.6	22.0	1.5	-58.8	PwC Zhong Tian
VanceInfo Technologies	VIT US	Out	9.69	15.00	54.8	410	19.7	13.6	11.0	11.1	1.4	-31.7	Deloitte Hua Yong
Youku.com	YOKU US	Under	21.92	21.00	-4.2	2,516	-31.8	-54.3	nmf	-4.1	3.8	-54.1	Ernst & Young Hua Ming
NetEase	NTES US	Out	59.14	65.00	9.9	7,728	13.4	27.3	13.0	29.4	3.8	-16.9	PwC Zhong Tian
Changyou	CYOU US	Out	21.35	34.00	59.3	1,121	4.7	15.6	4.6	47.7	2.0	-57.8	PwC Zhong Tian
Giant Interactive	GA US	Out	4.79	6.00	25.3	1,127	5.3	16.0	6.3	24.4	2.9	-37.7	Ernst & Young Hua Ming
Shanda Games	GAME US	Out	3.84	4.50	17.2	1,076	-6.8	-3.2	5.0	40.1	2.0	-27.1	PwC Zhong Tian
Perfect World	PWRD US	Neutral	9.64	10.00	3.7	457	-11.5	3.2	3.3	30.2	0.7	-67.4	PwC Zhong Tian

Source: Bloomberg, Macquarie Research, July 2012

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Recommendation definitions	Volatility index definition*	Financial definitions
<p>Macquarie - Australia/New Zealand Outperform – return >3% in excess of benchmark return Neutral – return within 3% of benchmark return Underperform – return >3% below benchmark return</p> <p>Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield</p> <p>Macquarie – Asia/Europe Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie First South - South Africa Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie - Canada Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie - USA Outperform (Buy) – return >5% in excess of Russell 3000 index return Neutral (Hold) – return within 5% of Russell 3000 index return Underperform (Sell) – return >5% below Russell 3000 index return</p>	<p>This is calculated from the volatility of historical price movements.</p> <p>Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low-medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ/Canada stocks only</p> <p>Recommendations – 12 months Note: Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / epowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

Recommendation proportions – For quarter ending 31 March 2012

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	53.90%	60.60%	57.50%	43.59%	66.67%	46.89%	(for US coverage by MCUSA, 10.86% of stocks covered are investment banking clients)
Neutral	31.56%	23.00%	32.50%	51.09%	30.00%	32.60%	(for US coverage by MCUSA, 9.50% of stocks covered are investment banking clients)
Underperform	14.54%	16.40%	10.00%	5.32%	3.33%	20.51%	(for US coverage by MCUSA, 1.36% of stocks covered are investment banking clients)

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