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CG Watch

Corporate governance in Asia

ACGA

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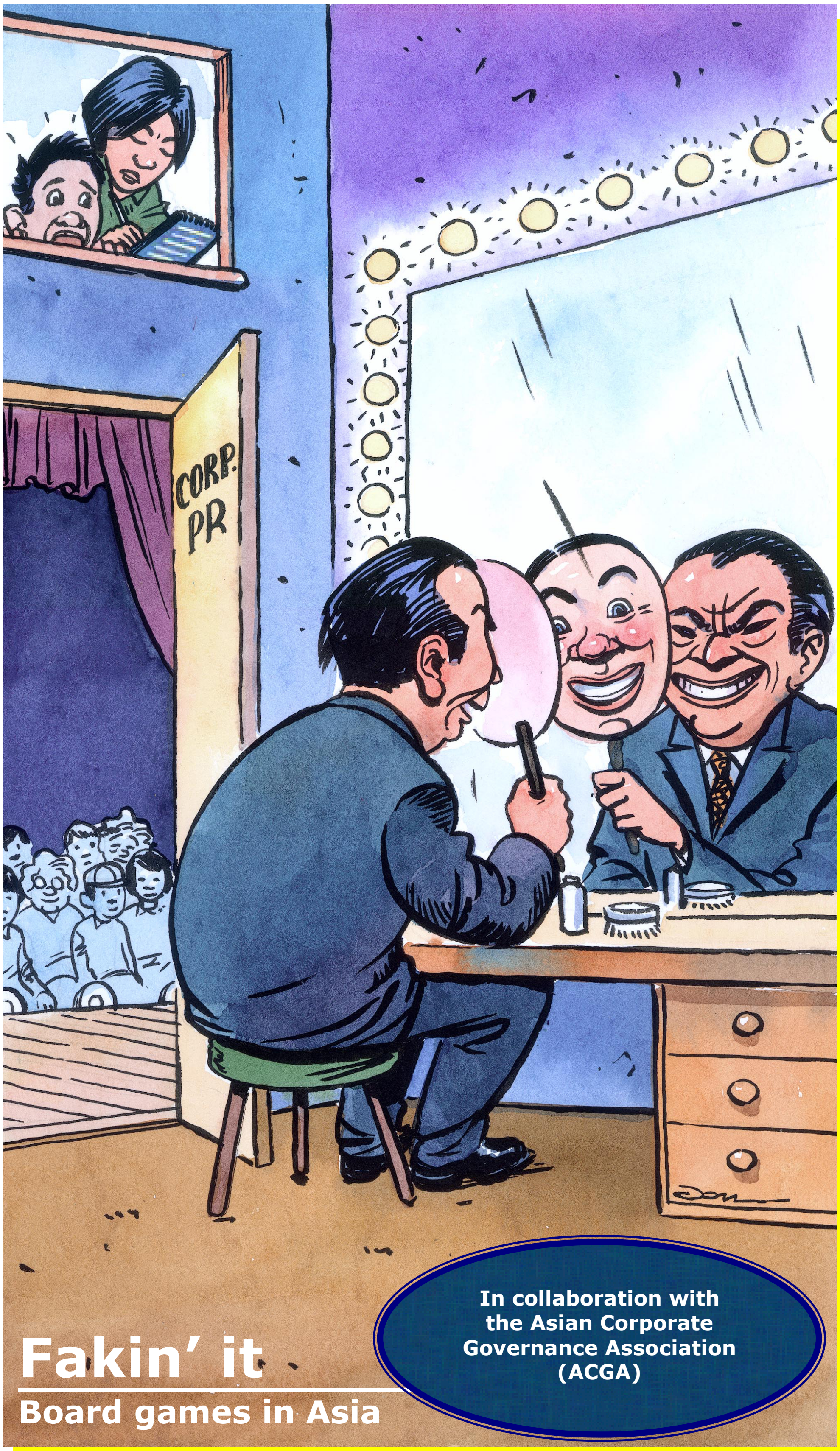
April 2003

Asia

Special report

CG stars
- HSBC
- Infosys
- TSMC
- KT Corp
- KT&G
- BAT Malaysia
- Public Bank
- Singapore Press
- ST Engineering
- Standard Chartered

Higher-ranking CG markets
- Singapore
- Hong Kong
- India
- Taiwan
- Korea



Fakin' it

Board games in Asia

In collaboration with the Asian Corporate Governance Association (ACGA)

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This report was produced in collaboration with the Asian Corporate Governance Association (ACGA), an independent, non-profit organisation based in Hong Kong and working on behalf of all investors and other interested parties to improve corporate governance practices in Asia. CLSA Emerging Markets is one of the Founding Corporate Sponsors of ACGA. For further information about the association, including a list of its sponsors and members, see Appendix 4 of this report.

ACGA endorses the methodology used in this survey and contributed to the country analysis. It did not participate in the assessments of companies, for which CLSA retains responsibility.

Fakin' it

High CG stocks outperform

In shorter periods, the outperformance of stocks with high marks for corporate governance (CG) is tenuous. But take the past five years, and the companies in the top CG quartile in each of the markets we cover outperformed on average by 35ppts, while the bottom quartile underperformed by 25ppts. This relationship is strongest, and clearer even in periods of one year, in markets where CG is a bigger concern. But in the larger markets, where the companies followed by international investors do not throw up major CG surprises, or where sectoral factors (eg, tech) dominate in the performance within the market, the relationship between CG and stock performance does not show up well.

Companies smarten up their *act*

On average the CG score for all companies under CLSA coverage has moved up 4ppts. But much of the improvement is in form – making publicly stated commitments to good CG, setting up of board committees, appointing nominally independent directors, etc. Indeed having a better-known system of examining CG scores can defeat the purpose: it makes it easier for companies to put up a fake front and to browbeat analysts preparing the CG score. The commitment to CG is not yet clear. In all the markets, cases abound of egregious transgressions. Still, investing in companies with good CG gives investors some safety in avoiding the worst blowups. Among the large caps under CLSA coverage with high CG scores, we have BUYs or Outperforms on **HSBC**, **Infosys**, **TSMC**, **KT Corp**, **KT&G**, **BAT Malaysia**, **Public Bank**, **Singapore Press**, **ST Engineering** and **Standard Chartered**.

Market regulations moving up

Singapore, Hong Kong and India are seen as offering investors the best macro CG environments of the markets we cover. Whereas Indonesia, the Philippines and China are the riskiest. For their part, Korea and Malaysia have seen the highest improvement in our macro CG scores since we began these in 2001. Across as much as within markets, those with high and/or improving CG generally outperform, and those with poor CG have underperformed significantly, especially over three to five years. But even the better markets have their own issues. Unless serious efforts are made to tighten up not just regulations but the means of redress for minorities, and the incentive is reduced for controlling shareholders to oftentimes take advantage of publicly listed companies, Asia is at risk of being perceived as making only cosmetic CG changes, while developed markets march, perhaps overzealously, ahead.

Time to organise

This is the first CG report that CLSA has written in collaboration with the Asian Corporate Governance Association (ACGA). ACGA notes some increased action by investors on CG. But institutional investors need to co-ordinate their efforts. The attitude of cutting losses and moving on when breaches occur, guarantees recurrence of similar transgressions. If perceived as generally low on CG and relatively high risk, markets in the region will be seen to deserve being at discounts. ACGA, however, puts forward ten suggestions for institutional investors to draw up their own path for working towards CG progress in the markets.

Country surveys from China to Thailand

Our survey of CG developments in the markets under coverage shows general improvement in regulation and efforts towards greater enforcement, but investors still need to be wary of corporate shenanigans - from outright fraud in some P-chips in China to massive insider selling prior to restating inflated earnings in an infamous case in Thailand. CG remains key in investment decisions and valuation metrics at both the macro and micro levels.

High CG stocks outperform

Positive effect of good CG is seen more clearly over three to five years in most markets

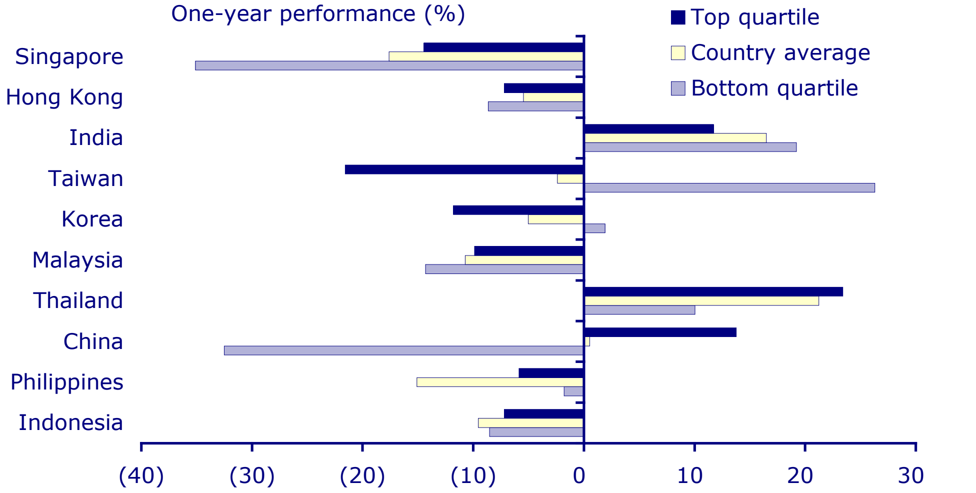
The positive effect of good corporate governance (CG) is more clearly seen over three to five years rather than in the short term. Companies in the top CG quartile in six of the ten countries in Asia under CLSA coverage outperformed over 2002, most notably in the Philippines and China. But over three and five years, the top-quartile companies outperformed in seven of the ten markets. Over the three years to end-2002, the top-quartile companies outperformed the average of companies we cover in each market by 5.0ppts, while over the past five years these companies outperformed by 35.2ppts.

Market returns have been negative but higher CG stocks outperformed relatively in 2002 . . .

. . . notably in China and the Philippines, as well as Singapore, Malaysia, Thailand and Indonesia

Figure 1

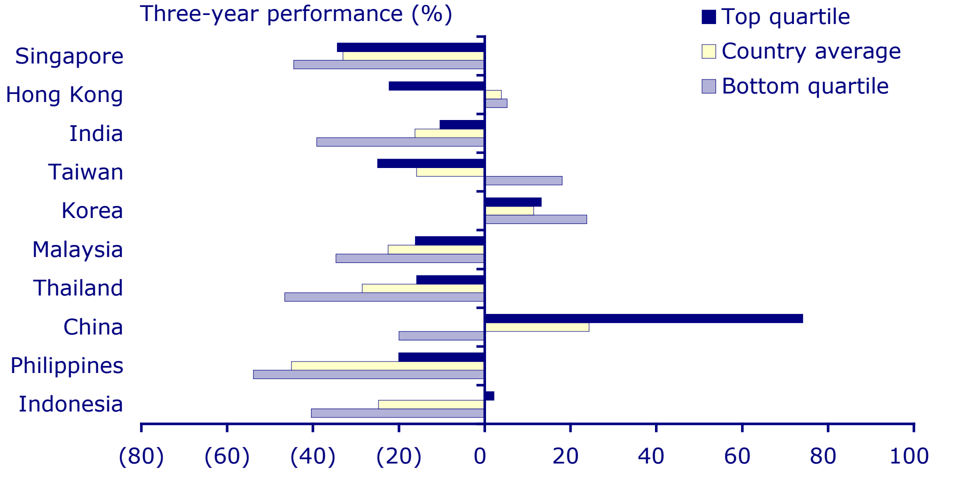
Top and bottom CG quartile performance to country average (2002)



Over three years to end-2002, higher CG stocks outperformed in all markets surveyed expect Singapore, HK and Taiwan

Figure 2

Top and bottom CG quartile performance to country average (2000-02)



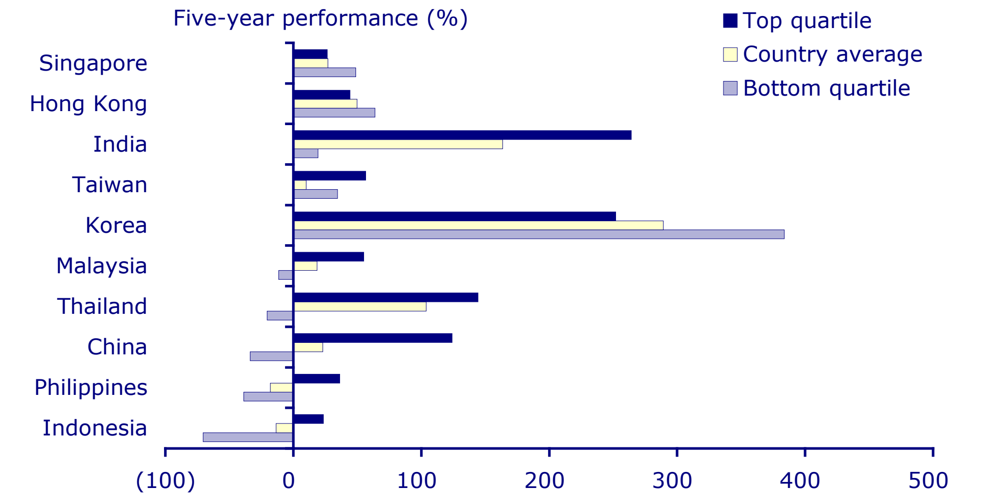
Source: CLSA Emerging Markets

Over the past five years, top CG companies outperformed in all markets except Korea . . .

. . . and marginally underperformed in Singapore and Hong Kong

Figure 3

Top and bottom CG quartile performance to country average (1998-2002)



Source: CLSA Emerging Markets

Underperformance of the bottom-quartile stocks especially over three and five years

The bottom-quartile CG stocks underperformed only in five of the ten markets under coverage for 2002 – in Singapore, Hong Kong, Malaysia, Thailand and China. But the underperformance was large enough such that on average the bottom quartile underperformed the average of all the quartiles of the respective market by an average of 3.8ppts last year. Over the previous three years, the bottom quartile underperformed in seven of the markets (the exceptions were Hong Kong, Taiwan and Korea) on average by 7.7ppts. And over the past five years, the bottom quartile underperformed the average performance in the market by 25.1ppts - though not in Singapore, Hong Kong, Taiwan and Korea.

Calculation based on simple averages to take out big-cap dominance

The calculation is based on the simple average performance of the stocks in the top quartile versus the average of the performance of all the quartiles. A simple average is used within each quartile rather than a market-cap weighted average, so that the quartile performance is not skewed by that of any large cap, as the aim is to examine whether on average better CG companies have stocks that perform well (irrespective of size). The comparison is made against the average of the four quartiles, rather than against the main country index, because the performance of the index is skewed towards the performance of the large caps. A simple average calculation for each quartile might have the counter-intuitive result that all quartiles outperformed the index if the big index stocks had seen a large fall, or conversely if the big-cap index stocks had seen a large rise. Hence consistency requires that the simple average performance of stocks in each quartile be compared with the simple average performance of all the quartiles.

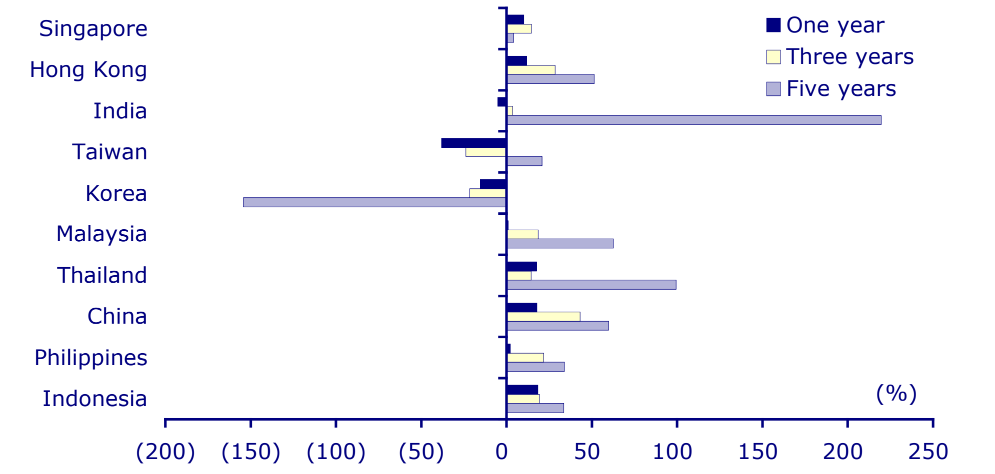
Top-quartile stocks did not outperform in Singapore, Hong Kong and Korea for the past five years

For the three years to end-2002, the only market where the top quartile did not outperform was Singapore (marginally), Taiwan and Hong Kong. For the five years to the end of last year, the three markets where the top quartile CG companies did not outperform were Singapore (again very marginally) Hong Kong and Korea.

Companies in the top half outperformed the bottom half over 2002 and more significantly over three and five years

Figure 4

Performance of top-half CG companies to bottom-half companies



Source: CLSA Emerging Markets

Top-half CG stocks relative to the bottom half

Top-half CG stocks outperformed the bottom half in all markets except Korea over past five years

For seven of the ten markets, stocks in the top two CG quartiles outperformed the bottom two quartiles in their respective markets over 2002 – the exceptions were Taiwan, Korea and India. The average outperformance of the top-half stocks against the bottom was however very slight (0.1ppts) for the year, because the bottom-half stocks – generally non-tech names - outperformed quite significantly in Taiwan and Korea. However, over the past three years in eight of the ten markets, companies in the top half outperformed the bottom half (exceptions were Taiwan and Korea) by an average of 9.6ppts. In all the markets under our coverage except Korea, the top-half companies outperformed the bottom half over the past five years. On average the return for companies in the top half on CG was 45.4ppts higher than for the bottom half.

Sectoral performance especially relating to tech can dominate over CG influence on stocks

The countries where the top-quartile companies did not noticeably outperform were markets where sectoral factors were the key to driving performance (eg, the performance of the tech sector in Taiwan, Korea and India), which can be seen as having dominated over the performance of quality companies as represented by good CG.

In better CG markets, the top CG companies do not necessarily outperform

But HK shows that high CG companies give higher beta-adjusted returns

The other reason why CG is sometimes not a key factor in performance of stocks is when overall standards of CG in that market is within the expectations of fund managers and there are not major shocks in the companies covered by most investors. Thus in Singapore and Hong Kong, the two markets which rate the highest for macro-CG determinants, the top quartile of CG companies do not generally outperform over the periods examined. Nevertheless, we find that even in Hong Kong, when the performance of stocks is adjusted for beta, the high CG companies give a better return when their stock performance is beta-adjusted. (See the Hong Kong section of this report.)

Where CG is an issue, higher CG stocks perform better

For countries with lower overall CG, top-quartile companies outperformed over all three periods

Noteworthy also is that for the five markets ranked in the lower half of our country rankings for macro CG determinants – Indonesia, Philippines, China, Thailand and Malaysia – the top-quartile CG companies outperformed over one, three and five years against the country average. For 2002, the top-quartile CG companies outperformed the average of the quartiles in these five markets by 5.6ppts, by a much wider 24.1ppts over three years and by an impressive 53.9ppts over five years. Companies in the top half for CG in these markets outperformed the bottom half by 11.4ppts in 2002, and by 23.4ppts over three years and 57.8ppts over five years. The bottom-quartile CG companies underperformed the respective country averages for these five markets by more than double the underperformance of the overall sample of ten markets - whether for one, three or five years. Over the past five years, for instance, the underperformance of the bottom CG quartile was minus 57.8ppts for the five poorer CG markets, versus minus 25.1% for the whole basket of markets covered.

Outperformance of good CG stocks where CG a bigger concern

Particularly where CG is a bigger concern, the evidence suggests much greater outperformance of the top CG stocks, and underperformance of poor CG stocks, over shorter periods of a year and quite certainly over the medium term.

Why CG will be correlated to stock performance

Is it just a statistical correlation?

A correlation between good or improving CG and share-price outperformance does not in itself prove causation. However, there are good reasons to believe that the correlation will be maintained, as emphasized in last year's CG Watch report, *Make me holy...* (February 2002).

CG is a reflection of quality of management

A key reason is that CG is a reflection of quality of management. Higher-calibre management clearly realise that high CG standards are not just what investors are seeking, but also what is required to keep checks and balances in their company for long-term sustained high operating performance, while preventing corporate abuse and mismanagement. Nothing can compare with the highest standards of transparency to deter mismanagement. And top-quality management tend to focus on financial returns as well. As we demonstrated in our 2001 CG report, *Saints & sinners* (April 2001), high CG companies tend to have high ROE and EVA ratios. As long as they are the largest value creators in their respective markets, they will remain outperformers over time. Quality of management is the key that ties in companies with good CG together with higher financial ratios and share-price outperformance.

Investors now able to choose across markets for best run companies

A second reason for the correlation is that investors are not constrained to particular markets and can avoid stocks and markets where CG is poor. In the early 1990s, dedicated country and region funds were popular products. However, the investors in these found that the emerging-market investment vehicles they chose were disasters. Had the investors kept their money in their home markets, many would have seen much better returns.

While conceptually the idea of spreading out one's investment geographically and diversifying into emerging markets appeals to provide better performance and spread the risk, the end-investor has much less confidence in being able to pick the right country or region. Hence this responsibility is being moved to the institutional fund manager.

The end-investor places funds in international or global accounts, rather than in specific country or regional funds. It is then up to the fund manager of these accounts to determine which countries and companies to invest in. The institutional fund manager is not constrained in the way the fund manager of a country fund would be, in choosing among what might be the best of a poor lot of companies for CG in a given market. The investor can get the same exposure to a particular industry from companies in other countries where CG standards might be higher.

CG itself is becoming an investment criterion to reduce risk

The huge menu of possible stock investments open to the global fund manager means the investor will be much more careful about investing in companies with poor CG standards, especially if he or she cannot monitor the developments at each of the companies as closely as a country-dedicated fund manager will be able to. Particularly given the poor CG record over the Asian crisis, when CG fiascos led to huge deratings of some stocks (and sometimes of markets), investors are generally more alert to the need to invest in companies with a minimum acceptable level of governance standards. CG becomes an investment criterion that determines how much investors are willing to pay up for a stock.

Companies smarten up their act

CG scores have gone up because of changes in form . . .

As the CLSA annual CG survey has become better known with companies getting feedback - usually of how poorly they scored - there has been a greater effort by the companies to present the right face – and to browbeat analysts into giving them higher scores. Regulators have also been setting the direction on what is needed. But much of these changes are in form: allocating a couple of pages in annual reports to discussions on the composition of the board, as well as the regularity and attendance of meetings; setting up various board committees; appointing what are presented as independent directors, etc.

. . . but commitment to these changes is still uncertain

But the commitment to high CG standards – the real substance behind these changes - is impossible to determine. While the scores have moved up, as can be seen in the various country sections, the true test will come as and when economic conditions become more difficult. It is in times like the Asian crisis when the urgency is greatest for controlling shareholders to use public-listed companies to protect private interest etc.

CLSA scoring methodology

Seven CG categories

CLSA's CG score is based on seven key categories:

- Discipline.
- Transparency.
- Independence accountability.
- Responsibility.
- Fairness.
- Social responsibility.

Under each of these categories, we assess the companies on issues that are key to constituting good corporate practices under these aspects. The questionnaire is in binary form to reduce subjectivity and is filled in by the CLSA analyst covering each company based on the best information available. *Please see Appendix 1 for details of our methodology and Appendix 2 for a sample of the questionnaire.*

Summary of CLSA's CG assessment

The CLSA CG score is based on how we rate a company on 57 issues under the seven main aspects that we take to constitute the concept of CG. The following is a summary of what we assess in our CG ranking:

I. Discipline

Public commitment to CG and financial discipline

- Explicit public statement placing priority on CG
- Management incentivised towards a higher share price
- Sticking to clearly defined core businesses
- Having an appropriate estimate of cost of equity
- Having an appropriate estimate of cost of capital
- Conservatism in issuance of equity or dilutive instruments
- Ensuring debt is manageable, used only for projects with adequate returns

- Returning excess cash to shareholders
- Discussion in Annual Report on CG

II. Transparency

Ability of outsiders to assess true position of a company

- Disclosure of financial targets (eg, three- and five-year ROA/ROE)
- Timely release of Annual Report
- Timely release of semi-annual financial announcements
- Timely release of quarterly results
- Prompt disclosure of results with no leakage ahead of announcement
- Clear and informative results disclosure
- Accounts presented according to IGAAP
- Prompt disclosure of market-sensitive information
- Accessibility of investors to senior management
- Website where announcements updated promptly

III. Independence

Board is independent of controlling shareholders and constituted separately from senior management

- Board and senior management treatment of shareholders
- Chairman who is independent from management
- Executive management committee comprised differently from the board
- Audit committee made up at least half by, and chaired by, independent directors
- Remuneration committee chaired by independent director
- Nominating committee chaired by independent director
- External auditors unrelated to the company and non-audit fees to auditor less than one-third of audit fee
- No representatives of banks or other large creditors on the board

IV. Accountability

Proper accountability of management to the board

- Board plays a supervisory rather than executive role
- Non-executive directors demonstrably independent
- Independent, non-executive directors at least half of the board
- Foreign nationals presence on the board
- Full board meetings at least every quarter
- Board members able to exercise effective scrutiny
- Audit committee that nominates and reviews work of external auditors
- Audit committee that supervises internal audit and accounting procedures

V. Responsibility

Record on taking measures in case of mismanagement

- Acting effectively against individuals who have transgressed
- Record on taking measures in cases of mismanagement

- Measures to protect minority interests
- Mechanisms to allow punishment of executive/management committee
- Share trading by board members fair and fully transparent
- Board small enough to be efficient and effective

VI. Fairness

Treatment of minorities

- Majority shareholders treatment of minority shareholders
- All equity holders having right to call general meetings
- Voting methods easily accessible (eg, through proxy voting)
- Quality of information provided for general meetings
- Guiding market expectations on fundamentals
- Issuance of ADRs or placement of shares fair to all shareholders
- Controlling shareholder group owning less than 40% of company
- Portfolio investors owning at least 20% of voting shares
- Priority given to investor relations
- Total board remuneration rising no faster than net profits

VII. Social awareness

Labour and environmental issues

- Explicit policy emphasising strict ethical behaviour
- Not employing the under-aged
- Explicit equal employment policy
- Adherence to specified industry guidelines on sourcing of materials
- Explicit policy on environmental responsibility
- Record of investments or deals not raising questions of propriety

Questionnaire designed to give a score for ranking purpose

The questionnaire was designed to give a numbered scored for our ranking of a company on each of the seven CG criteria, and a weighted overall CG score for the company. This figure, stated as a percentage, would reflect our view on the CG level of the company considered in itself, but also provides a ranking for each company within its market and within its sector across GEMs. We rank the companies by CG quartiles for each market, and in the country sections we show the companies that rate in the top two quartiles.

Risk in assessing just for form rather than substance

No system of rating companies for CG will be perfect. The risk is assessing and scoring for form rather than substance. There is little point in having nominally independent directors on the board if they are in fact friends of the major shareholders who give the major shareholders complete leeway to do with the company as they choose. Providing financials promptly is irrelevant if the numbers misrepresent. A policy statement that says CG is important, and a few paragraphs in an annual report that give lip service to CG can be just that - lip service.

Soft issues should not be ignored

Hence, what may be regarded as the 'soft' or qualitative side to CG cannot be ignored - ie, to determine the real commitment of management and major shareholders to high standards of governance. Not having any such questions would mean assessing only form irrespective of substance; having too many questions to judge the commitment of management results in a greater element of subjectivity that creeps in.

Just under 30% of the questions designed to assess commitment

The balance we have arrived at is that 16 of the 57 questions – just under 30% – is an assessment of the commitment of the company to particular aspects of CG where there is some interpretation required of the analyst. Nevertheless, the analyst has to provide a definite yes/no answer to reduce the degree of subjectivity for assessing these issues. The other 70% of the questions are based on hard facts, like whether the chairman is independent, whether there are independent directors heading nomination and remuneration committees, whether the board meets at least four times a year, etc.

Score to provide ranking

The answers to the questions are based on the best information available to the analysts. There could well be controversy over whether certain companies should rate higher or lower. However, this approach gives us a formal method to assess CG in the companies that we cover. We believe that the rankings we have arrived at are a fair reflection of the position of companies in the CG rankings in their market and within their sectors across Asia. Our CG ranking also provides investors with a means of judging the level of CG risk in holding a stock as indicated by our score. The rankings can be used to create a portfolio of companies ranked as having higher levels of CG in each of the markets or sectors.

Company scores not tied to country

Our scores do not mark down a company simply for being in a country that might be perceived to have a weak regulatory or legal framework. There clearly are companies in poorer CG environments that nevertheless have decided to follow higher CG standards – either because they are part of multinational corporations and follow the standards of their parent, or they need to follow such practices to be able to raise funds through American Depositary Receipts (ADR), or simply because of a push for world class CG by key persons in the companies. Whatever the reason for a company's high CG - and even if the key reasons do not include being in an environment where high CG standards are enforced by regulators – the key is determining the CG standards of the company, rather than 'discounting' its CG score for its environment.

Ranked 380 companies in ten Asian countries

Average score of 62% in sample of CLSA's core coverage

We ranked 380 companies in ten countries under CLSA's Asian coverage. The average CG score in our sample is 62.0%, 4.1ppts higher than the average from last year of 57.9%. (In our 2002 report, we had seen a 2ppt increase in the average score of the sample.) The biggest increase in score was under the discipline category where the average score has moved up 8.6ppts. This is one of the easiest areas for companies to increase their score by a greater stated commitment to CG tenets – eg, discussion in annual reports, becoming transparent on financial targets, etc. However, for accountability, responsibility and independence, the scores remain below the average of the other categories

It needs to be reiterated that the average is the simple average of scores for the companies under CLSA's core coverage. The score is almost certainly skewed upwards because of sample bias – ie, that CLSA (and other international securities houses) would be covering mainly the better companies in each of the markets. The average of all the companies in Asia quite certainly would be lower.

Still a wide range in scores

CG score range of 75 points

Averages usually hide more than they reveal. Against our 62% average CG score is a 75ppt range - the lowest score in our sample is 17.4% while the highest is 92.9%. The companies with weaker CG scores generally have much lower scores on independence and responsibility. The lowest ten companies in our overall sample scored 9% for independence, 18% for responsibility and averaged 24% for fairness. The average CG score of this group was just 29% or 60ppts lower than the top decile.

Key in having good overall CG is transparency and fairness – two categories where the top ten companies for CG in our survey score highest on. Their average overall score was 27ppts higher than the overall sample.

Figure 5

Average CG scores and top and bottom range

	Discipline (%)	Transparency (%)	Independence (%)	Accountability (%)	Responsibility (%)	Fairness (%)	Social (%)	Wgtd CG score (%)
Total sample average	60.2	68.2	56.8	51.8	55.9	70.9	75.0	62.0
Large-cap average	65.3	74.4	62.7	59.3	59.2	76.3	80.3	67.6
Top 10 CG companies	81.1	95.0	89.6	91.3	80.0	93.4	93.3	88.9
Bottom 10 CG companies	44.4	40.0	9.3	25.0	18.3	23.9	51.7	29.3

Source: CLSA Emerging Markets

Large-cap CG rankings and recommendations

Scores of large caps not significantly higher than the overall average

The largest 100 companies under CLSA coverage have a market cap of US$2bn and above, and would be of greater interest to the international portfolio manager. They have an average score of 67.6% which interestingly, is not significantly higher than the overall sample. The two areas where the larger caps score higher than average are transparency (6.2ppts above the average for the overall sample) and accountability (8.5ppts above).

The next table shows the top-ranked big caps in terms of CG by blocks of ten, sorted by country according to the macro CG environment. Of these companies, we have positive recommendations on **HSBC**, **Infosys**, **TSMC**, **KT Corp**, **KT&G**, **Samsung Fire & Marine**, **Public Bank**, **Singapore Press**, **Standard Chartered**, **Li & Fung**, **Esprit**, **Hindustan Lever**, **Samsung Electronics**, **Kepco**, **CNOOC Ltd**, **Singapore Airlines**, **Sun Hung Kai**, **Nan Ya Plastics**, **Formosa Plastics**, **UMC** (all BUYs), as well as **BAT Malaysia**, **ST Engineering** and **KT Freetel** (all Outperforms).

In the past five years, the top CG quartile of large caps showed an average return of 311% versus a 115% average for all four quartiles

We sorted these 100 largest stocks by CG quartiles and examined their performance. Over the past one to three years, there is little evidence of outperformance for the higher CG companies. But the outperformance shows clearly enough on a five-year view. Over the past five years, the top quartile showed an average return of 311% versus the average of 115% average for all the four quartiles. Companies in the top half on CG among these large caps had an average stock return of 190% versus 48% for the companies in the lower half. This again supports the evidence at the country level that in the short term CG may not be a strong factor determining performance, but over the medium to longer term companies with better CG tend to have stocks with the strongest returns.

Top 10 CG companies sorted by country ranking . . .

. . . 11 to 20 sorted by country ranking . . .

. . . 21 to 30 sorted by country ranking

Figure 6

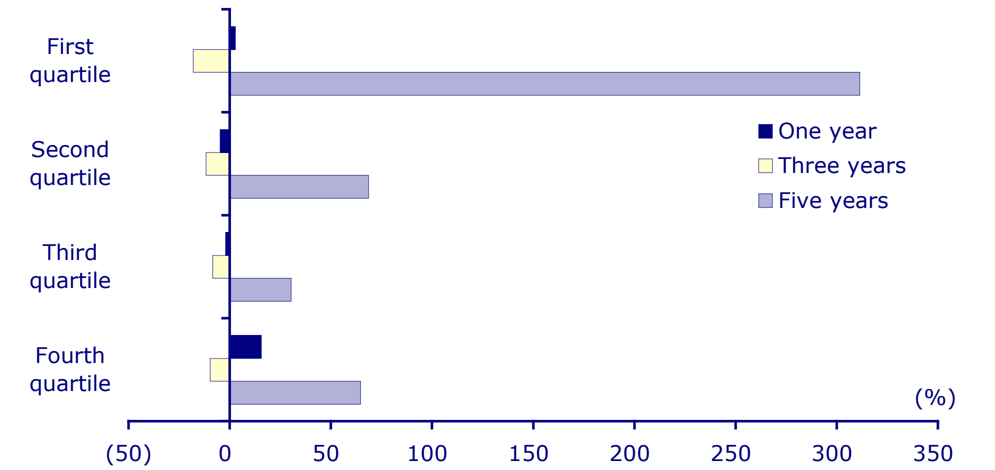
Top 30 CG stocks among large caps in Asia

Company	Country	Quartile ranking (within country)	Rec
HSBC	Hong Kong	First quartile	BUY
Infosys	India	First quartile	BUY
Wipro	India	First quartile	SELL
TSMC	Taiwan	First quartile	BUY
KT Corp	Korea	First quartile	BUY
KT&G	Korea	First quartile	BUY
Kookmin Bank	Korea	First quartile	SELL
Samsung Fire & Marine	Korea	First quartile	BUY
BAT Malaysia	Malaysia	First quartile	O-PF
Public Bank	Malaysia	First quartile	BUY
Singapore Press Holdings	Singapore	First quartile	BUY
ST Engineering	Singapore	First quartile	O-PF
Standard Chartered	Hong Kong	First quartile	BUY
Li & Fung	Hong Kong	First quartile	BUY
Esprit Holdings	Hong Kong	First quartile	BUY
Hindustan Lever	India	First quartile	BUY
Samsung Electronics	Korea	First quartile	BUY
KT Freetel	Korea	Second quartile	O-PF
Kepco	Korea	Second quartile	BUY
CNOOC Ltd	China	First quartile	BUY
Singapore Airlines	Singapore	Second quartile	BUY
Sun Hung Kai	Hong Kong	First quartile	BUY
Nan Ya Plastics	Taiwan	First quartile	BUY
Formosa Plastics	Taiwan	First quartile	BUY
UMC	Taiwan	First quartile	BUY
Samsung SDI	Korea	Second quartile	U-PF
Semco	Korea	Second quartile	U-PF
Maxis	Malaysia	First quartile	U-PF
Siam Cement	Thailand	First quartile	BUY
UTStarcom	China	First quartile	SELL

The top CG quartile of the large caps have provided strong five-year returns

Figure 7

Stock performance of large caps sorted by CG quartiles



Source: CLSA Emerging Markets

Market regulations moving up

Macro factors determine the CG environment

We ranked markets by macro CG determinants. The macro factors determining the CG environment should be distinguished from the CG characteristics at the company level. The macro factors are part of the determinants of the CG characteristics exemplified by companies. We weighted each of the macro criteria according to our view of its importance.

Figure 8

Macro factors and weightings accorded by CLSA in country rankings

	Weight (%)
Clear, transparent and comprehensive rules and regulations	10
Committed and effective enforcement of rules and regulations	30
Political and regulatory environment affecting CG and ability of companies to maximise value without arbitrary restrictions	20
Adoption of International Generally Accepted Accounting Principles (IGAAP)	20
Institutional mechanisms to promote awareness and a culture of good governance	20

Source: CLSA Emerging Markets

Enforcement given the highest weighting, quality of rules in itself has half of standard weight

Enforcement of rules and regulations has to be given the highest weight since it is clearly the most important macro determinant of the level of CG in a market. Without effective enforcement, companies can and will get away with scandalous behaviour, whatever might nominally be in the rule book. Hence, this is given 1.5x the standard weight. The existence of satisfactory rules and regulations in itself (without strict enforcement) is less important and hence is given half of the weight of the other macro factors.

Other macro factors have equal weight

The other three criteria of the macro determinants are given equal weight: the political and regulatory environment impacting CG and the ability of companies to maximize value for shareholders, adoption of internationally accepted accounting standards, and institutional mechanisms to promote awareness and a culture of good governance.

Singapore moves slightly ahead at top of the table

On our country macro determinants, Singapore this year moves slightly further ahead at the top of the table. The new Code of Corporate Governance has just come into force and there is greater heed to CG issues by companies. The issue of whether the government-linked companies (GLC) pursue shareholder value is the main CG-related concern for the market – but not a new one, while the charter announced by Temasek which owns the government's interest in the GLCs goes some way towards making transparent the purposes and objectives of these companies.

Hong Kong, Taiwan and Philippines scores basically unchanged

Our Hong Kong score is basically unchanged. The failure for the association of minority shareholders (HAMS) to get off the ground, while the reaction of issuers and professional groups to the new CG listing rules, and the buckling of the Exchanges to this pressure, show up Hong Kong poorly especially when a notorious case involving a smaller cap (ie, Boto) demonstrated that deals can still go through that make no sense for the company in question but are pushed through by controlling shareholders and management. Nevertheless, there has been an improvement in rules and regulations underway and there is greater enforcement than before by the regulators.

Our scores for Taiwan and the Philippines are also basically unchanged from last year. Other countries have seen their macro-determinants score moving up, most notably Korea, Malaysia, India and Indonesia from a low base.

Figure 9

Markets ranked by CG

	Rules & regulations	Enforcement	Political/ regulatory environment	Adoption of IGAAP	Institutional mechanisms & CG culture	Country score
Singapore	8.5	7.5	6.0	9.0	8.0	7.7
Hong Kong	8.0	6.5	6.5	9.0	7.0	7.3
India	8.0	6.0	6.0	7.5	6.5	6.6
Taiwan	7.0	5.0	5.0	7.0	6.0	5.8
Korea	7.0	3.5	5.0	7.0	6.5	5.5
Malaysia	9.0	3.5	4.0	7.0	6.5	5.5
Thailand	7.5	3.0	4.0	6.0	4.5	4.6
China	5.0	4.0	5.0	5.0	3.0	4.3
Philippines	6.5	2.0	2.0	6.0	4.0	3.7
Indonesia	4.5	1.5	4.0	5.0	2.5	3.2

Performance of markets ranked by CG

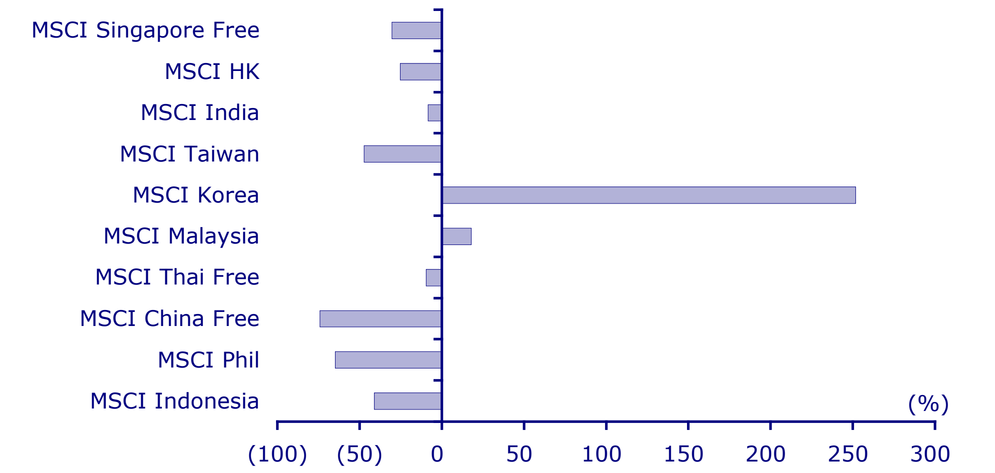
Indonesia, our lowest CG market, had the highest return in 2002

The one-year performance of the markets ranked for CG does not give any strong evidence favouring markets with better CG. Indonesia is the lowest-ranked market in our universe for CG. But owing to depressed market valuations at the beginning of 2002, an appreciating rupiah and the increasing lack of correlation with the rest of the world, Indonesia has been a strong performer last year - when global markets were in their third year of a severe bear decline. The 38% rise of the Indonesian market in 2002 when our top three CG markets fell an average of 9.3% and MSCI Asia ex-Japan fell 10.2% skews the performance of markets last year towards, paradoxically, better performance for poorer CG markets. The morale is a reminder that valuations and market correlations cannot be ignored in such analyses.

Markets have had negative returns but more so over the past five years in the lower CG countries

Figure 10

Performance of markets ranked by CG (five years)



Source: CLSA Emerging Markets

Top three CG markets declined on average 21.2% over past five years, while bottom three declined an average of 50.9%

However, over three and five years there is still good evidence that better CG markets outperform and poor CG markets underperform – even though the returns from equity markets globally and in Asia have been dire. MSCI Asia Free ex-Japan has fallen 46.2% for the three years to end 2002, and by 21.8% for the five years. Our group of the best three CG markets in our Asian universe outperformed very slightly, declining 45.7% for the three years and 21.2% for the five years. But the bottom three markets underperformed quite severely, down an average 60.6% for the three years and 50.9% for the five years to end 2002, with wrenching 65% to 75% declines over the past five years for the Philippines and China.

Markets with most noticeable improvements in CG environment – Malaysia and Korea – have outperformed

Worth noting too is that since we started this scoring of countries in our April 2001 CG report, the two countries that have seen the biggest improvement in macro CG scores – Malaysia and Korea – have also seen strong outperformance. Korea in particular is up 56.8% in the past two years (by the MSCI index), comparing very favourably against MSCI Asia ex-Japan which is down 15.5% for the two years. Malaysia also outperformed relatively in being barely unchanged (MSCI-Malaysia down 0.5%) for the two years.

The sample is small in terms of markets covered, but the evidence gives some support to the thesis that markets with improving CG can see strong performance particularly if coupled with favourable macro-economic and financial fundamentals. That good CG markets outperform over the medium-term (three to five years) while poor CG markets underperform, is underscored yet again in our analysis this year.

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Time to organise

How investors can improve corporate governance in Asia

Institutional investors have been called upon to get involved in CG of companies they invest in

In recent years, many Asian securities regulators have called upon domestic and foreign institutional investors to "get involved" in the governance of companies in which they invest. In late 1999, Korea was one of the first off the mark with a new code on corporate governance that urged institutions to "actively exercise their shareholder rights and monitor corporate management". The following year, a senior official of the Hong Kong Securities and Futures Commission (SFC) exhorted delegates at the CLSA Investor Forum to organise a shareholder association and push for better corporate governance in Hong Kong. Then early in 2002, China released its new code on corporate governance, which envisages the active participation of shareholders in company general meetings.

National investor organisations have been set up

Not content to wait for market forces to coalesce, some regulators and governments have seeded their own national investor organisations. Malaysia, most famously, formed a Minority Shareholder Watchdog Group in 2001 and put it under the leadership of the huge Employee Provident Fund. Thailand followed with a Shareholders' Association (for retail investors) and an Institutional Investors Club in mid-2002. Whether these groups help to expand the permitted scope for shareholder activism in those countries, or are impeded by their links to government, is an open question.

Institutional investors taking some action

On the ground, institutional investors have taken some action. In Japan, which has had no tradition of institutional activism, the Government Pension Investment Fund now requires its asset managers to vote proxies and report back afterwards (though so far most have voted with management!). There have been numerous cases around Asia of public-equity fund managers lobbying companies over specific transactions that they believe will damage shareholder value (a strategy called "invisible activism" because it often takes place behind the scenes). Many private-equity investors also take a low profile in trying to improve the governance of the companies in which they invest, as do some state investors such as the Thai Government Pension Fund. More visibly, a small number of fund managers, notably Templeton Asset Management, go public with their criticisms and actively vote against management proposals with which they disagree.

Why are investors important?

Fiduciary responsibility to clients

The most commonly cited reason why investors matter in the corporate-governance value chain is that they have a fiduciary duty to their clients to achieve the best possible returns and to guard against loss of the assets entrusted to them. Being an active and interested shareholder will at the very least help to strengthen corporate transparency and accountability, which in today's market is likely to lead to a higher share valuations (all else being equal). More immediately, it is likely to produce better financial and non-financial corporate data - something all investors want.

Regulators need investors

But there are also practical reasons why regulators need investors. All regulators lack resources and cannot undertake the job of enforcement on their own. They look to investors to defend their rights ("private enforcement") in the belief that this will produce a more efficient system of enforcement and a better securities market. Thus, market discipline is as necessary as regulatory discipline in the value chain.

Not yet organised

Institutional investors less organised in their efforts to tackle CG in Asia

What is apparent in the nascent efforts described above is that, unlike retail investors in markets such as Hong Kong, Korea and Singapore, institutional investors have been far less organised in their efforts to tackle governance issues in Asia. They have not, for example, created their own shareholder activist associations at the local or national level in Asia. (Note: The Asian Corporate Governance Association (ACGA), an organisation with strong investor backing, is a regional non-profit involved in research, advocacy and advisory work.) Does this mean that investors are not yet convinced of the benefits of corporate governance?

Many are not incentivised

While some investors may have their doubts (believing that savvy management is all that matters), for many others it is a question of the high costs involved and the uncertain short-term returns. Many are not incentivised by their clients (eg, pension funds) to invest time and money in detailed research of board structures, the quality of directors or the agendas of annual general meetings. Engaging in proxy voting is a time-consuming process that, depending on the proposals before shareholders, may make no immediate difference to a company's share price or overall performance. And there are the ever-present problems of free riding (others benefiting from your hard work) and conflicts of interest within financial conglomerates (an asset-management arm being restricted in what it can say and do by the commercial relationships of a parent bank).

But things may be changing in Asia . . .

The good news

Heightened interest

Over the past six to 12 months, it seems clear that institutional investors are taking a heightened interest in governance issues (and that this new environment is here to stay):

- Domestic institutional investors in Korea, including state pension funds, are more actively voting their proxies (partly due to a law change).
- Some foreign investors in Asia are paying more attention to voting generally (partly due to new US SEC rules following Sarbanes Oxley) and are developing in-house proxy voting policies.
- Certain institutions are taking greater interest in director elections and putting up their own candidates (eg, Prudential of the UK is actively voting in the election for the Hong Kong Exchanges and Clearing board in April 2003).
- Individual institutions are working closely with Asian asset managers to share information and experience on corporate governance (eg, Hermes of the UK and Nissay Asset Management of Japan).
- Proxy voting consultants are expanding their business in Asia.
- And the number of investor members in ACGA is on the rise.

Ten steps

Ten ideas to chart a CG path for investors

Where should investors interested in corporate governance start? What more can those already involved do? Here are ten ideas to help institutional investors chart their own path. They range from the basic to the more sophisticated:

1. Clarify why corporate governance is important to you and develop a general set of **corporate governance guidelines,** written simply and in your own words. You do not need to reinvent the wheel completely here, as investors such as CalPERS, TIAA-CREF, Hermes and Henderson all have such statements. But you may need to adapt them for different markets in Asia.
2. Develop your own **proxy voting policy** and procedures. Again, you do not need to reinvent the wheel: look at the International Corporate Governance Network, among others.
3. Develop a **corporate-governance screen** that assists your decision-making process and post-investment monitoring (and amend it regularly in light of experience). Add to this screen a list of "red flags" (important corporate reforms that have yet to be carried out or corporate actions that warn of a potential worsening in governance quality).
4. Form a centralised **governance unit** within your organisation that has responsibility for overseeing the implementation of your guidelines and policies, and for working with investee companies and potential supporters (ie, other investment funds).
5. (Depending on the size of your stake and the nature of your investment) Consider seeking a **board seat**. This may not be for everybody, since directorships carry a range of liabilities (eg, management of outsider and insider information; the possibility of being sued or prosecuted), are extremely time-consuming and may reduce one's objectivity (ie, you become captured by the board). Conversely, if your stake in a company is significant, a board seat may help you manage the investment and minimise risks.
6. Whether on the board or not, argue persuasively for a well-functioning and independent **audit committee** in your investee companies. The corollary is that the external auditor should be doing his job and that the independent directors are truly independent.
7. Seek basic information on the **independent directors** and try to understand how they contribute to the company and the minority shareholders. Are they appointed for their loyalty to management, for their business acumen or to bring some balance and diversity to the board? Are they paid sufficiently for what they do? If possible, seek meetings with the independent directors to assess their understanding of the company, their obligations as a director and their contribution to improving corporate performance.
8. Form or seek a mandate for a **focus fund** (that is, a fund that invests in under-valued companies and actively works with management to improve governance and, thereby, their share price). For some asset managers, this could become a new line of business. At the same time some asset managers are receiving mandates on the basis of their expertise in corporate governance.
9. Work with your own boards and trustees to **improve your internal governance**. Recent developments have shown that many people, not least the media, are becoming interested in the governance of institutional investors, especially pension funds and insurance companies.
10. **Join ACGA!** And come along to our new Investor Discussion Group.

The ACGA Investor Discussion Group

Not just a talk shop

In response to market demand, ACGA is forming a confidential and informal discussion group for institutional investors in Asia. Meetings will be held quarterly and will allow investors to share views, information and ideas about corporate governance in Asia. The general concerns of the group will be reflected in ACGA reports, presentations and advocacy work, and where appropriate will be conveyed to regulators and companies.

Looking ahead

The next two to five years could bring significant change to the way in which investors organise themselves to foster continuous improvements in corporate governance in Asia. The ongoing market volatility and economic uncertainty in the region make this job even more urgent, since securities markets play such a critical role in facilitating investment and therefore development. Strong economies require sound markets in which the interests of investors are protected. And as this CLSA survey shows, companies with better governance tend to outperform the market by a wide margin over the medium term. What could be a better reason to act?

China - Too entrepreneurial

Private enterprises have been derated over concerns of loose CG

Credibility and related corporate-governance issues of private enterprises listed in Hong Kong have been a major issue over the past year. **Euro Asia**'s collapse and share suspension quickly followed by confusion over the auditing of **Chaoda**'s accounts cast a long shadow over the rest of the sector. The "dishonest discount" introduced in our previous corporate-governance report unfortunately has proven to be apt for many companies.

In the domestic market, the China Securities Regulatory Commission's (CSRC) new regulations to tackle corporate fraud, improve CG and protect minority shareholders are at least bringing minorities' rights to the attention of companies. There has been visible improvement in communications by H-share companies and more detailed disclosure on operating details etc. For the first time, China now has a CG code and framework. **CNOOC Ltd**, **Zhejiang Expressway**, **Huaneng Power**, **Legend**, **UT Starcom** and **Wah Sang Gas** are all demonstrating a greater commitment to CG.

BUY/SELL summary

Company	CG quartile	Rerating drivers
High/improving CG BUYs		
CNOOC	1	CNOOC continues to set the benchmark for CG among China companies. Valuations do not factor in long-term oil prices in the mid-US$20s. BUY.
Huaneng Power	1	Management is proving most able among IPPs to make value-enhancing acquisitions. Audit and nomination committees have been established; its business has a large degree of autonomy from its parent. BUY.
Cosco Pacific	1	Focused conglomerate and consistent value-creator with good information disclosure. Only company in the listed China equity universe that has set up a corporate-governance committee. BUY.
Wah Sang Gas	1	Urbanisation to continue to drive the company's growth. Regular communication with the investor community. BUY.
Low/uncertain CG SELLs		
Brilliance	4	The Yang Rong debacle and insider sales by directors raise various uncertainties over the group. High CG risks remain. U-PF.
BYD	4	Margins to come under increasing pressure. The auto-maker acquisition raises questions over corporate strategy and CG red flags. U-PF.

Country ratings for macro determinants of CG

Company	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	5	+0.5	New regulations to protect minority shareholders' rights are being promulgated and followed by listed companies. Greater disclosure and weeding out accounting irregularities and corporate fraud are still required.
Enforcement	4	+1	Fraud cases are now widely publicised. However, penalties remain weak.
Political/regulatory environment	5	+0.5	Regulatory risk is lower with most market-opening measures already introduced. But risks on policy changes and uncertainty in key industries (eg, telecoms and banking) remain high.
Adoption of IGAAP	5	Unchanged	All companies seeking to raise money on domestic stock markets must have accounts audited by an international CPA firm. This was introduced a few years ago. Score unchanged.
Institutional mechanisms & CG culture	3	Unchanged	Training courses for independent directors have been set up for the first time. Also, to minimise connected transactions, directors in parent firms of listed companies are no longer allowed to hold positions in the listed spin-off. But P-chips still disappoint.

Source: Company data, CLSA Emerging Markets

Regulatory environment

2001 was the "Year of Corporate Governance"

The CG environment in China has improved visibly following the government's "Year of Corporate Governance" in 2001. Quarterly reporting and the minimum number of independent directors on the board were introduced in the A-share market from 1Q02 and H-share investors were beneficiaries as many H-share companies also have listed A shares. In addition, the CSRC, China's securities watchdog, set down clear requirements for the qualification and level of participation of the independent directors to put in place more effective checks and balances.

The success of improved regulation and disclosure within the A-share market has been reflected in lower turnover levels as "underground funds" have found it more difficult to manipulate stock prices. Accelerating SOE reform and early signs of the implementation of management incentive schemes are translating into improved communication with the investor community.

Supervision of overseas-registered private enterprises operating in China falls into a grey regulatory area. As a result, scandals among HK-listed private enterprises dominated the headlines in 2002. Some of these companies listed in Hong Kong to legitimise themselves, proving that greater cooperation between the mainland and Hong Kong regulators is needed. The CSRC's removal of its "no objection" letter to the these types of companies, effective 1 April 2003, will mean greater scepticism towards the future listings of the private companies.

The most rapid change over the past six months has been in the domestic market

While CG among overseas-listed China stocks continues to improve gradually, the most rapid change has been in the domestic market. A raft of new regulations has been issued by the CSRC aimed at improving transparency, limiting the scope for fraud and protecting minority shareholders' rights. The authorities are showing an increasing willingness to punish offenders without fear of the detrimental impact this has had on stock prices.

Quarterly reporting since 1Q02; a third of directors must be independent from June 2003

The quarterly reporting requirement was introduced in 1Q02 – moving ahead of Hong Kong where the current requirement is only for half-year announcements. By June 2003, at least one-third of listed companies' board members must be independent directors.

Code of Corporate Governance

The authorities have been aggressively promoting the concept of CG. China's first *Code of Corporate Governance* publication was issued in January 2002 and more and more domestic-listed companies have set up CG committees.

CSRC's vigorous clean-up drive

Clearly more needs to be done. However, the CSRC can be credited with rapidly improving the regulatory framework. Its efforts so far have been to educate retail punters about investing as opposed to gambling in the market; and to set the framework for protecting minority shareholders' interests. Its actions are also deterring corporate managers, accountants, brokers and fund managers from involvement in market manipulation, fabrication of financial statements or other unsavoury activities that were previously rife. Tighter regulation and negative exposure of companies once deemed to be high quality such as Guangdong Kelon, have alerted domestic retail and institutional investors to the necessity for CG.

CG stars

CNOOC is top of the pops

CNOOC remains the top-ranked stock in our China CG rankings. This company is closest to obtaining the goals set forth in our CG survey. Strict capital discipline, global benchmarking, good communication with the investment community and a track record of meeting growth targets, make it the new benchmark. CNOOC has a fine line to walk however, as the history of weak CG among state-owned PRC companies is a long one. The recent deal in Kazakhstan raised questions of CNOOC being called to do "national service".

Huaneng Power has built an excellent track record

Huaneng Power has come a long way. Since listing in New York in 1994, it has built an excellent track record of EPS growth and removed its currency mismatch. It had also established one of the best investor-relations departments among Chinese firms, creating audit, remuneration and other committees, as well as effecting a clear separation of the parent company's business from that of the listed company.

WS Gas emerges unscathed

Wah Sang Gas was one of the few private enterprises to emerge with an untarnished reputation over the past 12 months. It has produced excellent returns for shareholders as it focuses only on its core business, and the level of transparency and its management structure have continued to improve.

Zhejiang Expressway, highly transparent

Zhejiang Expressway and Huaneng Power are two of the most transparent and trustworthy H-share companies. Since listing in the mid-1990s, Zhejiang Expressway has kept its promise to shareholders regarding investment return, acquisition plans, etc.

Scoring higher

China Resources produced maiden, voluntary quarterly results in 3Q02. Results and deal briefings have shown a marked improvement in terms of disclosure.

COLI shows rising sense of accountability

China Overseas Land's March 2003 results warning is positive, as it marks a rising sense of accountability. The company has now made a full HK$480m provision against its Hong Kong property exposure that was accumulated before the 1997 financial crisis. As a government-affiliated company, this is a big help in overcoming potential government backlash for the diminution in state assets.

CG disappointments

Euro-Asia's collapse was most damaging of all

Euro-Asia's collapse and the house arrest of Yang Bin, founder and chairman of the orchid-growing company deemed to be the largest in China was the most damaging event for Hong Kong-listed PRC private enterprises last year. After repeatedly denying rumours of government investigations into illegal use of farm land, non-separation of listed and non-listed assets, tax evasion, falsified accounts and working-capital shortfalls within the listed entity and within the chairman's unlisted businesses, the chairman suddenly sold a large chunk of his shares to a couple of local "institutional" investors before he was put under house arrest. Its Hong Kong office was closed down due to funding problems and share trading has been suspended with investigations on alleged accounting fraud.

There is speculation that some of the assets disclosed in the listing prospectus do not actually belong to the company. The chairman was put under custody due to alleged tax evasion and commercial fraud. The house arrest came shortly after Yang's appointment as chief executive of the

Sanuijiu SAR, which led to speculation that the house arrest was related to this appointment that was made apparently without consulting the Chinese government, which was displeased to see the formation of the Sanuijiu SAR right next to China's border and its military zone.

Chaoda Agriculture's share suspension rubbed more salt in the wound

Chaoda Agriculture's announcement of results before its auditors signed off its accounts last October further aggravated investors who were already panicking following Euro-Asia's trading suspension. The auditor's eventual sign-off and the ensuing site visits do not appear to have removed investors' concerns over the agricultural produce maker's extremely high margin. The incoherent replies to investors' query on the high capex and earnings drivers etc have also raised scepticism. Since then, most institutional brokers have dropped coverage of the company.

The announcement of interim results showing margins shrink from 75% to 69% within the space of three months appears to confirm investors' concerns over the credibility of its high margins. The share price fell 35% soon after the results were announced in late March.

Credibility of Brilliance's new management remains to be seen; ownership structure remains unclear

A series of insider share sales, including some that were done immediately after **Brilliance** raised new equity funding, alerted the market that all was not well. While the details of the boardroom struggle are still being debated, Brilliance's founder and chairman have been ousted and the Liaoning government has installed itself as the major shareholder by purchasing the shares held by the State Education Foundation, an ill-defined entity set up to facilitate the company's 1991 NYSE IPO, at a nominal price of HK$0.10/share. A group of minority institutional investors tried to block the sale. The directors that made the initial insider sales have been promoted and continue to run the company.

BYD ventures into unrelated area soon after listing

Newly listed battery maker, **BYD**'s decision to purchase an auto manufacturer highlighted once again that while private enterprises are dynamic, their founders' ambitions may stretch well beyond the business area where they have built their initial success. Despite clarification from the chairman, the auto deal raises doubts over whether the deal was meant to cover a possible slowdown in the core battery business growth.

Related-party transactions are often a problem

Datang and **SIPD**'s unexpected margin decline in 1H02 highlights the main risk to PRC corporate earnings owing ultimately to poor CG – here because of too many obscure related-party transactions with the parent. Both companies have exhibited an increase in non-fuel unit costs every year since listing. The change in parent companies following the State Power break up hopefully will improve the situation, as it appears the old parent companies (gridcos, which will be merged into a new, separate grid company) were engaged in transfer pricing of services to their benefit.

Low ROI for PetroChina's acquisition of assets from its parent

PetroChina's decision to purchase its parent's retail gas station network raised eyebrows. The company acquired assets at an 18% discount to appraised book value, but even so, we estimate the return on investment will be only 4%. A likely easing in the mainland's strict valuation criteria (assets are seldom traded below book value) will allow listed companies more flexibility in negotiating deals with the parent that also satisfy the interests of minority shareholders.

Greater industry transparency for China Mobile

Market giant **China Mobile** has yet to impress on the CG front. The company continues to have a low CG rating. Transparency has improved on the regulatory front, which will help the company deal better with the investment community. The low CG score is partially due to the government as a major shareholder and having managed the industry in ways that have at times been counter to China Mobile's interests.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
Huaneng Power	1	❑ Transparency continues to improve. Recent acquisitions, which had initially sparkled some debate will prove to be attractively priced and offer strong growth potential. Accelerating growth momentum and stable management team could lead to further rerating.
China Resources Enterprises	2	❑ Quarterly reporting ❑ Appointment of non-executive directors via a nominating committee. ❑ Earlier-than-expected harvest from its massive investment in the retail operations.

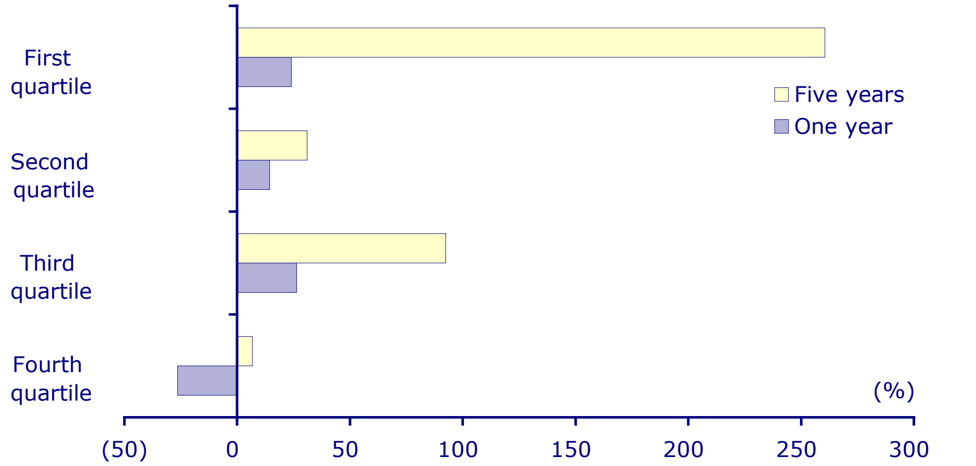
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
Shenzhen Expressway	2	❑ The recent sale of its major asset, accounting for 39% of FY01 earnings, to its parent could weaken the company's earnings outlook ❑ Replacing this income will be difficult as there are few attractive acquisition opportunities. Disclosure could suffer. ❑ The ongoing privatisation of infrastructure projects could further limit the chance for attractive deals.
China Resources Land	4	❑ Failing to meet sales targets twice in the past 12 months aroused doubts about management's grip on its operations. Slow response to the market change once again reinforces concerns on management's judgement ability. ❑ Frequent management changes at the ground level and deteriorating information disclosure are also shaking investors' confidence.

Source: Company data, CLSA Emerging Markets

Relative performance of high CG stocks

CG quartiles versus CLSA China World Index (1997–2002)



Source: CLSA Emerging Markets

Companies in the top quartile of CG scores have clearly outperformed over the past one to five years.

The top quartile has outperformed our benchmark CLSA China World Index by 261% over the past five years, led by **Legend** and **Zhejiang Expressway**; and by 24% over the past 12 months, led by **Cosco Pacific**, **Zhejiang Expressway** and **CNOOC**. Legend has performed strongly over the past five years, right through the tech and internet rally and bust in early 2000.

China Mobile saves the bottom quartile

The bottom quartile has underperformed by 26% over the past 12 months but outperformed by 7% over the past five years thanks to **China Mobile**, which has much to do with the unsettling regulatory environment and downfall of telecom valuations globally.

The performance of the second quartile has been much more moderate than the first quartile, outperforming our benchmark CLSA China World Index by 31% over the past five years. **Jiangsu Expressway** and **Shandong Power International** led the way in the past five years. The second quartile outperformed by 14% over the past 12 months, as a result of the strong performance of **China Shipping** and **Anhui Expressway** and a rebound in **Citic Pacific** and **China Merchant**.

The third quartile has actually performed better than the second quartile, outperforming the benchmark CLSA China World Index by 92% in the past five years. The strong performance is largely due to the **Yanzhou Coal**, **PetroChina** and **Beijing Airport**. **China Pharmaceutical**'s share-price appreciation of over 200% since it reached its trough last July, as well as the continued strength in Yanzhou Coal, has contributed to the third quartile's 26% outperformance against the benchmark index in the past 12 months.

Chinese companies in the top CG quartiles

First and second quartile Chinese companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
CNOOC	9	1
UTStarcom	13	1
Legend	15	1
Cosco Pacific	10	1
Wah Sang Gas	-	1
Hengan	-	1
Zhejiang Expressway	16	1
Huaneng Power	6	1
Bejing Datang Power	7	1
China Shipping Development	32	2
Anhui Expressway	25	2
China Resources	25	2
Shanghai Industrial	28	2
SIPD	24	2
Jiangsu Expressway	26	2
China Merchants	-	2
Shenzhen Expressway	20	2
CITIC Pacific	(1)	2

Source: CLSA Emerging Markets

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
China Shipping	+32	The sale of the loss making container-shipping business back to its parent demonstrates the ability of management to create value for shareholders.
Jiangsu Expressway	+26	Latest acquisitions have enhanced management credibility.
China Resources	+25	Better disclosure from quarterly reporting; greater transparency.
Anhui Expressway	+25	The company made a big effort to improve investor relations last year leading to provision of more information.
Zhejiang Expressway	+16	Improved IR and transparency. Profitable roads such as Shangsan inspire confidence in the company's ability to make value-enhancing acquisitions.
Brilliance China	(8)	The company's previous denial as to the legality of the ownership of its founder has led to lower score on transparency and fairness. The selling of shares and exercise of share options by insiders before a major event also raises concern.
China Rare Earth	(6)	Collapse in rare-earth pricing was not well communicated to the market. Management also made a large bet on raw-material prices which went wrong.

Source: CLSA Emerging Markets

Hong Kong - A CG torpedo called Boto

CG helps performance particularly when there are significant changes

The **Boto Holdings** issue (discussed below) summarised a major CG problem in Hong Kong: without class action suits, directors are able to weave between the rules and push through with legal immunity deals that are clearly against the interests of the company. New listing rules and their enforcement by the Securities and Futures Commission (SFC), rather than the exchange, will improve the overall regulatory structure. However, the proposal to make quarterly reporting mandatory was dropped.

Some companies are already implementing higher disclosure standards, taking on the form of improved CG (eg, **HK Land**, **Wharf**, **Kerry Properties** and **SCMP**). Companies in the top CG quartile do not necessarily outperform in a market like Hong Kong where CG is not a major issue by and large for the bigger-cap stocks. Selecting stocks with good fundamentals and attractive valuations is key for returns, while high CG reduces the risk. Big gains come from companies entering into deals that improve their CG structure - in 2002 these were **Esprit** and **Yue Yuen**. A major concern, however, is when a company appears to want to do deals for the sake of it, slants its statements differently when replying to different exchanges and pushes back its dividends - **PCCW** last year was the worst-performing index stock.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
HSBC	1	As perceptions on risks regarding Households International ease, expect a massive rerating for this value-enhancing acquisition.
Standard Chartered	1	Improving emerging market economies and improved consumer credit delinquencies in Hong Kong and Singapore will lead to outperformance.
Esprit	1	Already a strong performer in 2002 but with the US-dollar buying power of European customers increasing, expect further upside surprises in 2003.
HK Exchanges	1	Market liquidity play which is also improving the makeup of its Board.
Low/uncertain CG SELLs		
PCCW	4	Any realisation of major deals for this highly geared group will lead to further declines.
First Pac	4	Lower valuations than market expectations for disposal of its Philippine businesses would pull down the stock.
Smartone	4	Further competitive pressure on call charges will hold down stock value.
i-Cable	3	Risk of transparency suffering as competition intensifies with Television Broadcasts (TVB) entering into the pay-TV market.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	8	Unchanged	New rules coming but only taking effect in 2003.
Enforcement	6.5	+0.5	Some efforts to improve enforcement.
Political/regulatory environment	6.5	-0.5	The Boto case highlights CG risks where there is no group to take action on behalf of investors for companies where directors appear to act against the interests of the company.
Adoption of IGAAP	9	Unchanged	
Institutional mechanisms & CG culture	7	Unchanged	Failure of HAMS to be launched; reactionary stance against CG proposals by various professional bodies; but offset by greater attention to CG by companies.

Source: CLSA Emerging Markets

Regulatory environment

"Penny stocks" scandal caused HK$10bn loss

The credibility of the regulators took a knock, particularly in the eyes of retail investors, in what was called the "Penny Stocks" scandal. The Exchange, after consultation with the SFC, had issued a consultation paper in July 2002 proposing that companies which had stock prices trading below HK$0.50 for 30 trading days would have to either consolidate the shares or face a delisting of the stock. The man on the street reading media reports of this probably did not understand what consolidation of shares meant. They knew what suspension meant, and panicked. A number of stocks that were trading around or below the HK$0.50/share level plummeted when concerned investors dumped their holdings in an overall weak market environment. Some HK$10bn was lost in the market cap of related stocks.

HK Ex CEO steps down when contract expires

As a result of this destruction in wealth, both the Exchange and the SFC came under flak. Arguably, the retail investing public overreacted to the proposal: it did not require automatic delisting of such companies, but only if the company did not take any actions like consolidation of shares. Also it was only a proposal in a consultation paper, and not a rule that was near to being implemented. Still, in what was seen as taking responsibility for the incident, the Chief Executive of the Exchanges announced that he would step down when his current contract expires this April.

Listing regulations being moved away from the Exchanges to SFC

The Financial Secretary also set up a Panel of Inquiry into the Penny Stocks Incident (officially acronymed PIPSI). The PIPSI recommended that an Expert Group be set up to review the regulatory structure of the securities and futures markets. This Expert Group has just recommended, and the Financial Secretary has accepted, that the power to approve new listings and to enforce the listing regulations be moved from HK Exchanges to a new body, the Hong Kong Listing Authority, under the SFC. This is likely to come into force in the latter part of 2004. Hong Kong will become the first Asian market to make such a move, following the lead of the UK. This significant change addresses the criticism that had been levelled against the exchange, that as a regulator but also a for-profit listed company, there was an irreconcilable conflict in its interests to maximise profits and have as many new listings but also to ensure that only the right sort of companies are listed.

SFO comes into force

Coming into force more immediately, from 1 April 2003, is the new Securities and Futures Ordinance (SFO) which consolidates and updates ten existing ordinances. The Legislative Council (LegCo) had enacted this ordinance in March 2002. Under the SFO, the disclosure threshold for declaring one's interest in a company is reduced from 10% to 5% and the notification period is reduced from five to three business days.

Market Misconduct Tribunal set up

A Market Misconduct Tribunal (MMT) will be set up under the SFC, to work together with the Insider Dealing Tribunal, handling civil cases of all forms of market misconduct (market manipulation, price rigging, etc.). Powers to obtain documents from listed companies will extend to parties closely connected such as its banks, auditors and transaction counterparties. The MMT will decide cases on the lower civil standard of proof and have a range of civil sanctions – eg, ordering the disgorgement of profits, disqualifying a person from directorship, "cease and desist" as well as "cold shoulder" orders. All forms of market misconduct can also still be subject to criminal prosecution.

Findings of the MMT in relation to market misconduct will be admissible in a private civil action. Investors suffering loss as a result of false or misleading public statements concerning securities made fraudulently or negligently will have a right of action under the SFO against those who make such statements.

Consultations completed on amendment to Listing Rules to improve CG

Meanwhile, the Stock Exchange published in January 2003 the conclusion of its consultations on proposed amendments to the Listing Rules relating to CG. The key issue that had been proposed in the paper last year was to move towards quarterly reporting. After the consultations, however, the Exchange decided not to make this mandatory. The Exchange will review its position on quarterly reporting in 2005, the target date for implementation of quarterly reporting in Europe. Other changes to be made to the Listing Rules, expected to take force by the later part of this year, include:

Three independent directors becomes minimum

- Listed companies will be required to appoint at least three independent non-executive directors (INED), at least one of whom is to have professional qualifications or experience in financial matters. The revised Code of Best Practice will recommend that INEDs comprise at least one-third of the board.

Audit committees become mandatory

- It will become mandatory for a listed company to have an audit committee, with a majority of the members and the chairman being an INED. At least one of the INEDs on the audit committee must have experience or qualifications in financial reporting. Companies will have to disclose information relating to the audit committee and their functioning in the annual report.
- INEDs will have to provide confirmation to the Exchange of their independence and any factors that might affect their independence.
- Companies listed on the main board will have to disclose directors remuneration on an individual basis, though they will not be required to disclose the directors' names.

Conditions on issuing new shares at larger than 20% discount

- Listed companies will only be able to issue shares at a discount of 20% or greater if they satisfy the Exchange that they are in severe financial difficulty. If a placement is made at such a discount, the company will have to provide a "generic description" of the 10 largest placees and the number of shares subscribed by each.
- Where the company is considering entering into any transaction where any of the shareholders have to abstain from voting, the company will establish an independent board committee to advise shareholders and appoint an independent expert who will advise the committee on the transaction.
- Listed companies will have to include a report on CG in their annual reports and disclose information relating to their CG practices in the report, stating any deviation from the minimum standards set out in the Code of Best Practices. Any changes in the company's CG practices must also be disclosed in half-yearly announcements.

Code of Best Practices is an Appendix of Listing Rules

- The Code of Best Practices (an Appendix of the Listing Rules) will include as a minimum standard the establishment of both a remuneration and a nomination committee each of which to be comprised of a majority of INEDs. Companies will have to disclose information on the remuneration and nomination committees in the annual reports.

- A minimum standard of the Code of Best Practices is that the company should segregate the responsibilities of Chairman and Chief Executive.
- Shareholders will need to approve any director's contract if for a period exceeding three years, or if the contract stipulates a one-year notice period.
- Listed companies will be required to announce any change in directorship; where there has been a resignation of a director, the company will have to reveal the reasons for the resignation and if there are any disagreements with the company and the departing director.

A detailed presentation of the original proposals and the consultation conclusions can be found at the Exchanges's web site (www.hkex.com.hk).

Although much of the measures being introduced are clearly positive for improving CG in the market, the Exchanges final recommendations after the consultation period softened some of the original proposals. Quarterly reporting, though originally proposed, was not made mandatory. Instead of the original proposal to require that one-third of any Board of Directors be comprised of INEDs, this became only a recommendation of best practice, while the minimum requirement would be just three INEDs. One of the criteria for independence was originally proposed to require that professional advisors to a company could only be considered an independent director after a two-year "cooling off" period. After the consultations, this was reduced to just one year. The softening in these regulations has been seen as the Exchanges caving in to pressure by issuers and accountants as well as some other professional bodies.

HAMS proposal floundered

While regulations will improve, the question is whether investors are able to use these rules to avoid outcomes that disadvantage minorities. Having an activist group mandated to act on behalf of investors would give greater force to these rules – particularly in instituting civil, rather than criminal, action against directors and companies (see Boto case below). Thus it is a disappointment that the proposal to set up a Hong Kong Association of Minority Shareholder (HAMS) has floundered with the SFC not agreeing to provide the funding for such an organisation. The Market Manipulation Tribunal of the SFC will be taking up civil cases as well as criminal, but its ambit will be share price manipulation rather than directors' negligence. Thus there remains an uncomfortable gap given the lack of shareholder activism in Hong Kong which does not look to be changing.

CG stars

Multinational banks subject to various regulations will generally have higher standards

A global bank operating in multiple jurisdictions, with no significant shareholder and run as conservatively as **HSBC** would almost certainly have one of the highest CG standards. The bank remains at the top of our rankings in Hong Kong and Asia. **Standard Chartered**, which we commenced coverage of in 2002 with its listing in Hong Kong, comes a close second. Although Standard Chartered has a significant shareholder, he is a passive investor and it remains in the interests of the bank to have the highest CG standards for all its shareholders.

International retailers /trading companies also with high CG

Beyond the larger banks, **Li & Fung** and **Esprit** also have a high CG ranking, emulating practices of other companies in the retailing/trading sector in developed markets. Li & Fung has, for instance, a Chief Compliance Officer to ensure that its conduct meets its code.

V-Tech is a small cap with a big CG score

More surprising, however, are some of the smaller-cap companies which have high CG scores. In our rankings, among the top ten is **V-Tech**. Although the acquisition of Lucent's wired business was a disaster because of subsequent massive provisions that had to be made on the business acquired, Vtech's crisis management was impressive, taking upfront the provisions for overpaying in the acquisition while pursuing Lucent for damages (it has since also filed a suit against PwC for poor advice relating to the transaction) and bringing the company back to positive cashflow. Some of the senior management were ousted - a responsible way of punishing mismanagement which scores extra points in our CG scoring. Vtech, in seeking to re-establish credibility, has appointed a number of independent non-executive directors replacing senior management on the board. The new INEDs include the chairman of Johnson Electric, the MD of Li & Fung, as well as senior representatives of G2000 group and chinadotcom. The company thus scores highly in our independence and accountability categories.

Significant disclosures push up score for Kerry Properties

Kerry Properties is another smaller cap that enters our top quartile for CG in Hong Kong. Its recent annual report has two full pages of CG disclosure, discussing the board (including the number of board meetings as well as the attendance of executive, non-executive and independent non-executive directors), a similar discussion for the audit committee and finance committee. Internal controls and audit is discussed extensively. They have also put more emphasis on environmental protection and promotion, including setting up stringent environmental protection standards for its developments and discusses attempts to reduce waste and recycle of materials in properties under management. Its CG score has risen seven points, while sister-company **SCMP** also sees a six-point improvement in our score in making a similar attempt to reflect an improvement in CG form.

CG disappointments

Boto scandal: Selling off the main business at a lower multiple than market valuation

The major CG blot for Hong Kong in 2002 came in the name of **Boto Holdings**. The company, in March 2002, entered into an agreement to dispose its main business – the manufacture of plastic Christmas trees and garden accessories – to a vehicle that would be 70%-owned by the Carlyle Group of the US and 30%-controlled by the Chairman of Boto and his family trust. The problem for investors is that this deal valued the business at a lower multiple than what the market was trading the stock on. Worse still, upon the disposal of its main business, the listed company would be left with just a loss-making computer-animation business run by the Chairman's son.

Terms revised so that not considered related-party transaction

Under the original terms of the transaction, as the business was to be sold to a company in which the controlling shareholder had an interest, the major shareholders would have had to abstain from voting. However, the company revised the terms of the transaction in July. Under the revised terms, Boto would dispose 75% (rather than 100%) of its main business to a limited partnership affiliated with Carlyle, but in which the Chairman of Boto had no declared interest.

Deal passed with relatives of controlling shareholder and management voting

Under the revised terms, this was no longer a related-party transaction. Nevertheless the Chairman and some of his family members abstained from voting. But others related to the company, including a nephew of the Chairman, were allowed to vote. The result was close. The deal was passed, by a margin of 53% to 47%.

No independent advisor apparently found to endorse the deal

Because related parties to the Chairman were allowed to vote, the Exchanges was criticised. Its defence is that the deal was revised such that it was no longer a related-party transaction and hence, under the regulations, all shareholders were entitled to vote. On this technicality, the Exchange appears to be right. However, this was a transaction where even the independent financial advisor, appointed by the company, advised shareholders against accepting the transaction. Indeed, this is striking as no independent advisor has recommended against any Hong Kong deal for more than a decade. The decision by Anglo Chinese Corporate Finance to advise against the deal was a shocker and should have woken up all on the Board of Boto.

Were directors acting in best interest of the company?

The question then is why the management and directors still went ahead with this deal. Arguably, any board member who recommended or voted for this proposal was in breach of their fiduciary responsibility to be acting in the best interests of the company. The rub is that Hong Kong, like other Asian jurisdictions, does not allow class-action suits. It also does not allow contingency fees for lawyers. Losers will usually have to pay the court costs of the winning side as well. Hence, on balance, it is not in the interest of any of the individual minority shareholders to pursue the matter in the courts. And controlling shareholders and directors have little legal risk in proposing and pushing for such transactions.

Henderson Investment privatisation proposal drew investors' ire

Boto is a small-cap company (although it did have a major global fund as an investor). The large-cap company that drew the ire of investors was **Henderson Investors**, when its controlling shareholder, Henderson Land, proposed to privatise the associate which was trading at a huge discount to net asset value. While the offer was at a 28% premium to the market price, this was still almost 30% below book value. The deal was defeated in the vote – where the controlling shareholder did abstain – by a very narrow margin.

That proposal defeated reflects positively on minorities being able to exercise their rights

Whether this is a CG issue is debatable: a public bid by one set of shareholders to other shareholders to take over their interest can be seen as a commercial proposal. Unlike other countries where nominees of the controlling shareholder can almost certainly be expected to secure the vote, here this did not happen. That the privatisation proposal could be defeated in a fair vote would on balance reflect positively on protection of minority rights: investors are able to exercise these rights without underhanded practices by controlling shareholders that make actions by minorities at EGMs futile in many other jurisdictions.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
HK Exchanges	1	❑ Honouring a pledge made three years ago, the government will reduce its appointed directors from eight to six thus scaling back its influence on the exchange. ❑ HKEx will commence publishing quarterly results from 1Q03. ❑ Improving capital management reflected in higher payout for 2002.
Bank of China (BoC) - HK	4	❑ Because of its recent listing, BoC is disadvantaged on a number of questions in our CG score that relate to five-year track records. The score should improve over time.

Source: CLSA Emerging Markets

Companies with CG downside risk

Company	CG quartile	Events that could change CG score
Hutchison	4	❑ Accounting issues could arise if there are attempts to massage the losses of the 3G start-up operations. ❑ Accessibility to senior management may become an issue as the market seeks greater clarity on 3G rollout. ❑ Same auditors who accept write-offs of 3G operations by its partners, while allowing the 3G operations to remain stated at book value for Hutchison.
i-Cable	3	❑ As competition intensifies, management accessibility and transparency could suffer.

Source: CLSA Emerging Markets

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How to value a property company?

While on the topic of CG, it is interesting to note the lack of transparency from Hong Kong's landlords. The problem is two-fold in terms of a lack of transparency both on rents and the cap rates used for portfolio valuation.

Face rents are kept artificially high and reduced with rent free

It is common practice in Hong Kong to build up the face rent on a lease to unrealistic levels and then to reduce the effective rent paid by use of rent free, however much of the rent free is hidden away by the use of confidentiality clauses and confidential side letters, thus denying both the market and analysts a proper basis for comparison.

Often this is done with confidential side letters

The use of rent free is self explanatory, however the use of side letters requires a bit of explanation. Leases for more than three years in length have to be registered with the Lands department and as such anyone prepared to pay a small fee can get hold of a copy and read the rental terms. However, side letters do not have to be registered along with the lease and thus a HK$30 rent stated in the lease could really be a HK$20 rent by use of a side letter granting 12 months rent free over the three-year term.

Creates a two-tier market designed to benefit landlords on rent reviews

The reason for all this secrecy is two-fold. Firstly Landlords seem to believe that by creating some opacity they can control the direction of rents. Secondly, the wording of most rent-review clauses in Hong Kong tries to exclude rent free from the calculation of the fair market rent. This means that by keeping face rents high, they are protecting the average rents of the existing portfolio. This has led to the current situation where real rents are in many cases some 40% lower than the face rents stated in the leases.

But a series of UK court decisions have put paid to relevance of this tactic

However a number of UK court cases (collectively known as the Broadgate decisions) have established that the exclusion of rent free in the calculation of rent during a rent review will not be accepted by the courts unless an extremely onerous and specific set of wording has been used. Such a set of wording is unlikely to be acceptable to a tenant's legal advisor given the strength of tenants in negotiations these days and as such this reason for high face rents seems somewhat moribund.

And yet landlords continue with the practice

Despite these UK court decisions, Hong Kong landlords seem wedded to this principle of high face rents and long rent frees. The problem is that the lack of transparency leaves analysts without clear guidance on one of the key components of the valuation of the companies NAV.

Hongkong Land is the one stand out as a good CG player in this regard

Hongkong Land is to be commended as it is the only one of the landlords who publishes its average portfolio rents. This information allows for more accurate forecasting as well as getting a better feel for the direction of change in the rental market.

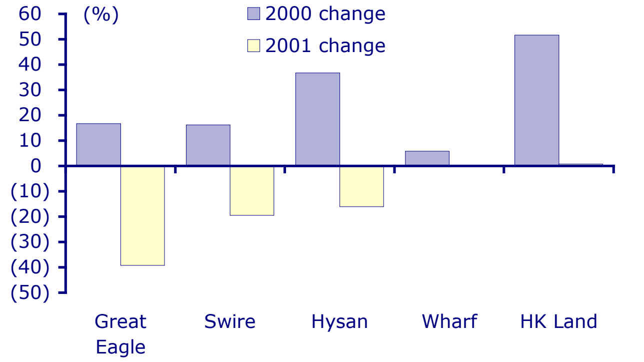
But even it doesn't share the cap rates

However even Hongkong Land isn't perfect in terms of the overall portfolio valuation, given that it does not publish the cap rates used for the year-end revaluation of properties. Armed with the rents, some estimate can be made, however with no breakdown on the valuation of individual assets it is only possible to calculate a blended cap rate for the valuation of the portfolio as a whole, which includes retail and office as well as buildings of very different ages.

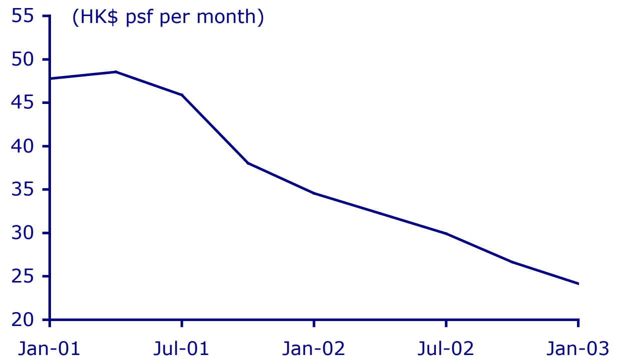
Look at the revaluations of investment properties and it is clear that valuers have been generous

If we look for a moment at the revaluation of investment properties versus the falls in average rents as reported by the major leasing agents, it quickly becomes clear that values have not dropped nearly as far as people would have expected.

Change in investment properties' revaluation reserve



Effective rents in Central district



Source: CLSA Emerging Markets

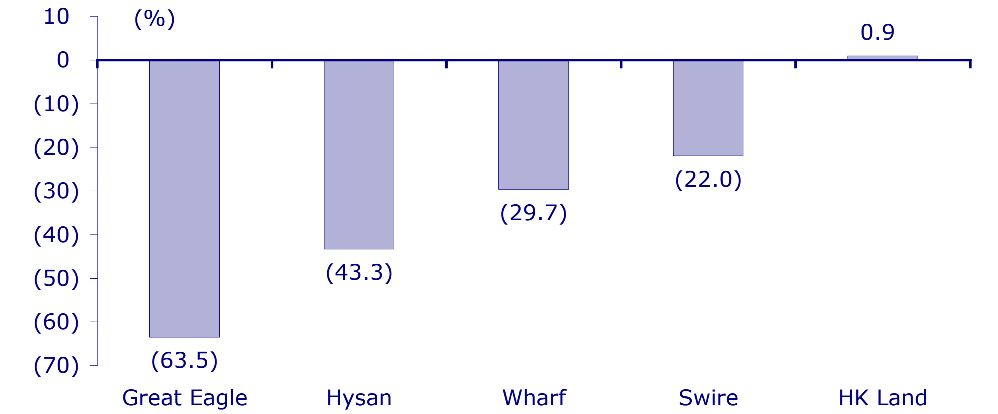
The argument is that cap rates should fall as interest rates fall, but we believe that this is a dangerous assumption

Landlords would argue that this is because cap rates have been falling as interest rates have been falling and of course a declining cap rate will act to reverse the effect of falling rents. Now, for valuers, the choice of a cap rate is a difficult one. Most valuers are taught that the best method is to find a recently sold property of a similar type, analyse the transaction and apply the same cap rate. In Hong Kong, however, there are virtually no Grade A buildings ever sold en bloc (arguably the last was The Entertainment Centre, bought by Hysan in 1997). As such, valuers are left to estimate the cap rate in the light of secondary-building cap rates and the prevailing direction of interest rates.

Evidence from the more liquid Grade B market has been showing cap rates going up

We contend however that the practice of dropping cap rates simply because interest rates have fallen is a dangerous one. In an environment where rents are definitely going to fall (and they are and will continue to for some time) one would expect to be compensated for this decline in cashflow by a higher-than-market yield. Indeed there is evidence to this effect with the increase in cap rates for Grade B product (the actively traded stuff), despite the falls in interest rates. However regardless of your view on the detail of property valuation and appropriate cap rates, one thing is clear. Investors don't believe in the valuations of the assets. If they did, these stocks would not be trading at the huge discounts that they are. While it could be said that some discount should exist to reflect low asset turnover and ROEs, discounts this wide belie a basic lack of belief.

Landlords discounts to NAV



We believe that more information would not be harmful to companies' commercial positions

We believe that more sharing of information on rents and cap rates would not be harmful to these companies' commercial positions as some would have you believe. If REITS do come to Hong Kong they will act to force through some of these changes with higher levels of disclosure of both rents and valuations, as well as substantially greater regulation of valuers and their valuation of investment portfolios. By denying information on rents and values, shareholders are unable to make accurate decisions as the value of companies in the same way as if there is a lack of transparency on any other area of the balance sheet. With the one-year lag to the book value and the high volatility of property rents and values in Hong Kong, this position is exacerbated.

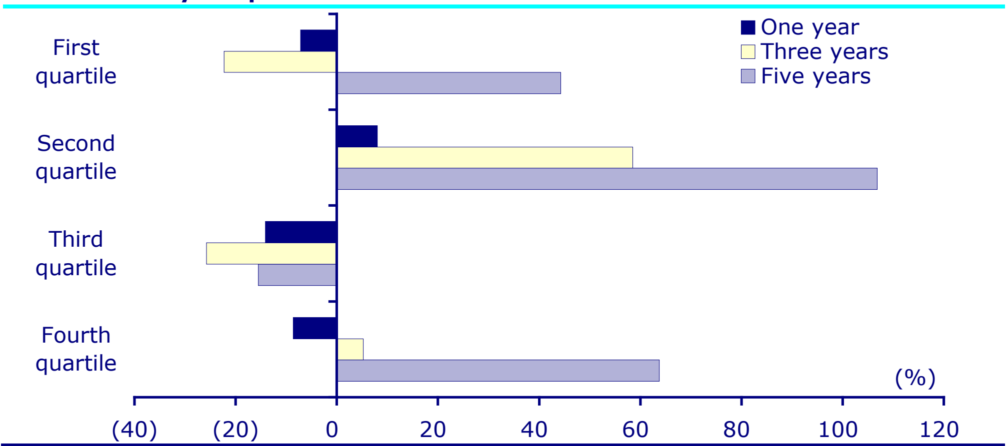
Relative performance of high CG stocks

Top CG stocks did not outperform in HK in 2002 . . .

In a market that suffered a decline of 21% in 2002 (by MSCI-HK) and where a number of the larger-cap index stocks are higher beta but also provide higher CG, it is not surprising that the top CG quartile did not outperform the other quartiles in 2002. The top quartile CG companies on average declined 7.2% versus an average decline of 5.5% for the four quartiles. (The performance of each quartile is on a simple average basis to prevent large-cap stocks to skew the results in any particular quartile. The index fell by more than each of the quartiles because larger-cap index stocks were bigger decliners in the market. Hence performance of any particular quartile against the index is misleading.)

. . . but high CG stocks have outperformers over the medium term

Performance by CG quartiles

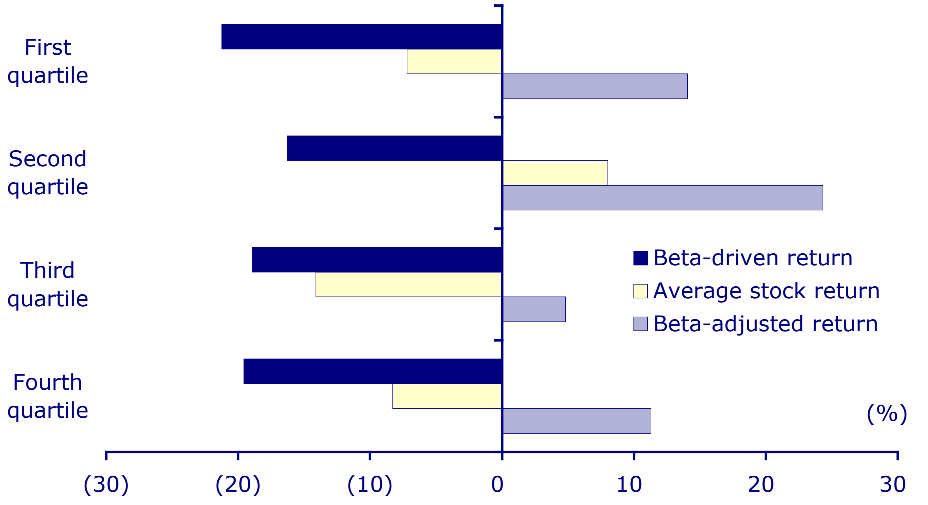


Source: CLSA Emerging Markets

The top-performing quartile in 2002 was the second by CG rankings purely because of stellar performance of **Techtronic** which was up 137% last year (and 483% over the past three years).

Higher returns for better CG companies on a beta-adjusted basis

Higher beta-adjusted returns for better CG stocks



Source: CLSA Emerging Markets

Top quartile had an average return 14ppts higher than their beta multiplied by MSCI decline

Interestingly though for 2002, adjusting the performance of the stocks for their beta, we find that the higher CG quartiles give a better performance than would be derived from the beta of the stocks multiplied against the MSCI-HK return. On average, the top CG quartile return based purely on the beta of the stocks multiplied by the MSCI-HK decline would have been minus 21.2%. The actual average return of the stocks in the quartile was minus 7.2%, giving a beta-adjusted positive return of 14.1%. The second quartile had an even stronger beta-adjusted return of 24.3% (owing largely to **Techtronic**). These returns are much higher than for the stocks in the lower two quartiles: the third-quartile average beta-adjusted return was 4.8% and for the fourth quartile 11.3%. (The higher average returns for every quartile against the market is owing to comparing a simple average against a market-cap weighted average.)

Over the longer term, and especially over five years, a simple average of the top CG companies did however outperform. The top quartile gave a simple average return of 51.5% over the five years to end-2002, significantly outperforming the bottom quartile's 35.8% average return. The top half companies for CG in our coverage gave an average stock return of 60%, versus the 43.8% average five-year return for the stocks in the lower half of the CG table.

Outperformance especially for those that enter CG-improving deals

Picking stocks of companies where CG is improving does help performance, at least on a relative basis. The six companies with most noticeable CG improvements over our scores last year are **Esprit**, **Yue Yuen**, **Wharf**, **Hongkong Land**, **Kerry Properties** and **SCMP** (see table below). This group of companies with noticeable CG improvement had a simple average positive return of +1.8%, which was creditable against the market decline of 21%. This was owing to strong performance last year in the share prices of Esprit and Yue Yuen that more than offset the declines in the property companies (Hongkong Land, Kerry Properties and, to an extent, Wharf) as well as SCMP which had large decline in its share values because of cyclical factors.

For Esprit, the acquisition of Esprit (US) not just provides a source of long-term growth, but the removal of paying management fees from out of the group as well as action against management in certain sectors that have been underperforming are CG positives. Yue Yuen's acquisition of the upstream materials business from its parent removes the previous related-party transactions for its shoe-manufacturing operations. Its disposal of its computer monitor manufacturing business allows it to focus more on its main shoe business. These positive transactions fundamentally as well as in improving CG relationships, resulted in massive outperformance of the stocks.

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
Esprit	+16.3	Acquisition of US arm ends management fee being paid out of the listed company. Management is scrupulous about disclosure of anything that could raise eyebrows including sale of shares from options exercise.
Yue Yuen	+15.0	Acquisition of upstream operations from parent ends the related-party transactions. Sale of stake in computer monitor manufacturer results in greater focus on core business. Management has improved access to investment community, enhanced corporate website.
Wharf	+8.8	More focused strategy on core businesses, tightened financial and risk management and better asset and liabilities management.
Hongkong Land	+7.6	Separate section in annual report detailing policies on CG.
Kerry Properties	+7.3	Two full pages of CG disclosure in annual report discussing number of board meetings and attendance of directors, internal controls, audit committee, finance committee and internal audit responsibilities. Greater emphasis on environmental protection and promotion.
SCMP	+6.0	Two full pages of CG disclosure in annual report discussing number of board meetings and attendance of directors, internal controls, audit committee, finance committee and internal audit responsibilities. Documented code of conduct for directors, managers, employees.
CLP	-5.9	Poor guidance ahead of results on HK$300m provisions that surfaced in 2002 results. Even in results announcement and presentation there was little transparency on this. However remains in the top CG quartile for HK.
PCCW	-9.9	Amended question on dilution results in lower score for large issue of options to management. Disclosure on attempt to acquire C&W was seen as misleading and is being investigated by HK Exchanges.

Source: CLSA Emerging Markets

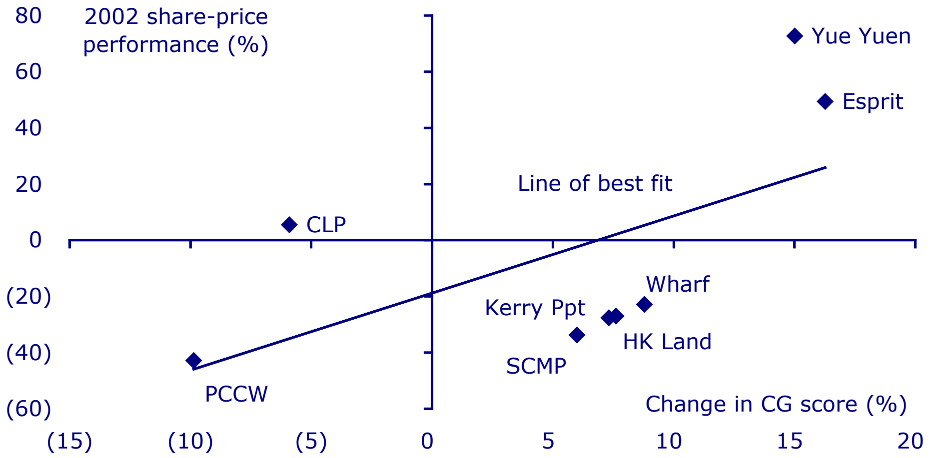
PCCW's stock declined and it also had a large drop in CG score

PCCW's clumsy attempt at a takeover of C&W in the UK and differing statements to the Hong Kong and London exchanges has reduced its CG score down 9.9 points, the biggest decline in our Hong Kong coverage. Its stock fell 42.8% last year with a large part of the decline happening soon after news of the attempt at a takeover of C&W.

CLP's lack of guidance before announcing HK$300m provisions in its 2002 results, and lack of clarity on these provisions subsequent to the announcement, brings its CG score down a notch – although it still remains among the highest in our Hong Kong universe and also favoured by investors for defensive earnings; the stock was a relative outperformer in the market.

Changing CG score can lead to major share-price move

2002 share-price performance against CG score change



Deals that impact on CG can have amplified impact on stocks

CG is not a major issue for most of the bigger caps in the market, certainly in comparison to other markets. Thus CG is not itself a major determinant of stock performance - at least over one to three years, although top CG companies do show outperformance over a five-year period. But choosing companies with good fundamentals at fair valuations, (the BUYs and Outperforms in our coverage) that come together with high CG, reduces risks. Companies that are involved in corporate transactions that improve their CG structure can lead to big outperformance. Those companies that, however, allow the market perception on their CG to slip can see a massive derating.

Hong Kong companies in the top CG quartiles

First and second quartile Hong Kong companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
HSBC	(2.7)	1
Standard Chartered	na	1
Li & Fung	0.1	1
Esprit Holdings	16.3	1
HK Exchanges	na	1
VTech	3.9	1
Swire	4.4	1
Cathay Pacific	(1.1)	1
Kerry	7.3	1
Sun Hung Kai	2.7	1
CLP	(5.9)	1
Hongkong Land (US$)	7.6	2
MTRC	(0.3)	2
KMB	na	2
Henderson Land	3.5	2
Johnson Electric	3.5	2
Giordano	(1.1)	2
CRA	(1.5)	2
Café de Coral	na	2
Wing Hang	1.9	2
HK Electric	(0.8)	2
Hang Seng Bank	0.8	2

Source: CLSA Emerging Markets

India - CG gaining further acceptance

New standards, more companies with half of board being independent directors

CG adherence gained further ground in 2002 with the tightening up of some of the existing requirements as well as implementation of new norms - as suggested by two high-powered committees set up by the Securities and Exchange Board of India (SEBI), the market regulator, and the Department of Company Affairs (DCA). The number of companies with independent directors making up more than half of their board has risen significantly in 2002. Overall disclosure standards have shown a dramatic improvement with critical information now generally being provided to shareholders in a timely manner, even as the gap between Indian GAAP and US GAAP has substantively narrowed. Passage of the SEBI Bill 2002, is an important landmark giving more powers to the regulator to deal with corporate misdemeanour.

CG stars of 2002 continue to retain their position as high CG companies this year too. Companies with significant improvement in CG score are **Mphasis BFL**, **Satyam**, **BHEL**, **Zee Telefilms**, **Hindalco**, **Wipro**, **ABB** and **Ranbaxy**. Meanwhile, **Hughes Software**, **VSNL**, **L&T** and **BPCL** have shown a decline in CG scores.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
Infosys	1	Impending multi-million dollar outsourcing contracts would redefine the next phase of growth.
HDFC	1	Ongoing mortgage boom in the country will continue to drive strong volume growth sustaining its premium valuations.
HLL	1	Strong rebound in top-line growth trend from 1Q03 onwards will drive rerating. Near-term high dividend yield acts as the icing on the cake.
Dr Reddy’s	1	Victory in some of some of the many patent challenges could lead to stellar earnings growth. Newsflow on amlodipine is a near-term trigger.
Hero Honda	1	Re-enforcement of Honda's support to this venture over the next few weeks will ease investor concerns on the stock driving a rerating.
Low/uncertain CG SELLs		
ACC	4	Near-term outlook for cement prices remains weak - a risk for near-term earnings and stocks premium valuations.
Gujarat Ambuja	4	Near-term earnings risk due to weak cement prices and uncertainties on open offer issue for ACC will keep the stock price under pressure.
IOC	4	Government is likely to use IOC as an instrument for implementing public policy, to the detriment of minority shareholders.
ICICI Bank	4	Rising NPLs will put pressure on interest income as well as valuations.
Tata Tea	4	Downward trend in tea prices will keep stock under pressure.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	8	Unchanged	Existing norms made more stringent, new rules introduced; but already at a high score.
Enforcement	6	+1	Companies have adhered to norms relating to better disclosures in results, annual reports and independence of board and audit committee.
Political/regulatory environment	6	Unchanged	Political environment is conducive to better CG standards.
Adoption of IGAAP	7.5	+1.5	With consolidation, segmental reporting, deferred tax accounting, related-party transactions gap between Indian and US GAAP is minimal.
Institutional mechanisms & CG culture	6.5	+0.5	Greater awareness of and adherence to good CG practices.

Source: CLSA Emerging Markets

Regulatory environment

The bar has been raised

Significant improvement in disclosures with new norms in place

The first glimpse of the improving CG atmosphere in India, after our last CG report, came from FY02/CY01 annual reports (and quarterly results). For the first time in India's accounting history, companies presented consolidated accounts with segmental breakdown of key financial information as well as related-party transactions. Most of the companies have also reconstituted their boards to increase the number of independent directors in the board (with many companies now having more than 50% independent members) and the audit committee (in many companies the audit committee comprises of only independent directors).

Going beyond the rule book, a few companies have also lifted their transparency levels as well communication with investors (**ABB India**, **Hindalco**, **Cummins**, **Dr Reddy's**) with more frequent analyst meets, detailed presentations after the quarterly results and meetings/ conference calls to discuss key developments relating to the company.

SEBI has moved beyond the KM Birla committee recommendations

However the most important development on CG front in 2002 has been that SEBI and other regulatory authorities have now moved beyond the initial set of recommendations given by the Kumar Mangalam Birla Committee to further improve the CG standards in India. During the year, the Naresh Chandra Committee on CG and audit reforms (constituted by the Department of Company Affairs) and Kania Committee on corporatisation and demutualisation of stock exchanges submitted their reports. The key recommendations by Naresh Chandra committees are as follows.

Higher independence for the board . . .

- At least half of the Board should be comprised of independent directors (against the earlier norm of one-third of the board) and nominee directors are to be excluded in determining who are independent directors. The minimum number of directors for a listed company shall not be less than seven, of which, four shall be independent directors.

. . . and the audit committee

- The audit committee should consist entirely of independent directors (versus earlier recommendation of at least half of the directors being independent directors). An audit committee charter would have to be prepared and this charter would lay down the role and functions of the audit committee.

Top management to be responsible for accounts

- The CEO and the CFO of the company will also have to certify the accounts of a company. The auditors, it has been recommended by the NC committee, should highlight their views on the management's description of the material liabilities in the significant accounting policies, notes on accounts as well as the auditor's report, where necessary.

Relationship with auditors - at an arms length

- Along with its subsidiary, associates or affiliated entities, an audit firm should not derive more than 25% of its business from a single corporate client.
- The partners and at least 50% of the audit team working on the accounts of a company need to be rotated by a firm every five years.

Serious fraud office to deal with corporate misdemeanour

- The committee has also recommended setting up a Serious Frauds Office (SFO), as proposed by department of company affairs (DCA), to look into corporate misdemeanour. The legislative framework should enable the agency to investigate all aspects of the fraud and direct the prosecution in appropriate courts.

Electronic filing of data by companies to improve information flow

In July 2002, SEBI also introduced the Electronic Data Information Filing and Retrieval (EDIFAR) System under which the 200 largest companies are required to electronically file certain documents and statements in addition to physical filing with stock exchanges. In December the list of companies required to file data under EDIFAR was extended to another 500 companies. And the SEBI Chairman has declared his intention to bring in at least 1,700 companies under this system by April 2003.

More teeth to the regulator

More powers to SEBI to deal with corporate malpracticies

The Finance Ministry has shown a clear resolve that it is committed towards better CG standards in the country. In November, the ministry introduced SEBI (Amendment) Bill 2002 in the parliament, which provides significant powers to SEBI to investigate and enforce measures against market malpractices. The key provisions of the Bill are as follows:

Access to information

- The bill empowers SEBI to call for information and records of any transaction in securities, which are under investigation from any government organisation. At present, SEBI can call for information only from intermediaries.

Power to search and seize books

- SEBI will also be granted powers to search and seize books, registers and documents of intermediaries or any persons associated with the securities market.
- SEBI can also issue orders to cease and desist any person who is likely to violate the provisions of the Act. Earlier, under the provisions of the Companies Act, SEBI could conduct inspection of listed companies only for violations of certain provisions of the Companies Act. It could not conduct inspection of any listed public company for violation of the SEBI Act.

Board strength has been increased

- SEBI's board strength has been increased from six to nine. SEBI will also have the power to impound and retain the proceeds or securities in respect of any transaction, which is under investigation.

Increased penalty for offences

- The Ordinance has also raised the penalty level for a number of offences. The penalty for insider trading, fraudulent and unfair trade practices and non disclosure in case of take-over and acquisition of shares has been enhanced to Rs250m or three-times the amount of profit made out of the violation, whichever is higher.

CG stars

Infosys retains the top spot

Infosys, the company with the highest CG score in last year's report, across all the markets we cover, continues be the highest scorer in India's CG matrix this year too. The company has been following some of the current guidelines on CG, long before they became mandatory. Even today its disclosure standards – detailed segmental data, presentation of accounts as per GAAP of eight countries - are among the best in the industry. The company policy, as given in its last annual report is to earn a return on capital employed at least twice the cost of capital. The cost of capital, estimated for 2002 by the company is 17.2%. According to the latest annual report, Infosys is one of the very few companies in India to have a nomination committee. Infosys however loses some points on our scoring system on account of issue of stock options, high cash levels impacting return ratios and a relatively a large board with about 15 board members.

HLL continues to show its commitment to create shareholder value

Hindustan Lever (HLL) has once again emerged as one of the best CG companies in India and rightly so. The company has been disclosing the consolidated P&L and balance sheet since 1995, even when it was not mandatory and also discloses detailed segmental results on its seven business segments. HLL has been proactive in disclosing the profitability of its ice-cream business separately, which was not required under existing regulations. The announcement of bonus debentures and special cash dividend highlights the company's resolve to deliver higher shareholder value.

Dr Reddy's has good updates on material events

Dr Reddy's, which had shown highest improvement in CG scores in our last CG report, continues to move up the ladder. The communications for company-related developments are regular and access to management is good. Dr Reddy's declares both Indian GAAP as well as US GAAP accounts. The company holds conference calls not only after results but also after critical events, which materially impact the business. For instance it held a conference call after losing exclusivity on omeprazole.

Satyam and Mphasis have shown a big improvement in CG score

Satyam Computers and **Mphasis BFL** have seen a significant improvement in CG scores. Better disclosure standards, quarterly reports which include management discussion have led to improved clarity on companies' businesses. Also Mphasis is one of the few companies to give ROE targets. The annual and quarterly reports too have been published on time in the past year. The board quality has improved and over 50% of the board members are now independent.

CG disappointments

Some of the obvious cases of deterioration in CG this year have been companies where there has been a change in management control.

VSNL board decides to invest Rs12bn in Tata Teleservices

VSNL's CG score took a hit primarily due to the Board's decision in May 2002 to invest Rs12bn in Tata Teleservices. The issue became particularly contentious, given that the Tatas had acquired the government's divested stake in the cash-rich VSNL in February 2002, and it was felt that the investment was tantamount to diversion of funds post-acquisition. However, management contended that the investment was purely business in nature since VSNL could leverage off Tata Teleservices' fixed-line base. After much controversy, an independent committee (represented by the government and VSNL) constituted to look into the matter, gave its decision in October 2002, and held that VSNL would invest Rs8bn over a seven-year period into Tata Teleservices.

L&T's CG suffers with continued dispute on management control

Larsen & Toubro (L&T) also moved from the third quartile to fourth quartile in CG ranking, with the ongoing controversy between Grasim and L&T management over the control of company. Grasim, which currently holds 15% in L&T, is interested in L&T's cement business and has proposed a vertical de-merger of the company into cement and non-cement entities. L&T management however has opposed the move and has tried to rope in strategic and financial investors to foil Grasim's plan. Financial institutions, which currently are the largest shareholders in L&T and have their nominees on the board, have remained non-committal. This has heightened uncertainty on the future among employees and we believe a prolonged phase of uncertainty will have an adverse impact on business.

BSES stops talking after Reliance control, Tata Power invest more in telecom

BSES's CG score has also deteriorated after Reliance took over management control late last year. Accessibility to senior management has gone down significantly and we have been finding it difficult to get some basic information about company's operations and financial results. **Tata Power**, the other power utility under our coverage, has also shown deterioration in

Hugues Software – BPO and diversification into finance vertical drag on CG

Pricing decisions driven by politics mar the CG of HPCL, BPCL and IOC

CG score due to company's increased investments in group's telecom ventures, most of which is not likely to generate any positive returns in near to medium term.

Our CG score of **Hughes Software** has declined despite the company maintaining high CG standards on most counts. The company loses out on options issued (like all other software companies), lack of stated return targets and decline in profitability. The company's score under 'Responsibility' section has come down significantly as the company has diversified into financial services and business-process outsourcing (BPO), which could strain management time and company could lose its niche of being a telecom-focused house. The company certainly has demonstrated ability to succeed in its focus area – telecoms - but it remains to be seen how it fairs in the already crowded financial services vertical.

The decline in CG of government-owned oil companies – **Hindustan Petroleum** (HPCL), **Bharat Petroleum** (BPCL) and **Indian Oil Corp** (IOC) - has been due to fact that their pricing decisions post deregulation of oil sector are getting influenced by political pressure from the government as against commercial considerations. Clearly, this is a negative for minority shareholders.

We highlight below companies most likely to see CG improvements, as well as companies that we believe are at risk of deteriorating CG.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
HPCL	3	❑ Change in management control, through privatisation, should lead to improvement in CG score.
ITC	3	❑ Company is likely to reduce its investments in non-core businesses and increase its dividend payout.
Tata Power	3	❑ Investment in group companies likely to cease, given the strong likelihood of TCS IPO during the year and the approval for use of VSNL's cashflow for group telecom investments.

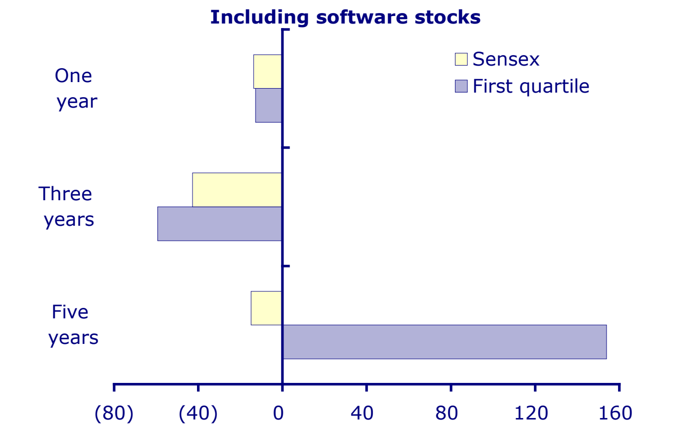
Companies with CG downside risk

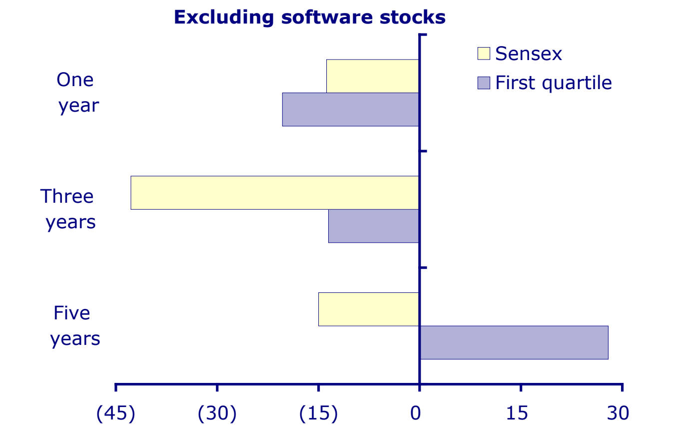
Company	CG quartile	Events that could change CG score
BSES	2	❑ Post Reliance's recent acquisition of a +50% stake in the company (and subsequent management changes), investor communication, disclosures have suffered.
L&T	4	❑ Given the ongoing dispute between the current L&T management and acquirer Grasim over control of the company, the risk of CG being compromised has risen.
Cipla	1	❑ Investors concern on access to senior management and lack of clarity on material issues like status of CFC free inhaler exports.

Source: CLSA Emerging Markets

Relative performance of high CG stocks

Performance of stocks in first CG quartile versus Sensex





Source: CLSA Emerging Markets

Long term, high CG stocks outperform the market by significant margins

Our study of the performance of high CG stocks versus the market index suggests that in the long-term period high CG stocks significantly outperform the market. Over past five years, the stocks in the first quartile of our CG ranking have outperformed the Sensex by a massive 169%. While the Sensex is down by 15% over this period, the market capitalisation of the high CG stocks is up 154%. To a large extent this outperformance is because of the predominance of software stocks (Infosys, Wipro, Digital and Mastek) in the high CG group. However even after removing the software stocks, the high CG stocks has outperformed the Sensex (which includes software stocks) by 43% over last five-year period.

In the medium term (past three years), however, high CG stocks seem to have underperformed the index. Again, higher weightage of software stocks in the high CG group is the key reason for this underperformance. Three years back, almost at the peak of the technology, media and telecoms (TMT) bubble, software stocks were trading at astronomical valuations and have seen substantial erosion in market value since then. This is reflected in high CG stocks having underperformed the index by 16% over the same period. However, non-software high CG stocks have outperformed the market by 29%. Over the past one year, high CG stocks have marginally outperformed the Sensex.

Indian companies in the top CG quartiles

First and second quartile Indian companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
Infosys	0.0	1
Wipro	6.3	1
HDFC Bank	1.1	1
HDFC	(0.0)	1
Hindustan Lever	(0.4)	1
Dr Reddy	3.7	1
Gujarat Gas	0.7	1
Cipla	2.2	1
Castrol	(0.5)	1
I-flex Solutions	na	1
Hero Honda	3.3	1
Mastek	(0.7)	1
Hindalco	6.7	1
Digital GlobalSoft	na	1
Indo gulf	na	1
Punjab Tractors	4.6	1
ABB	5.6	1
BHEL	7.4	2
State Bank of India	1.5	2
Cummins India	4.8	2
Indal	(2.8)	2
Asian Paint	(0.1)	2
HCL Technologies	(2.0)	2
BSES	(0.9)	2
MphasiS-BFL	13.8	2
Bharti	na	2
TISCO	3.1	2
Moser	na	2
Glaxo India	1.9	2
Ranbaxy	na	2
Colgate-Palmolive India	0.2	2
Satyam Computers	9.5	2
Hughes Software	(11.5)	2

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
MphasiS-BFL	13.8	Better disclosure norms, improved clarity on business, higher board independence have led to CG improvement.
Satyam Computers	9.5	Better disclosure norms, improved clarity on business, higher board independence have led to CG improvement.
BHEL	7.4	Reduction in board size, better review of audit function.
Zee Telefilms	6.7	Timely publication of annual report, simplification of corporate structure, improved communication on key developments.
Hindalco	6.7	Better disclosure of market sensitive information, detailed discussions with analysts, half yearly reports, US GAAP accounts, better review of audit function.
Wipro	6.3	Improved disclosure of consolidated financials, closure of loss making businesses and better corporate communication.
ABB	5.6	Improved interaction with analysts, better disclosure norms.
Ranbaxy	5.3	Better financial disclosures and significant improvement in corporate communication.
BPCL	(6.5)	Pricing decisions post deregulation of oil sector have been influenced by political pressures as against commercial considerations.
L & T	(6.9)	The ongoing tussle for control - between the L&T management and acquirer Grasim - has raised concerns whether management will, at all points of time, place interests of minority shareholders ahead of their own interests.
VSNL	(9.4)	Board's decision to invest Rs12bn in Tata Teleservices has hit company's CG score.
Hughes Software	(11.5)	Diversification into financial services, BPO could strain management time and company may loose its distinction of being a telecom focused house.

Source: CLSA Emerging Markets

Indonesia - You win some, you lose some

The reality on CG still lags well behind the rhetoric

Indonesia continues to make positive noises about CG issues. However, the reality lags well behind the rhetoric. On the legal front, regulators require companies to have independent commissioners and audit committees, with independent directors recommended. But in reality, they have yet to enforce this effectively. Independent directors and commissioners continue to serve at the whim of majority shareholders, with often close links between them

A number of companies did, however, make significant progress

A number of companies did make significant progress in 2002 in terms of improved disclosure and more independent boards. There has been continued improvement in **Unilever Indonesia** (an active participant on a governance project) and important improvement seen in **Telkom** and **Aneka Tambang**. Last year's company with the lowest CG score, **Indocement**, has made a large improvement with new owner Heidelberger having taken control.

As with previous years, companies with good CG did relatively well compared to those with low scores. Investors continue to pay a premium for trustworthy management. The highest CG scores in 2003 went to Unilever, **Bank Central Asia, Indosat**, Aneka Tambang, Telkom and **Ramayana**. At the bottom of the list are Lippo Group companies, **Lippo Bank** and **Matahari**, where CG issues have multiplied.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
Unilever	1	Continued improvement in CG score. Business is growing, yields are rising and the outlook remains positive. The firm seems genuinely committed to improving governance in Indonesia. BUY.
Bank Central Asia	1	Further improvement in CG score. The bank is building strong management systems, it is committed to paying out excess cash to shareholders and corporate releases are both timely and informative. BUY.
Telkom	1	Low valuation, rapid growth in cellular business. CG has improved with much better access to senior management. BUY.
Aneka Tambang	2	Rising metal prices. Possible new projects. BUY.
Low/uncertain CG SELLs		
Matahari Putra Prima	4	Continuing doubts as to quality of accounts, plus huge debt burden from bond issue. SELL.
Lippo Bank	4	Groups seen to be manipulating bank to reduce price to repurchase. SELL.
Semen Gresik	4	Subsidiaries remain out of control. SELL.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	4.5	+0.5	Slight improvement in rules.
Enforcement	1.5	+0.5	Bapepam is trying, although lacks resources.
Political/regulatory environment	4.0	-1	Lack of political will from the top down, plus rule of law is weak.
Adoption of IGAAP	5.0	+1	Improvement in accounting standards.
Institutional mechanisms & CG culture	2.5	+0.5	New directors organisation and improvements in state enterprises.

Source: CLSA Emerging Markets

Regulatory environment

Implementation of rules is the issue

The Indonesian experience of CG and regulation has been one of much talking but little action. As with all laws in this country, it is not the quality of the legal drafting that is the issue (although it sometimes is), but the implementation and enforcement of law.

Rules have now been implemented to enforce the creation of audit committees and the requirement that Boards of Commissioners must have independent members. However, that independence is rarely verified and at this stage all independent directors remain on the board at the sufferance of the major shareholder. That is not a recipe for independent thought!

Bapepam required all companies to form audit committees

Rules enforcing a minimum number of directors (minimum of three and maximum of seven) have begun to be enforced. Rules on independent directors, however, have been repeatedly flouted. The regulatory authority, Bapepam, has also ruled that all companies must form an audit committee, but how effective this is remains to be seen. Certainly, many lack the independence to make them effective.

CG stars

Unilever stands out with strong CG culture

Several companies have made significant improvements to their CG scores this year. **Unilever** continues to be the standout stock with a strong CG culture.

Positive changes at Bank Central Asia by the new controlling shareholders

There has been continued improvement from **Bank Central Asia**. While Standard Chartered lost the bidding process, the new owners (Farindo consortium) have instituted positive changes. The bank seems genuinely committed to ongoing improvements. Their employee share ownership plan (ESOP) has widened participation in ownership by employees. Improvements to business practises are ongoing. Public disclosure is excellent, timely and includes data not formally required by the regulators. Although there have been problems with the policy, the company remains committed to paying out excess capital as dividends, underpinning a 10% dividend yield. At the same time business growth has been cautious, suggesting an eye on long-term profitability rather than just the short term.

Much improved transparency at Telkom

Telkom has also undergone a significant change in 2002/03. In the past analyst access was limited, but this changed with the appointment of a new President Director. Telkom now holds analyst presentations with detailed notes and discussion about various business areas. The company reports using US GAAP and Indonesian accounts.

Aneka Tambang cutting costs and making real attempt to appoint independent directors

Surprisingly, a second state-owned company, **Aneka Tambang**, also makes the list for CG stars in 2003. Management has a serious focus on cost-cutting - rare for a state-owned company. It is making a real attempt to appoint independent directors to the board who will oversee the audit committee. The first director is truly independent.

All three companies have done well in terms of stock-market performance over the past year. Bank Central Asia is up 18%, Aneka Tambang is up 12% and Telkom is up 3%, while the overall index is down 10%.

CG disappointments

Dubious transactions in the Lippo group

Once again Lippo Group stands out for its glaring CG lapses. The group continues to treat minorities with disdain. In the case of **Matahari**, this has to do with accounting issues and the questionable rationale behind the raising of a large expensive bond issue for a company that should not need the funding. However, that was not the worst transgression during the past year.

Lippo Bank appears to have been operated on by the Group (despite their tiny 10% shareholding) to lower the book value, opening the way up for a low cost repurchase from the government. A huge and sustained barrage of criticism has seen efforts to reduce book value and force a rights issue abandoned - for now.

Semen Gresik seems to have no control over subsidiaries

Other companies with serious CG issues include **Semen Gresik**. There is no sense that the company has any control over its subsidiaries, and nor is any likely. Plans to privatize the company look to be on hold indefinitely.

Potential CG movers – up and down – highlighted below

We highlight below companies most likely to see CG improvements owing to the government's latest initiatives, and companies we believe are at risk of deteriorating CG.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
HM Sampoerna	3	❑ Appointment of truly independent directors. The company's board needs to be seen to act for the company rather than the major shareholder.
Panin Bank	3	❑ Increased role of ANZ bank in CG issues.
Astra International	2	❑ Rights issue now out of the way. Renewed focus on CG and company management rather than finances.
Indofood	3	❑ Independent directors are appointed. Now we need to see their independence. Information flows still improving.

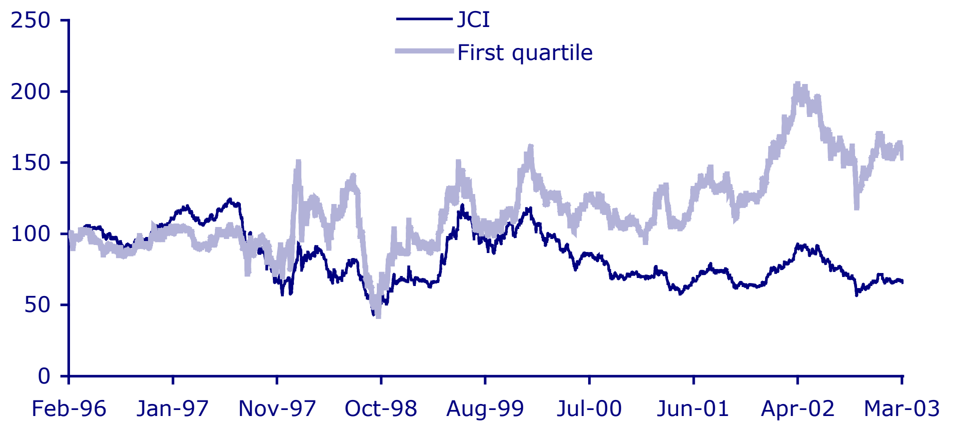
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
Ramayana	2	❑ Tough business conditions could cause company to cut corners.
Surya Citra Media	2	❑ Post-listing performance has been disappointing. Information flows are uneven.
Telkom	1	❑ May be called upon to do national service against shareholders' interests.

Relative performance of high CG stocks

High CG stocks have been significant outperformers

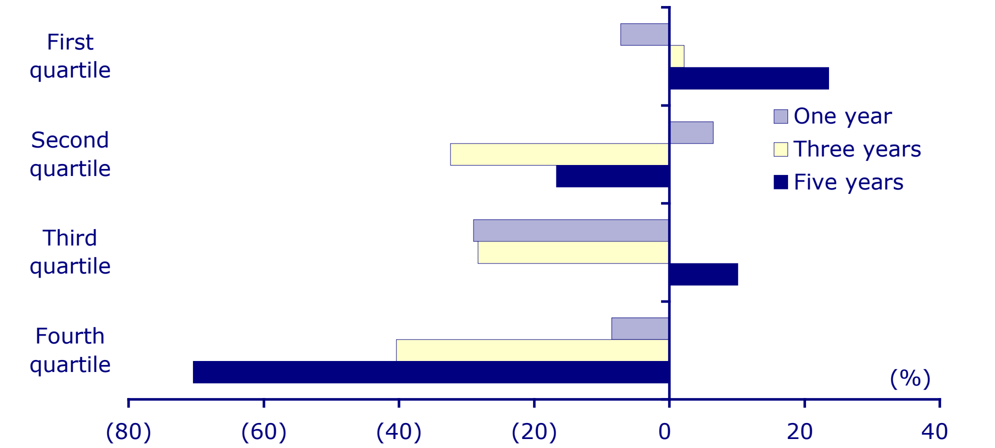
Top CG quartile versus index



Source: CLSA Emerging Markets

High CG stocks have been significant outperformers in the longer term

Performance of stocks ranked by CG quartile



Clear outperformance over three and five years

High CG stocks have outperformed the JCI significantly over a three- and five-year period and performed respectably on a one-year view, slightly outperforming the market. On a three-year view, the top quartile outperformed the JCI by 33% and over a five-year view by 41%. The stock with the highest CG score, **Unilever**, outperformed the market by a massive 340% over a five-year period.

Low CG company can be run well and profitable, hence have strong performance

Interestingly, third-quartile stocks outperformed second-quartile stocks on a three and five-year view. This was due to a good share-price performance (+46% versus JCI over five years) by **HM Sampoerna** which, while ranked quite low in our CG test, is clearly a well run and profitable company.

Indonesian companies in the top CG quartiles

First and second quartile Indonesian companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
Unilever	+18.6	1
Astra Autoparts	+18.2	1
Bank Central Asia	+18.5	1
Indosat	+2.9	1
Telkom	10.2	1
Aneka Tambang	New coverage	1
Ramayana	+4.3	2
Astra Agro Lestari	New coverage	2
Astra International	+4.1	2
Surya Citra Media	New coverage	2
Indocement	+25	2

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
Indocement	+25.0	Across the board improvement in CG scores now that Heidelberger is in control.
Unilever	+18.6	Further improvement in CG score in 2002. Actively promoting improved CG in Indonesia.
Bank Central Asia	+18.5	Setting out specific CG targets
Bimantara	-7.2	Unclear who controls this conglomerate. Moving into new businesses.
Semen Gresik	-7.4	No sign of resolution in dispute with subsidiary.
Matahari	-9.2	Questionable bond issuance will pressure reported earnings. Doubts about quality of accounts also.

Source: CLSA Emerging Markets

Korea - Tick the box?

CG increasing in importance as shareholder activism rises and the President seeks to increase transparency of corporate Korea

Three things have put CG squarely on the map in Korea for 2003, and hopefully long after that. First is a sharp rise in the profile of shareholder activism led by the People's Solidarity for Participatory Democracy (PSPD). Second is a regulatory change that requires domestic institutions to vote on all shareholder resolutions (or state clearly why they did not) for any stock where they have a meaningful holding. Third, and most significantly, the new President has put transparency and governance right at the front and centre of his policy agenda.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
KT Corp	1	Pricing in zero growth to perpetuity. Strong commitment to improving governance and shareholder returns since privatisation in mid-2002.
KT&G	1	Defensive earnings, 8% dividend yield and recent privatisation.
Samsung Electronics	1	Global leader in terms of both products and returns. The ultimate tech defensive, especially on 7x PE.
Low/uncertain CG SELLs		
S-Oil	4	Chairman and senior executives indicted on over 23,000 counts of insider trading. Refining margins continue to deteriorate. Sustainability of dividend in doubt. SELL.
SK Corp	4	LT value destroyer in declining margin business. 39% owner of SK Global, which was recently investigated for accounting fraud. U-PF.
Shinsegae	3	Consumer pessimism, nearing saturation and rising price competition will erode earnings growth in 2003. SELL.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	7	+1	Much of the improvement in scores over the past two years attributed to new rules put in place.
Enforcement	3.5	+0.5	The clear policy of chaebol reform enunciated by President Roh and the high profile indictment of top SK Group executives indicate a change in the level of commitment at the very top. But the deferral of further investigations until after NK and Iraq are resolved could be interpreted as capitulation to the powerful forces that the regulators are up against.
Political/regulatory environment	5	+1	Tougher voting requirements for domestic funds and the commitment of Roh to improving transparency generally and his specific goal to introduce class-action suits that can be bought by minorities will be a big positive for 2003.
Adoption of IGAAP	7	Unchanged	Accounting standards continue to be modified to move closer to IGAAP. Of greater significance, perhaps, is the perceived independence and competence of those tasked with checking compliance.
Institutional mechanisms & CG culture	6.5	+1.5	The rise of shareholder activist groups and their success in putting pressure on wayward management is a positive recent development. We eagerly await implementation of the government's proposal to introduce a dividend index focused on transparent companies with leading CG practices.

Source: CLSA Emerging Markets

Legal culpability rears its head

It is interesting that this year's CG survey has garnered far more attention from the companies we have surveyed than any of our previous efforts. Alas we have not found all that attention to be a positive thing. Companies are intent on reaching the maximum possible scores, at times without regard for the intent behind the CG process. Rather they focus on whether the correct regulation exists in their manuals or articles of incorporation. A classic example is question 54 (see Appendix 2 for the full questionnaire) which deals with the issue of equal-employment policy. Any investor that has visited Korea will know that every single Korean company should score a "No" due to the obvious gender discrimination (How many female directors can you name in Korea?). However, since all companies have an equal-employment policy in their manuals CLSA would be legally culpable if we marked "no" to this question, despite obvious appearances to the contrary.

Regulatory push evident; but hard to believe this has permeated into corporate culture

It is fair to conclude that the significant improvement in Korea's CG scores post crisis is primarily a function of regulatory change and not proactive management attitudes to the whole concept. The persistence of the "Korean discount" reminds us that this is not yet the case. It is a fair observation that much of the improvement in CG scores among our Korean universe is a function of a stricter, improved regulatory framework. It would be a large leap of faith to suggest that a focus on CG and shareholder value has permeated right through the corporate culture of Korea. Surely the fact Korea sustains the lowest dividend-payout ratios in Asia is testament to that.

Convoluted structure of chaebols undermines transparency

Perhaps the key overriding issue in the Korean market that is hampering best practices in CG is the continued dominance of a few chaebol groups that remain minority owned but controlled by their family owners, often through convoluted structures that do little to add transparency to corporate Korea as a whole. As the group structure indicates (see next page) the ingredients for trouble at SK Corp have long been in existence, and this is reflected in their scoring third from bottom in CLSA's 2002 CG survey.

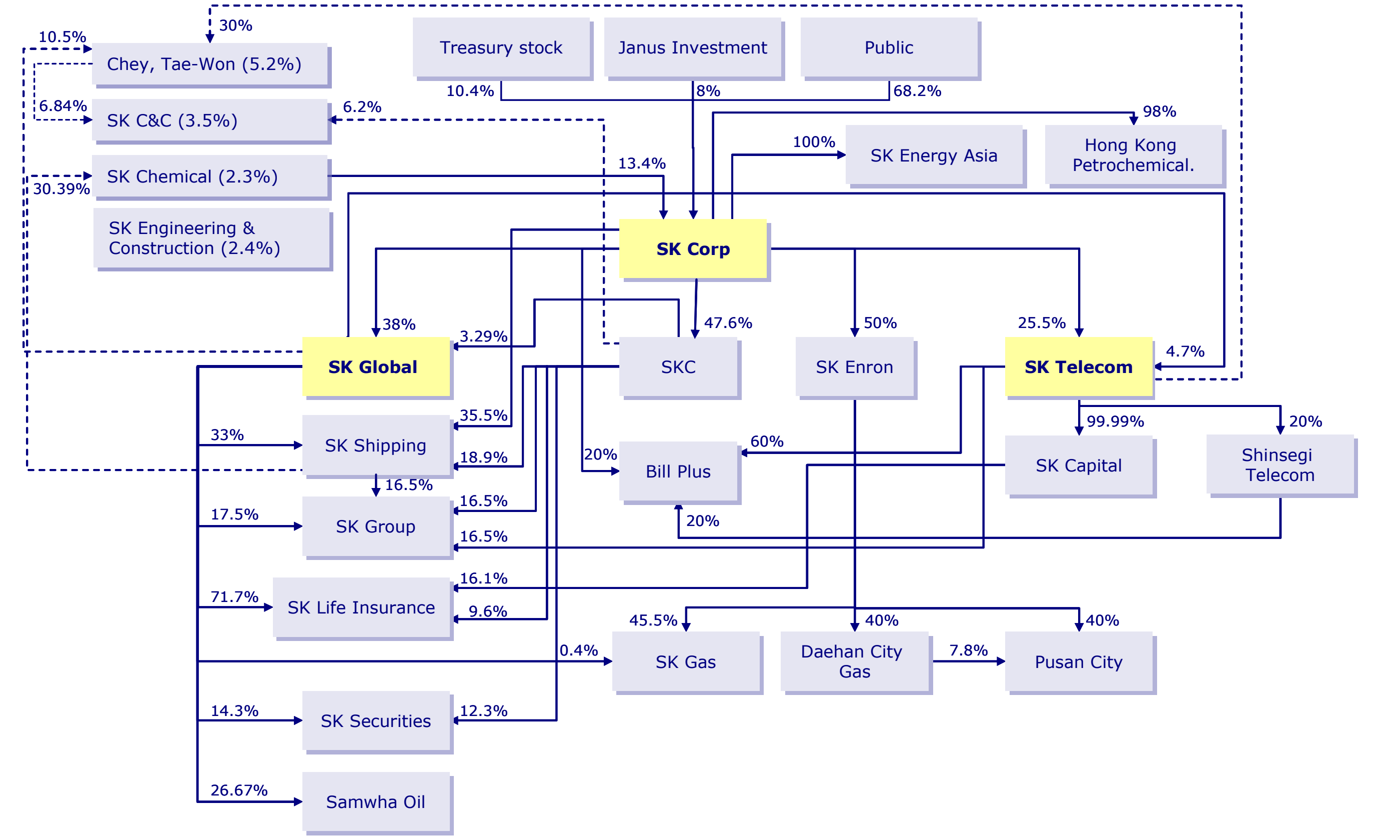
Lack of clarity in dividing private and public assets; absence of professional management independent of controlling shareholders

Hence, while individual companies have become more transparent with better disclosure, convoluted group structures do not allow investors to step back and understand the system or competitive environment. Furthermore the lack of clarity in the division between private and public assets and the absence of purely professional management divorced from ownership compromises independence.

President Roh is committed to unwinding convoluted structures

It is thus significant that President Roh is committed to increasing transparency and attempting to unwind some of the convoluted structures that exist across the large business groups in Korea. Much scepticism remains as to how successful he will be especially considering the level of potential problems that may exist. Nonetheless it is positive for the broader CG environment. Only time will tell whether the ethos behind this policy is embraced by business owners across Korea.

SK Corp group structure



Source: CLSA Emerging Markets

CG adherence - A mixed year

Active legislative agenda and rising shareholder activism

A combination of an active legislative agenda and rising shareholder activism has meant CG has received its fair share of attention in Korea. While audit committees, independent directors and the other checks and balances have been implemented by way of regulatory mandate, it seems that CG has yet to fully permeate the corporate culture (other than in a few isolated instances).

As we have noted the systemic potholes posed by the web of crossholdings of chaebol groups, the sheer concentration of wealth and influence in a few business groups and the government ownership of large chunks of the banking system do not create an environment conducive to CG best practices.

Non-core acquisitions, national service, bailouts par for the course for listed Korea

The period from 2Q02-1Q03 was very mixed for Korean companies in terms of CG adherence. We saw several top-50 companies use surplus cash to acquire non-core businesses/assets ranging from lotteries to Moscow property to a golf course. We saw the government again raise the spectre of National Service, with major chaebol companies asked to participate in the **KT Corp** "privatisation". We saw continued bank bail-outs for distressed companies, most notably **Hynix Semiconductor** - although almost all participating creditors are now government controlled.

Korea's largest bank volunteered to buy credit-card debt

If we buy into the notion it is deeds and not words or mandated regulations that matter then recent developments in Korea, as some degree of "crisis" has descended, do not provide room for optimism. In the face of a looming credit-card liquidity crisis, Kookmin Bank "volunteered" to buy credit-card debt in the markets. This move smacked of government suasion and was all the more suprising when the value-added solution was to privatise its 75%-subsidiary **Kookmin Credit Card** (thereby automatically reducing KCC's funding costs by allowing it to leverage the bank's bigger balance sheet and stronger credit rating), which would have benefited the minorities of both KCC and **Kookmin Bank**.

Massive fraud at SK Global

Meanwhile the first steps of chaebol reform uncovered massive accounting fraud at SK Global. Notwithstanding this revelation was apparently the work of a couple of whistle-blowers, we find it difficult to believe it will be the last skeleton to fall out of the collective chaebol closet. Also, worrying has been the aftermath, with leading creditors calling for financial assistance in the SK Global bail-out from both **SK Corp** and **SK Telecom**. While SK Corp and SK Telecom have publicly denied they will participate in this process, the assumption of creditors that it was their duty is an example of the priorities as perceived by players within the system.

CG stars

Increase in share buybacks and cancellation of some of these buybacks

On the flipside there was a continued increase in the frequency of share buybacks as free cashflow increased. Even more pleasing was the cancellation of some of these buybacks, most significantly the recent 1tr won announced by market bellwether, **Samsung Electronics**. It should be noted the company also resisted government pressure to do national service in 2002 by not taking a stake in the KT privatisation.

LG Electronics demerger rewarded by strong rerating – incentive to others

The **LG Electronics** demerger in April 2002 from its non-core businesses has also been rewarded by a rerating (it more than doubled in the three months after this news was released). This share-price performance may serve to incentivise action from some other companies with obvious, but as yet unresolved, restructuring issues. SK Group has a strong incentive to be next.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
LG Electronics	3	❑ Having demerged in April 2002 it now intends to spin off its TFT-LCD business that would further boost transparency and unlock significant trapped value for minorities.
Kangwon Land	4	❑ IR has become more professional and disclosure has improved both in content and timeliness. A vocal minority shareholder group will also keep the pressure on for further positive reforms.
LG Ad	3	❑ Recently acquired by WPP (global MNC), which corresponded with a sharp hike in its dividend payout ratio. Sign of things to come?

Companies with CG downside risk

Company	CG quartile	Events that could change CG score
Shinhan Financial Group	2	❑ Following the pricey acquisition of Good Morning and in light of the well known desire of Shinhan to increase its scale and the govt's desire to sell off some of it banks, "national service" (a Cho Hung acquisition at a premium to the market) cannot be ruled out.
Kogas	3	❑ The CEO is a political appointee and thus will be replaced, meaning the high dividend policy pursued over the past 12 months may not be sustained, especially if there is an increasing emphasis on energy security and Kogas must finance a gas pipeline.
Kookmin Bank	1	❑ Those with deepest pockets? Kookmin's recent investments in the stock market (rather than simply buying back its own stock) and its purchases of credit-card debt (rather than simply privatising KCC) raise the spectre as to whether it will be increasingly used as a tool for government policy to "stabilise" unstable situations.

Source: CLSA Emerging Markets

CG scores improve – Form over substance?

CG-score upgrades reflect improvement in access and a more balanced approach

Strict followers of our CG-survey scores would conclude from Korea's improvement in 2002 and 2003 that all is well on the CG front. However as we have already highlighted the devil is always in the details. It is a fair summation that the vast bulk of the upgrades in score are a result of regulatory changes (which companies have been forced to comply with) and better disclosure. While both these factors force us to tick the box for several additional questions it is quite clear they offer no greater comfort as to whether minority shareholders' share of returns will come to them.

Companies are providing right info on ROE targets and cost of capital

It is true that unlike in previous years most companies have provided reasonable cost-of-capital assumptions and ROE targets (this is worth three additional "yes" answers by our CG scoring), however what is less clear is whether those concepts are truly understood and, more importantly, actually used in managing the business.

Companies providing access to independent directors

It is true that again unlike in previous years we have been granted access (in most cases) to independent directors allowing three to four additional questions to be marked "Yes". However given the importance of the "old boy" network in Seoul business/government circles and the well chronicled lack of qualified directors, it would seem unlikely that all these independent directors truly carry out their function. However, at a company level, this is not something we can easily prove.

Board committees set up – but their efficacy unproven

Greater pressure on chaebol auditors to compromise

Furthermore while it is true that audit committees, nominating committees and the like have become the norm, they are, as with the much-touted credit-scoring systems implemented by the banks, unproven. Clearly with the blow-up of SK Global and its US$1.2bn of inflated profit one has to call into question the independence of the external auditors never mind the efficacy of the internal audit committee that is meant to be monitoring them. On this note it is worth considering that if auditors were compromised in a market as diverse as the US imagine the pressure brought to bear on an audit partner when faced with revealing a potential accounting fraud by a major chaebol (given the potential business he risks losing should he come down on the "wrong" side of this debate).

Major disappointments in the deeds

Ultimately it is deeds and not words/boxes/systems that matter. On that account the high profile CG mishaps in the past 12 months remind us that "national service" (KT privatisation), di-worse-ification (golf courses, lotteries, Moscow property) and rampant insider trading (S-Oil) have not been prevented by the measures put in place to date.

More involved companies, more diligence, more problems

Companies have a poor grasp of what CG means to investors

In approaching the thorny issue of a CG survey in Korea, we took a slightly different tack this year by allowing the companies in question to score themselves. This allowed them a better chance to study the questions and allowed us to focus on only those areas where our answers and theirs differed. I can bear witness to the copious hours invested by our Korean analysts as companies have haggled, debated and in some cases obfuscated over the answer to each question, especially those where subjectivity plays a part. Frankly, the companies' own interpretation of their scores taught us how little most companies really grasp the concept of CG and what it means to a minority shareholder. Since this ignorance was, by and large communicated by IR team members who deal with institutional investors on a daily basis, what chance is there that senior management, more divorced from investor feedback, can divine the true intent of good CG.

Korean companies in the top CG quartiles

First and second quartile Korean companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
KT Corp	41	1
Good Morning Shinhan	na	1
KT&G	23	1
Kookmin Bank	12	1
Kookmin Credit Card	15	1
Samsung Fire & Marine	7	1
LG Telecom	na	1
Samsung Electronics	na	1
Hana Bank	4	1
Chohung Bank	na	1
Koram Bank	14	2
Kogas	na	2
LG Card	na	2
KT Freetel	14	2
Kepco	8	2
Daelim Ind	16	2
KEB Credit Service	na	2
Samsung SDI	na	2
Semco	na	2
Daishin Sec	na	2

Source: CLSA Emerging Markets

Samsung Electronics has made major strides in improving CG

Samsung Electronics has demonstrated one of the most improved CG practices in Korea. Widely praised by fund managers for its comprehensive approach to investor relations, SEC offers a level of access unrivalled in Korea with four global roadshows each year that include representatives of each major product line. Its high CG score reflects great strides in improving transparency (eg, timely and detailed quarterly conference calls; a comprehensive English language web-site), accountability (eg, majority of directors now independent), and responsibility (eg, demonstrable evidence of meritocracy in terms of management advancement).

Our exhaustive efforts to understand SEC's CG – which included contacting independent directors and a detailed examination of its Articles of Incorporation - confirmed that our 2001 score was understated. SEC's placing in this year's CG survey shows it is one of the most improved in Korea and is acknowledgement of its push to achieve consistent annual improvement in CG.

KT Corp demonstrating commitment to increasing shareholder value

KT Corp's privatisation in May 2002 allowed it to implement several long-awaited CG reforms. With the government no longer a shareholder, KT Corp has reformed its board of directors and is now one of the few companies in Asia with an independent chairman. It is also one of the few blue chips in Korea to have a CEO significantly incentivised with out-of-the-money long-dated stock options, and a performance bonus linked to share-price performance, EVA™ and return on assets.

Basis for KT Corp's score upgrade

Question[1]	KT Corp April-02	KT Corp March-03	Comments
Discipline	**66.6**	**100.0**	
1	No	Yes	Since privatisation, KT has spoken of its commitment to positive CG many times at conferences, on roadshows and in shareholder meetings. It has also been a key theme in its corporate presentations.
2	No	Yes	Incentivisation structure has been completely reworked, with more than 50% of the CEO's remuneration linked to stock options and stock performance.
9	No	Yes	2001 annual report did not, 2002 report does.
Transparency	**80.0**	**100.0**	
14	No	Yes	Quality of reported numbers has improved.
18	No	Yes	Standardised to 'yes' for all Korean companies.
Independence	**14.3**	**100.0**	
20	No	Yes	Last time we answered 'no' to this as the government was seen to have forced capex on KT. The government is no longer a shareholder and in 2002 KT demonstrated its commitment to keeping capex down despite pressure from the government.
21	No	Yes	New board has an independent chairman.
22	No	Yes	Could not be demonstrated in 2001. New structure has a clear separation between board and management.
23	No	Yes	KT's new audit committee chaired by independent.
24	No	Yes	KT's new remuneration committee chaired by independent.
25	No	Yes	KT's new nominating committee chaired by independent.
Accountability	**15.0**	**75.0**	
29	No	Yes	Could not be demonstrated for 2001. Have spoken to an independent director and new directors have clearly no links to KT.
31	No	Yes	A foreign national was appointed to the board in 2002.
Responsibility	**33.3**	**83.3**	
36	No	Yes	New board has the ability to fire the CEO and punish executives. This was always a much more nebulous issue prior to privatisation when the government was the major shareholder.
37	No	Yes	New board has the ability to fire the CEO and punish executives. This was always a much more nebulous issue prior to privatisation when the government was the major shareholder.
38	No	Yes	Last time we answered 'no' to this as the government was seen to have forced capex on KT. The government is no longer a shareholder and in 2002 KT demonstrated a commitment to minority protection.
Fairness	**33.3**	**94.4**	
42	No	Yes	Last time we answered 'no' to this as the government was seen to have forced capex on KT. The government is no longer a shareholder and in 2002 KT demonstrated a commitment to minority protection.
43	No	Yes	Scored incorrectly in 2002.
45	No	Yes	Improvement made post-privatisation with new board structure.
46	No	Yes	Major change in approaching capex, return on capital, incentivisation and use of free cashflow since the government sold down its holding.
Social awareness	**66.7**	**100.0**	
52	No	Yes	New KT has this policy.
54	No	Yes	New KT has this policy.
Total	52.1	92.9	

[1] See Appendix 2 for the full CG questionnaire. Source: CLSA Emerging Markets

Beyond this 'box checking', however, KT Corp's resistance to pressure to increase capex, sensible guidance and emphasis on capital allocation in investor presentations clearly reveals its commitment to value maximisation for minorities. In particular, spending only 2tr won on capex in 2002 versus 2.6tr in 2001 and 3.4tr in 2000 demonstrates this is no longer a government company, either in letter or spirit.

Shareholder activism – The silver lining

Shareholder activism led by PSPD

The most positive aspect of the current Korean CG environment (something also observed by the Asian Corporate Governance Association (ACGA)) has been the rise of shareholder activism led by the People's Solidarity for Participatory Democracy (PSPD), a civil organisation dedicated to promoting justice and human rights in Korea. This group claims that minority activism was non-existent in Korea until it began its campaign in 1997.

Professor Hasung Jang of Korea University and chief analyst of the centre for good corporate governance (CGCG) has led the PSPD's activism. (In contrast to the PSPD, the CGCG is a research, information and policy think-tank, which aims to educate and provide investors with the implications of CG issues, rather than lobbying companies directly.) PSPD activism has recently been credited with forcing Posco's chairman (already facing trial for removing company funds) to resign ahead of the company's AGM.

Example of PSPD at work

PSPD demands to SKT management

PSPD delivered its demands to the board of directors

On 14 March 2003, the PSPD announced it had delivered a written statement to SK Telecom's board of directors, demanding that the company take certain specific measures in the wake of SK Global's accounting scandal and Tea-Won Choi's arrest.

The following summarises the PSPD's demands:

1. Resignation of Chairman Gil-Seoung Son, Tea-Won Choi and Jae-Won Choi
2. Incorporation of SK C&C as a wholly-owned subsidiary
3. Termination of business relationship with widerthan.com and other private companies owned by Tae-Won Choi
4. No share buyback from SK Global
5. No asset purchase from SK Global

Source: CLSA Emerging Markets

Class-action suits – The bone of contention

Chaebols have campaigned against class-action suits

Probably the most controversial piece of legislation remains class-action suits, which allows minorities to sue management for egregious transactions that clearly benefit the owners at the expense of minorities. Somewhat unsurprisingly the federation of Korean industries FKI (the chaebol voice box) has been emphatically lobbying against this legislation.

New President in favour of class-action suits

The most recent twist has been the commitment of President Roh to push it through, although it is unclear whether this will be possible as he does not control the National Assembly (ie Korean parliament). Nonetheless, the chaebol concerns that management will be distracted seem like smokescreens and reinforce the notion that any buy-in to the whole CG concept at the top level of business is far from complete.

Chaebols agree to class-action suits but under conditions that make these ineffective

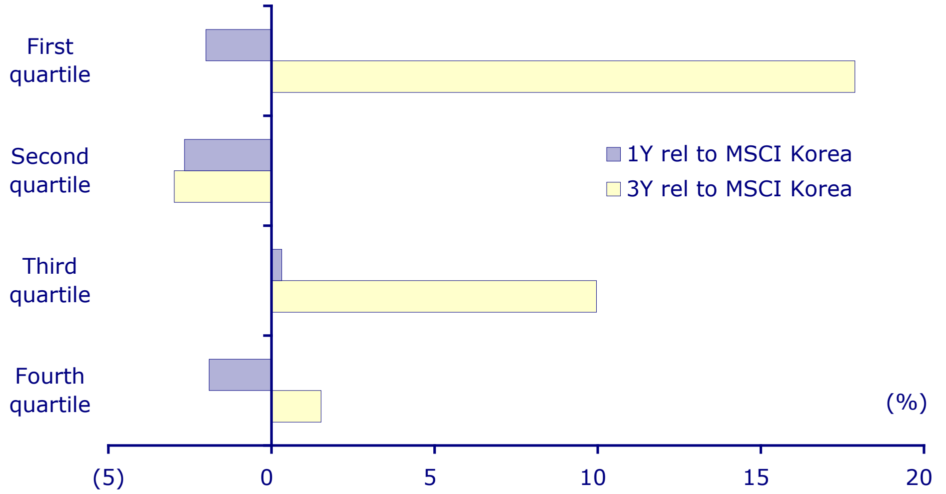
On 19 March the FKI and other major business groups finally seemed to have caved in (clearly under staunch government pressure). However their acceptance of the class-action suits comes with so many conditions as to render it almost inoperable. Clearly investors need to be asking themselves what is it that chaebol owners fear so much if they are indeed CG converts?

Relative performance of high CG stocks

Market down over 40% since April 02 with banks being pulled down for over-aggressive consumer lending

The past 12 months has seen the Kospi continue an unfortunate trend of boom and bust that now dates back 15 years. Since the market peak in April 2002, the Kospi has lost over 40% of its value. Until very recently, when the market began to focus on chaebol reform and regulators uncovered abuses at SK Group, the reasons behind this decline had little to do with governance. Despite the banking system showing continuing improvement in CG systems these organisations are once again the main cause of the market's decline, as a slavish attraction for growth, this time in consumer credit, once again proved their undoing. Unlike 1997-8, investors can attribute this to mismanagement and inadequate risk controls rather than non-commercial lending. Nonetheless, this provides little solace in the context of the damage done to their earnings and share prices.

Performance chart by quartile



Source: CLSA Emerging Markets

Correlation of CG and stock performance stronger over past one year than three or five years

Since our universe of companies has a strong asymmetric bias towards the better companies within the Korean universe it is no great surprise to see that most have handily outperformed the MSCI Korea in the past three years. It is very interesting however, that while the correlation between performance and CG ranking is negligible on both a three- and five-year view it is very clear on a one-year view. This make sense to the extent that CG has become a far more prominent issue in the decision-making process of investors in the past 12-18 months (post Enron?). Furthermore, in a bear market (which we have had for most of the past 12 months) investors look for defensive stocks, and positive CG is commonly used as a criteria for safety.

Malaysia - Steps in the right direction

2002 was the year of enforcement

The CG environment in Malaysia improved in 2002 thanks to the implementation of government reforms introduced in 2001. The new regulatory requirements include appointment of independent board members, independent audit committees, accounting standards becoming compliant with international standards, etc. Despite some reservations on whether the rules apply equally to all – a result of bitter experiences over earlier years - the changes of late are in the right direction.

There has been an overall improvement of scores in transparency, independence and accountability. Substantial improvements were seen in companies like **Malaysia Airlines** and **Celcom**, following the change in shareholders (not coincidentally both previously had the same controlling shareholder). Since last year's CG report, 22 of 45 companies in our universe have seen an increase in CG scores, but the average score is basically unchanged (from 63.3% to 64.0%).

Top CG quartile companies consistent outperformers – 68ppts over the past five years

Reflecting a difficult market in 2002, our top CG scorers (ie, those in the first quartile – the list is not much different from 2002) were mild outperformers beating the KLCI's 12.7% decline by 3.2ppts. Over the past five years though, the top CG quartile has outperformed the market by 68ppts, while the bottom quartile underperformed the KLCI by 4ppts. The top scorers will continue to outperform the market underscored by quality management and an excellent track record. We expect these companies to maintain their outperformance in the medium term.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
BAT Malaysia	1	Curbing of contraband market will result in improved market share. Highest yielding stock with dividend yield 8.7%.
Public Bank	1	Strong balance sheet will cushion an uncertain environment. Merger of finance company and commercial bank will see cost savings.
Road Builder	1	Ports will provide new leg of growth.
Tanjong	1	Positive structural changes in the numbers forecast industry. Possible acquisition of third earnings leg to support NFO and power business.
Low/uncertain CG SELLs		
Tenaga	4	Higher operating costs and IPP purchases will erode earnings.
RHB Capital	4	Entry of politically well-connected shareholders may erode risk management.
K. Guthrie	3	Lacking in transparency and accountability. High government ownership – could be pressured into "national service" undertakings.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	9	Unchanged	Just minor changes, if any.
Enforcement	3.5	+0.5	Stricter implementation and enforcement of CG best practices in 2002.
Political/regulatory environment	4	+1	Marked emphasis by the government to improve accountability of management to all shareholders.
Adoption of IGAAP	7.0	+1.0	Efforts continuing to keep reporting in line with international accounting standards. Inclusion of cashflow in quarterly reporting.
Institutional mechanisms & CG culture	6.5	+0.5	Greater awareness of and adherence to good CG practices.

Source: CLSA Emerging Markets

Regulatory environment

Implementation of new initiatives introduced in 2001

In 2002, the regulatory environment in Malaysia continued to evolve, moving towards implementation of the various initiatives that were put in place by the Kuala Lumpur Stock Exchange in 2001. The most significant moves were:

New model for Malaysia Inc

- A new model for Malaysia Inc, with the separation of ownership and management, and institutionalising shareholders. This was evident in groups like **Renong**, **TRI/Celcom**, **Malaysia Airlines** and **MRCB**, which saw new shareholders and the appointment of professional managers.

CG disclosure in annual reports

- Disclosure in annual reports on the application and compliance with principles and best practices of the Malaysian Code of Corporate Governance.
- Strengthening rules on related-party transactions and inter-company borrowings.

Compliance with international accounting standards.

- Better accounting quality. The Malaysian Accounting Standards Board (MASB) has adopted International Accounting Standard (IAS) 23, which requires interest charges on assets already in operation to be expensed off rather than capitalised previously.

Undertaking directors education programme

- Undertaking directors education programme. In 2002, even the most senior of corporate directors were seen attending these programmes and some accompanied by English/Malay interpreters!

Protection of minority shareholder rights

- Protection of minority shareholder rights as per recommendations in the Malaysian Code of Corporate Governance. As in the case of Maruichi, minority shareholders blocked the acquisition of Malaysian Merchant Marine end 2002 on the basis that it will erode the value of the company. This deal was subsequently aborted by the company.

Two new practice notes issued in 2002

With the regulatory framework overhauled in 2001, the additional changes were two practice notes issued in 2002 by the KLSE to further tighten CG, which included:

- Stricter guidelines governing the appointment of independent directors.
- Requisite qualification for the special audit committee member (ie, accounting background with minimum three years experience).
- Restriction in the number directorships that can be held by an individual - 10 for listed companies and 15 for unlisted companies.
- Not more than 50% of shares available under an approved Employee Share Option Scheme should be allocated to directors and senior management.

CG stars

Malaysia Airlines and Celcom were CG stars in 2002

The biggest stars in 2002 were companies that once belonged to Tajuddin Ramli, **Malaysia Airlines** and **Celcom** (formerly known as TRI). Institutional shareholders replaced Tajuddin–Khazanah (Ministry of Finance's investment arm) for Malaysia Airlines and **Telekom Malaysia** at Celcom. A completely new professional management team revamped and restructured the businesses to enhance shareholder value. Together with a new emphasis on improving transparency and accountability both stocks were rerated in 2002 – up 26.4% for Celcom and 1.7% for Malaysia Airlines against the KLCI which was down 7%.

Drastic improvement with Magnum and B Toto

We have also seen a drastic improvement with numbers-forecast operator **Magnum** and **B Toto.** Both made a concerted effort to improve their investor relations and overall CG standards. Both went on global roadshows and in the case of B Toto, it was represented by major shareholder Vincent Tan to explain a RM750m ICULS bond issue to partially repay the RM1.1bn inter-group loan.

CG disappointments

Courts saw the biggest downgrade in 2002 - lack of guidance from management

Retail operator **Courts Mammoth** saw the biggest CG downgrade in 2002, down 8.17ppts. The disappointment came on the back of a deterioration in accountability. Profit guidance was extremely poor. Management gave an overall impression that operations were on track, however when 1H03 results were announced in November, it came in 52% below market consensus on the back of poor sales. As a consequence, the stock price collapsed and underperformed the market by 5.4% in 2002.

Family feud consumed Tan Chong Motor in 2002 - CG score down 5.6ppts

Another big disappointment was **Tan Chong Motor** which saw a 5.6ppt deterioration in its CG score in 2002. This was reflected in the relative underperformance of its share price by 20% versus the KLCI in 2002. With an on-going feud between its major shareholders from two branches of the Tan family, the Board has lacked independence and accountability. As such, there was an overhanging threat that the company could loose its Nissan franchise in Malaysia.

Poor guidance and access to management at Proton

Another big disappointment was **Proton.** Previously investor friendly with willingness to share financial information and industry updates, access to management was carefully managed in 2002. With the dynamics of the sector evolving rapidly ahead of the Asean Free Trade Area (AFTA), guidance in 2002 was poor and could have been better.

Potential movers and shakers

We highlight below companies most likely to see CG improvements owing to the government's latest initiatives, as well as companies which we believe are at risk of deteriorating CG.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
Malaysia Airlines	4	❑ Further improvement, as management increasingly becomes more transparent.
YTL Corp	3	❑ Acquisition of new assets overseas will remove perception of the group's dependence on political patronage locally.
B Toto	3	❑ Resolution of RM780m ICLUS issue and repayment of inter-co loans

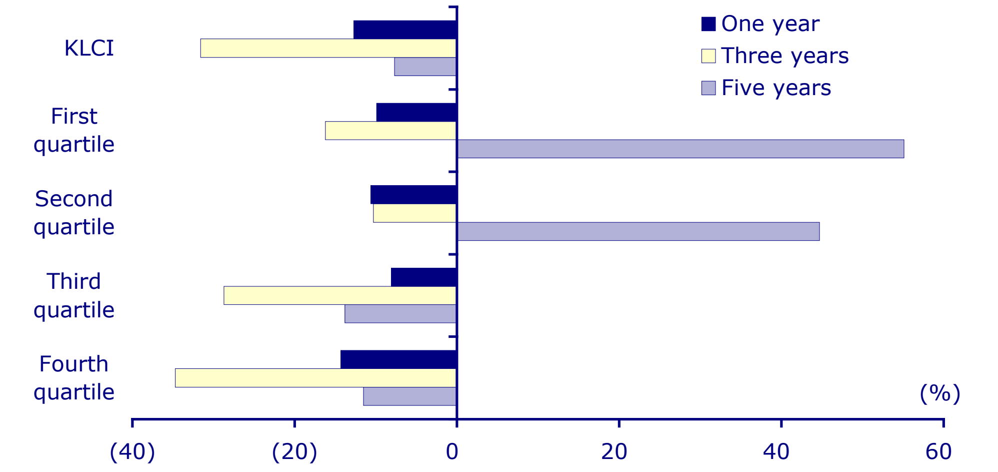
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
RHB Capital	4	❑ Risk that new politically well-connected owner could lead the bank to undertake "political" loans.
Malakoff	2	❑ Possible injection of shareholder's assets at premium prices with a financially stretched controlling shareholder.
Celcom	3	❑ Excellent turnaround initiatives implemented by current CEO could be hampered if new shareholder Telekom takes a more active role.
PLUS	4	❑ Possible injection of Khazanah's other toll roads at premium prices

Source: CLSA Emerging Markets

Relative performance of high CG stocks

KLCI and quartile absolute performance



Source: CLSA Emerging Markets

Our sample of high CG stocks have, without exception, outperformed the KLCI

High CG stocks have outperformed the KLCI by 68% over the five years to end-2002 and marginally by 4% in 2002 reflecting generally a difficult market. The stock with the highest CG score, **BAT Malaysia**, outperformed by 20% in the past five years, while the construction companies - **Road Builder**, **Gamuda** and **IJM -** outperformed the KLCI by more than 100% in the past five years - benefiting from the government's aggressive fiscal pump-priming activities. The market continues to accord a premium for companies with good CG as reflected in the valuations of the first-quartile CG stocks.

Bottom-quartile CG stocks have marginally underperformed the KLCI by 4%

Our sample of bottom-quartile CG stocks marginally underperformed the KLCI by 4% over the past five years. The results are skewed by the substantial outperformance of a gaming company with an international following. However a number of other companies with serious CG issues have underperformed the KLCI by about 50% over the last five years.

Malaysian companies in the top CG quartiles

First and second quartile Malaysian companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
BAT Malaysia	+0.7	1
Public Bank	(0.5)	1
Road Builder	+3.2	1
Tanjong	+3.0	1
Carlsberg	(0.1)	1
Digi	+0.4	1
Nestle	+4.0	1
Maxis[1]	na	1
Maybank	(0.5)	1
Gamuda	+1.0	1
IJM	(0.2)	1
IOI Prop	(4.7)	1
IOI Corp	(4.0)	2
UMW	(5.7)	2
EON Cap	na	2
MISC(F)	+0.9	2
EON	(4.5)	2
Commerce	(5.7)	2
AMMB	(4.0)	2
Proton	(6.1)	2
Malakoff	(4.1)	2
Star	+0.9	2
Unisem	(1.9)	2
Courts Mammoth	(8.2)	2

[1] Listed in 2002.

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
Celcom	+18.2	Change in major shareholder. Now run by a professional team of managers.
Malaysia Airlines	+14.5	The national carrier is now owned by the government. Clear separation of ownership and management.
Telekom	+6.5	More transparency with better disclosures.
Magnum	+6.1	Greater accessibility to management. Better disclosures and guiding market expectations.
Golden Hope	+5.7	Better disclosures and more informed annual reports.
YTL Corp	+5.3	Greater accessibility to management. A potential litigation that was subsequently dropped in the UK reaffirmed the group's improving CG practices.
Tan Chong	(5.6)	Shareholder feud with very little accessibility to management.
Commerce Asset	(5.7)	The unpopular Bank Niaga deal was not conveyed well to shareholders. Share buybacks to support falling share price.
Resorts	(6.0)	Poor guidance from its subsidiary Star Cruises which surprised the market with operating performance in 4Q02.
Proton	(6.1)	Lack of accessibility and information flow from the company.
Courts Mammoth	(8.2)	Poor guidance to the market on its operations.

Source: CLSA Emerging Markets

Philippines - Government under scrutiny

SEC required public companies to submit their CG manual

The basic framework regulating the CG environment in the Philippines improved in 2002 as the Securities and Exchange Commission (SEC) required all companies to submit their CG manual. These manuals, which must be consistent with the new Code on Corporate Governance adopted by the SEC in April 2002, have become enforceable at the beginning of 2003. They are to be made available to all shareholders, allowing minorities to act as a watchdog in the enforcement of CG. With the framework in place, the major task ahead will be to ensure adherence to the rules.

Focus is on dealing with the country's uncertainty not CG

Despite these developments, the overall market remains in the doldrums (down 13% last year), as the country's economic uncertainties were the main concern of investors. Our top CG companies (belonging to the first quartile) outperformed the market, with a decline of only 6%. **Jollibee Food Corp** is the major mover in terms of CG for 2002, dislodging **Philippine Long Distance Telephone** (PLDT) for the top ranking in the Philippines. PLDT saw the largest decline in score following the aborted takeover attempt by the JG Summit group.

BUY/SELL summary

Company	CG quartile	Rerating drivers
High/improving CG BUYs		
Jollibee Food Corp	1	Enjoying brisk business despite the tough environment.
SM Prime	1	Still loved by investors as the company remains focused on retail.
Globe Telecom	1	Good disclosure; regularly updates the market on major developments.
Bank of the Philippine Islands	1	Management is ahead in provisioning for non-performing loans (NPL).
Low/uncertain CG SELLs		
Petron Corp	4	Poor disclosure and late in submitting financial statements.
Filinvest Land	4	Deteriorating disclosure level.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	6.5	+0.5	SEC required CG manuals from all public companies.
Enforcement	2.0	Unchanged	Government has no credibility to enforce.
Political/regulatory environment	2.0	Unchanged	Government remains involved.
Adoption of IGAAP	6.0	Unchanged	Local accounting standards council moving towards IAS; 2002 annual reports will be the test case in terms of more disclosures.
Institutional mechanisms & CG culture	4.0	Unchanged	

Source: CLSA Emerging Markets

Regulatory environment

CG manuals to be issued by companies

The salient points of the CG manuals that companies are required to issue, are the following:

- Public listed corporations are required to have at least two independent directors in its board.
- Higher qualifications and ethical standards set for board members.
- There is now a mandatory tender offer to all shareholders.

- External auditors are required to be rotated/replaced every five years.
- Companies are required to form committees for audit and compliance, nomination and compensation, and risk management.
- Corporations must have an independent auditor and audit committee reporting to an independent director.

Can the government instil the right culture and commitment?

There is however an issue in the credibility of the government in enforcing better governance. The government will have a hard time instilling the right culture and commitment, rather than just formal adherence, when it itself is under scrutiny regarding economic data released to the public.

Government economic data put into question

The economic data released by the government was put into question last year as most economists point out the inconsistency of this data. The high GDP growth of 4.6% was inconsistent with low tax revenue even if government officials highlighted that that buoyant growth came from the untaxed agricultural sector. Economists were not convinced, given that high agricultural growth should have translated to rising rural income, which would have easily boosted private consumption to eventually lift VAT receipts.

Import numbers are under-reported

The more fundamental issue is that most of the economic data is flawed, as we have highlighted. This was reported in the *Asian Wall Street Journal* in relation to the under-reported imports. The balance of payments data has subsequently been revised, but it is claimed that the GDP data will not be impacted. If imports are significantly higher than previously stated, how can this not affect GDP, unless the GDP expenditure breakdown (including net exports) was flawed to begin with?

CG stars

Jollibee moved up in the rankings

Jollibee Food Corp moved up in the CG ranking as the company has been more responsive to the needs of investors and analysts. Moreover, the company has been active in joining roadshows and conferences to provide investors with management's view on the developments in the company and the quick-service industry.

Henry Sy of SM Prime is now with San Miguel's board

Henry Sy's buy-in into **San Miguel Corp** (SMC) was viewed as a vote of confidence for management under Chairman Eduardo Cojuangco Jr and President Ramon S Ang. This is another feather in the cap for Cojuangco and Ang, following the string of partnerships and alliances they've signed since taking over SMC in 1998. The noteworthy partners include the Coca-Cola Company and Kirin Brewery, both familiar and credible names whose investment not only shows appreciation of good business prospects but also faith in the people running the business.

Investors welcomed Henry Sy's entry into SMC given his reputation as an owner that protects the interest of minority shareholders. Sy is well known in the investment community as an owner who listens and looks after the interest of minority investors. His presence would further raise the credibility profile of the SMC board and Sy's business acumen will come in handy on SMC's board.

CG disappointments

PLDT was the biggest CG loser

The aborted **PLDT** takeover by JG Summit group in 2002 bears its fair share of responsibility in driving the downside and uncertainty in the market for most of the year. PLDT has not only fallen from grace with most investors, but the drama behind the takeover, also raised potential concerns on the remaking of the corporate landscape in the telecoms, property and conglomerate sectors.

Aside from the historical CG concerns attached to the JG Summit group, the whole exercise highlighted how minority shareholders are again being left at the wayside. The JG takeover of PLDT would only have benefited First Pacific Corp, as the deal was structured as a joint venture, thus it would not trigger a tender offer. However, there were also positive things that came out of the aborted deal, JG summit group is more open to analysts and discussed more in details the operations of its various businesses.

Filinvest's latest disclosure adversely affected the stock

Filinvest Land's late disclosure of its convertible preferred transaction last year was viewed negatively by investors. Accusations of insider trading were hurled against management, but eventually nothing substantial came out after the initial outcry. However, the company's stock suffered as its price crashed 62% by end-2002.

Potential movers and shakers

We highlight below companies most likely to see CG improvements owing to the better disclosures required by the SEC.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
an Miguel Corp	2	❑ Entry of Henry Sy should mean more protections for minorities.
Meralco	2	❑ Regulatory body allows the public to scrutinise its tariff structure.

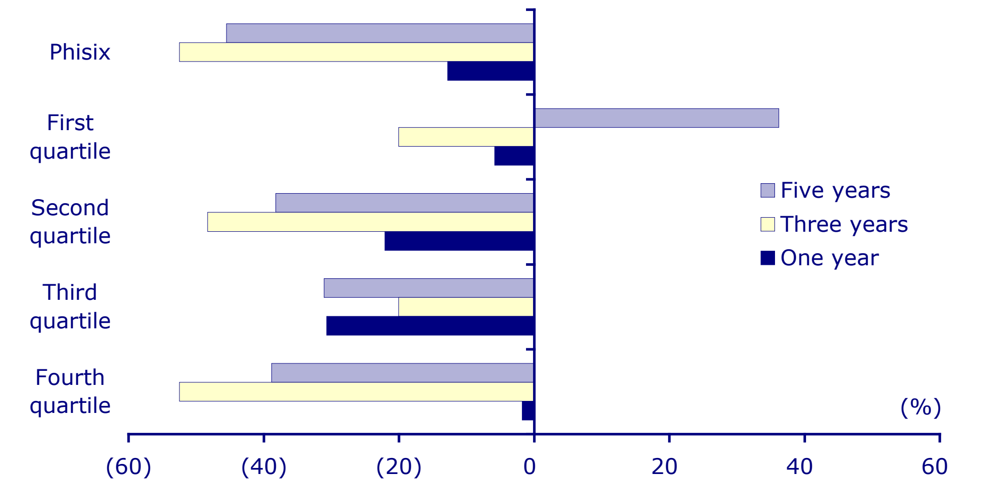
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
First Philippine Holdings	3	❑ Entry into road project may drain its cash-cow power business.
Metrobank	3	❑ Magnitude of ROPOA remains unclear to many investors/analysts.

High CG stocks have been big outperformers

Relative performance of high CG stocks

Phisix and quartile absolute performance



Source: CLSA Emerging Markets

Our sample of high CG stocks have outperformed Phisix without exception

High-CG stocks outperformed the Phisix by 81% over the five years to end-2002 and by 7.5% in 2002. The stock with the highest CG score, **Jollibee** has an absolute return of 49% last year and 9% over five years. However, the other three high CG companies - **SM Prime**, **Globe Telecoms** and **Bank of the Philippine Islands** (BPI) - underperformed the market by 5% to 18% last year. This underperformance can be attributed to foreign investors selling down their exposure in the market.

The bottom-quartile CG stocks barely outperformed the index over a five-year period, but outperformed by 10% last year. The stock price of these companies hardly moved last year, thus provided better relative performance. We expect this trend to continue as the stocks lack liquidity.

Philippine companies in the top CG quartiles

First and second quartile Philippine companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
Jollibee Food	(1.7)	1
SM Prime	(13.4)	1
Globe Telecom	(15.2)	1
BPI	(16.2)	1
PLDT	(31.2)	2
San Miguel Corp	(0.5)	2
Ayala Corp	(6.4)	2
Meralco	(6.9)	2

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
PLDT	(31.8)	The aborted JG Summit's takeover significantly impacted management’s credibility.
BPI	(16.2)	Refusal to provide for Meralco’s P3bn loan.
Globe Telecom	(15.4)	Late disclosure in writing off P3.2b worth of assets surprised the market.
SM Prime	(13.4)	Needs to add one more independent director.
Petron Corp	(11.3)	Poor disclosure and late in submitting financial statements.

Source: CLSA Emerging Markets

Singapore - Fellowship of the code

CG has been taken seriously in Singapore; the CG Code is now implemented

CG ratings have risen, and dividend payouts and non-core divestments have taken place

CG has been taken seriously in Singapore over the past few years, and this has culminated in the Corporate Governance Code (CGC), which takes effect this year. The code encompasses key elements of transparency and independence (eg, existence of independent audit, remuneration committees, split CEO/Chairman), and the early adoption of the code has been a key reason for the upgrade in Singapore's aggregate CG score to 69.5 (up from 65.6 last year). Looking ahead, Singapore companies will be increasingly judged on how they pursue the spirit of the CGC (see our December 2002 report, *Spirit of the code,* for more on this theme), as the procedural requirements desired by the CGC becomes the norm. Meanwhile, we detect an underlying shift in corporate Singapore's mindset that is indeed taking CG seriously. Most fundamental has been the increasing appreciation that shareholders are the true owners of the company and that the board and management are the appointed stewards - non-core divestments and the steady return of excess cash to shareholders (dividend payouts are up substantially) is the clearest evidence. As for CG missteps, we have seen a few recently, but certainly nothing as dramatic as events in previous years.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
Keppel Corp	1	Divesting non-core assets (M1, property assets), raised dividends to shareholders, evaluating performance of board members, etc.
SPH	1	Divesting non-core assets (M1), returning annual cashflow to shareholders.
F&N	2	The group has improved transparency; shown willingness to return excess cash to shareholders through recent capital reduction exercise.
Low/uncertain CG SELLs[1]		
Want Want	4	Diversification into non-related business.
Datacraft	4	Bad control over receivables; one-time write-offs looking routine.

[1] Given depressed valuations we find difficulty looking for clear SELLs.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	8.5	+0.5	Positive steps continue (eg, new CG code of conduct in force since January 2003).
Enforcement	7.5	+0.5	SGX has been stringent, querying for clarification where disclosures are deemed insufficient and issuing warnings where lapses are made. Unknown to many is an even more powerful group known as the Securities Industry Council, which has been extremely tough on ensuring equal access to information.
Political/regulatory environment	6	+0.5	Moves toward disclosure-based regime, clarification of Temasek's charter, shake-up in top management among government-linked companies are considered positive steps.
Adoption of IGAAP	9.0	Unchanged	Singapore's rules are now largely synchronous with international accounting practices. Rules on accounting for management compensation including options expensing now being finalised.
Institutional mechanisms & CG culture	8.0	Unchanged	Recent moves on divesting non-core assets, excess capacity, top management adjustments suggest increasing accountability to shareholders. We keep the already high eight-point score flat.

Source: CLSA Emerging Markets

Regulatory environment

CG has evolved substantially since 1996 and is now enshrined in the comprehensive CG Code that took effect this year

Starting from a one-chapter reference in the Singapore Exchange's listing manual in 1996, CG policy has evolved into a national campaign for better disclosure, accountability and audit independence. While there seems to have been a short break in the country's CG crusade during the 1997/1998 Asian crisis, the crisis and resulting collapse of the financial markets probably accelerated the transition of the mindset, allowing significant breakthroughs in balance-sheet transparency. The implementation of the CG Code this year marks a new milestone for CG in Singapore.

Major events in Singapore's CG history

Date	Event
Nov-96	Singapore Exchange issues Chapter 9B on CG in its Listing Manual with the aim of raising corporate-governance standards among listed companies. Requirements centre on audit committees (formation, roles, duties) and the overall audit of listed companies.
Dec-97	DPM Lee forms Corporate Finance Committee to improve the efficiency of the corporate fund-raising process and standards of corporate disclosure.
May-98	Singapore Exchange replaces Chapter 9B with a Best Practices Guide after consulting listed corporates. Compliance is encouraged but not mandatory, although differences/shortfalls must be disclosed in annual report.
Jul-98	Singapore Institute of Directors set up as the national association of company directors. Aim: to represent directors' interests and ultimately become leading authority on CG and directorship practices in Singapore.
Dec-99	Minister of Finance, Monetary Authority of Singapore and the Attorney-General's Chambers set up three private-sector-led committees to assess various aspects of CG: one for Company Legislation and Regulatory Framework, one for Disclosure and Accounting Standards and another for CG per se.
Aug-00	Institute of Certified Accountants of Singapore (ICPAS)'s announcement to accelerate the alignment of local and international accounting standards.
Nov-00	Corporate Governance Committee releases consultation document suggesting corporate-governance best practices.
Nov-00	Parliament amends Companies Act with changes to rules on initial public offers, annual reports, material disclosure and share buybacks. Companies are now legally obliged to make timely, accurate and detailed disclosure. This is a response to Corporate Finance Committee recommendations.
Dec-00	Disclosure and Accounting Standards Committee releases consultation document on accounting standards and regulation. Proposes quarterly reporting, trimmed reporting periods, more information on directors and key executives, risk management policies and CG practices, etc.
Jan-01	Monetary Authority of Singapore issues consultation document on rule changes which will tighten rules preventing insider trading. Was vested with the power to pursue civil prosecution of listed companies which fail to make timely disclosure of material information, and also any market participants suspected of misconduct.
Mar-01	Corporate Governance Committee finalises and publishes framework and recommendations, within 1Q01 deadline originally guided.
Oct-01	Securities and Futures Act (SFA) passed. Henceforth, "... Failure by companies to make disclosure of material information could render it liable to the payment of civil fines or criminal prosecution (where the failure is intentional or reckless)."
Oct-01	Government accepts recommendations of Disclosure and Accounting Standards – makes compliance with prescribed accounting standards a legal requirement; companies to adopt standards issued by International Accounting Standards Board, to set up Council on Corporate Disclosure and Governance panel by early 2002, etc
Jan-02	Updated Takeover Code takes effect. Mandatory offer threshold raised from 25% to 30%; creeper rule tightened, offer period for consideration raised.
May-02	DBS, OCBC, UOB issue joint statement to disclose directors' remuneration from effect from 2003, proposes that all audit committee members comprise non-executive directors.
Aug-02	Council on Corporate Disclosure and Governance is set up to prescribe accounting standards, strengthen framework on disclosure practices and update CG code to maintain relevance.
Sep-02	MAS introduces more stringent CG framework for the insurance industry (vs listed companies).
Oct-02	Singapore issued a set of rules on auditor independence with effect on October 2002 as part of moves to improve CG. Public accountants and their current audit clients were given a transition period of 12 months to make the necessary adjustments.
Nov-02	Singapore confirms quarterly reporting mandatory for larger firms from January 2003.
Jan-03	Corporate Governance Code takes effect for Singapore listings.

Note: Given depressed valuations we find difficulty looking for clear SELLs. Source: CLSA Emerging Markets

Quarterly reporting should improve transparency, though we are still wary of short-term views

Quarterly reporting has begun for most companies. This will certainly improve the overall transparency of Singapore's listed entities. The danger is, of course, that quarterly reporting heightens the short-*termism* among investors and company managements. We can only hope that investors continue to focus on the long term, and treat quarterly reporting as small milestones along the trajectory. Certainly, Singapore seems to have little choice in the matter – when other markets have already moved towards quarterly reporting, Singapore does not have the luxury to stand back and demur.

Companies must now follow a continuous reporting principle or risk prosecution

Since October 2001, "... Failure by companies to make disclosure of material information could render it liable to the payment of civil fines or criminal prosecution (where the failure is intentional or reckless)". So far, SGX has played a very active role in querying for additional information where disclosure has been deemed insufficient, particularly when companies make public announcements, eg, during results. Looking ahead, we believe that this continuous reporting principle together with the pursuit of fair information to all will help further the basic CG tenet of transparency.

Apart from the SGX, the SIC is a powerful body overseeing the securities industry

At present, the Securities Industry Council (SIC) has been vested with tremendous powers and authority in matters related to the securities industry. The rules state that the SIC "shall have the power, in the exercise of its functions, to enquire into any matter or thing related to the securities industry and may, for this purpose, summon any person to give evidence on oath or affirmation or produce any document or material necessary for the purpose of the enquiry." In addition, all SIC members, when executing his SIC duties, shall have "the like protection and privileges as are by law given to a Judge in the execution of his office." For now, anecdotal evidence suggests that the SIC seems to have taken its role very conscientiously and seriously, which is laudable.

Tremendous progress can be made if the SIC starts building a repository of decisions for reference

Going forward, we would suggest that just as a judge provides transparency to his final decision, via written public records, the SIC should be able to do the same. We see tremendous upside if this is done. Imagine a repository containing all of the SIC's decisions that can be accessed for reference by companies and investors alike. It will surely help the investment industry progress more smoothly and quickly along the CG evolution.

Corporate developments

Many CG allegations have already been addressed in our February 2002 report

In our last regional CG report, *Make me holy… but not yet* (dated February 2002), we raised various CG concerns. These included the pricing of overseas acquisitions by DBS Group (Dao Heng Group), Datacraft (timing of insider sales and profit warning), UOL (sale of Haw Par shares to related party) and F&N (use of legal loophole to privatise Times Pub and Centrepoint). We see little reason to revisit these issues.

Looking ahead, we see more CG activity as the CG Code takes effect

Looking ahead, we see more CG activity in Singapore with the CG Code taking effect from this year (January). While the CG code ostensibly contains just recommendations, listed companies will have to disclose differences from the prescribed standards. For example, recent studies do show that there remains a significant gap between the CG Code recommendations and 2001 disclosures in some areas. For example, only 2% of listed companies disclosed what individual directors earned in their annual reports and only 29% had split the chairman and CEO roles. We expect that Singapore companies will likely comply with the CG Code rather than risk bad publicity by disclosing where they fall short. This should help improve CG in some aspects.

In the ensuing paragraphs, we will examine more specific events that have arisen since Feb 2002 which we believe have CG implications. In addition, we include other pertinent issues that may have been missed in previous issues of our CG reports.

CG stars

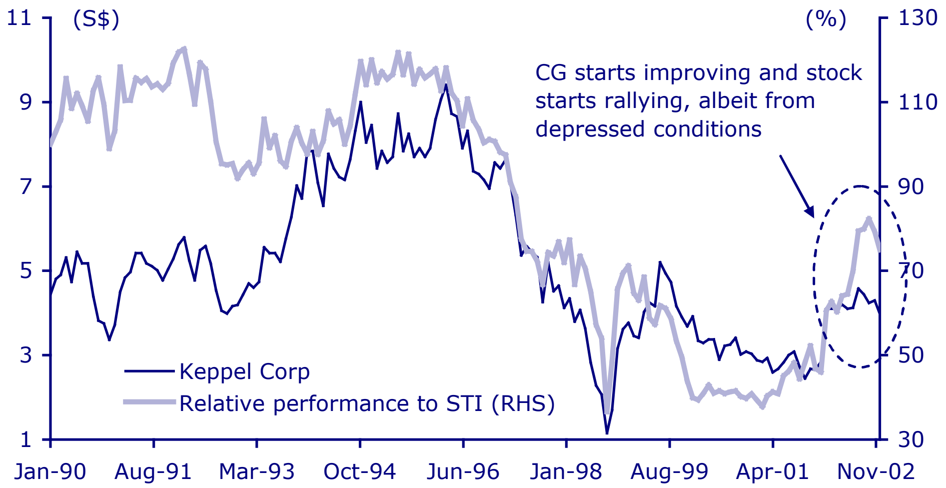
Keppel Corp – The CG poster boy

Keppel Corp has metamorphosed into a CG poster boy, and recently bagged the top award for CG in Singapore

Over the past five years, Keppel Corp has ascended from CG pariah to a poster boy of CG reform. In fact, the latest annual report awards organised jointly by The Institute of Certified Public Accountants of Singapore, Singapore Institute of Management, SGX, Singapore Institute of Directors, The Business Times and the Securities Investors Association (Singapore), the group bagged the top position for the coveted corporate-governance award. The shares have likewise done tremendously well, reflecting both the improving earnings outlook, and by all anecdotal accounts from institutional investors, a growing faith in the credibility of top management.

Shares have rallied strongly since January 2002 when pro-CG moves gathered steam

Keppel Corp's share-price history



Source: Datastream

Now Keppel's corporate access is among the best in Singapore

Dividends raised and capital return announced

In recent months, Keppel Corp has improved their management access tremendously – global corporate roadshows are becoming routine. Divestment of non-core assets are finally happening, starting from the mega Kep Capital (bank) in July 2001 and, more recently, MobileOne in November 2002 and the S$490m office property securitisation by subsidiary Keppel Land. They are also one of the first to conduct internal performance appraisals for the board of directors. FY02 dividends were raised yet again, to S18¢/share, up from S16¢/share in FY01. This is not including a S12¢/share capital distribution.

Since July 2001, Keppel has divested various non-core assets, returned excess cash to shareholders and improved transparency and accountability

CG track record of Keppel Corp

Date	Event	CG comment
Jul-01	Sold Keppel Capital for S$1.7bn	Non-core asset divested: start of Keppel's restructuring program
Aug-01	Proposed to privatise FELS	Articulated clear strategy/benefits of privatisation move
Nov-01	Capital return of S50¢/share	Returning excess cash, positive for shareholder value
Dec-01	Proposed to privatise KHZ, Kep T&T	KHZ's privatisation synergistic with that of FELS'
Mar-02	KTT privatisation/Friedman's fiasco	A slight dent to overall improving CG
Jul-02	Keppel delivers maiden interim cash dividend	Still returning excess cash to shareholders
Nov-02	Divested MobileOne	Delivered another major divestment within promised timeline
Nov-02	Subsidiary Keppel Land divests commercial office building via securitisation	Another major divestment delivered as promised
During 2002	❑ Identified non-core assets to be divested	❑ Commitment to improve shareholder value
	❑ Started quarterly reporting in early 2002	❑ One year ahead of mandatory requirements
	❑ Improved corporate access	❑ Improves transparency
	❑ Starts performance appraisal of director performance	❑ Increases accountability of board

Source: CLSA Emerging Markets

Singapore Press Holdings

SPH's strong CG rating rises further with independent chairman appointed

Singapore Press Holdings has been one of our favourite stocks for a long time, and the CG score has risen even further from an already high perch. The appointment of an independent chairman and the start of quarterly reporting later this year (required for all listed companies) are the key reasons for the incremental uptick in SPH's CG score.

High cash payouts have been welcome and investors look forward to a payout from proceeds of M1 divestment

In recent years, SPH's strong payout ratio has also been welcome, as investors have always felt that SPH has had an excessively high cash position on their balance sheet. The reduction of their stake in mobile operator M1 during the latter's IPO in November 2002 raised the group's cash holdings even further, and there are certainly hopes that the S77¢/share in divestment proceeds will also be returned to shareholders soon.

There are some CG issues that investors need to monitor

Looking ahead, we see some CG potholes that investors need to be mindful of. The three areas of concern are:

- ❑ Property portfolio and follow-through on divestment.
- ❑ TV division. Will the cash calls ever end?
- ❑ Will SPH make an expensive and/or non-core acquisition, given its significant cash hoard?
- ❑ For now, we believe these CG issues present minor risk.

On the property portfolio, it remains a drag on the overall returns for the group. The delay in the divestment process - demerger plans were put on the backburner in 2002 - did disappoint us, but in hindsight, it is unclear if the plans for the encashment of TPL (the name of the property arm that was planned to be distributed in specie to SPH shareholders) would have been achievable given difficult market conditions. As and when the economy shows signs of life, investors will need to watch if management pushes ahead on the divestment plan. For now, it makes little sense to sell the property portfolio given that it will likely require fire-sale type discounts to attract a buyer, and the Paragon building extension has yet to produce its full rental income and thereby achieve its full valuation.

Investors should be aware that another capital injection into the TV division might be needed if economic malaise extends

On the TV division, SPH Mediaworks, investors need to be mindful of how much more capital needs to be injected into the division. In February 2001, SPH's TV division announced that they were raising another S$90m in loans, on top of the S$90m capital injection from the parent SPH Group. The assertion then was that this would last the company through to its IPO. Since then, for quite valid reasons (economic downturn in particular), the TV division has required additional funding and SPH parent has agreed to provide another S$40m in funding to the group. While our analysis concurs that this S$40m should be sufficient to nurse the TV division to self-funding status, an extended economic malaise might delay this.

As for risk of non-related or expensive acquisition, we believe the risk is low

On the final all-important concern, investors continue to be wary of SPH displaying excessive ambition with its cash hoard. For now, we see nothing significant that can realistically interest SPH management (and the board). Nonetheless, investors are now extremely cautious and will perceive any accumulation of cash as a precursor to an acquisition too.

We laud the company for being upfront about the critical residual tax credit of S$596m

On positives, we welcome SPH's improving guidance to operational parameters, eg, half-yearly handouts, which clearly breakdown operating cost and revenue drivers. The disclosure of their substantial section 44 tax credit balance (S$596m), was also a powerful signal that management was aware of the significant level of dividends that would be needed to exhaust these credits by 2007. Many have since followed SPH's example in disclosing their section 44 tax credit balances.

Fraser & Neave

A recluse starts meeting investors

Management has become more accessible to investors over the past six months. Top management has been stepping up efforts to meet institutional investors, including a global marketing trip to raise awareness among the overseas investment community. This is a far cry from a year ago when management stayed very reclusive. We believe this is the start of trend towards greater transparency.

Management explains reasons for avoiding investors

But damage has been done and it will take time to regain institutional investors' faith

We believe this transparency improvement is actually coming from a low base. Management explained that their avoidance of investors in the past was due to various significant and confidential manoeuvres, eg, privatisation of Centrepoint and Times Publishing. We would suggest that regardless of the reasons, the lack of communication during the interim has caused many institutional investors to take the stock off their radar screens. It will take some time to rebuild this bridge.

Recent privatisation of Centrepoint made sense, but investors continue to frown on Times Publishing

On the privatisation of Centrepoint and Times Publishing, the first is very logical but the second far more controversial. The privatisation of Centrepoint has removed an illiquid, undervalued stock from the market, and helped boost the group's profitability and RNAV. On the other hand, Times Publishing continues to puzzle investors. This book store/publications company is considered an unnecessary distraction by many investors, and does not seem to fit the overall property/consumer franchise of F&N.

Shareholders have reason to be positive

One positive would be the first major asset divestment from the group. This would be the securitisation of the Compass Point property project which would unlock a net S$270m or about S$1.00/share for F&N. We are quite confident that this early success will pave the way for more similar divestments. Shareholders have reason to be optimistic.

CG disappointments

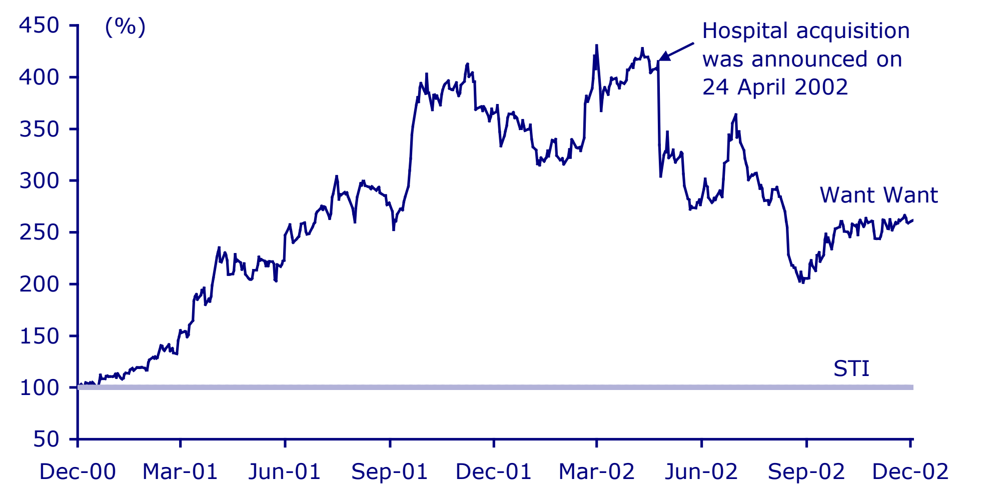
Want Want

Snack food company ventures into hospital business

Want Want's core business is in snack foods, and many investors had considered it to be a potential branded consumer play into the growing China market. In April 2002, the group acquired a hospital in China for US$28m without very compelling reasons. Given the substantially different core competencies required to run a hospital (versus snack foods manufacturing, marketing and distribution), the ensuing stock sell-down does not surprise.

Share price plummets after period of rerating

Want Want shares versus STI



Source: Datastream

Inability to articulate payout policy frustrates even value investors

Meanwhile, investors have requested clarity on the group's payout policy going forward. The inability to articulate a firm strategy on dividends has further frustrated value investors and lost the company even more fans.

Datacraft

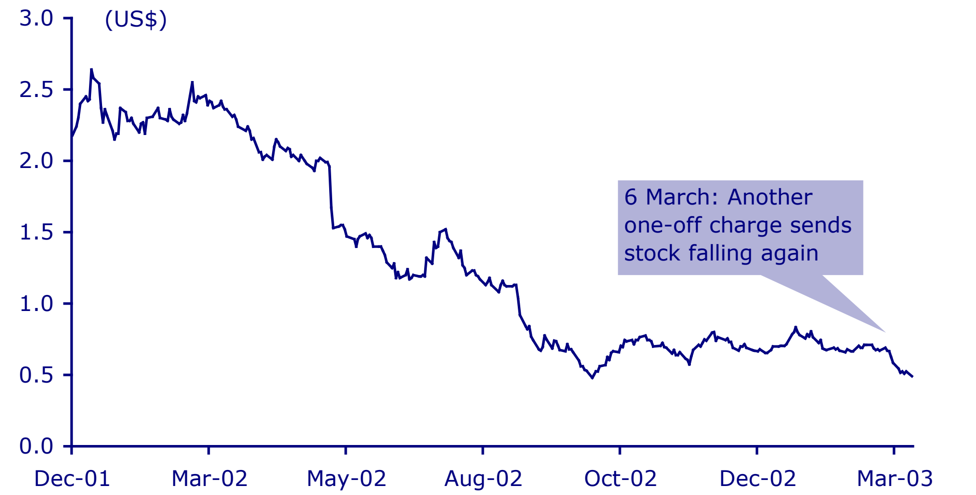
In our last regional CG report, we highlighted investor concerns regarding insider transactions

Datacraft risks being considered as a serial disappointer – has just disclosed another set of "one-off" charges

In our last regional CG report, we had highlighted investor concerns regarding the proximity between Datacraft's insider transactions and their subsequent earnings warning. This year, Datacraft's shares actually witnessed a rebound as some investors started believing that "the worst was over" for the company, especially with various "one-off charges" taken in FY02 (September year-end). Unfortunately, investors were disappointed again as Datacraft revealed the need to take more "one-off" charges on 6 March this year. While on the one hand, this early warning of a need to take exceptional charges is a positive step insofar as disclosure is concerned, on the other hand, having to take another round of "one-off charges" does shake the faith of investors. The subsequent selldown in Datacraft's shares post the announcement reflected this disappointment quite clearly.

Datacraft suffers selldown after brief respite

Datacraft's share-price history



Source: Bloomberg

CG developments in other companies

SingTel

In discussions with SingTel since our last CG report, management's position has become clearer

Since our last CG report, Spirit of the Code, we have had very fruitful discussions with management regarding the direction of CG and received clarification on our concerns. In particular, we would like to highlight two areas that investors have, in the past, been concerned with: 1) whether SingTel did overpay for Optus, and 2) whether SingTel's top management and board set out to defend minority shareholder interests. Our positive assessment on both has resulted in an uptick to SingTel's CG score. In addition, as we look ahead, we believe that SingTel's moves to divest non-core assets in the postal and directories' business will also be perceived positively from both CG and valuation creation perspectives.

On whether SingTel overpaid for Optus, our assessment is "no"

First, on whether SingTel did overpay for their Optus acquisition. In our report, Spirit of the Code December 2002, we took the opportunity to re-examine the valuation premium that was paid in the major acquisitions that Singapore companies have done over the last two years. The valuation premium is defined by the difference between the acquisition price and the standalone valuation of the acquiree. In valuing the acquiree, we have used valuation metrics that were ruling in the marketplace at the time before acquisition rumours began. We then compute the time required to recover the valuation premium from annual estimated synergies.

Our analysis shows that while the Dao Heng acquisition premium required 23 years to recoup via synergies . . .

Our quantitative analysis shows that DBS might have paid the highest premium for their entrée into Hong Kong, requiring 23 years to recover the premium paid via estimated annual synergies. As for the other companies, the recovery period is lower at between 14 and 19 years. SingTel stands out with our assessment showing no premium paid at all, based on prevailing market values when the acquisition was made.

. . . other major acquisitions required 14-19 years

SingTel seemed to have paid no premium at all

Estimated time to recover premiums paid based on synergies

Company	Acquiree	Acquisition Price[1] (S$bn)	Standalone valuation[2] (S$bn)	Estimated annual synergies (S$m)	Premium to standalone value (%)	Years to recover synergies
DBS	Dao Heng Bank	9.6[3]	5.7	170	69	23
OCBC	Keppel Capital	5.3	3.4	100	55	19
UOB	OUB	10.1	6.8	250	53	14
SIA	Virgin Atlantic	1.6	0.76	65[4]	118	14
SingTel	Optus	14	15	300	(0)	0

Notes:
[1] Where acquisition price includes share tendered, value of shares measured using same method as standalone valuation.
[2]. Basis of estimates for standalone valuation:
Dao Heng, Kep Capital, OUB, Optus: Using two month average traded share price, measured from one month before acquisition rumours were first mentioned in press articles.
Virgin Atlantic: based on 11x estimated profit of 50m UK pounds. The profit is an estimate as Virgin is a private company and the acquisition was made between FY99 and FY00.
[3] Includes consideration for second tranche to be paid on Jan 03.
[4] Virgin and SIA synergies estimated at 5% of Virgin's operating costs, largely from savings on aircraft purchases.
Source: Published data, CLSA assessment, company announcements

Optus' acquisition valuation was not expensive vs SingTel's trading valuation either

Another check on the valuation between SingTel vs Optus showed that both were trading at similar EV/Ebitda multiples of approximate 12x, a favoured valuation methodology at that point in time. It thus appears that investors, including ourselves, felt that telecom sector valuations were too high then, and therefore did not favour further telco asset acquisitions, and certainly not with cash. (Note that Singtel used S$8.4bn in cash and bonds in addition to 2.4bn shares for Optus purchase for the S$13bn total acquisition consideration). From the standpoint of SingTel, it can be argued that the market price was the fair price for Optus, thus providing the management a case against allegations of a CG breach.

SingTel's management/ board appears to fight hard for minority shareholder rights

On the second question relates to whether SingTel's top management and board do set out to defend minority shareholder interests, even if it means disagreeing with their major shareholder, ie, the government. Basically, is SingTel's management and board truly independent? We believe there is sufficient evidence to suggest that they are indeed independent.

First, there was the marathon legal case with the Infocomm Development Authority (IDA) which began in 2Q02. The IDA sued SingTel when the latter refused to return S$388m out of S$1.5bn in compensation for one particular phase of Singapore's plan to accelerate the liberalisation of the telecommunications sector. We see this as a CG positive because SingTel, a GLC, chose to defend minority shareholder's interests against a regulator. The fact that SingTel finally won the legal case actually helps allay another broader concern – it reinforced the integrity of Singapore's judicial system.

Management and board pushed for the best possible compensation, but was ultimately faced with Hobson's choice

A second example happened much earlier in 1996. This was during the compensation assessment in 1996 when the government decided to accelerate the liberalisation of the telecoms industry. SingTel had originally sought S$5bn+ in compensation for the accelerated liberalisation in 1996 while the telecoms regulator was looking closer to the S$1bn figure. This implies a S$4bn gap. We had suggested in our previous report that management did not fight hard enough to close this compensation assessment gap. After examining the court documents, we stand corrected.

The legal affidavits show that the board and management were very tenacious is pushing for the best compensation from the government, on behalf of shareholders. Unfortunately, on this particular matter, the Minister's decision is considered final and not subject to appeal. SingTel had to finally settle for a compensation of S$1.5bn, when faced with a real risk that they may actually get no compensation at all.

Chartered Semiconductor

September 2002 rights issue was not welcome by investors

In September 2002, Chartered Semiconductor announced a US$0.6bn rights issue. Many shareholders were quite upset about this issue as they claimed to be surprised by it. To be fair, management had never ruled out a rights issue and did allude to needing more funding in the future. Unfortunately, feedback from our investors seemed quite adamant that the timing of the cash-raising was completely unexpected. They felt that Chartered had US$1bn in gross cash prior to the rights issue and that management had always assured them that this was sufficient to cover its capex need of US$400-500m, with little danger of cashflow constraints in the near term. Coupled with the poor valuations on the stock, they had presumed that there was no imminent requirement to raise capital. When the rights issue was announced in September 2002, the market did not take it well. Since our December 2002 Singapore CG Special, *Spirit of the code*, we have had a fruitful discussion with Chartered on this issue. Chartered's responses were as follows:

Management believes they acted in the best interest of shareholders

- Management believes it has acted in the best interest of shareholders given constrained circumstances.
- Various fundraising alternatives were evaluated, including a secondary equity offering, equity-linked offering and debt before deciding on a rights issue as the most appropriate route.
- Given the focus on controlling debt-to-equity levels, management felt that raising more debt capital would not be appropriate.
- Evaluating the weak market conditions and negative sector sentiment, management also rejected the secondary equity offering. In addition, this could result in significant dilution to the existing shareholders.
- The equity-linked option was considered inappropriate because of the debt covenant at the CSP level, which would have limited the proceeds to a smaller amount. (There is an existing debt convenant at CSP (Fab 6) which prohibits the ST Group from diluting its current ownership level of 60.05% to below 51%.)

In management's view, the rights offering was the best among available options due to:

- High certainty of proceeds
- No dilution in the stake of existing shareholders who subscribe
- Existing majority shareholder, Singapore Technologies, had committed its support previously
- Provides equal opportunity for all shareholders to subscribe to the offer and invest in the company at current levels

Looking ahead, we believe Chartered is taking the right steps, which should help raise its CG rating

Despite the perspective of management, the share-price reaction to the announcement of the rights indicates that it was badly handled, particularly in raising equity capital when the valuations on the stock are low, ie, its cost of

Investors believe the share placement came "too soon" after a non-deal roadshow

China concerns combined with specific placement concerns pushed shares down

Could not hold against a decline in the broader China market

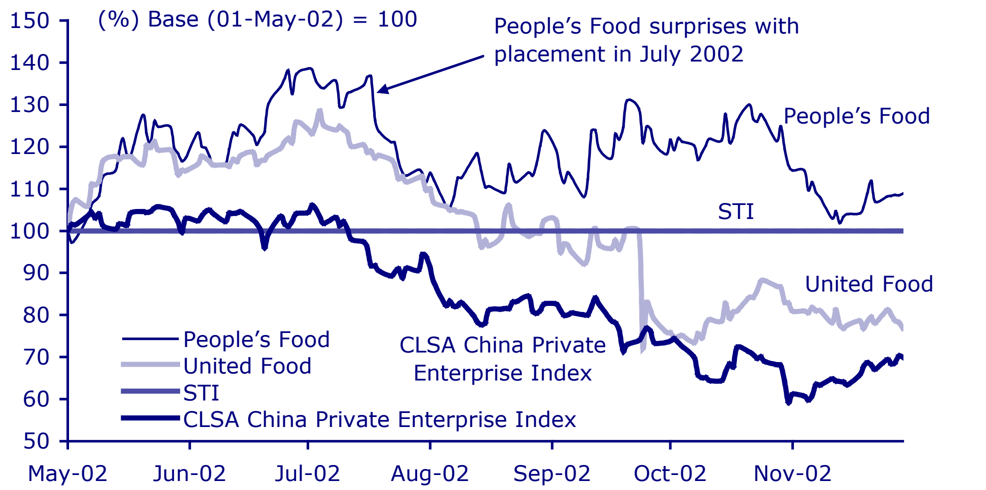
equity was high; hence we have downgraded the CG score on the company. Looking ahead, we see room for Chartered to improve on its CG rating. Certainly, the recently announced cut-backs in capacity and headcount reduction is a strong signal that management is not averse to taking drastic restructuring steps to move towards profitability. Unfortunately, profitability will remain elusive until the broader demand picture improves for the semiconductor industry, hopefully by 2H04.

People's Food

Investors have raised issues on the group's share placement shortly after a non-deal roadshow in the middle of 2002. We believe the company lacked proper communication with investors then. The market has since penalised the company by derating the stock.

While this specific placement issue had some negative impact on People's Food's share price, the actual contribution of this specific event to the decline in People's Food shares during the period is unclear. There was an overall decline in China stocks and peer company, United Foods, also saw its shares sold off. Certainly, the placement gave the investment community an excuse to label People's Food as similar to other China companies in terms of CG.

People's Food shares performance relative to STI



Company's proactive move to meet investors on issues will take time to bear fruit

People's Food's management has become, however, more aware of CG issues and has raised investor communication efforts of late. For example, when nasty market rumours arose recently, they were quick to provide clarifications via a stock-exchange announcement and proactively met the investment community to explain and counter. This effort is in the right direction, but will require persistence to impact on perceptions over its transparency and accountability. For now, People's Food's CG score puts it into our Tier 4.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
Chartered	4	❑ Greater willingness by management to reduce costs and control cashflow to improve shareholder returns. ❑ Reduction of shareholding by Singapore Technologies, which improves the perception of shareholder independence.
People's Food	4	❑ Hike dividends.

Source: CLSA Emerging Markets

SIA and SPH are the two companies that investors worry about

Looking ahead, we see SPH and SIA as two companies which might see CG downgrades if certain events that investors fear, actually pan out. Our current assessment is that both management teams are sufficiently aware of these investor fears and will only proceed if they are convinced of the synergy potential of an acquisition.

Our contact with SPH suggests they are unlikely to make non-value-adding acquisitions

For SPH, the group continues to have just over S$1bn in cash and cash-equivalents, excluding the debt attributable and secured against its property assets. Thankfully, this cash hoard is no longer growing given the 100%+ cash payout ratios that the group has been delivering to shareholders. In fact, our meetings with the new CEO and new Chairman suggests that both will continue the pro-shareholder track record of the group. We believe that this particular investor concern will abate after another year or two when investors become more familiar with the new CEO.

For SIA, investors should expect acquisitions, but not pre-judge the entry premium

On SIA, the group's ambition towards a bigger franchise remains. In fact, the company has already admitted that both Australia (medium term) and China (longer term) are targeted new markets. We believe that SIA's expansion into these new markets are not the issue, insofar as CG is concerned. The issue is that when the market entry happens, eg, through an acquisition, whether SIA will pay excessive premiums.

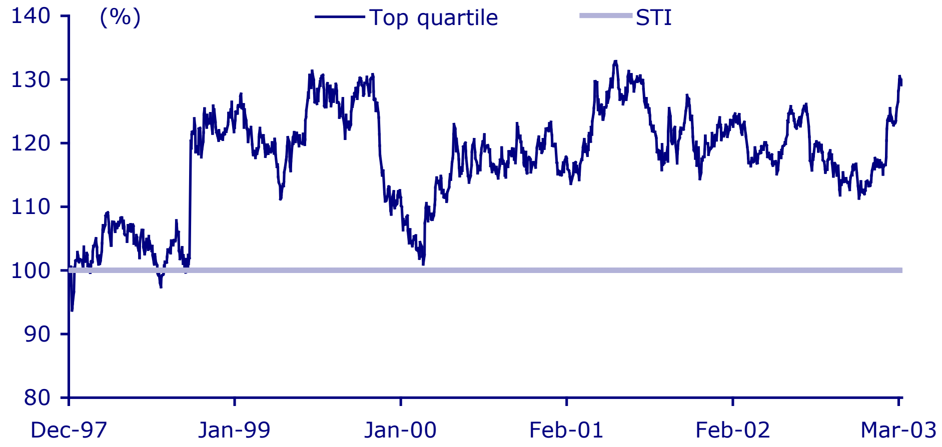
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
Singapore Press Holdings	1	❑ Risk is that SPH uses its hefty cash hoard to make a non-related acquisition. So far, it remains a fear that has shown no signs of emerging.
Singapore Airlines	2	❑ Risk is that SIA pays a big premium to enter new markets like Australia, China or even the US. This remains the lingering fear among investors.

High CG stocks have been big outperformers

Relative performance of high CG stocks

Top CG quartile versus index (Rebased: End-2002 = 100)



Source: CLSA Emerging Markets

Our sample of High-CG stocks have outperformed the STI over the past five years

Over the long term, companies with high CG tended to outperform. Among the top-tier companies, **SPH**'s shares are 15% higher than five years ago, **SIA** is 26% higher, **ST Engg** is 30% higher and **SembCorp Logistics** is 153% higher. This compares well with the STI's 11% decline over the same five-year period. Note that the significantly higher dividends from SPH and ST Engg would have been gravy to investors.

Singapore companies in the top CG quartiles

First and second quartile Singapore companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
Keppel Corp	14.0	1
SembMarine	6.8	1
Capitaland	5.6	1
SPH	5.3	1
NOL	2.6	1
SembLog	1.5	1
SCI	0.4	1
ST Engg	0.0	1
F&N	26.6	2
KepLand	3.4	2
SIA	1.7	2
OCBC	1.7	2
SGX	0.0	2
Great Eastern	New score	2
SIA Engg	New score	2

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
F&N	26.6	The group has improved transparency and has shown willingness to return excess cash to shareholders through its recent capital-reduction exercise.
Keppel Corp	14.0	A higher component of compensation is now performance-based, performance appraisals for directors has begun, non-core asset divestments continue, etc.
Datacraft	(5.0)	Bad control over receivables.
Venture	(7.5)	Extraordinarily large issue of employee share options at low price.
Chartered	(23.7)	Mishandling of the recent rights issue.

Source: CLSA Emerging Markets

Taiwan - Paying more cash dividends

Moving to higher cash payout ratios

Taiwan is a country where share ownership is high and the government frequently intervenes in the equity market. Factors which depress share prices are discussed and the government certainly tries to treat the symptoms as well as (sometimes) the underlying causes of equity-market weakness. Right now the government is encouraging companies to pay higher cash dividends. This is to address foreign investors' complaints about companies hoarding cash when they are not investing, as well as to encourage lower employee bonus-share payments. These payments are linked to stock dividends - so more cash, less stock, means less employee bonus shares. Companies are responding to this guidance and we are seeing lower employee bonus-share payments and higher cash dividends.

There is a sharp sectoral bias in the CG scores in Taiwan. Tech stocks make up 75% of companies in the first quartile of CG scores in Taiwan, but only 25% of companies in the fourth quartile. The reason for this is that tech companies depend on the equity market for the strength of their business, both by raising new equity and paying employees in stock. Therefore they have good disclosure, good investor relations (IR) and are often ADR-listed, requiring them to issue higher-standard accounts. As a consequence, they have higher CG scores than non-tech stocks. Therefore the performance of the CG quartiles primarily reflects sector factors in Taiwan – and tech has underperformed.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
TSMC	1	Conversion on the road to Damascus: the Chairman starts to see employee bonus share payments from the foreign shareholders perspective. BUY.
Formosa Group Companies	1	Will now start to pay out much larger cash dividends. BUY.
Compal	1	Historically thought of as trailing Quanta in the CG stakes, the company has improved disclosure. BUY.
Low/uncertain CG SELLs		
First Bank	4	Chairman likes foreign shareholders because they don't vote. SELL.
Macronix	3	Multiple downward revisions to guidance. SELL.
China Airlines	3	Government requires purchase from Boeing for political reasons. U-PF.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	7	Unchanged	New code in force since last year.
Enforcement	5	Unchanged	Have investigated some instances of poor guidance but no prosecutions.
Political/regulatory environment	5	Unchanged	Government still sees many listed companies as vehicles to help its electoral aspirations. China Steel is the best example of this.
Adoption of IGAAP	7	Unchanged	Mostly follow International Accounting Standards (IAS), although Ministry of Finance (MoF) issues special accounting regulations which always conflict with IAS (eg, expensing employee bonus payments).
Institutional mechanisms & CG culture	6	Unchanged	Much greater awareness and culture improving although still really government driven.

Source: CLSA Emerging Markets

Regulatory environment

Civil law rather than common law system

Taiwan follows civil law rather than a common law system. In very simplistic terms, we can say that in the common law system, everything is legal unless there is a law against it. While in the civil law system, everything is illegal unless there is a law in favour of it. Civil law systems tend to prevent innovation in finance, which has its downside in the creation of products which spread risk and find innovative ways to deploy savings. However, there is clearly an upside to the civil law system as regards CG. Many of the abuses we find in the Hong Kong market result from innovations that could not happen in Taiwan because the regulators simply wouldn't give permission.

New CG guidelines from SFC in 2002

In 2002, in response to the public debate about CG, the Securities and Futures Commission (SFC) introduced a new CG guidelines. CG, for the first time ever, has become a highly important issue in the public debate. A large number of conferences and public hearings have been held on the subject, and legislative efforts are under way on several fronts to ensure greater independence of directors' boards, to protect the rights of minority shareholders and to provide a higher level of transparency. We expect that several of these measures will be implemented in 2003.

Taiwan, for the most part, follows IAS

Taiwan mostly follows the International Accounting Standards (IAS) rather than US GAAP. However, the local accounting regulator can be overruled by the Ministry of Finance (MoF) and by legislation when it suits the government. The most recent example of this is the rule which allows losses on sale of non-performing loans (NPL) to asset management companies (AMC) to be written off over five years. The purpose of this rule is to allow shareholder funds to remain higher than they otherwise would be, so that capital adequacy rules are not breached.

This rule is necessary because the Resolution Trust Corp (RTC) does not have sufficient funds to bail out the banks. The government is seeking NT$1tr (10% of GDP) of bond issuing capacity for the RTC for this purpose, but seems likely only to get NT$300bn from the legislature in the current session. As this authorisation is not currently available, if the banks were to declare the true value of their NPLs, they could not be made solvent, although they would be given whatever level of liquidity was required.

Accountants are expected to be complicit in questionable accounting for NPLs at the banks

The fact that there is seen to be the need to allow write-offs to be made over five years suggests it is generally acknowledged that the value of loans in many banks' accounts is overstated. The implication is that the accountants in Taiwan are expected by the government to ignore this. This is not good accounting and not good CG.

The example above shows the negative aspect of having the government and bureaucracy so closely involved in the regulation of companies. If there had been an independent accounting regulator in Taiwan who had forced the proper valuation of NPLs on the books of the banks, there would have been a crisis, which would have forced government action long ago. The result would have been a recession, but at least the problem would not have got to its current size and the economy would not be held back today by the weakness in the banking system.

Higher cash dividends

The government is currently encouraging companies to pay much higher cash dividends to investors. They are doing this after complaints from foreign investors and it will address the following two issues.

The first issue is about net-cash companies having low or zero payout ratios, when there are no investment opportunities in their core businesses. Investors are complaining that they don't get enough cash back and some are even conscious of the amount of withholding tax that they are paying on stock dividends.

The second factor is that higher cash payouts address the amount of shares going to staff as bonus payments. As explained in detail below, employees (primarily in tech companies) receive cash bonuses in proportion to cash dividends to shareholders, and stock bonuses in proportion to stock dividends to shareholders. Hence shifting to high cash-payout ratios results in lower employee bonus payments.

Obliged by law to make bonus payments

In Taiwan, companies are obliged by law to make bonus payments to their employees derived from their tax paid profits. These bonuses must be deducted directly from reserves. This is another example of legislation conflicting with good accounting, as elsewhere these payments would have to be expensed in the earnings statement.

Technology companies make these payments in the form of stock

It is almost exclusively tech companies that choose to make these bonus payments in the form of stock. Many non-tech companies will make large cash payments and some make small stock payments. The table at the end of this sub-section shows the impact on EPS, PE and ROE from expensing bonuses at their market value.

There are three types of payments made which are deducted from reserves: cash bonuses to directors, cash bonuses to staff and stock bonuses to staff. The latter is covered by transferring par value (nearly always NT$10) per share from retained earnings to paid in capital.

The table at the end of this sub-section shows the five-year averages for cash bonuses to directors and staff as a percentage of profits. It also shows the five-year averages for issuance of bonus shares to employees as a percentage of shares in issue. We also show forecasts for these figures. Companies must follow their articles of incorporation in determining stock bonus payments to employees but these still allow substantial flexibility to management in determining the level of the bonus payment. Most tech companies will specify a percentage of tax paid profit (after deduction of a 10% legal reserve) which should be given to staff.

However the distribution of this profit is only made in proportion to the distribution to shareholders. Thus if only say 80% of profit available for distribution to shareholders is actually distributed, then only 80% of the employee portion of profit will be distributed also. Consequently although a company could lose money in one year, it could still make distributions to both shareholders and employees from prior years' distributable reserves.

Employees prefer stock dividend payments to shareholders so that they can receive stock bonuses

In addition to this, distributions to employees should be in the same form as the distribution to shareholders. This means that if the shareholder only receives a cash dividend, then the employee will only receive a cash bonus. However, given that bonuses are valued at par in the reserves, all employees of companies with share prices higher than par value would rather receive stock bonuses. Therefore they would rather the shareholders took stock dividends. The employee bonus shares are issued the same day that stock dividends are paid, but do not qualify for the stock dividend, this means that the larger the stock dividend the more the employee bonus shares are diluted. However, this impact is small compared with the reduction in employee stock dividends resulting from moving to cash dividends.

Therefore the employees should still prefer the companies to make stock dividend payments to shareholders. From the shareholders perspective, this is not attractive as they have to pay a 20% withholding tax to get these stock dividends delivered from the registrar and they normally have to wait between one to two months before the stock dividend shares are delivered. During this period they are denied liquidity on their shares. These two factors account for the large increase in share price on the first day a company in Taiwan goes ex its stock dividend. The ex bonus shares don't have any tax to be paid on them and they are freely tradeable.

Non-tech companies to pay much larger cash dividends

The government is having considerable success persuading non-tech companies to pay much larger cash dividends. In the banking sector, we have seen increases across the board and companies such as **Taishin**, which had previously not paid cash dividends will now do so. The **Formosa Group** companies have also announced higher cash dividends. We have also seen this from many smaller companies in Taiwan. At a time when dividend yields are in favour, the non-tech companies are doing the right thing and they will outperform. Compliance in the tech sector has not been as good. We notice that most companies are proposing stock-option schemes in addition to the stock bonuses already being paid to employees. Overall payout ratios (stock plus cash dividends) in the tech sector have gone up implying that tech companies are dependent on stock based compensation to retain key employees. However on all the other measures in our CG scoring system, the tech companies score more highly, so they still have higher CG scores overall.

Technology companies are creating stock-option programmes

Most technology companies are announcing the creation of stock option programmes. The SFC requires that the exercise price of the option be higher than the market price on the day the exercise price is set. The options are long-dated and the volatility in Taiwanese tech companies is high. In order to maximise the value of the options to employees, we believes tech companies are trying to time the market in setting the exercise price. This means that investors should be suspicious of the near-term newsflow for those companies that have SFC permission for their option programmes but have yet to set their exercise price – **Realtek** is an example of this. No one knows more about a company than its management and if they think that in the best interests of employees they should defer setting the exercise price, then presumably investors should also defer any decision to buy the stock.

For long-dated options, with the exercise price set at today's price and high volatility in the underlying stock, the value of the option is roughly equivalent to half a share. On this basis we can assess the impact of option schemes on tech company shareholders. The table at the end of this sub-section shows historic five-year averages for share issuance to employees. For each option scheme, we can divide the number of options to be issued in half and consider that number equivalent to the issuance of straight equity. On that basis, the initial evidence suggest that rising stock dividend payout ratios of tech companies combined with options programmes means greater dilution for shareholders in the long term. Essentially some tech companies are being forced to compensate employees for lower share prices/valuations by increasing the rate of dilution. This is bad news for the tech sector.

Taiwan Stockwatch - Earnings adjusted for employees and directors' bonuses at market value

Company	Price NT$	As percent of profit: Directors 5Y avg	As percent of profit: Staff 5Y avg	Staff & directors cash bonuses as % profit: 02CL	03CL	04CL	Share dilution(%): 5Y avg	02CL	03CL	04CL	EPS reduction (%): 02CL	03CL	04CL	PE (x): 02CL	03CL	04CL	ROE (%): 02CL	03CL	04CL
CLSA universe				1.58	1.47	1.40	0.9	0.6	0.7	0.8	14.1	13.9	13.8	22.0	16.2	12.5	8.1	10.2	12.1
CLSA tech				2.41	2.08	1.62	1.7	1.2	1.4	1.5	30.1	28.9	23.1	33.1	23.6	13.2	6.3	8.0	12.8
CLSA non-tech				0.97	1.00	1.14	0.1	0.1	0.1	0.1	2.1	2.1	2.4	16.1	12.0	11.8	9.5	11.9	11.5
Semiconductors: Ming-Kai Cheng & Dhruv Vohra / Networking, notebooks: Robert Cheng & Angela Lo / Motherboards, panels: Jeff Su																			
Accton	29.4	4.33		4.5	4.5	4.5	2.36	2.4	2.3	2.4	38	41	43	22.2	21.8	20.2	6.1	5.8	5.8
Advantech	61.5	0.54	4.74	5.0	5.0	5.0	2.47	1.7	1.7	1.7	30	31	30	20.4	18.6	15.4	18.7	17.6	18.1
Altek Corp	80.5			3.0	3.0	3.0	-	2.0	2.0	2.0	33	29	28	21.5	14.9	11.6	24.6	29.6	29.5
Ambit	99.0	0.71		0.9	0.9	0.9	2.85	2.9	2.9	2.9	45	43	44	27.6	21.4	19.4	13.8	15.5	14.4
Anpec	40.0	3.00				2.0	na	3.0	3.0	3.0	43	47	47	23.7	23.8	19.7	14.9	12.2	12.3
ASE	18.6	1.39	0.39	2.0	2.0	2.0	1.03	0.1	0.7	1.0	37	25	24	749	40.3	22.2	0.2	3.5	6.0
Asustek	68.0	0.82	7.33	7.5	7.5	7.5	0.71	0.7	0.7	0.7	18	19	19	17.8	16.4	15.2	11.3	11.6	11.7
AU Optronics	19.4	0.09					0.29	0.3	-	0.3	4	0	4	13.1	na	10.4	9.5	na	9.4
BenQ	39.1			2.0	2.0	2.0	1.50	1.5	1.5	1.5	16	21	19	10.3	12.9	8.5	18.7	12.9	16.7
Compal	35.5	2.00	0.00	2.0	2.0	2.0	1.71	1.7	1.7	1.7	23	23	24	15.2	12.7	11.4	14.3	16.7	15.9
Compeq	16.5		0.18				0.60	-	0.2	0.6	-	6	11	na	31.4	16.6	na	2.9	5.2
Delta Taiwan	39.2	0.05					1.67	1.6	1.7	na	21	22	na	15.9	13.8	na	11.9	12.6	na
D-Link	26.8	1.69	0.43	2.0	2.0	2.0	1.99	1.9	1.4	2.0	30	32	35	20.6	25.2	17.8	6.8	5.2	7.1
Gemtek	84.0	1.18	0.42	2.0	2.0	2.0	-	3.0	3.0	3.0	48	52	48	28.6	28.6	20.7	12.4	9.5	11.1
Gigabyte	47.0	2.16		2.0	2.0	2.0	3.26	3.3	3.3	3.3	36	40	42	15.1	15.7	15.1	10.6	9.6	9.4
HTC	151.0	0.88	3.52	4.5	4.5	4.5	6.20	3.5	3.5	3.5	65	61	62	48.8	34.5	31.5	12.8	13.6	10.7
Hon Hai	112.5	0.05	1.32	1.5	1.5	1.5	1.84	1.8	1.8	na	27	27	na	19.3	15.5	na	19.2	19.1	na
Lite-On IT	86.0			2.0	2.0	2.0	2.58	2.5	2.5	na	21	18	na	8.5	5.4	na	35.0	26.6	na
Macronix	8.8	0.72		2.0	2.0	2.0	2.96	3.1	1.2	3.0	na	na	na	na	na	na	na	na	na
MediaTek	263.0	0.90	0.73	3.6	3.6	3.6	4.50	4.1	4.1	4.1	45	52	53	17.6	19.6	17.2	36.1	21.5	17.6
Nanya Tech	19.2						-	na	na	na	na	na	na	27.6	24.8	17.6	5.6	5.9	7.8
Phoenixtec	26.6	2.00	4.00	6.0	6.0	6.0	-	na	na	na	na	na	na	11.0	9.3	8.1	15.2	17.4	18.9
Premier Image	47.4	1.18		1.0	1.0	1.0	3.11	2.8	2.7	3.1	55	56	57	42.8	39.4	31.3	6.9	7.2	8.2
Princeton	46.5	1.12					3.75	3.7	3.7	3.7	34	34	33	12.4	10.3	7.5	27.0	24.3	24.7
ProMOS	7.7	1.25	0.45	2.0	2.0	2.0	1.13	-	0.6	1.1	-	14	15	na	18.5	10.1	na	3.9	6.8
Quanta	62.5	0.27	1.33	1.5	1.5	1.5	1.43	1.4	1.4	1.4	22	24	23	17.7	16.7	13.6	19.2	17.1	17.4
Realtek	74.0	1.48	0.48	2.4	2.4	2.4	3.72	3.7	3.6	3.7	48	54	59	22.4	25.4	26.8	13.1	9.1	7.5
SPIL	16.9	1.71	0.00	1.5	1.5	1.5	1.07	0.2	0.6	1.1	16	26	21	89.5	48.5	17.8	1.4	2.5	6.4
Sunplus	48.4	1.18	0.35	1.5	1.5	1.5	2.04	2.0	2.0	2.0	35	36	34	24.2	22.6	17.9	11.0	11.0	13.1
TSMC	42.8	0.90		1.0	1.0	1.0	1.77	0.6	1.1	1.8	24	32	27	48.3	35.1	14.4	5.7	7.3	15.5
UMC	19.5	0.69		0.0	0.0	0.0	0.93	0.2	0.4	0.9	7	9	10	43.3	19.9	8.4	2.8	5.8	13.2
Unimicron	14.1	1.62	2.21	5.0	5.0	5.0	1.43	1.0	1.3	1.4	15	20	21	11.5	11.2	8.9	7.4	7.1	8.2
VIA	32.5	0.67	1.04	1.5	1.5	1.5	2.06	1.2	0.8	2.1	40	45	48	51.8	80.6	33.1	2.8	1.8	4.2
Weltrend	26.5	2.76	0.11	3.0	3.0	3.0	2.77	2.3	2.7	2.8	34	35	36	18.8	14.9	12.1	10.3	11.9	12.6
Winbond	13.0	0.94	0.00	2.0	2.0	2.0	0.98	-	0.2	1.0	-	15	35	na	65.9	41.4	na	1.5	2.3
ZyXEL	61.5	2.70	0.28	3.0	3.0	3.0	1.70	1.7	1.7	1.7	30	28	28	22.0	16.6	14.0	14.0	15.7	15.4
Petrochemicals: Joe Pai / Steel: Geoff Boyd																			
Formosa Chemical	35.7			0.5	0.5	0.5	-	na	na	na	na	na	na	14.7	15.1	11.8	11.1	10.3	12.7
Formosa Plastics	44.8	0.21	0.21	0.5	0.5	0.5	-	na	na	na	na	na	na	23.4	16.5	13.3	9.4	12.8	15.0
Nan Ya Plastic	32.6	0.22	0.22	0.5	0.5	0.5	-	na	na	na	na	na	na	13.2	11.3	na	11.2	11.7	na
Nien Hsing	31.5	0.77	0.81	1.5	1.5	1.5	-	na	na	na	na	na	na	10.7	9.3	na	18.2	19.5	na
China Steel	19.9	0.30	0.30	0.5	0.5	0.5	0.26	0.3	0.3	0.3	3	3	4	10.6	8.1	10.7	13.2	16.1	11.7
Consumer, miscellaneous small caps: Heather Hsu																			
CTCI	20.4	0.82		0.5	0.5	0.5	0.48	0.3	0.4	0.5	5	6	7	17.1	13.4	10.4	8.9	11.1	14.0
National Petrol	26.7	4.06	1.51	5.0	5.0	5.0	0.20	0.1	0.1	0.2	6	7	7	13.8	10.7	9.7	16.7	20.7	21.9
Basso	56.0	1.11	0.09	1.0	1.0	1.0	0.56	0.5	0.6	0.6	8	8	9	14.0	12.1	11.2	24.5	26.6	26.5
Mobiletron	48.3	1.62	1.86	3.5	3.5	3.5	-	na	na	na	na	na	na	10.8	8.1	6.5	23.0	25.8	27.1
Holiday	18.7	0.36	2.28	5.0	5.0	5.0	0.59	0.6	0.5	0.6	9	10	10	7.8	7.1	5.9	17.0	16.8	18.2
PCSC	41.2	1.15	0.71	1.0	1.0	1.0	-	na	na	na	na	na	na	16.8	15.9	14.9	17.8	16.9	16.2
Pou Chen	32.0	2.64	0.35	3.0	3.0	3.0	0.29	0.2	0.3	0.3	7	7	7	17.3	12.9	9.5	11.8	14.0	16.1
Twn Hon Chuan	50.5	0.84	0.84	1.5	1.5	1.5	-	na	na	na	na	na	na	15.0	12.5	11.0	22.4	24.4	23.8
Taiwan Secom	27.4	5.41	0.54	5.0	5.0	5.0	-	na	na	na	na	na	na	12.5	11.3	10.5	12.3	12.9	13.3
Financials: Martin Printz																			
Chinatrust	27.5						0.18	0.2	0.2	0.2	2	2	2	11.7	9.7	8.0	16.3	18.3	19.8
First FHC	20.9			3.5	3.5	3.5	0.39	-	0.3	0.4	-	9	10	na	19.3	13.2	na	6.8	9.1
Fubon	26.7	1.79	1.08	3.5	3.5	3.5	-	na	na	na	na	na	na	18.8	14.3	12.2	7.9	9.3	9.9
Mega FHC	15.5	1.00	1.00	2.0	2.0	2.0	-	na	na	na	na	na	na	13.7	9.1	7.7	6.9	10.5	11.7
SinoPac	12.3						0.45	0.5	0.4	0.5	6	6	6	14.0	12.2	9.5	9.8	8.2	9.6
Taishin	16.1						0.12	0.1	0.1	0.1	1	1	1	10.1	8.0	6.6	14.0	15.8	14.9
Automotive, transportation: Heather Hsu																			
China Motor	64.5	0.45	4.49	5.0	5.0	5.0	-	na	na	na	na	na	na	15.4	12.8	11.7	16.0	17.6	17.6
Giant Manuf	36.9	5.83	1.79	7.5	7.5	7.5	0.09	0.1	0.1	na	9	9	na	15.1	12.3	10.3	14.4	14.7	14.4
Tong Yang	41.6	1.20	0.40	1.5	1.5	1.5	-	na	na	na	na	na	na	27.1	14.6	12.2	11.9	20.2	21.4
TYC Brother	65.0	0.14	0.87	1.5	1.5	1.5	-	na	na	na	na	na	na	16.1	12.5	10.5	19.5	21.9	23.2
China Airlines	11.9						0.34	0.2	0.3	0.3	3	3	4	10.7	10.9	9.5	6.2	5.9	6.5
EVA Airways	10.3	0.14	0.67	1.0	1.0	1.0	-	na	na	na	na	na	na	9.0	8.1	7.4	8.1	8.4	8.7
Wan Hai	29.6	0.51	0.51	1.5	1.5	1.5	-	na	na	na	na	na	na	12.5	11.0	10.6	17.8	17.0	15.1
Telecoms: Francis Cheung																			
Chunghwa Tel	54.0						-	na	na	na	na	na	na	12.1	14.2	18.2	11.2	9.5	7.4
Far EasTone	26.3	0.19	0.37				-	na	na	na	na	na	na	8.8	8.8	10.6	19.9	17.6	13.2
Taiwan Cellular	23.5	0.51	1.22				0.37	0.4	0.4	0.4	3	4	5	7.7	8.5	11.5	21.9	17.9	12.2

Note: The table above shows the historic five year averages for cash bonus payments to both directors and employees as a percentage of earnings, and for issuance of employee share bonuses, as a percentage of shares in issue. Source: CLSA Emerging Markets

CG stars

The most substantial improvements in CG scores have come from **Formosa Group** companies. These are primarily due to large swings towards cash dividends and away from stock dividends as well as a significant improvement in general market disclosure and investor relations. Our CG scores rose by 25ppts for **Formosa Plastics** and by 24ppts for **Nan Ya Plastics**. These are the largest increases in our sample and both companies are now first quartile CG. Both companies are in our Taiwan model portfolio.

CG disappointments

Potential CG movers – up and down – highlighted below

Mosel and Infineon are the major shareholders in **ProMOS**. ProMOS is supposed to sell all output through these companies at a price representing fair market value. When Mosel and Infineon disagreed over who should get how much of the output, it became clear that the output was worth more than either were paying. Why not bid for the right to buy on a regular basis? In addition to this, Infineon claims that Mosel's use of ProMOS shares as security for a bond issue, represents a breach of its obligation to offer the shares to Infineon first in the event of sale.

Yageo revised down its profit guidance three times in 2002 when it was under severe financial pressure and was presumed to be raising money.

Chou Chin has been suspended from trading in Taiwan because management was alleged to use company money to support the share price. On 7 March, this stock was subject of the largest stock settlement default in Taiwan for five years. Under this scam, a syndicate will bid up a company's share price, then when the share price peaks, a large block of stock will be sold, the seller will receive his money before the buyer makes payment and then the buyer will default. The losers are securities companies and underground financiers providing up to 90% margin loans. The chairman has allegedly admitted he embezzled NT$200m for the purposes of stock manipulation and has resigned.

Close ties to the Taiwan government

First FHC announced that it would raise money through a global depository receipts (GDR) issue sold to foreign portfolio investors. The Chairman said they preferred a GDR because they see foreign investors as passive and non-voting. The governing Democratic Progressive Party (DPP) administration has close contacts to First FHC and in the run-up to the election we expect rumours of assistance to help the government with funding for the election. Following the DPP's poor showing in the Kaoshiung election, the government sacked the chairman of China Steel (based in Kaohsiung and major organiser of DPP support in the area). They replaced him with the former Chairman of Taiwan Power, who was forced to resign last year after a planned four-hour power outage was implemented without notice to users. It is presumed that the new Chairman will better organise their support for the 2004 election.

We highlight below companies most likely to see CG improvements and companies we believe are at risk of deteriorating CG.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
China Steel	2	❑ Government wants to sell down its shareholding. No more changes of chairman for political reasons would be good.
MediaTek	2	❑ Is considering the government's request to reduce its employee bonus share payout.

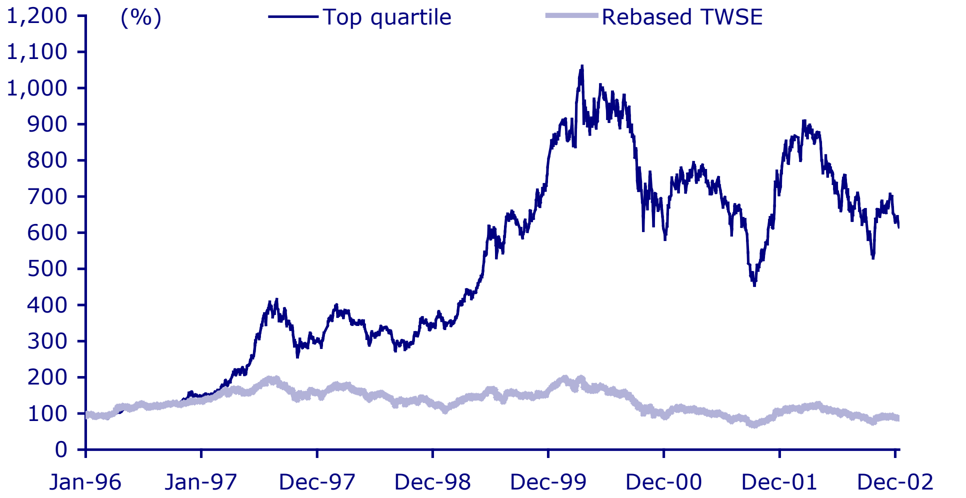
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
President Chain Store	1	❑ The company has created a new core business – property development.

High CG stocks have been big outperformers over five years but not recently

Relative performance of high CG stocks

Top CG quartile versus index



Source: CLSA Emerging Markets

Our sample of high CG stocks have, without exception, outperformed the KLCI

High CG stocks performed strongly in absolute terms until they peaked in February 2000. In relative terms, outperformance finished in July 2001. The key factor driving underperformance since then has been sector bias. Tech stocks represent 75% of companies in the first quartile of CG scores in Taiwan, but only 25% of companies in the fourth quartile.

Taiwan companies in the top CG quartiles

First and second quartile Taiwan companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
TSMC	-	1
Nan Ya Plastics	25.3	1
Formosa Plastics	24.2	1
UMC	-	1
Quanta	-	1
Realtek	1.7	1
PCSC	-	1
Sunplus	2.8	1
VIA	-	1
Ambit	3.8	1
Compal	-	1
Winbond	-	1
Asustek	-	2
TCC	-	2
Sinopac FHC	-	2
BenQ	4.9	2
ZyXel	5.1	2
China Steel	-	2
Compeq	-	2
Delta	-	2
Far Eastone	-	2
D-Link	(2.4)	2
MediaTek	-	2

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
Nan Ya Plastics	25.3	Improved disclosure on board practices
Formosa Plastics	24.2	Improved disclosure on board practices
Advantech	14.1	Unlike many other tech companies it does not have US GAAP accounts

Source: CLSA Emerging Markets

Thailand - Making steady progress

Thai authorities have taken a number of steps in the past few years to clean up their act

Thai regulatory authorities have taken several steps to strengthen CG practices in recent years. The Stock Exchange of Thailand (SET) has been working on three vital areas to improve guidelines on good CG for listed firms, including strengthening the quality of disclosure, establishing an audit committee and encouraging a framework for the development of good CG practices in Thailand. With help from the World Bank, the SET, the Bank of Thailand and other agencies, this led to the establishment of the Thai Institute of Directors, which works to raise the abilities of Thailand's company directors to meet global standards.

But the entire corporate sector is not yet convinced of the merits of good CG

The difficulty is in getting the corporate sector to fully comply. There have been instances where independent directors have in practice been linked to the controlling shareholder. This includes firms like government-linked PTT Plc. There has also been cases of poor and untimely disclosure, including outright fraud. Thus while the authorities recognise the need to improve CG practices, the improvement in practices and performance and the perceptions of investors on the market improves only as fast as its slowest (or weakest) member. We rate **Thai Union Frozen**, **Advanced Info Service** (AIS) and **Siam Cement** as among having the best CG practices in Thailand. Among the lowest scoring firms in our CG survey are **Telecom Asia** and **PTT**.

BUY/SELL summary

Company	Country CG quartile	Rerating drivers
High/improving CG BUYs		
Siam Cement	1	Developing market leadership in all areas of CG.
Advanced Info Service	1	Price competition is easing, capex is reduced, FCF is rising.
National Petrochemical	2	Incremental demand will outpace supply until 2005.
Thai Farmers Bank	2	Hybrid debt will be repaid in 2004; earnings prospects are improving.
Low/uncertain CG SELLs		
Siam City Cement	3	Weak public disclosure towards its possible acquisition of TPI Polene.
Golden Land	3	Large amounts of dilutive warrants outstanding, questions as to commitment to improving minority rights.
Egco	3	Growth prospects are unexciting, new management team untried.

Country ratings for macro determinants of CG

	Rating (1-10)	Change from previous rating (February 2002)	Comments
Rules & regulations	7.5	Unchanged	
Enforcement	3	+1	SEC has been more proactive in prosecuting company digressions.
Political/regulatory environment	4	+1	The government has made greater emphasis on recognising the importance of good CG.
Adoption of IGAAP	6	+1	Accounting policies are increasingly modelled on IASB.
Institutional mechanisms & CG culture	4.5	+0.5	Shareholder associations being established; CG ratings being done. Investor training by SEC.

Source: CLSA Emerging Markets

Regulatory environment

Continuing improvement on CG, with SEC taking initiative to enhance accountability of boards

The Asian Crisis brought home to regulatory authorities in Thailand the importance of strengthening CG practices. However, regulators have realised that there are limits to what they can do. Creating a legal framework is one thing, enforcement is another. To improve attitudes the authorities have emphasised education programmes with legal amendments.

Hence last year was declared as the year of "The Good Corporate Governance Campaign". This saw a greater effort by the SET to promote good CG at the corporate level to enhance accountability of the Board of Directors. Companies were required to:

- Establish an audit committee.
- Increase the number of independent directors to no less than one-third of the Board of Directors.
- Issue a statement of best practices including a code of ethics for management and directors alike.
- Undertake a director education program.

An Institute of Directors has been set up to strengthen CG practices

In addition to all of the above, the Thai Institute of Directors (IOD) was established in late 1999, with the support of the SEC, the Bank of Thailand and the World Bank. The purpose of the IOD was to promote greater awareness of the roles and responsibilities of company directors as well as to upgrade their professional standards, skills and knowledge. In essence, as a springboard to lifting CG habits for Thai companies.

SET and SEC working towards introducing class-action suits

Finally, the SET has issued guidelines for listed company shareholders' meetings. This is to make sure that shareholders have sufficient information at hand for making decisions. In addition, both the SET and the Securities and Exchange Committee (SEC) have supported the establishment of a Shareholder Association as well as introducing laws allowing class-action lawsuits for securities complaints.

Accounting standards have also been tightened

Accounting standards are being tightened up as well. Presently, companies listed on the SET have to follow the Thai GAAP which implements 21 out of 34 standards as set out by the International Accounting Standards (IAS). However, it is the policy of the Institute of Certified Accountants and Auditors of Thailand (ICAAT) that within four years all the IAS that are applicable to Thailand will be adopted by the Thai GAAP.

There is also a continuing effort to provide further protection to shareholders under the Public Limited Company Act by:

- Improving on the sufficiency of information that companies have to furnish to investors in advance of the shareholder meeting.
- Reducing the threshold for shareholders to take derivative action against the management of the company.
- Reducing the threshold for minority shareholders to call for meetings.
- Adding a provision that shareholders can seek a court order to stop or compel the company to take any action where it can be proved that shareholder rights are being oppressed.

CG stars

Siam Cement has arguably shown the most dramatic improvement in CG in the past few years

Siam Cement has among the best CG of Thai companies. This is particularly evident since the crisis. Two of the most notable changes are transparency and communication. Prior to 1997, Siam Cement seldom met with investors and analysts. Since then, however, the company has made a concerted effort to improve communication with its shareholders including the implementation of a clear restructuring plan. Accounting disclosure was strengthened showing clear divisional breakdown of revenue, profitability and assets.

Last year, we wrote how **PTT** scored poorly because of the group's large off-balance-sheet obligations by way of shareholders' support to subsidiaries. At the time, this totalled US$460m. Both transparency and disclosure on the issue was poor. It is encouraging then that, 12 months later, the group has cleaned up much of these off-balance-sheet items by consolidating loss-making affiliates and restructuring the operations. Investor communication has also improved as the investors relation function has been strengthened.

CG disappointments

Roynet has been the worst CG offender in the past year

The most notable CG issue in the past 12 months has been the fiasco surrounding **Roynet** and its president, Kittipat Yaoprukse. Roynet was an internet service provider that listed early last year. Less than 12 months later, the stock has been suspended with charges of falsifying accounting statements and insider trading brought against the company and management. This was after Kittipat and his family, who owned 63% of the company back in April last year, sold all their stock just weeks before the company restated third-quarter and nine-month earnings from a profit to a sizeable loss. The SET has since suspended Roynet from trading, barred Kittipat from holding any executive post in any listed company for 10 years and is pressing charges which could see the former high flyer jailed for up to five years.

Meanwhile, though certainly not of the same magnitude of CG, **BEC World** continues to show no inclination to disperse its US$100m cash pile. While the Maleenond Family has not been tempted to 'di-worsify' the business through acquisition and has a conservative financial management, such a high level of cash on the company's balance sheet (and no debt) is not capital efficient. That being said, it is somewhat positive that BEC has paid out 100% of earnings in the past couple of years, preventing cash from being built up.

We highlight below companies most likely to see CG improvements owing to the government's latest initiatives, and companies we believe are at risk of deteriorating CG.

Companies with CG upside potential

Company	CG quartile	Events that could change CG score
PTT Plc	4	❑ Reduced off-balance-sheet liabilities.
		❑ Improved board composition to allow for truly independent directors.
Ratchaburi	4	❑ Better flow of information.
Land & Houses	2	❑ Successful implementation of risk management including forex risk exposure, commitment and contingent liabilities in 2001.

Source: CLSA Emerging Markets

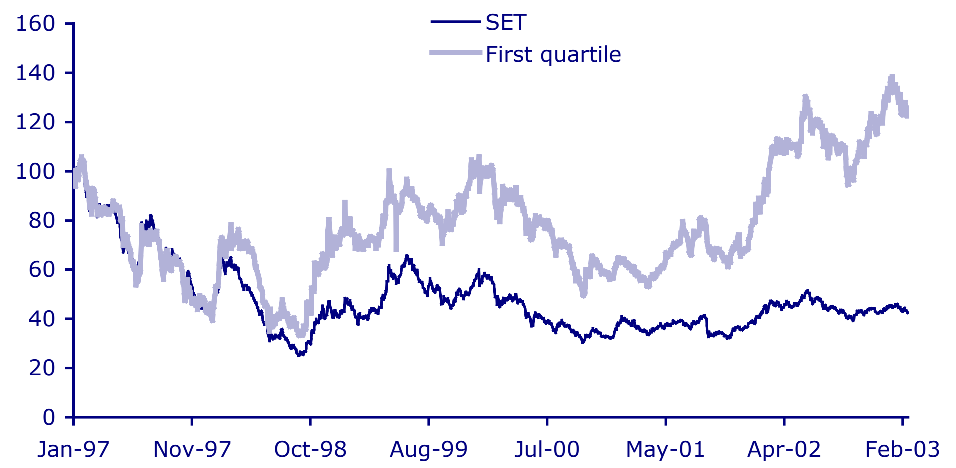
Companies with CG downside risk

Company	CG quartile	Events that could change CG score
Advanced Info Service	1	❑ Concentration of ownership by Shin Corp (40%), actions could potentially conflict CG (ie dividend payout)
Siam City Cement	3	❑ Poor disclosure over the company's plans to buy TPI Polene.
BEC World	1	❑ Poor management guidance regarding the intent to dispose of its growing cash pile.

High CG stocks have been big outperformers in the past few years

Relative performance of high CG stocks

Top CG quartile versus index



Source: CLSA Emerging Markets

Our sample of high CG stocks have, without exception, outperformed the KLCI

As the chart above shows, the top-quartile CG stocks have greatly outperformed the SET. Over the past five years, the top quartile of CG stocks beat the SET by 138% in US-dollar terms and by 4% in the 12 months ended 2002. The stock with the highest CG score, **Thai Union Frozen**, has outperformed the SET by 140% in the past five years. However, **Siam Cement** had the biggest outperformance among top-quartile CG firms - outperforming the SET in US-dollar terms by 138% over one year, 73% over three years and 447% over five years. Interestingly, the company has also seen one of the greatest CG improvements in that time as well (see our earlier remarks on the company).

Interestingly, our sample of the bottom-quartile CG stocks have also outperformed the index over a five-year period, although the results are skewed by the performance of Central Pattana which has beaten the SET by more than 330% in the past five years. Excluding it, the bottom quartile of stocks would have underperformed the SET by 10% in the past 12 months, 11% over three years and 26% over five years. Holding these companies has not been a profitable proposition.

Thailand companies in the top CG quartiles

First and second quartile Thailand companies sorted by CLSA CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Ranking by country quartile
Thai Union Frozen	-	1
Advanced Info Service	4.8	1
Siam Cement	11.3	1
Aeon Thanasinsap	Not ranked	1
BEC World	3.0	1
Hana Microelectronics	-	1
Big C Supercenter	6.0	1
Siam Makro	6.0	2
Asian Property	Not ranked	2
National Petrochemical	-	2
Siam Commercial	-	2
PTTEP	3.3	2
Thai Farmers Bank	5.0	2
Land & Houses	3.9	2

Companies with significant change in CG score

	Change in CG score from previous ranking (February 2002) (ppts)	Comments
Siam Cement	11.3	Sold unprofitable units, consolidated affiliates and streamlined business divisions.
PTT	8.5	Has consolidated off balance-sheet liabilities and strengthened transparency.
Golden Land	(4.5)	Large overhang from new capital raising plans with limited disclosure.

Source: CLSA Emerging Markets

Appendix 1: CLSA CG methodology

Methodology developed since the initial October 2000 CG report

In October 2000, CLSA produced its first GEM report on CG, *The Tide Is Out: Who's Swimming Naked?* This covered an initial sample of 115 of the largest companies in 25 emerging markets that we covered. CG scoring of the companies was through a questionnaire filled out by our analysts in each country for the companies that they covered. That questionnaire was made more rigorous in our second CG report of April 2001, *Saints and Sinners: Who's Got Religion?* Fifteen qualitative/interpretative questions were replaced with questions that focused on hard data and numbers. Essentially the same questionnaire with minor amendments was used for our 2002 report *Make me holy*, as well as this fourth report, *Fakin' it*. *See Appendix 2 for the corporate governance questionnaire.*

57 issues under seven key criteria of CG assessed

The questionnaire is designed such that all questions have strictly binary answers (yes/no) to reduce analysts' subjectivity. The questionnaire assessed the companies on 57 main issues divided into seven key criteria that we take to constitute the concept of good CG: management discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. The first six criteria were each given an equal weight of 15% and the last, social responsibility, was given a lower weight of 10%, owing to the split response from fund managers as feedback on whether they did or did not see this as part of CG.

Broad definition with no sharp distinction between good management and good governance

A broad definition of CG is backed by good authority. Our definition encompasses not just the fair treatment of minority shareholders and other stakeholders, but also aspects like management discipline (including financial discipline) and social responsibility. We take all these as being aspects of how well a company is run (ie, that there is no sharp distinction between good management and good governance). If a company does not know its cost of capital, this is not just poor management but also an aspect of bad governance. It entails a higher risk that the company might embark on projects where returns are below cost of capital, but which may nevertheless have some allure for management. This would certainly be an investor concern, and could well be to the detriment of shareholders, and thus we believe it is appropriately placed under the concept of CG. Similarly, if a company engages in bribery or invests in countries where the governments lack legitimacy, it reflects poorly on management. Not only would many retail investors and trustees object to this, but ignoring social responsibility would generally be seen as being a bad corporate citizen and not keeping up to global best standards of good governance.

Social responsibility is part of being a good corporate citizen

Breadth of definition depends on purpose

Whether one should focus on a broader or narrower concept of CG depends on one's purposes. Our purpose is to set a yardstick of best international standards. However, for those who seek to employ a narrower standard focusing on the protection of minority rights over the short- and medium-term, our questionnaire and scoring system has the flexibility to focus on particular categories of CG and to give different weights (even zero) to any of these seven aspects. Each question in each section has an equal weight, except for the first questions in the independence and fairness sections. These questions were whether there has been any controversy over whether the board or senior management have made decisions that favoured them over shareholders, and whether any decisions by senior management have been perceived to favour majority shareholders over minorities. These questions each are given half the weight in their sections as we consider them to be the key issue under their respective categories.

Appendix 2: CLSA 2002 CG questionnaire

Notes on application of questionnaire:

1. *For Transparency Section, if in any doubt, answer "No". For other sections, use best judgement but always seek necessary clarification. Any question where the facts cannot be ascertained, but there has been <u>controversy, or questions raised,</u> over whether best practices have been met and/or minority shareholders or other stakeholders have been disadvantaged, answer negatively.*

2. *If any doubt in interpreting a question, note that for each question **"Yes" is a positive answer regarding CG standards** and "No" is negative.*

3. *For questions that refer to the past five years but new controlling shareholders have taken over for a period shorter than five years, take the question to refer to the period that the company has been under the control of the present controlling shareholder.*

4. *Five questions (6, 23, 26, 42, 57) have been slightly amended from last year to reflect more current concerns. The changes are underlined below.*

Discipline (15%)

1. Has the company issued a "mission statement" that explicitly places a priority on good corporate governance or has the company or management publicly articulated principles of good corporate governance that it is committed to maintaining?

2. Is senior management incentivised to work towards a higher share price for the company - eg, more than 50% of net worth of CEO or controlling family is in the company's equity or at least 50% of expected remuneration for the top executive(s) is tied to the value of the shares? ("Yes" answer must be verified with the individuals in question.)

3. Does management stick to clearly defined core businesses? (Any diversification into an unrelated area in the past three years would count as "No".)

4. A) What is management's estimate of its cost of equity? (Please specify management's estimate.)

   B) Is management's view of its cost of equity within 10% of a CAPM derived estimate?

5. A) What is management's estimate of its weighted average cost of capital? (Please specify management's estimate.)

   B) Is management's estimate of its cost of capital within 10% of our estimate based on its capital structure?

6. Over the past five years, is it true that the Company has not issued equity, or warrants/options for new equity, for acquisitions and/or financing new projects where there was any controversy over whether the acquisition/project was financially sound, or whether the issue of equity was the best way of financing the project, <u>or where options/equity are issued to management/directors as compensation at a rate equivalent to</u>

more than a 5% increase in share capital over three years? Is it true there is no reason to be concerned on these grounds about the issue of equity/warrants for new equity in the foreseeable future?

7. Does senior management use debt for investments/capex only where ROA (or average ROI) is clearly higher than cost of debt and where interest cover is no less than 2.5x? In using debt, has management always shown sensitivity to potential asset-liability duration and currency mismatches? ("Yes" if company has no gearing.)

8. Over the past five years, is it true that the company has not built up cash levels, through retained earnings or cash calls, that has brought down ROE?

9. Does the company's Annual Report include a section devoted to the company's performance in implementing corporate governance principles?

Transparency (15%)

10. Has management disclosed three or five year ROA or ROE targets? If so please state in (10b).

11. Does the company publish its Annual Report within four months of the end of the financial year?

12. Does the company publish/announce semi-annual reports within two months of the end of the half-year?

13. Does the company publish/announce quarterly reports within two months of the end of the quarter?

14. A) In the past 12 months, what is the longest time period between the Board meeting to accept results for a period (quarterly/half-year/finals), and the announcement of the results? (State in working days.)

    B) Has the public announcement of results been no longer than two working days of the Board meeting? Is it true that there has not been any case in the past five years when the share price moved noticeably just before the release of results and in a direction that anticipated the results?

15. Are the reports clear and informative? (Based on perception of analyst. Answer "No" if, for example, consolidated accounts are not presented; or if over the past five years there has been occasion when the results announced lacked disclosure subsequently revealed as relevant; if negative factors were downplayed when presenting the Company's results that were important in assessing the business value; or if there is inadequate information on the revenue/profit split for different businesses, or regions/countries and product lines; or inadequate disclosure and/or provisions for contingent liabilities, NPLs and/or likely future losses; or inadequate details of group/related company transactions and their rationale.)

16. Are accounts presented according to IGAAP? Are the accounts free of substantial non-IGAAP compliant qualifications? (If the Company employs

non-IGAAP methods to improve stated profits, answer "No". If Company provides two or more sets of accounts and at least one that is readily accessible is according to IGAAP, answer "Yes".)

17. Does the company consistently disclose major and market sensitive information punctually? Is it true that the company has not in the past five years ever failed to disclose information that investors deemed relevant in a timely fashion? (Answer "No" if, for example, any instance over the past five years of share price movement ahead of and anticipating an announcement which was believed to be insider buying.)

18. Do analysts have good access to senior management? Good access implies accessibility soon after results are announced and timely meetings where analysts are given all relevant information and are not misled.

19. Does the Company have an English language web-site where results and other announcements are updated promptly (no later than one business day)?

Independence (15%)

20. Is it true that there has been no controversy or questions raised over whether the board and senior management have made decisions in the past five years that benefit them, at the expense of shareholders? (Any questionable inter-company loan would mean "No").

21. Is the Chairman an independent, non-executive director?

22. Does the company have an executive or management committee that makes most of the executive decisions, which is substantially different from members of the Board and not believed to be dominated by major shareholders? (ie, no more than half are also Board members and major shareholder not perceived as dominating executive decision making.)

23. Does the company have an audit committee? Is it chaired by a perceived genuine independent director and <u>are more than half the members of the audit committee independent directors</u>?

24. Does the company have a remuneration committee? Is it chaired by a perceived genuine independent director?

25. Does the company have a nominating committee? Is it chaired by a perceived genuine independent director?

26. Are the external auditors of the company in other respects seen to be completely unrelated to the company? <u>Does the company provide a breakdown of audit and non-audit fees to auditors, and if so are the non-audit fees not more than one-third of the audit fees?</u> ("No" if answers to any of these questions are negative.}

27. Is it true that the board has no direct representatives of banks or other large creditors of the company who are likely to direct corporate policy in favour of creditors rather than shareholders?

Accountability (15%)

28. Are the board members and members of the executive/management committee substantially different such that the Board is clearly seen to be playing a primarily supervisory as opposed to an executive role? (ie, no more than half of one committee sits on the other?

29. Does the company have non-executive directors who are demonstrably and unquestionably independent? (Independence of directors must be demonstrated by either being appointed through nomination of non-major shareholders or having on record voted on certain issues against the rest of the Board. If no evidence of independence, other than being stated to be so by the company and the director(s), then answer "No".)

30. Do independent, non-executive directors account for more than 50% of the Board?

31. Are there any foreign nationals on the Board who are seen as providing added credibility of the Board's independence?

32. Are full Board meetings held at least once a quarter?

33. Are Board members well briefed before Board meetings? Are they provided, as far as the analyst can tell, with the necessary information for effective scrutiny of the company, prior to the meeting, in a clear and informative manner? (Answers 33-35 must be based on direct communication with an independent Board member. If no access is provided, and no verification of an independent director is provided, answer "No" to each question.)

34. Does the audit committee nominate and conduct a proper review the work of external auditors as far as the analyst can tell?

35. Does the audit committee supervise internal audit and accounting procedures as far as the analyst can tell?

Responsibility (15%)

36. If the Board/senior management have made decisions in recent years seen to benefit them at the expense of shareholders (cf Q20 above), has the Company been seen as acting effectively against individuals responsible and corrected such behaviour promptly (ie, within six months)? (If no such case, answer this question as "Yes".)

37. Does the company have a known record of taking effective measures in the event of mismanagement? Over the past five years, if there were flagrant business failures or misdemeanors, were the persons responsible appropriately and voluntarily punished? (If no cases, the Company does not have such a record, then answer this question as "No.")

38. Is it true that there is no controversy or questions over whether the Board and/or senior management take measures to safeguard the interests of all and not just the dominant shareholders? (eg, if EGMs with genuine independent advice for related party transactions were not held, or independent verification of appropriate pricing for recurrent related party transactions not obtained, answer as "No".)

39. Are there mechanisms to allow punishment of the executive/management committee in the event of mismanagement as far as the analyst can tell for certain?

40. Is it true that there have been no controversies/questions over whether the share trading by Board members have been fair, fully transparent and well intentioned? (Are announcements made to the exchange within three working days, and do the major shareholders reveal or transactions including those under nominee names? Any case where believed by some that parties related to major shareholder were involved in transactions not disclosed to the exchange, or allegations of insider trading, would mean "No".)

41. A) How many members are on the Board? (Please specify.)

    B) Is the board small enough to be efficient and effective? (If more than 12, answer "No".)

Fairness (15%)

42. Is it true that there have not been any controversy or questions raised over any decisions by senior management in the past five years where majority shareholders are believed to have gained at the expense of minority shareholders? (<u>Management fees paid from the listed group out to a parent company, or to a private company controlled by the major shareholders on the basis of revenues or profits would be deemed a negative</u>.)

43. Do all equity holders have the right to call General Meetings? (Any classes of shares that disenfranchise their holders would mean "No" answer.)

44. Are voting methods easily accessible (eg, proxy voting)?

45. Are all necessary (ie, not just obligatory, but also relevant in the view of the analyst regarding accounting etc) information for General Meetings made available prior to General Meeting?

46. Is senior management unquestionably seen as trying to ensure fair value is reflected in the market price of the stock, by guiding market expectations about fundamentals in the right direction through frank discussion on risk/returns, actions like share buy-backs and investor meetings, etc?

47. Is it true that there has been no questions or perceived controversy over whether the Company has issued depositary receipts that benefited primarily major shareholders, nor has the Company issued new shares to investors near peak prices, nor have the major shareholders sold shares near peak prices without prior guidance to market on why shares are seen as fully-valued? (Any such example in past five years, would mean "No".)

48. Does the majority shareholder group own less than 40% of the company?

49. Do foreign portfolio managers, and/or domestic portfolio investors who have a track record in engaging management on CG issues, own at least 20% of the total shares with voting rights?

50. Does the head of Investor Relations report to either the CEO or a Board member?

51 A) hat is total remuneration of the Board as a percentage of net profit after exceptionals?

B) Over the past five years, is it true that total directors remuneration has not increased faster than net profit after exceptionals as far as an analyst can tell? (Answer "No" if directors remuneration has increased faster than profits or if Company does not make any declaration to clarify.)

Social awareness (10%)

52. Does the company have an explicit (clearly worded) public policy statement that emphasises strict ethical behaviour: ie, one that looks at the spirit and not just the letter of the law? (Internal employee conduct manual that emphasizes ethical behaviour and no ground to believe otherwise in company's corporate culture would count as "Yes".)

53. Does the company have a policy/culture that prohibits the employment of the under-aged as far as the analyst can tell?

54. Does the company have an explicit equal employment policy: ie, no discrimination on the basis of sex, race, religion etc?

55. Does the Company adhere to specified industry guidelines on sourcing of materials as far as the analyst can tell?

56. Is the company explicitly environmentally conscious? Does it promote use of environmentally efficient products, or takes steps to reduce pollution, or to participate in environment-related campaigns? (If there are no concrete examples of this, then answer "No".)

<u>Is it true that the company has made no investments/acquisitions and not entered into deals that raised questions of propriety</u> (eg, any allegations of bribery or dealing with regimes that do not have legitimate authority like Myanmar)?

Appendix 3: Country average CG scores

	First quartile	Second quartile	Third quartile	Fourth quartile	Average
Korea	85.5	76.5	67.9	55.1	70.8
Singapore	81.4	74.2	68.1	54.5	69.5
Hong Kong	75.5	68.8	62.9	56.3	65.9
Malaysia	77.5	67.6	61.5	50.6	65.0
India	77.4	67.5	61.7	52.7	64.8
Thailand	74.0	64.3	55.2	47.3	60.2
Taiwan	72.5	59.4	53.9	47.7	58.7
China	70.4	62.3	50.6	43.8	57.4
Indonesia	59.7	47.0	38.3	27.3	43.0
Philippines	49.9	42.1	36.2	31.2	39.8

Source: CLSA Emerging Markets

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Appendix 4: About ACGA

The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership organisation working on behalf of all investors and other interested parties for the improvement of corporate governance in Asia. ACGA is funded by a growing network of sponsors and corporate members, including many investment funds, financial institutions and intermediaries (see below for a full list).

ACGA advocates the competitive benefits of better corporate governance and works closely with institutional investors, regulators and companies to achieve concrete improvements. It is one of the few organisations systematically researching corporate governance developments around Asia, tracking 11 markets and producing independent analyses of new laws and regulations, investor action and corporate initiatives.

ACGA is incorporated under the laws of Hong Kong and is managed by a secretariat based there. Its governing Council comprises directors from around Asia.

Website

For further information about ACGA and comprehensive coverage of corporate-governance developments in Asia, go to **www.acga-asia.org**.

Members

ACGA began building its corporate-membership base in 2002. It now has 30 blue-chip corporate members, including many of the region's most successful and innovative fund managers, intermediaries, listed companies and educational institutions.

Members include (in alphabetical order):

❑ Aberdeen Asset Management Asia	❑ Li & Fung
❑ AIG Investment Corporation (Asia)	❑ Lloyd George Management (Hong Kong)
❑ Aon Hong Kong	❑ **Lombard Asian Private Investment Company**[1]
❑ California State Teachers' Retirement System (CalSTRS)	❑ Marsh, Inc.
❑ **Chubb Insurance**[1]	❑ Mirant Asia-Pacific
❑ Citigroup Asset Management - Asia	❑ Morley Fund Management (Singapore)
❑ **CLSA Emerging Markets**[1]	❑ Neptune Orient Lines
❑ Coudert Brothers	❑ Prudential Portfolio Managers Asia
❑ GIC Special Investments	❑ Standard and Poor's
❑ Hermes Pensions Management	❑ State Street Global Advisors (Asia)
❑ Hewitt Associates	❑ **Sun Life Financial Asia**[1]
❑ Hong Kong University of Science and Technology	❑ SUNDAY Communications
❑ IMC Pan Asia Alliance Corporation	❑ Taiwan Semiconductor Manufacturing Company (TSMC)
❑ Jardine Lloyd Thompson Asia	❑ Templeton
❑ Kookmin Bank	❑ Value Partners

[1] Also a Founding Corporate Sponsor of ACGA. Source: ACGA

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Key to investment rankings: BUY = Expected total return greater than >20%; **SELL** = the share price is expected to decline. **O-PF** = stocks with expected local market relative performance of more than 0%; **U-PF** = stocks with expected local market relative performance of less than 0%. Recommendations are made on a 12 month time horizon.

Additional information is available upon request