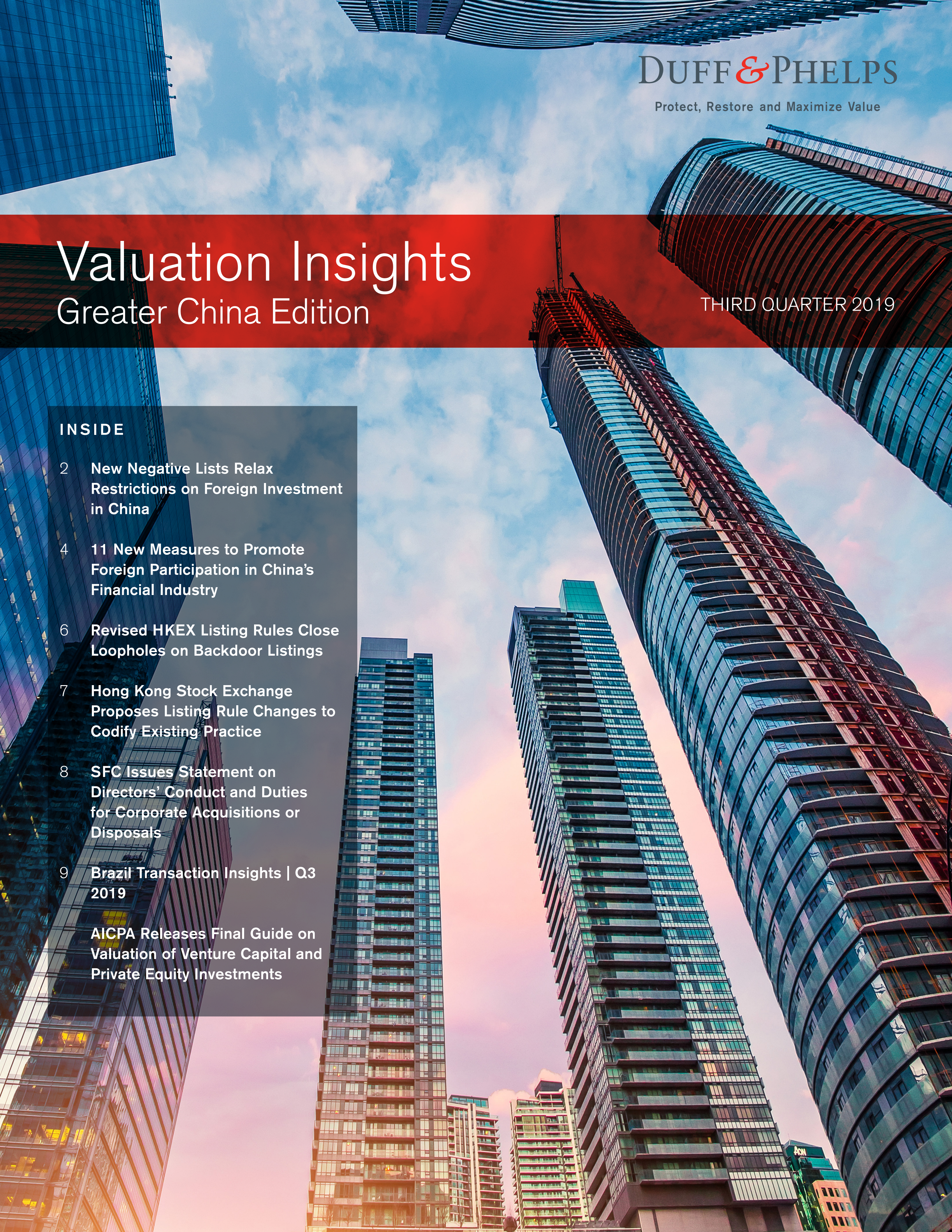

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Valuation Insights

Greater China Edition

THIRD QUARTER 2019

INSIDE

New Negative Lists Relax Restrictions on Foreign Investment in China

The Chinese government announced new policy changes on June 30 to ease investment rules for foreign investors.

Consisting of three documents jointly released by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), the policy revisions remove restrictions on foreign investment while allowing foreign investors wider access to agriculture, mining, manufacturing and service industries. The changes took effect by July 30.

Two "negative lists" specify sectors and businesses that remain off-limits or restricted to foreign investors. Foreign entities may invest in sectors and businesses not mentioned in either list and compete on an equal basis with Chinese firms.[i]

Both lists contain significantly less items than previous versions:

- The **2019 Special Administrative Measures (Negative List) for Foreign Investment Access** contains 40 items, eight less than the previous version. This list covers sectors and businesses outside the purview of China's free trade zones (FTZs). [ii]
- The **Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones** contains 37 items, significantly less than the previous version's 45.[iii] This list covers sectors and businesses operating within China's FTZs, including those in Shanghai, Fujian, Guangdong and Tianjin.

The third list, the **2019 Catalogue of Encouraged Industries for Foreign Investment**[iv] (Catalogue of Encouraged Industries) is divided into two sections:

- **National Catalogue of Encouraged Industries for Foreign Investment** enumerates 415 industries where foreign investment and technology transfer are officially encouraged. More than 80% of the listed industries are involved in manufacturing, particularly "high-end, intelligent and green manufacturing, including 5G core components, etching machines for integrated circuits, chip packaging equipment and cloud computing equipment."[v]
- **Catalogue of Industries for Foreign-investment in Central and Western China** lists 693 items that encourage further investment in China's central, western and northeastern regions (covering inner Mongolia and the provinces of Anhui, Hunan, Sichuan, Henan and Yunnan), providing a solution for investors concerned about rising overhead costs in China's coastal provinces.

Incentives for foreign entities following the Catalogue of Encouraged Industries include corporate income tax exemptions, fast-tracked approval procedures and reduced land prices.

The 2019 version of the negative lists is the fifth time they have been shortened since their launch in 2013. Changes include, but are not limited to, the following industries:

- **Transportation industry**—Removed restriction against foreign controlling interest over domestic vessel agencies.
- **Infrastructure industry**—Removed restriction against foreign controlling interest over natural gas and heating pipelines in cities with a population above 500,000.
- **Value-added telecommunications**—Removed restrictions on foreign investment in multi-party communication, store-and-forward and call centers.
- **Agriculture**—Removed prohibition on exploiting wildlife resources.
- **Mining**—Removed limitation on foreign investment in exploring and developing oil and natural gas to joint ventures and cooperation; removed restriction on exploring and mining molybdenum, tin, antimony and fluorite.

"The negative list is intended to simplify instead of adding extra rules," explained NDRC spokesperson Meng Wei. "The country is looking to completely cancel all restrictive rules not on the negative list before 2019 ends, and will implement more encouraging measures for industries where foreign investment has flown, especially in central and western China."[vi]

The continuous revisions to the negative lists have benefited foreign businesses investing in China's FTZs as much as the national government collecting the revenue and know-how from such investments.

"As the negative list is shortened year over year, the business environment in FTZs has been optimized, which has driven innovation and economic growth," explained MOFCOM spokesperson Gao Feng. "In 2018, 9,409 FIEs were set up in FTZs [...] up 37.5% from the previous year; RMB107.31 billion of foreign investment was utilized, 12.1% of the national total, and up 3.2% year-on-year."[vii]

i. "Economic Watch: China's Foreign Investment Law to Improve Business Environment." Xinhuanet.com. March 11, 2019. Accessed August 12, 2019. http://www.xinhuanet.com/english/2019-03/11/c_137886753.htm

ii. （负面清单）(2019 年版）. National Development and Reform Commission, People's Republic of China. June 30, 2019. Accessed August 12, 2019. http://www.ndrc.gov.cn/zcfb/zcfbl/201906/W020190628615780569680.pdf

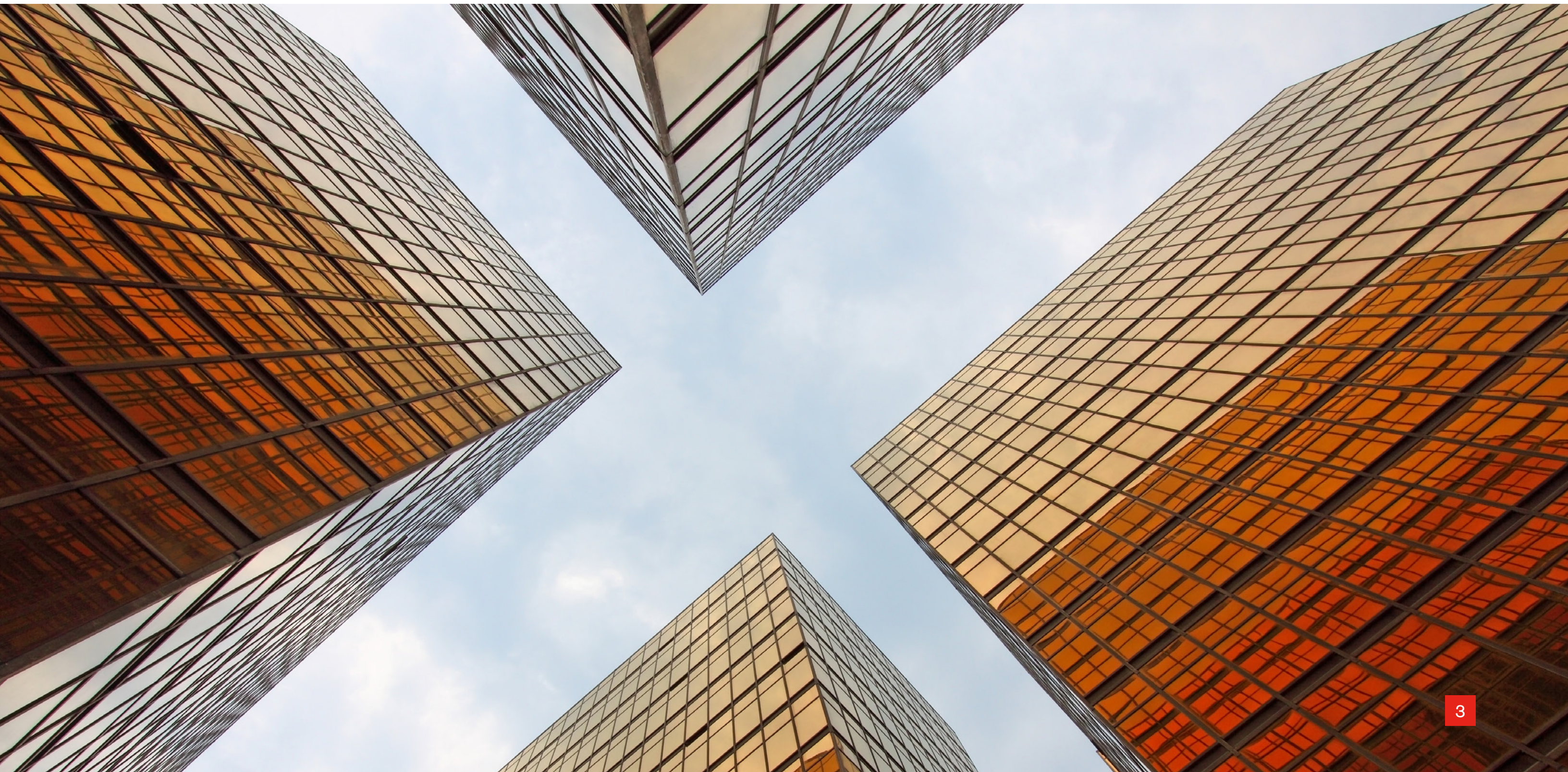
iii. 自由贸易试验区外商投资准入特别管理措施（负面清单）(2019 年版）). National Development and Reform Commission, People's Republic of China. June 30, 2019. Accessed August 12, 2019. http://www.ndrc.gov.cn/zcfb/zcfbl/201906/W020190628622285604978.pdf

iv. 鼓励外商投资产业目录
2019 年版）. National Development and Reform Commission, People's Republic of China. June 30, 2019. Accessed August 12, 2019. http://www.ndrc.gov.cn/zcfb/zcfbl/201906/W020190628622707054403.pdf

v. 李潇阳. "Opening Wider." Beijing Review. July 15, 2019. Accessed August 12, 2019. http://www.bjreview.com/Business/201907/t20190715_800173485.html

vi. "New Negative List to Further Encourage Foreign Investment." English.gov.cn. July 9, 2019. Accessed August 12, 2019. http://english.www.gov.cn/policies/latestreleases/201907/09/content_WS5d247a78c6d03ce67879a283.html

vii. "Regular Press Conference of the Ministry of Commerce (July 4, 2019)." English.mofcomgov.cn. July 5, 2019. Accessed August 12, 2019. http://english.mofcom.gov.cn/article/newsrelease/press/201907/20190702882017.shtml



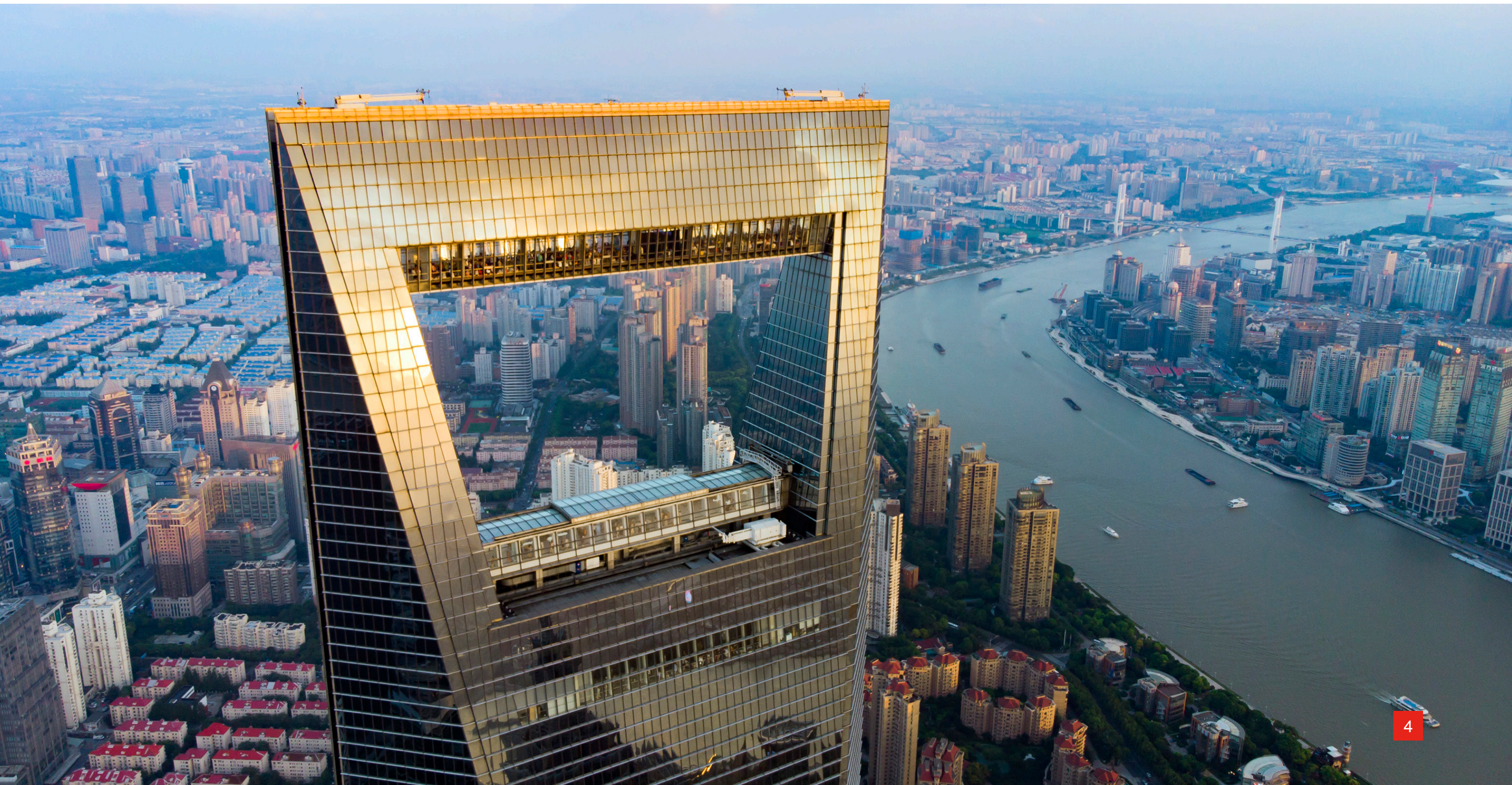
11 New Measures to Promote Foreign Participation in China's Financial Industry

Foreign investment in the Chinese financial sector, once officially discouraged, has seen a policy turnaround in the last couple of years. A new announcement by China's State Council continues this promising trend, with the release of **Relevant Measures for Further Opening Up the Financial Sector** (11 Measures).[i]

Announced on 20 July 2019 by the State Council's Financial Stability and Development Committee, the 11 Measures consist of the following:

1. Foreign-invested institutions may conduct credit rating businesses in China
2. Overseas financial institutions may participate in the establishment and investment of commercial banks' asset management subsidiaries
3. Overseas asset management institutions may partner with Chinese banks or insurance companies to establish asset management companies (AMCs) controlled by foreign parties
4. Overseas financial institutions may invest in pension fund management companies
5. Foreign investors may be supported when establishing or participating in currency brokerage companies
6. Transition period towards relaxing restrictions on foreign ownership in life insurance companies—from 51% to 100%—will be advanced to 2020
7. Removal of 25% foreign shareholding limit for insurance AMCs
8. Relaxed restrictions on entry of foreign-invested insurance companies, canceling the 30-year track record requirement
9. Restrictions on foreign ownership in securities companies, fund management companies and futures companies will end in 2020 instead of 2021
10. Foreign-funded institutions are now allowed to obtain Type A lead underwriting licenses in inter-bank bond market
11. Foreign institutional investors to gain more convenience and increased access in investing in China's interbank bond market

The 11 Measures deliver on the timetable promised by the People's Bank of China (PBOC) governor Yi Gang at the Boao Forum for Asia in April 2018, where he first outlined details on the Chinese financial sector's plan to increase market access to foreign investors.[ii]



"The openness, competitiveness and influence of China's financial market have been growing and widely recognized by the international market," explained Mr. Yi.[iii]

The increasing openness signaled by the 11 Measures and other government actions promise significant business opportunities for foreign financial institutions wishing to enter (or expand their presence in) China's financial services sector. Few firms will dare pass up the opportunity to participate in the third largest bond market in the world, with a market capitalization of US$13 trillion.[iv] China also happens to be the world's second-largest insurance market, with an original premium income of $554.6 billion—a tempting target for foreign-invested insurance companies who will benefit from the access now permitted by the measures.[v]

On one hand, policy makers hope the trend towards greater openness to foreign direct investment will serve both to increase the number of international market players in their respective sectors and help the China market learn from foreign partners' advanced experience.

On the other, continuing growth for China's economy can only be guaranteed with a more diversified market structure, which can be achieved by reducing entry restrictions on foreign-invested institutions, explained Dong Shaopeng, an adviser for the China Securities Regulatory Commission: "China's further financial openness comes from its need to develop."[vi]

i "Measures for Further Opening Up the Financial Sector." People's Bank of China. July 20, 2019. Accessed August 12, 2019. http://www.pbc.gov.cn/en/3688110/3688172/3863256/index.html

ii "易纲行长在博鳌亚洲论坛宣布进一步扩大金融业对外开放的具体措施和时间表" People's Bank of China. April 11, 2018. Accessed August 12, 2019. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3517821/index.html

iii Xinhua. "Breakthroughs in China's financial market opening-up: central bank governor." China Daily. March 25, 2019. Accessed August 12, 2019. http://www.chinadaily.com.cn/a/201903/25/WS5c97b147a3104842260b2388.html

iv Smith, Colby. "China's Bond Markets Still Have a Way to Go." FT Alphaville. April 1, 2019. Accessed August 12, 2019. https://ftalphaville.ft.com/2019/04/01/1554091223000/China-s-bond-markets-still-have-a-way-to-go/

v 于小明. "Foreign Investors Upbeat on China's Insurance Market." China Daily. June 21, 2019. Accessed August 12, 2019. http://www.chinadaily.com.cn/a/201906/21/WS5d0c94f1a3103dbf14329957.html

vi Qingqing Chen, and Song Lin. "China Further Opens Financial Market to Foreign Investors." Global Times. July 20, 2019. Accessed August 12, 2019. http://www.globaltimes.cn/content/1158491.shtml

Revised HKEX Listing Rules Close Loopholes on Backdoor Listings

Backdoor listings and shell corporations have long been a headache for Hong Kong regulators, as they undermine investor confidence by circumventing oversight and facilitating market manipulation.

To tighten listing rules against backdoor listings, the Hong Kong Exchanges and Clearing Limited (HKEX) published consultation conclusions in July 2019 to close loopholes on reverse takeovers, extreme transactions and other matters.[i]

The revised listing rules are due to take effect on 1 October 2019. Once in place, the revised rules will make backdoor listings too challenging and time-consuming to exploit—making new listing applications a more attractive option by comparison.

Changes to existing rules on reverse takeovers (RTOs) codify a principle-based approach to applying the rules currently contained in stock exchange guidance.

The "principle-based test" had defined RTOs as any acquisition seen as "an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new applicants."

The revised listing rules codify six assessment factors under the principle-based test as laid out in guidance letter GL78-14; extends aggregation periods in bright-line tests for RTOs to 36 months; modifies bright line tests to restrict any material disposal within 36 months after a change in control of the issuer unless conditions in listing rule 8.05 are met; and codifies guidance letter GL84-15 to disallow backdoor listings through large-scale issues of securities for cash.

"Extreme transactions" will be codified and will replace the rules' current "extreme Very Substantial Acquisition (VSA)" requirements under guidance letter GL78-14—requiring issuers to satisfy further conditions before they can make use of the "extreme transaction" category.

These conditions include, among other things, further steps to perform due diligence on acquisition targets and additional eligibility criteria for transactions.

Suitability criteria for listing will be modified for both reverse takeovers and extreme transactions. Acquisition targets must satisfy listing rule 8.04 (suitability for listing) and listing rule 8.05 (financial tests for listing), and the enlarged group must meet all chapter 8 new listing requirements (except rule 8.05).

For continuing listing criteria, the revisions have tightened requirements on sufficiency of operations. Amendments will affect the following rules:

- **Listing rule 13.24 (sufficient operations)**—Issuers must carry out a business with a sufficient level of operations and assets (not or) of sufficient value to support its operations to warrant its continued listing.
- **Listing rules 14.82 and 14.83 (cash companies)**—Issuers whose assets consist wholly or substantially of cash / short-term investments will not be regarded as suitable for listing.

Finally, a **transitional period of 12 months** from effective date (i.e. 1 October 2019) will apply to issuers who, due to the listing rules amendments, fall out of compliance with revised listing rules 13.24 or 14.82. This gives them a year-long grace period to comply with the amended rules.

- Read the full document here: Consultation Conclusions: Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments

i. "Consultation Conclusions: Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments." Hong Kong Exchanges and Clearing Limited. July 2019. Accessed August 12, 2019. https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/June-2018-Backdoor-and-Continuing-Listing/Conclusions-(July-2019)/cp201806cc.pdf

Hong Kong Stock Exchange Proposes Listing Rule Changes to Codify Existing Practice

As part of their continued efforts to enhance the listing process in Hong Kong, the Hong Kong Exchanges and Clearing Limited (HKEX) issued a **Consultation Paper on Codification of General Waivers and Principles relating to IPOs and Listed Issuers and Minor Rule Amendments** (Consultation Paper).

Historically, HKEX has used its regulatory power to grant waivers or issue guidance letters under appropriate circumstances. In response to market demands to consolidate its guidance materials and codify certain requirements set out in its guidance materials, the Consultation Paper seeks feedback on proposed codification covering:

- Waivers with general effect, previously approved by the Hong Kong Securities and Futures Commission (SFC)
- Principles and conditions underpinning a number of waivers that have been granted by HKEX on more than one occasion
- Minor rule amendments

In cases where the basis for certain general waivers relating to IPOs and listed issuers are unlikely to change in the long-term, HKEX proposes to codify such waivers into the rules. The waivers cover circumstances such as:

- Publication and distribution of annual results and reports;
- Shareholder approval requirement for bonus or capitalization issues by People's Republic of China (PRC)-incorporated issuers;
- Calculation of the consideration ratio for PRC-incorporated issuers dually listed on HKEX and a PRC-based exchange; and
- Inclusion of stock code in documents.

In cases where waivers have been granted on more than one occasion on the basis of general principles, HKEX proposes to codify these principles into the rules. These include:

- **Financial disclosure**—Including disclosure of financial information of subsidiaries and businesses acquired or to be acquired after trading record period; disclosure of financial information by overseas banking companies; change of financial year period; and publication and distribution of interim results and reports
- **Acquisition**—Including acquisition of aircraft by airline operators; share option scheme limit for a listed issuer's subsidiary to be spun-off for separate listing; and determination of exercise price of options under a share option scheme adopted by issuers dually listed on HKEX and a PRC-based exchange
- **Others**—Covering the experience and qualification of company secretaries; and working capital statements in listing documents and transaction circulars of main board issuers that are banking companies or insurance companies

The Consultation Paper also contains minor rule amendments and housekeeping amendments to improve clarity of the rules, correct mistakes, update outdated references and codify administrative guidance covered in previous guidance letters or listing decisions.

Read the document here: Consultation Paper on Codification of General Waivers and Principles relating to IPOs and Listed Issuers and Minor Rule Amendments

SFC Issues Statement on Directors' Conduct and Duties for Corporate Acquisitions or Disposals

To remind directors of Hong Kong Exchanges and Clearing Limited (HKEX)-listed companies of their statutory and legal duties to their principals, the Hong Kong Securities and Futures Commission (SFC) published a **Statement on the Conduct and Duties of Directors in the Context of Corporate Acquisitions or Disposals** (the Statement).[i]

Issued on 4 July, the Statement noted that from 2017 to 2018, "the SFC issued letters of concern to more than 46 listed issuers about proposed corporate transactions or other actions. More than 55% of these cases involved proposed corporate acquisitions or disposals."

The Statement noted that several common forms of misconduct were found to occur in the course of such transactions. These include:

- **Failure to obtain independent professional valuation**—this kind of negligence may be seen as a breach of duty by the SFC.
- **Failure to exercise independent judgment, either by relying on valuation** reports that lack a credible basis for assessing a proposed acquisition; or from fraudulent collusion between insiders and the valuer to justify a predetermined price estimate.
- **Failure to perform due diligence on earnings,** particularly in cases where such information serves as the basis for the acquisition price. Directors might ignore risk factors like historical losses, unexplained increases in sales or questionable sources of revenue.
- **Comparables not presented fairly,** if multiples of other publicly traded companies help determine the valuation of the target, appropriate comparable companies must be selected, be a fair and representative sample and not be cherry-picked to skew the data in the listed company's favor.
- **Failure to assess impact on financial position,** either by neglecting to assess the negative impact of the acquisition on the listed company's resources or financial position; or by neglecting to consider the necessary capital expenditure to sustain the target's business.
- **Cases involving compensation to listed issuers,** where no verification of the seller's ability to pay was performed, nor any safeguards set up (like holding funds in escrow) to protect the listed issuers' interests.
- **Suspicious connected parties,** where existing relationships or arrangements between supposedly independent third parties were not disclosed. If such relationships cause these parties to act contrary to the interests of the listed issuer, the SFC may be compelled to take enforcement action.

All efforts must be made to ensure that due care is taken to compile any forecast or estimation for any planned corporate acquisition or disposal; that directors act in good faith for their principal's best interests and consider the need for a financial adviser when necessary.

Seeking independent professional valuation or any other form of financial advice does not in any way discharge directors of their statutory or fiduciary duties.

Finally, should the SFC suspect misconduct in the course of an announced corporate acquisition or disposal—especially if the misconduct violates the Securities and Futures Ordinance or other applicable laws—the organization is duty-bound to investigate and prosecute where necessary.

For further clarification, directors may refer to the SFC's guidance note dated 15 May 2017 on directors' duties in the context of valuations in corporate transactions.[ii]

- Read the full document here: Statement on the Conduct and Duties of Directors when Considering Corporate Acquisitions or Disposals

i. "Statement on the Conduct and Duties of Directors when Considering Corporate Acquisitions or Disposals." Hong Kong Securities and Futures Commission. July 4, 2019. Accessed August 12, 2019. https://www.sfc.hk/web/EN/news-and-announcements/policy-statements-and-announcements/statement-on-the-conduct-and-duties-of-directors.html

ii. "Guidance note on directors' duties in the context of valuations in corporate transactions." Hong Kong Securities and Futures Commission. 15 May 2017. Accessed August 12, 2019. https://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidance-note-on-directors%E2%80%99-duties-in-the-context-of-valuations-in-corporate-transactions/guidance-note-on-directors%E2%80%99-duties-in-the-context-of-valuations-in-corporate-transactions.pdf

Brazil Transaction Insights Q3 2019

Since the inauguration of President Jair Bolsonaro in January 2019, a trend of cautious optimism has swept over the Brazilian business community.

Following the guidance of the Minister of Economy, Paulo Guedes, the new government has proposed to host free market reforms that piqued the interest of both domestic and foreign investors.

The government's largest mandate includes pension reform, which may bolster fiscal health of the nation and endorse the relation between the executive power and congress. This will likely pave the way for the approval of other relevant reforms (like tax and anti-crime) and further actions of the government for sweeping deregulation and privatization, fostering new investments after years of sluggish economic growth.

The IBOVESPA index reached an all-time-high (105k points) in July 2019, reflecting investors' increasing confidence in the country.

Brazil is currently boasting a healthy balance of external accounts, stabilized inflation and a more stable fiscal situation.

Read the full report here. https://www.duffandphelps.hk/insights/publications/m-and-a/brazilian-transaction-insights-q3-2019

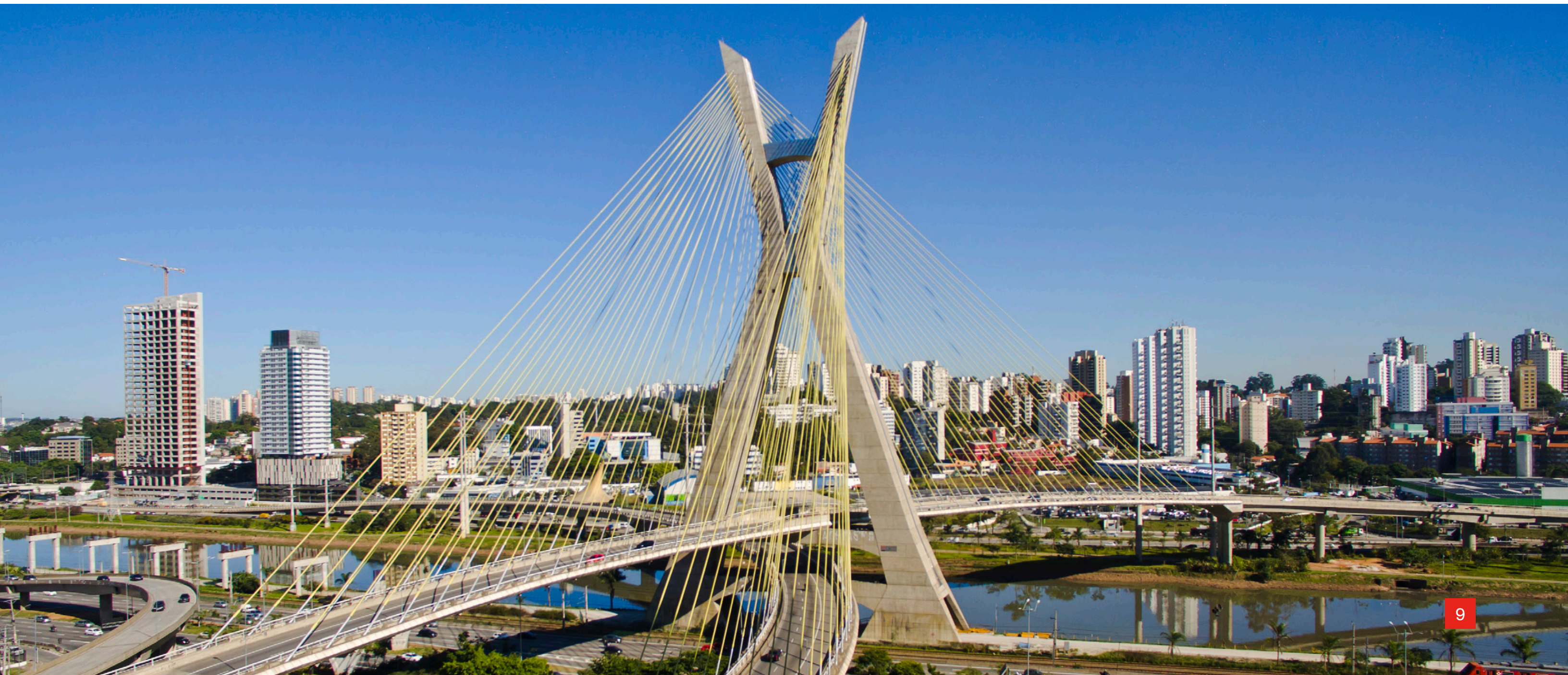
AICPA Releases Final Guide on Valuation of Venture Capital and Private Equity Investments

The American Institute of CPAs (AICPA) has issued guidance for investment companies on how to fair value their portfolio company investments. The accounting and valuation guide titled Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies is intended to harmonize views of industry participants, auditors and valuation specialists.

The guide provides nonauthoritative guidance and examples for preparers of financial statements, independent auditors, and valuation specialists regarding the accounting for and valuation of portfolio company investments held by investment companies within the scope of FASB ASC 946, Financial Services–Investment Companies (including private equity funds, venture capital funds, hedge funds, and business development companies) in determining Fair Value in accordance with FASB ASC 200.

The guide was developed by the AICPA PE/VC Task Force, which includes members from the PE/VC industry, auditors, valuation practitioners, and AICPA staff. David Larsen, Managing Director of Duff & Phelps, has been a member of the AICPA PE/VC Task Force for six years and was instrumental in the development of the guide.

Read the press release here. https://www.duffandphelps.hk/insights/publications/valuation/aicpa-final-guide-valuation-venture-capital-private-equity-investments



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