PART I:  ABOUT US
A. OUR APPROACH
B. OUR RESULTS

PART II: CURRENT THEMES / ISSUES

PART III: CASE STUDIES / ILLUSTRATIVE EXAMPLES
Leading Forensic Accounting Research

- Since 1994, CFRA has been the recognized leader in forensic accounting research
- Aggressive accounting practices can be used to mask business deterioration
- We uncover underappreciated differences between reported financial results and underlying economic reality
Our Approach

- **Identify**
  - Find warning signs of, and/or use of accounting policies to hide deteriorating or disappointing business conditions

- **Investigate**
  - Dissect and analyze company filings and publicly available information
  - Validate, cross-check and discuss findings with management
  - Provide custom research projects for our clients

- **Provide Insight**
  - Analyze the financial implications of discretionary and imposed changes in accounting rules
  - Provide key intelligence on industry trends
  - Offer tools to assist the research and analysis process of clients
A Unique Idea Generation Process

CFRA’s “exception-based” research process has effectively and consistently forewarned clients of business deterioration as well as instances of accounting fraud.

Screening and Triage
- Proprietary quantitative and qualitative screening
- Sourced on changes in key metrics, trends, strategies, policies, etc.
- Universe of 11,000+ companies

Analyze and Prioritize
- In-depth review of financial statements, footnotes, transcripts, filings and conversation with management
- Intense peer review process

Publish
- Ideas chose for in-depth research publication are noteworthy for insight, actionability, and uniqueness
CFRA has had a long history of writing on Asia-based companies

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Ticker</th>
<th>Performance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Security &amp; Surveillance</td>
<td>CSR</td>
<td>+84.4</td>
</tr>
<tr>
<td>Asia Info</td>
<td>ASIA</td>
<td>+60.6</td>
</tr>
<tr>
<td>Perfect World Co.</td>
<td>PWRD</td>
<td>+27.2</td>
</tr>
<tr>
<td>Shanda Interactive Entertainment</td>
<td>SNDA</td>
<td>+31.7</td>
</tr>
<tr>
<td>UTStarcom Inc.</td>
<td>UTSI</td>
<td>+67.2</td>
</tr>
<tr>
<td>Yingli Green Energy</td>
<td>YGE</td>
<td>+45.4</td>
</tr>
<tr>
<td>Suntech Power</td>
<td>STP</td>
<td>+123.2</td>
</tr>
<tr>
<td>Syntax Brilliant</td>
<td>BRLC</td>
<td>+90.1</td>
</tr>
</tbody>
</table>
Asia Research

- We are opportunistic; always looking for companies and geographies where risks are underappreciated
- Geographies include (but are not limited to) companies listed on the HKEx, ASX, SGX, TWSE, TSE, NSE and BSE, in addition to ADRs.

<table>
<thead>
<tr>
<th>FORMER BIGGEST CONCERNS (HK listed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Name</td>
</tr>
<tr>
<td>Lonking Holdings</td>
</tr>
<tr>
<td>Apollo Solar Energy Tech</td>
</tr>
<tr>
<td>Skyworth</td>
</tr>
<tr>
<td>West China Cement</td>
</tr>
<tr>
<td>Comba Telecom Systems</td>
</tr>
</tbody>
</table>
PART I: ABOUT US
   A. OUR APPROACH
   B. OUR RESULTS

PART II: CURRENT THEMES / ISSUES

PART III: CASE STUDIES / ILLUSTRATIVE EXAMPLES
# Current Accounting Themes – Asia Focus

<table>
<thead>
<tr>
<th>Themes</th>
<th>Suntech Power</th>
<th>West China Cement</th>
<th>Longtop Financial Tech</th>
<th>Apollo Solar Energy Tech</th>
<th>Shanda Interactive</th>
<th>Lonking</th>
<th>ZTE Corp.</th>
<th>Comba Telecom Systems</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1: Unusual transactions</td>
<td></td>
<td></td>
<td>☑</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td>☑</td>
<td>☑</td>
</tr>
<tr>
<td>#2: Selling to related parties</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td>☑</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>#3: Factoring</td>
<td>☑</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>☑</td>
<td>☑</td>
<td></td>
</tr>
<tr>
<td>#4: Government incentives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>☑</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>#5: Rising Receivables</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>☑</td>
<td>☑</td>
</tr>
</tbody>
</table>

- Above is not exhaustive; just covers what we will discuss today
PART I: ABOUT US
   A. OUR APPROACH
   B. OUR RESULTS

PART II: CURRENT THEMES / ISSUES

PART III: CASE STUDIES / ILLUSTRATIVE EXAMPLES
THEME #1: Unusual Transactions

• Longtop (LFT)
• Apollo (566.HK)
THEME #1: Unusual Transactions

- **Background:**
  - These range from unusual stock gifts from the Chairman (LFT) to odd acquisitions (Satyam) to intangible asset disposals (Apollo) to in-kind transactions (SFUN)
  - Similarity is that these are head scratchers – what is the business purpose? Why is the Company doing this?

- **Accounting and Finance Issues:**
  - These range from revenue recognition, to overstated margin / earnings (LFT, SFUN and Apollo), to hiding debt...
 THEME #1: Unusual Transactions

- **What Might Mislead Investors:**
  - The substance of the transaction
    - What is really going on and what is the motivation?
      - Hiding costs? Inflating revenues? Offloading debt?
  - Related parties / arms’ length
LFT: Unusual Stock Gifts

- Longtop Financial Technologies was a software developer/provider to financial services institutions in China

- LFT chairman gifted 11+ mn shares to current and former employees and consultants as thank you gifts.
  - LFT claimed no formal agreement existed, no vesting schedule
  - $80 million charge 9/10 qtr as stock gift
  - $25 million charge 12/07 qtr as stock gift
  - Charges were considered one-offs.

- Narrative was offered to explain these gifts. Nevertheless, they were unusual.
LFT: Unusual Stock Gift

LFT Statement:
• Over 100 employees received Sept 2010 stock gift
• At 03/10, there were 4,258 employees

CFRA Analysis:
• Even if we generously assume all 303 employees categorized as G&A received stock, that equates to US$136,532/employee
CFRA writes on LFT; focusing on stock gifts from Chairman
Apollo is a former toy company, but through a series of odd transactions transformed into a solar line equipment manufacturer in 2009

**Unusual Transactions**

- June 2010, the Company agreed to sell (with an independent third party) an intangible asset and transfer technology know-how.
- The transaction was material: Gains on both, net of tax, were HK$124m, boosting H1/10 EBIT by 54%. Raises quality of earnings issues.
The book value amount of the disposals were (at a maximum) HK$11m. What a gain!

<table>
<thead>
<tr>
<th>(In millions of HK$)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of intangibles, net of accumulated amortization, 1/1/10</td>
<td>459</td>
</tr>
<tr>
<td>Additions</td>
<td>11</td>
</tr>
<tr>
<td>Amortization</td>
<td>(51)</td>
</tr>
<tr>
<td>Disposals</td>
<td>(11)</td>
</tr>
<tr>
<td>Fx</td>
<td>6</td>
</tr>
<tr>
<td>Net book value, 12/31/10</td>
<td>414</td>
</tr>
</tbody>
</table>

The transaction was odd since all of Apollo’s technology know how had just been purchased in February and September 2009 (9-16 months prior) via a related party transaction for HK$385m.

Why sell know-how so close after the acquisition? If it wasn’t worthwhile to keep, who was willing to buy it?
Addition to Biggest Concerns List

Profit warning from large write-off of accounts receivable.
QUESTIONS

QUESTIONS@CFRARERESEARCH.COM
THEME #2: Related Party Transactions

- Suntech (STP)
Theme #2: Related Party Transactions

- **Background:**
  - Definition of related party transaction (IFRS) is:
    - “transfer of resources, services, or obligations between related parties, regardless of whether a price is charged.”

- **Accounting and Finance Issues:**
  - Disclosure
  - Consolidation

- **What Might Mislead Investors:**
  - Arms’ length / overstating revenues and margins
  - Corporate governance
  - Off-balance sheet liabilities
  - Viability and robustness of business model
STEP 1:

- June-Sept 08 STP Invests $258 mils. in GSF, an investment fund *(material: 24% of equity)*. Basic question: what is the economic substance?
- STP has 86% Stock Ownership but only 50% of Voting Interest. As a result, GSF was accounted for as an equity method investment instead of being consolidated.
- Several questions from SEC on GSF arrangement.
STP: Related Party Sales

- Suntech CEO Zhengrong Shi and Javier Romero (entrepreneur and manager of the partnership) sit on the board (mentioned in filing). Recent news reports suggest they own the remaining 14%.

Diagram:
- STP
  - 86% stock, 50% votes
- Suntech CEO
  - 7%-10% stock, ??% votes
- Javier Romero
  - 7%-10% stock, ??% votes

Global Solar Fund (GSF)
European Investment Fund

- Portfolio Company A
- Portfolio Company B
- Portfolio Company C
STP: Related Party Sales

STEP 2:

- STP records equipment sales of $116m to investees of GSF in H1.09 (from 6K filing on 8/21/09). “Sales to the investee companies of GSF were conducted under terms comparable to those with unrelated parties…” These represent 18% of the period’s sales!

Global Solar Fund (GSF)
European Investment Fund

Equipment sales of $116m to investees of GSF, 18% of H1/09 sales
STP: Related Party Sales

STEP 3:

- Virtually no cash is collected from the investee of GSF on the $116m of H1/09 sales.

- 20F filing for 12/31/09 shows Accounts Receivable from Investee at $110m at 12/31/09 (29% of total A/R balance)

Equipment sales of $116m to GSF investees, accounting for 18% of H1/09 sales. No sales in H2/09. A/R balance was $110m at 12/31/09.
STP: Related Party Sales

STEP 4:

- May 2010 – guaranteed payment obligations to China Development Bank on behalf of one of GSF’s investee companies for €554m. “As security for our obligations under the guarantee, we received a pledge of €560m in German government bonds from GSF Capital PTE Ltd., the parent of the general partner of GSF.”
STP: Related Party Sales – The Post Script

- July 2012: Company says it might have been the victim of a fraud
- Suntech claims the €560m in German government bonds may not exist
- Fraud blamed on Javier Romero, former sales agent in Spain
- Between 2009-2011, GSF sold $346.8m worth of STP panels through affiliates in Spain and Italy
- Pending lawsuit
QUESTIONS

QUESTIONS@CFRARESEARCH.COM
THEME #3: Factoring

- Lonking (3339.HK)
- Double Boost example
- ZTE Corp. (763.HK)
THEME #3: Factoring

- **Background:** Factoring involves the sale of receivables in order to receive cash up front. Allows the Company to free up working capital rather than waiting for customers to pay.

- **Accounting and Finance Issues:** 1) Recognition versus derecognition; 2) *Typically* higher financing cost, depending upon geography.
What Might Mislead Investors: 1) Receivables factored without recourse allow the Company to derecognize them and take them off balance sheet, thereby “boosting” Cash Flow from Operations (“CFFO”) in the initial transaction (and in the future when factoring levels increase).

- It appears that a large amount of receivables have been “collected” in the Statement of Cash Flows.

- Dr. Cash
  - Cr. Accounts Receivable
THEME #3: Factoring

- What Might Mislead Investors (continued): 2) the Collection of Receivables metrics (receivables turnover and Days Sales Outstanding) are flattered in initial transactions 3) Double boost we are seeing in several HK listed companies:
  - Dr. Cash (from bank / financing arm – initial transaction)
    - Cr. Accounts Receivable
  - Dr. Cash (customer pays Company instead of bank)
    - Cr. Accounts Payable
3339.HK: Factoring

- Finance Lease Receivables declined by RMB 1.1b at 6/30/11.

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>06/30/11</th>
<th>12/31/10</th>
<th>6/30/10</th>
<th>12/31/09</th>
<th>6/30/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance Lease Receivables (from the B/S)</td>
<td>2,143</td>
<td>3,280</td>
<td>3,137</td>
<td>1,743</td>
<td>1,251</td>
</tr>
<tr>
<td>Changes in Finance Lease Receivables (from the SCF)</td>
<td>1,137</td>
<td>(140)</td>
<td>(1,403)</td>
<td>(492)</td>
<td>(419)</td>
</tr>
</tbody>
</table>

- At the same time, Lonking ceased disclosing the amount of finance lease sales in H1/11.

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>06/30/11</th>
<th>12/31/10</th>
<th>6/30/10</th>
<th>12/31/09</th>
<th>6/30/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenues</td>
<td>8,398</td>
<td>5,454</td>
<td>6,566</td>
<td>3,328</td>
<td>3,573</td>
</tr>
<tr>
<td>Of which are finance lease sales</td>
<td>Not disclosed</td>
<td>1,646</td>
<td>2,568</td>
<td>1,052</td>
<td>1,460</td>
</tr>
</tbody>
</table>
• In addition, new (and murky) disclosure appeared in the interim H1/11 filing (MD&A section):

“The total of current and non-current finance lease receivables balance as at 30 June 2011 decreased approximately RMB1,137 million because the Group has begun to change business strategy since 2011. The finance leases business will be gradually transferred to the third party finance lease providers in order to avoid cash flow pressure and finance risk.”

• The amount is material; constituting 35% of finance lease receivables at 12/10 and over 100% of CFFO for H1/11
3339.HK: Factoring

- The Company could not be reached to confirm whether 1) third party financing for customers is now being utilized and / or 2) finance lease receivables were factored; and 3) if factoring did occur, the amount of finance lease receivables factored / boost to cash flow (see cash flow section).

- Note that Finance Lease Terms (per a notes offering memorandum) are 6-42 months. Finance lease offering began in 2007.
Finance lease receivables decreased from 12/10 to 6/11 by **RMB 1.1b**. However, even if all short-term finance lease receivables at 12/10 were collected in 06/11 (just 6 months later) and no new finance leases were entered into during H1/11, this totals only a **RMB 936m decrease**.

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>06/30/11</th>
<th>12/31/10</th>
<th>6/30/10</th>
<th>12/31/09</th>
<th>6/30/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term Finance Lease Receivables (from the B/S)</td>
<td>1,320</td>
<td>936</td>
<td>1,960</td>
<td>1,215</td>
<td>966</td>
</tr>
<tr>
<td>Long-term Finance Lease Receivables (from the B/S)</td>
<td>824</td>
<td>2,344</td>
<td>1,176</td>
<td>528</td>
<td>285</td>
</tr>
</tbody>
</table>
3339.HK: Factoring

- Is this fraud? No, but quite misleading to investors:

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>12/31/11</th>
<th>06/30/11</th>
<th>12/31/10</th>
<th>6/30/10</th>
<th>12/31/09</th>
<th>6/30/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free cash flow as reported, LTM basis</td>
<td>184</td>
<td>(806)</td>
<td>(272)</td>
<td>(9)</td>
<td>(725)</td>
<td></td>
</tr>
<tr>
<td>Changes in Finance Lease Receivables (from the SCF)</td>
<td>1,137</td>
<td>(140)</td>
<td>(1,403)</td>
<td>(492)</td>
<td>(419)</td>
<td></td>
</tr>
<tr>
<td>Free cash flow considering factoring, LTM basis**</td>
<td>(813)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DSO (finance lease segment only) as reported</td>
<td>Not disclosed</td>
<td>No interim disclosure</td>
<td>313</td>
<td>No interim disclosure</td>
<td>253</td>
<td>No interim disclosure</td>
</tr>
<tr>
<td>DSO (finance lease segment only) making some assumptions for factoring</td>
<td>393</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

** assumes the entire decrease in finance lease receivables is factoring for illustrative purposes
3339.HK: Stock Chart

First profit warning in February
Added to Biggest Concerns List
Second profit warning in June
Removed from Biggest Concerns List

Data Source: Exshare ©FactSet Research Systems 2012
Factoring: “the double boost”

- **First boost:** Initial boost from the first time selling non-recourse receivables or an acceleration of factored non-recourse receivables
  - We adjust CFFO for the incremental rise
- **Second boost:** a rise in “Other Payables”, “Cash collected on behalf of banks”, “Collection of accounts receivables on behalf of banks under factoring programs”
  - Represents getting paid **TWICE** for the same receivable
  - A pass through (or should be), but it matters when we are talking about large factoring increases as we’ll see in example on next page
  - We adjust CFFO for the incremental rise with a caveat
Factoring: “the double boost”

Example (from current BC name)

<table>
<thead>
<tr>
<th>(In m of RMB)</th>
<th>06/30/12 A</th>
<th>06/30/11 B</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOOST #1 Trade A/R factored without recourse (B/S account within trade receivables)</td>
<td>2,063</td>
<td>0</td>
</tr>
<tr>
<td>BOOST #1 Finance lease receivables factored without recourse (B/S account within finance lease receivables)</td>
<td>8,043</td>
<td>4,565</td>
</tr>
<tr>
<td>BOOST #2 Cash collected on behalf of banks (B/S account within other payables)</td>
<td>1,282</td>
<td>168</td>
</tr>
<tr>
<td>Total boosts</td>
<td>6,655</td>
<td>(A-B)</td>
</tr>
</tbody>
</table>
### 763.HK: Factoring

- **Revenue**
  - Telecommunications system contracts: 48,889,101, 44,296,942
  - Sale of goods: 17,927,439, 13,073,619
  - Sale of services: 3,447,334, 2,902,002
  - **Total Revenue:** 70,263,874, 60,272,563

- **Other income**
  - VAT refunds and other tax subsidies: 1,530,782, 1,123,111
  - Dividend income: 6,023, 2,100
  - Bank and other interest income: 101,020, 110,715
  - Others: 471,367, 268,310
  - **Total Other Income:** 2,109,192, 1,504,236

- **Gains**
  - Gain on deemed disposal of an associate: 440,318, 0
  - Gain on derivative financial instruments: 90,297, 12,560
  - Exchange gain: 0, 206,702
  - **Total Gains:** 530,615, 219,262

- **Total Revenue and Gains:** 2,639,807, 1,723,498

---

**Explanation:**

Gain of RMB838 million (32% of PRC GAAP operating income in 2010) disclosed in the footnote of a footnote.

**Why was the gain included in revenue?** Gains belong in the section for gains.
763.HK: Factoring

Added to Biggest Concerns

Profit warning: revenue and margins disappoint

Profit warning: revenue and margins disappoint
THEME #4: Government Incentives, Tax Benefits

- Shanda (SNDA)
- West China Cement (2233.HK)
THEME #4: Government Incentives, Tax Benefits

- **Background:**
  - Particularly in Asia, many companies have government support via grants, lower tax rates, VAT rebates

- **Accounting and Finance Issues:**
  - Often recorded as other income, but is this operational? Non-operating income?
  - When and how is the income recorded? At cash collection? Using reasonable assurance?
THEME #4: Government Incentives, Tax Benefits

- What Might Mislead Investors:
  - Is this ongoing?
  - Quality of earnings as we sometimes see these increase dramatically
SNDA: Gov’t Incentives

- Shanda is an interactive entertainment company focused on online games
- In Q3/09, SNDA ceased disclosing detail of its “other income” in its filings
- Beginning Q3/09, the detail was provided only on the earnings calls (and transcripts).
SNDA: Gov’t Incentives

- Incentives become almost **16%** of pre-tax income versus **9%** on a year over year basis

<table>
<thead>
<tr>
<th></th>
<th>09/30/09</th>
<th>06/30/09</th>
<th>3/31/09</th>
<th>12/31/08</th>
<th>09/30/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Income</td>
<td>ND</td>
<td>14.4</td>
<td>28.0</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Other Income (gov’t)</td>
<td>ND</td>
<td>31.1</td>
<td>1.3</td>
<td>29.9</td>
<td>33.2</td>
</tr>
<tr>
<td>of which government</td>
<td>92.7</td>
<td>36.5</td>
<td>5.4</td>
<td>14.5</td>
<td>40.6</td>
</tr>
<tr>
<td>financial incentives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total other income,</td>
<td>84.8</td>
<td>45.5</td>
<td>29.3</td>
<td>31.6</td>
<td>34.9</td>
</tr>
<tr>
<td>net</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GOV’T FINANCIAL</td>
<td><strong>15.9%</strong></td>
<td><strong>6.7%</strong></td>
<td><strong>1.1%</strong></td>
<td><strong>3.2%</strong></td>
<td><strong>9.3%</strong></td>
</tr>
<tr>
<td>INCENTIVES AS A % OF</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PRETAX INCOME</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- How is this revenue recognized and what is the bottom line impact? Is this recurring?
SNDA: Stock Chart

Added to Biggest Concerns List

Removal from Biggest Concerns List
2233.HK: Gov’t Incentives

- West China Cement is a cement producer in western provinces in China.
- From the 2010 annual report: “Details of other receivables are as follows”:

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>12/31/10</th>
<th>12/31/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value-added tax (“VAT”) recoverable and income tax receivable</td>
<td>43,997</td>
<td>17,839</td>
</tr>
<tr>
<td>VAT refund receivable</td>
<td>17,171</td>
<td>0</td>
</tr>
<tr>
<td>Receivable from non-controlling interests of a subsidiary</td>
<td>0</td>
<td>30,000</td>
</tr>
<tr>
<td>Others</td>
<td>123,083</td>
<td>7,136</td>
</tr>
<tr>
<td>Total (which ties to “other receivables” in b/s)</td>
<td>184,251</td>
<td>54,975</td>
</tr>
</tbody>
</table>
2233.HK: Gov’t Incentives

- From the Other Income footnote:

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>12/31/10</th>
<th>12/31/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax refund (Note (a))</td>
<td>162,647</td>
<td>65,035</td>
</tr>
<tr>
<td>Government grant</td>
<td>8,964</td>
<td>6,491</td>
</tr>
<tr>
<td>Total</td>
<td>171,611</td>
<td>71,526</td>
</tr>
</tbody>
</table>

“Note a) The tax refund mainly represents the refund of VAT for sales of certain types of cement where industrial and construction wastes have been recycled.”
The amounts were growing both on an absolute basis and as a % of EPS; material

<table>
<thead>
<tr>
<th>(In millions of RMB)</th>
<th>6/30/11 HY</th>
<th>12/31/10 FY</th>
<th>6/30/10 HY</th>
<th>12/31/09 FY</th>
<th>6/30/09 HY</th>
<th>12/31/08 FY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax refund</td>
<td>ND</td>
<td>163</td>
<td>ND</td>
<td>65</td>
<td>ND</td>
<td>39</td>
</tr>
<tr>
<td>As a % of EPS</td>
<td>ND</td>
<td>17%</td>
<td>ND</td>
<td>13%</td>
<td>ND</td>
<td>16%</td>
</tr>
<tr>
<td>Total other income</td>
<td>82</td>
<td>172</td>
<td>56</td>
<td>72</td>
<td>31</td>
<td>43</td>
</tr>
</tbody>
</table>

While originally IR stated there was no p&l impact, they clarified stating it was a “long term incentive for waste recycling by the PRC Government and is set to continue for many years…falls straight to the bottom line so 100% margin.”
2233.HK: Gov’t Incentives

Considerable room for maneuvering:

*From West China Cement’s annual report:*

“Grants from the government are recognized at their fair value where there is a *reasonable assurance* that the grant will be received and the Group will comply with all the attached conditions…

…Government grants relating to property, plant and equipment are included in non-current liabilities as deferred income and are credited to the consolidated statement of comprehensive income on a straight-line basis over the expected useful lives of the related assets.”
THEME #5: Rising Receivables

• Comba Telecom Systems (2342.HK)
• ZTE Corp. (763.HK)
2342.HK: Rising Receivables

- Accounts Receivable
  - DSO reached a multi-year high at 6/2011
  - Deterioration in ageing
  - High customer concentration as one customer (China Mobile) accounted for 57% of revenue
2342.HK: Rising Receivables

- DSO Increased in June 2011

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>4,326</td>
<td>2,896</td>
<td>2,758</td>
<td>2,112</td>
<td>1,905</td>
<td>1,273</td>
<td>1,381</td>
<td>1,100</td>
</tr>
<tr>
<td>Revenue</td>
<td>2,545</td>
<td>3,189</td>
<td>2,002</td>
<td>2,673</td>
<td>1,767</td>
<td>1,690</td>
<td>835</td>
<td>991</td>
</tr>
<tr>
<td>DSO (half year revenue)</td>
<td>308</td>
<td>167</td>
<td>249</td>
<td>145</td>
<td>195</td>
<td>139</td>
<td>301</td>
<td>204</td>
</tr>
<tr>
<td>DSO (TTM revenue)</td>
<td>275</td>
<td>204</td>
<td>215</td>
<td>174</td>
<td>201</td>
<td>184</td>
<td>276</td>
<td>227</td>
</tr>
</tbody>
</table>

- Ageing deteriorated in June 2011

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Receivables Over 6 Months</td>
<td>50.1%</td>
<td>29.4%</td>
<td>44.9%</td>
<td>29.5%</td>
<td>37.6%</td>
<td>37.1%</td>
<td>48.2%</td>
<td>42.7%</td>
</tr>
</tbody>
</table>
Does an increase in DSO matter?

What we hear: “Comba has had almost no bad debt in recent years and approximately 85% of revenue comes from three Chinese telecom operators, which are not viewed as a credit risk.”

August 2012 profit warning:

“Because of the postponement of certain investment activities and inspection process conducted by the PRC telecommunications operators, some of the Group’s projects revenue were not recognized in the Reporting Period and that may result in a decline in the Group’s revenue of some major products as compared to the same period last year.”
2342.HK: Rising Receivables

- Added to the Biggest Concerns List
- Profit warning issued. Revenue and margins decline.
- Removal from Biggest Concerns List
763.HK: Rising Receivables

- DSO increased to 191 days at 9/2011 from 184 days in the year-ago period and 157 days two years ago.

<table>
<thead>
<tr>
<th></th>
<th>Q3, 9/11</th>
<th>Q2, 6/11</th>
<th>Q1, 3/11</th>
<th>Q4, 12/10</th>
<th>Q3, 9/10</th>
<th>Q2, 6/10</th>
<th>Q1, 3/10</th>
<th>Q4, 12/09</th>
<th>Q3, 9/09</th>
<th>Q2, 6/09</th>
<th>Q1, 3/09</th>
<th>Q4, 12/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>DSO*</td>
<td>191</td>
<td>203</td>
<td>176</td>
<td>168</td>
<td>184</td>
<td>185</td>
<td>190</td>
<td>163</td>
<td>157</td>
<td>160</td>
<td>170</td>
<td>136</td>
</tr>
</tbody>
</table>

*Includes accounts receivable, bills receivable, contract receivables, factored receivables that remain on the balance sheet, offset by advances. Uses trailing six month revenue since ZTE’s receivables seem to relate most closely to this period.
Similar to other companies in the industry, ZTE uses percentage-of-completion revenue recognition:

“The Group’s material revenue streams are the result of a wide range of activities, from custom design and installation over a period of time to a single delivery of equipment to a customer...Newer technologies within one of the Group’s reporting segments may also have different revenue recognition policies, depending on, among other factors, the specific performance and acceptance criteria within the applicable contracts. Therefore, management must use significant judgment in determining how to apply the current accounting standards and interpretations...”
763.HK: Rising Receivables

- Why does DSO matter if customers are viewed to be creditworthy?
- Increases in DSO can signal a weak business environment. In 10/2012, ZTE warned its revenue would decline on a quarterly basis for the first time in years:

Operating revenue of the Company for the three months ended 30 September 2012 decreased by approximately 13% as compared to same period last year, reflecting primarily the combined effect of delayed progress of certain international projects and the collective procurement method adopted by domestic carriers on the Company’s revenue recognition; the overall gross profit margin of the Company for the three months ended 30 September 2012 decreased by approximately 13 percentage points, reflecting a larger number of low-margin contracts in Europe, Asia and the domestic market recognised for the period.
763.HK: Rising Receivables

Profit warning: revenue and margins disappoint

Added to Biggest Concerns