

#### 4. RISK FACTORS

BEFORE INVESTING IN OUR SHARES, YOU SHOULD PAY PARTICULAR ATTENTION TO THE FACT THAT WE, AND TO A LARGE EXTENT OUR ACTIVITIES ARE SUBJECT TO THE LEGAL, REGULATORY AND BUSINESS ENVIRONMENT IN PRC. OUR BUSINESS IS SUBJECT TO A NUMBER OF FACTORS, MANY OF WHICH ARE OUTSIDE OF OUR CONTROL.

BEFORE MAKING AN INVESTMENT DECISION, YOU SHOULD CAREFULLY CONSIDER, ALONG WITH THE OTHER MATTERS IN THIS PROSPECTUS, THE RISKS AND INVESTMENT CONSIDERATIONS SET OUT BELOW. THE RISKS AND INVESTMENT CONSIDERATIONS SET OUT BELOW ARE NOT AN EXHAUSTIVE AND EXCLUSIVE LIST OF THE CHALLENGES THAT WE CURRENTLY FACE OR THAT MAY DEVELOP IN THE FUTURE. ADDITIONAL RISKS, WHETHER KNOWN OR UNKNOWN, MAY IN THE FUTURE HAVE A MATERIAL ADVERSE EFFECT ON US OR OUR SHARES.

##### 4.1 RISKS RELATING TO OUR BUSINESS AND INDUSTRY

###### 4.1.1 We operate in the competitive sports shoe industry

We believe that sports shoe industry is competitive in the PRC and globally. The barriers to entry for new competitors are relatively moderate. Numerous domestic and international brands compete with one another based on, amongst other things, product variety, design, quality, price and services. However, we are an OEM/ODM sports shoe manufacturer and hence, rather than competing directly with brand owners, we compete with other sports shoe manufacturers. In the event that our competitors are able to provide comparable products at more competitive prices or offer a wider range of designs and products or provide better services that will meet our customers' needs, we may not be able to compete successfully with them.

If we are unable to compete effectively with our competitors, or fail to adapt to the changing and competitive market environment, our business, operating results and financial condition may be adversely affected.

###### 4.1.2 We may be unable to effectively manage our expansion

We currently have four (4) production lines with an average annual capacity of approximately 8 million pairs of sports shoes per annum. As set out in **Section 7.4** of this Prospectus, our sales volume has increased from 4 million pairs of sports shoes in FYE 2006 to approximately 11 million pairs of sports shoes in FYE 2009. In addition, we also outsource some of our sports shoe orders to external contract manufacturers to meet our customers' orders. As the sales volume of our sports shoes increase further, we intend to expand our production capacity by acquiring additional production lines. Please refer to **Section 5.12** of this Prospectus for details of our future plans.

The above plans may strain our financial resources and overstretch our human and capital resources. In the event that our future plans are not commercially viable or successful, or the demand for our products diminishes, our business operations and financial results may be adversely affected.

###### 4.1.3 We may not be able to respond promptly to market trends and produce commercially viable sports shoes

We believe our success depends largely on our ability to keep abreast with market trends as well as our ability to anticipate and react to the fast changing sports shoe segment in a timely manner. Hence, it is important that we continue to react promptly to new sports shoe designs and use materials that would appeal to our customers' target markets.

#### 4. RISK FACTORS (Cont'd)

There can be no assurance that our Group will be able to continuously develop products which would successfully meet the fast changing market trends of sports shoe industry. If we are unable to consistently produce and/or design commercially viable sports shoes for our customers, our business operations and financial results may be adversely affected.

##### 4.1.4 Absence of long-term contracts with customers

We do not have any long-term contracts with our customers as our customers typically place their orders via purchase orders, which to the best of our Board's knowledge is common practice in our industry.

Our ability to retain our customers is important to the continued success of our Group. There is however no assurance that our customers will continue to purchase our products at current levels in the future. In the event that they cease or reduce significantly their purchase of our products and we are unable to secure sufficient orders from the loss and/or reduced orders, there will be an adverse impact on our financial performance.

Despite the lack of long-term contracts, we have established strong relationships with our customers by offering them quality products, reliable service and timely product delivery at competitive prices. For the FYE 2009, approximately 53.2% of the revenue was derived from repeat customers. It is unlikely that such customers will switch their orders to other sports shoe manufacturers unless there is a failure by us in meeting customers' expectations.

Our Group believes that our ability to offer quality products as well as strong D&D capabilities are increasingly recognised by our customers which is evidenced by the increase in our Group's sales volume from approximately 4 million pairs of sports shoes sold in FYE 2006 to approximately 11 million pairs of sports shoes sold in FYE 2009. In addition, our management believes that our strong focus on D&D to improve and extend our product range will enable our Group to maintain and attract existing and new customers thus mitigating the risk of absence of long-term contracts.

##### 4.1.5 We are fairly reliant on our external contract manufacturers

We started to outsource some of our sports shoe orders to external contract manufacturers since FYE 2006. External contract manufacturing accounted for approximately 23.7%, 23.7%, 43.1%, 45.0% and 41.9% of our total revenue for the FYE 2006, FYE 2007, FYE 2008, FYE 2009 and 1H 2010 respectively. As such, we are fairly reliant on our external contract manufacturers. However, our reliance on external contract manufacturers are mitigated to a large extent as there are approximately 3,000 shoe manufacturers in the Jinjiang area, many of whom are contract manufacturers for OEM, thus giving us a large pool of external contract manufacturers to choose from. We select our external contract manufacturers based on their product quality, reliability, price range of designs, speed of delivery and reputation.

In fact, outsourcing allows us to (i) conserve some manpower and financial resources to focus on other areas of our business, which is design, marketing and quality control of our products; (ii) provide flexibilities to cater for a slowdown in demand, where we can first trim the outsourcing production; and (iii) to allow us to cope during periods of high demand.

Notwithstanding the above, in the event that we are unable to source for suitable alternative external contract manufacturers in a timely manner or when there is a failure by any of our external contract manufacturers to perform, our business operations and financial performance may be adversely affected.

**4. RISK FACTORS (Cont'd)****4.1.6 We depend on the continuous supply of quality raw materials**

Our ability to produce quality products is dependent on our ability to obtain adequate supply of quality raw materials at competitive prices. We purchase all our raw materials on an order-by-order basis and have no long-term contracts with any of our suppliers. In the event that we are unable to secure adequate supplies of raw materials at competitive prices and on a timely basis for our production needs, our operations may be adversely affected.

In mitigation, as our production facilities are located in Jinjiang City, Fujian Province, a place which is renowned as one of the PRC's largest sports shoe manufacturing base, we have easy access to a large pool of suppliers in close proximity to our production facilities. Our suppliers are primarily located in Quanzhou City and Jinjiang City, Fujian Province, where there is a high concentration of suppliers of raw materials for the sports shoe industry.

We also maintain records of our raw material inventory levels to ensure sufficient procurement of raw material and to ensure that there is no material disruption in raw material supply. We have not previously experienced any difficulties in sourcing for our raw materials.

**4.1.7 We may face rising production costs in the PRC**

Production costs such as cost of raw material and labour cost accounted for approximately 82.8% of our total cost of sales for FYE 2009. The raw materials for our sports shoes mainly comprise leather, fabrics, PU, PVC and sole units. Prices for our raw materials such as PU leather, synthetic leather, genuine leather, nylon and sole unit generally move in tandem with oil prices, labour cost and are also affected by the economic conditions in the PRC. Our raw material cost as a proportion of total cost of sales increased from 62.6% in FYE 2006 to 71.1% in FYE 2009 mainly due to the increase in oil prices.

In addition, the sports shoe industry is labour intensive and our labour cost in the PRC have been on an upward trend in the last few years in line with the strength and growth of the PRC economy.

However, our Group is able to obtain the raw materials from our suppliers at competitive prices due to the availability of a large pool of suppliers based in Fujian province, PRC. We have so far been able to pass any increase in our production costs to our customers.

There is no assurance that the production costs will not continue to increase in the future. If we fail to offset such increase in production costs against a corresponding increase in the selling prices of our products, our business operations and profit margins may be adversely affected.

**4.1.8 We may inadvertently infringe third-party intellectual property rights**

As at the LPD, we have not infringed on any third-party intellectual property rights in the past. Nevertheless, there can be no assurance that we would not inadvertently infringe the intellectual property rights of others or others would not assert infringement claims against us or claim that we have infringed their intellectual property rights as we continue to develop new sports shoe designs.

Any such claims of the intellectual property rights infringement, with or without merits, could be time consuming, resulting in costly litigation and diversion of technical and management personnel, causing product shipment delays or requiring us to develop non-infringing products or enter into licensing agreements. Such licensing agreement, if required, may not be available on terms acceptable to us or at all. In the event of a successful claim of intellectual property rights infringement against us and/or our failure or inability to develop non-infringing products or to license the infringed intellectual property rights in a timely or cost-effective basis and on terms acceptable to us, our business operations and financial performance may be adversely affected.

#### 4. RISK FACTORS (Cont'd)

In mitigating the risk of infringement of intellectual property rights, for orders placed by our customers, particularly for more renowned brands, we maintain and will continue to request for authorisation letters from the brand distributors, trading houses or brand owners, where possible. For other less popular brands, we will usually rely on the representations from the trading houses that they are duly authorized, and conduct some verification from the understanding of the relevant brand owners' corporate profile or websites. As for designs developed in-house, we will conduct searches or rely on information obtained through our sales and marketing team to avoid any potential infringement.

Please refer to **Section 6.14** for details on the third party authorisation letters obtained by us.

##### 4.1.9 Our reputation may be affected by the quality of our products

We are dependent on our reputation and the quality of our products for the continued growth of our business. Failure to consistently deliver quality products may result in such products being returned which may materially and adversely affect our ability to retain our existing customers, secure new customers or develop new market segments, thereby hampering our future business growth.

Although we place emphasis on the quality of our products and have put in place stringent quality assurance measures throughout the production processes, there may be complaints from customers from time to time in relation to any defect in our products. Such negative publicity, regardless of their validity, may result in a diminution in the goodwill associated with our products. In such events, our reputation may be adversely affected and consequently our business operations and financial performance may be adversely affected.

As at the LPD, we have not experienced any rejection from our customers due to product quality matters. However, there is no assurance that such situation will not occur in the future.

##### 4.1.10 We are exposed to the credit risk of our customers

Our financial position and performance are dependent, to a certain extent, on the creditworthiness of our customers. We usually extend credit terms of 90 days to 120 days to existing customers. We are exposed to credit risk due to the inherent uncertainties in our customers' business environment, caused by, *inter alia*, political, social, legal, economic and foreign exchange factors, as well as those arising from unanticipated events.

Although there has not been any material collection problem for trade receivables or bad debts in the Financial Period under Review and up to the LPD, there is no assurance that we will not encounter collection difficulties in the future. A delay or default in payment and/or significant increase in the amount of bad debts written off and/or provision for impairment of trade receivables incurred may adversely affect our financial position and performance.

##### 4.1.11 We are exposed to fluctuations in the economic conditions of our export markets and discretionary consumer spending, as well as restrictions on the import of our products

We derive our revenue from sales through trading houses and brand distributors who mainly serve overseas markets such as USA, Europe, Japan, South Korea, South America, Middle East and South East Asia. Please refer to **Section 7.4.1** of this Prospectus for more details on our revenue by geographical regions.

**4. RISK FACTORS (Cont'd)**

Accordingly, the success of our business depends on the conditions and the continued growth of the overseas consumer markets. The growth in such markets in turn depend on the conditions and the continued growth in their respective economies and individual income levels. We believe that consumer spending habits are adversely affected during periods of economic downturn, and as such may have an adverse effect on certain enterprises operating within the consumer and retail sectors, including our Group.

Furthermore, any import restrictions, such as import tariffs and anti-dumping measures, that may be imposed by the countries to which our products are sold may result in an increase in our export costs, or limitations to our export volumes. As at the LPD, we are not aware of any significant barriers in relation to the import of our products into the overseas countries to which our products are sold. However, there can be no assurance that the relevant government authorities will not impose adverse restrictions in the future. In such event, our business operations and financial performance may be adversely affected.

**4.1.12 Certain preferential tax treatment to which we are entitled may be subject to change**

Zhenxing Shoes is qualified taxpayer under the PRC tax laws and regulations. Currently, Zhenxing Shoes is subject to an income tax rate of 25% and a VAT rate of 17%.

Pursuant to a Notice of Tax Rebate for Goods promulgated by the State Council in 1985 and its amendments from time to time, companies shall enjoy tax rebate for goods exported at specific rates by category. Zhenxing Shoes is entitled to approximately 15% tax rebate. Moreover, according to "Certain Opinions for Encouragement to Expand Export (晋政文(2004)131号) issued by People's Government of Jinjiang City, a company engaging in normal trade business shall enjoy reward based on its actual annual export amount. Accordingly, Zhenxing Shoes who exports sports shoes is entitled to enjoy such reward yearly for its self-support exportation from the Finance Bureau of Jinjiang City.

However, there is no assurance that the current income tax rate and this application of the tax rebate rate as well as the reward policy for exportation will remain in effect or will not be subject to change. In the event that we are required to pay higher income tax rate, or we are unsuccessful in our application for the tax rebate and tax reward, our financial performance may be adversely affected.

**4.1.13 We may be subject to foreign exchange risk**

In FYE 2009, approximately 3% of our revenue was denominated in USD whilst a substantial part of our expenses and operating costs was denominated in RMB. To the extent that our revenue, purchases and operating costs are not naturally matched in the same currency and to the extent that there are timing differences between invoicing and collection or payment, as the case may be, we will be exposed to any adverse fluctuation of the RMB and USD. Please refer to **Section 7.4.2 (vi)** of this Prospectus for further details on the foreign exchange exposure.

Presently, we do not have any specific policy to hedge our foreign exchange exposure as our revenue denominated in USD is minimal. We may, should we deem it necessary and appropriate, enter into agreements with our banks to lock in agreed exchange rates. However, there is no assurance that such efforts will successfully hedge against foreign currency fluctuations.

#### 4. RISK FACTORS (Cont'd)

##### 4.1.14 We are dependent on executive directors, key management and skilled workforce

We believe that the success of our business depends to a significant extent on the continued services of our Executive Director and Chairman, Li Kwai Chun, who is responsible for formulating and implementing growth, corporate development and overall business strategies, and our CEO, Mr Xie Zhen'an and other senior management, who are spearheading the growth and development of Zhenxing Shoes. Another key factor to the success of our business is the continued services of our skilled workers. Our skilled workers are mainly responsible for quality control and D&D. Thus, they play an integral role in ensuring the quality of our products and our products' D&D process.

As such, any loss of the services of our Executive Directors and key management and/or substantial loss of any of our skilled workforce would have an adverse impact on our business operations.

Recognising the importance of our management team and difficulties in procuring timely and adequate replacements, we will continuously consider appropriate measures to attract and retain qualified key personnel. Our Group believes that by offering a competitive salary package, providing training and a conducive working environment, we should be able to mitigate the risk of any of our key personnel leaving our Group. In addition, we believe that by increasing our profile through our Listing, we will be able to attract more qualified personnel to play an active role in the growth of our Group.

##### 4.1.15 We are exposed to operational risks such as accidents, power shortage, fire outbreaks, floods and insurance coverage

We are susceptible to various operational risks such as accidents, power shortage, production downtime, outbreaks of fire or floods and/or other natural disasters, which may cause disruption and/or loss of or damage to our goods, warehouse, manufacturing facility and office. We are also aware of the adverse consequences arising from inadequate insurance coverage for the accidents and outbreaks that could disrupt our business operations.

We seek to limit the above risks through the following plans and risk management practices:-

- (i) our facilities are equipped with the regulatory basic fire-fighting equipment such as fire extinguishers and/or hose reels. Our employees are also trained on the use of this equipment as well as the proper fire-fighting techniques and procedures. In addition, we purchase fire insurance coverage on our properties, warehouses and equipment;
- (ii) we ensure that we have equipment and spare parts to cope with unexpected emergencies at any one time, such as our spare parts storage policy. Our management also holds regular meetings and discussions to identify and mitigate any foreseeable problems in our business operations; and
- (iii) we ensure that our facilities, manufacturing plant and warehouse meet all safety requirements stipulated in various licenses issued by relevant authorities. We also conduct various in-house training and briefing on safety requirements to minimise the risks of industrial accidents in our facilities.

Our Directors are of the opinion that we have adequate insurance coverage for our business operations and we review our insurance policies on a regular basis to ensure sufficient insurance coverage for our assets.

Although we have not experienced any significant disruption of operations in the past, we can give no assurance that our business operations and financial performance will not be adversely affected in the future due to the operational risks highlighted above and/or inadequate insurance coverage.

**4. RISK FACTORS (Cont'd)****4.1.16 Our operations may suffer a material adverse impact if there is a non-renewal of our permits, licences and certificates**

We have obtained all requisite permits, licences and certificates for our current business operations. However, some of these permits, licences and certificates are subject to periodic review and renewal by the relevant PRC government authorities. In addition, the standards of compliance required in relation thereto may from time to time be subject to changes. Non-renewal of our permits, licences and certificates and/or changes imposed on the terms and conditions of licensing may have a material adverse effect on our operations and profitability.

Although our Group has not experienced any difficulty in maintaining the relevant licenses and permits in the past, and we do not foresee any potential issues arising from the renewal of our existing licences and permits, no assurance can be given that our licenses and permits will be renewed, or renewed within the anticipated timeframe.

**4.1.17 We have not obtained land use rights certificate and property ownership certificates for some of our production facilities**

We had applied for the land use rights certificate for a piece of land measuring 15,318 sq m located in Zhushuxia Industrial Zone, Jinjiang City, Fujian Province, PRC ("Land") and property ownership certificates for one (1) block of warehouse, two (2) blocks of factory building and three (3) blocks of staff dormitory building (collectively refers to as the "Buildings"). As at the LPD, we have not yet obtained the land use rights certificate and the property ownership certificates for the abovementioned Land and Buildings. Please refer to **Section 9.1** of this Prospectus for further details on the properties of our Group. In the event that we fail to obtain the relevant land use rights and property ownership certificates, our rights to use or occupy the Land and Buildings may be challenged. If we are ordered by the relevant PRC authorities to vacate the Land and demolish the Buildings, we will have to vacate these properties and relocate the production lines presently installed at the properties. In which event, our operations and financial performance may be adversely affected.

In addressing this risk, we have obtained confirmations from relevant authorities, namely, the Real Estate and Land Management Bureau of Jinjiang City (晋江市国土资源局) and the Planning and Construction and Housing Management Bureau of Jinjiang City (晋江市规划建设与房产管理局) that there will be no legal obstacle for Zhenxing Shoes to complete the procedure for obtaining the land use rights certificate and property ownership certificates. In addition, by a letter dated 15 December 2009 the Villagers Committee of Zhushuxia Village, Jinjiang City ("Villagers Committee") confirmed that Zhenxing Shoes has paid the compensation of RMB4,600,000 for the use of the Land, and consequently, the Villagers Committee agrees to allow Zhenxing Shoes to apply for the relevant land use rights certificate. Our PRC legal adviser, Messrs Haihua Yongtai Law Firm had further via its legal opinion dated 5 October 2010 opined that based on the aforementioned confirmations, they are not aware of any legal restriction which would prevent Zhenxing Shoes from obtaining the relevant land use rights certificate and property ownership certificates and there are no restriction for Zhenxing Shoes to occupy and use the abovementioned land and buildings for the their current business operations.

As such, our Directors are of the view that the chances of this risk materialising are minimal. In addition, the Company will use its best endeavour to follow up closely with the relevant authorities on the issuance of the land use rights certificate and property ownership certificates.

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**4. RISK FACTORS (Cont'd)**


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**4.2 RISKS RELATING TO THE PRC****4.2.1 Uncertainty in the PRC legal system may make it difficult for us to predict the outcome of any disputes that we may be involved in**

The PRC legal system is based on the PRC Constitution and is made up of written laws, regulations, circulars and directives. The PRC government is still in the process of developing its legal system, so as to meet the needs of investors and to encourage foreign investment. As the PRC economy is undergoing development generally at a faster pace than its legal system, some degree of uncertainty exists in connection with whether and how existing laws and regulations will apply to certain events or circumstances.

Some of the laws and regulations, and the interpretation, implementation and enforcement thereof, are still subject to policy changes. There is no assurance that the introduction of new laws, changes to existing laws and the interpretation or application thereof or the delays in obtaining approvals from the relevant authorities will not have an adverse impact on our business or prospects.

Further, precedents on the interpretation, implementation and enforcement of PRC laws and regulations are limited, and unlike other common law countries such as Malaysia, decisions on precedent cases are not binding on lower courts. As such, the outcome of dispute resolutions may not be consistent or predictable as in the other jurisdictions and it may be difficult to obtain swift or equitable enforcement of the laws in the PRC, or obtain enforcement of judgment by a court of another jurisdiction.

**4.2.2 Changes in the PRC governmental rules and regulations will have a significant impact on our business**

Currently, our business and operations in the PRC entail the procurement of licences and permits from the relevant authorities. Thus, our business and operations in the PRC are subject to the PRC government rules and regulations. From time to time, changes in the rules and regulations or the implementation thereof may require us to obtain additional approvals and licences from the PRC authorities for the conduct of our operations in the PRC. In such event, we may need to incur additional expenses in order to comply with such requirements. This will in turn affect our financial performance as our business cost will increase. Furthermore, there can be no assurance that such approvals or licences will be granted to us promptly or at all. If we experience delay in or are unable to obtain such required approvals or licences, our operations and business in the PRC, and hence our overall financial performance will be adversely affected. Please refer to **Section 6.15** of this Prospectus for further details on the major licenses, permits, regulations and certifications of our Group.



#### **4. RISK FACTORS (Cont'd)**

##### **4.2.3 New labour laws in the PRC may adversely affect our operations**

The shoe manufacturing industry is labour intensive. As at 30 June 2010, we had 1,683 employees in the PRC. On 29 June 2007, the PRC Government promulgated a new labour law, namely, the Employment Contracts Law ("New Labour Law") which became effective on 1 January 2008.

The New Labour Law imposes greater liabilities on employers and significantly impacts the cost of an employer's decision to reduce its workforce. Further, it requires certain terminations to be based upon seniority and not merit. If we decide to significantly change or decrease our workforce in the PRC, the New Labour Law could adversely affect our ability to enact such changes in a manner that is most advantageous to us or in a timely and cost effective manner, thus our financial performance or operations could be adversely affected. There are also no assurances that the PRC government will not make any further amendments to the labour laws in the future.

##### **4.2.4 PRC foreign exchange control may affect our ability to receive dividends and other payments from our PRC subsidiary**

Our PRC-incorporated subsidiary, Zhenxing Shoes is subject to the PRC rules and regulations on currency conversion. In the PRC, the State Administration for Foreign Exchange ("SAFE") regulates the conversion of the RMB into foreign currencies. Currently, foreign investment enterprises ("FIEs") are required to apply to the SAFE for "Foreign Exchange Registration Certificates for FIEs". With such registration certifications (which need to be examined annually), FIEs are allowed to open foreign currency accounts including the "basic account" and "capital account". Currently, conversion within the scope of the "basic account" (e.g. remittance of foreign currencies for payment of dividends, etc.) can be effected without requiring the approval of SAFE. However, conversion of currency in the "capital account" (e.g. for capital items such as direct investments, loans, securities, etc.) still requires the approval of SAFE.

There is no assurance that the PRC regulatory authorities will not impose further restrictions on the convertibility of the RMB. As all our revenue is derived from our PRC subsidiary and these revenues are mainly denominated in RMB, any future restriction on currency exchanges may limit the ability of our PRC subsidiary to repatriate such revenues to our Company in the form of dividend income or otherwise.

Further, as our Company is an investment holding company with no business operations, in the absence of such dividend income from our PRC subsidiary, our Company will not be able to distribute dividends to shareholders even if our Group, on a consolidated basis, is profitable.

##### **4.2.5 We are a holding company that relies heavily on dividend payment from our subsidiary for funding**

Our Company is a holding company incorporated in Malaysia. We operate our business primarily through our subsidiary in China. Therefore, the availability of funds to enable us to pay dividends to our shareholders and to service our indebtedness depends upon dividends received from our subsidiary. If our subsidiary incurs indebtedness or losses, such indebtedness or losses may impair Zhenxing Shoes' ability to pay dividends or other distributions to us and in turn restrict our ability to pay dividends to shareholders.

**4. RISK FACTORS (Cont'd)**

PRC laws require that dividends be paid only out of net profit calculated according to PRC accounting principles, which differ in many respects from generally accepted accounting principles in other jurisdictions. PRC laws also require a wholly foreign owned enterprise (commonly referred to as WOFE) such as Zhenxing Shoes to set aside 10% of its net profit as statutory reserves. This transfer of reserves will continue until the reserve balance reaches 50% of Zhenxing Shoes' registered capital, at which point no additional contribution is required to be made. These statutory reserves are not available for distribution as cash dividends. The reserve funds may be used by a WOFE to offset its accumulated losses and with the consent of the examination and approval authority, can also be used to expand its production operations and to increase its registered capital.

In addition, restrictive covenants in bank credit facilities or other agreements that our subsidiary may enter into in the future may also restrict the ability of our subsidiary to make contributions to us and hence, our ability to receive distributions. Therefore, these restrictions on the availability and usage of our major source of funding may impact our ability to pay dividends to our shareholders and to service our indebtedness.

**4.2.6 Our operating results and financial conditions are highly susceptible to changes in PRC's political, economic and social conditions as our revenue is currently wholly derived from our operations in PRC**

Since 1978, the PRC government has undertaken various reforms of its economic systems. Such reforms have resulted in economic growth for PRC in the last three decades. However, many of the reforms are unprecedented or experimental, and are expected to be refined and modified from time to time. Other political, economic and social factors may also lead to further adjustment of the reform measures. This refinement and adjustment process may consequently have a material impact on our operations in PRC or a material adverse impact on our financial performance. Our results and financial condition may be adversely affected by changes in the PRC's political, economic and social conditions and by changes in policies of the PRC government or changes in laws, regulations or the interpretation or implementation thereof.

**4.2.7 Fluctuations in exchange rate may materially affect our financial position**

The value of RMB against foreign currencies is subject to changes in the PRC Government's policies and international economic and political developments. Under the unified floating exchange rate system, the conversion of RMB into foreign currencies has been based on rates set by the People's Bank of China (the "PBOC") which have generally been stable.

The PBOC (acting as the Central Bank of PRC) reformed the exchange rate regime on 21 July 2005 by moving into a managed floating exchange regime based on market supply and demand, with reference to a basket of currencies, and removing the pegging of the RMB to the USD. On 23 September 2005, the PRC Government widened the daily trading band for RMB against non-USD currencies from 1.5% to 3.0% to improve the flexibility of the new foreign exchange system.

There has been pressure from foreign countries on the PRC recently to adopt a more flexible currency system that could lead to further appreciation of the RMB. The RMB may be revalued further against the USD or other currencies, or may be permitted to enter into a full or limited free float, which may result in an appreciation or depreciation in the value of the RMB against the USD or other currencies. In such event, adverse fluctuations of the RMB and currencies other than RMB may adversely affect our operating results, financial position, and the value of any dividends payable on our Shares in foreign currency terms.

In addition, any appreciation of RMB may result in the funds in RM raised by our Company pursuant to our IPO, when converted into RMB, being less than that required for our future plans and strategies, as set out in **Section 5.12** of this Prospectus.

#### **4. RISK FACTORS (Cont'd)**

### **4.3 RISKS RELATING TO INVESTMENT IN OUR SHARES**

#### **4.3.1 The IPO may not result in an active or liquid market for our Shares**

We cannot assure you that an active public market will develop or be sustained after the IPO. Active, liquid trading markets generally result in more efficient execution of buy and sell orders for investors. Liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. Therefore, there can be no assurance as to the liquidity of any market that may develop for our Shares, the ability of holders to sell their Shares or the prices at which holders would be able to sell their Shares. While the SC has approved the IPO and given approval for our Listing, there can be no assurance that our Shares will be accepted for listing and quotation on the anticipated date by Bursa Securities. In the event that our Shares are not admitted to the Official List within six (6) weeks from the date of the Prospectus and the IPO Shares have not been issued to the applicants, we will return the monies paid in respect of any application for Shares without interest within fourteen (14) days after our Company becomes liable to do so.

Our Shares could also trade at prices lower than the Issue Price depending on many factors including prevailing economic, political and financial conditions in Malaysia, our operating results and the market for similar securities. Neither we nor the Underwriter have any obligation to create a market for our Shares. There can be no assurance that we will be able to maintain our Listing.

#### **4.3.2 Our share price may be volatile in the future which could result in losses for investors purchasing our Shares pursuant to the IPO**

The Issue Price has been determined through negotiations between us and OSK as the Underwriter and Placement Agent, and may not be indicative of prices that will prevail in the trading market. You may not be able to resell your Shares at or above the Issue Price. Volatility in the trading price of our Shares may be caused by amongst others, the following factors, some of which are beyond our control:

- (i) variation in our operating results;
- (ii) changes in securities analysts' estimates of our financial performance;
- (iii) announcements by us of significant acquisitions, strategic alliances or joint ventures;
- (iv) additions or departures of key personnel;
- (v) fluctuation in stock market prices and volume;
- (vi) involvement in litigation;
- (vii) changes in general economic and stock market conditions; and
- (viii) negative publicity which includes those relating to our Board and substantial shareholders.

#### **4.3.3 We may require additional funding for our growth plans, and such funding may result in a dilution of your investment**

We attempted to estimate our funding requirements in order to implement our business plans. In the event that the costs of implementing such plans significantly exceed these estimates or if we come across other opportunities which cannot be predicted, and our funds generated from our operations prove insufficient for such purposes, we may need to raise additional funds to meet these funding requirements.

#### 4. RISK FACTORS (Cont'd)

These additional funds may be raised by issuing equity or debt securities or by borrowing from banks or other resources. We cannot ensure that we will be able to obtain any additional financing on terms that are favourable to us, or at all. If we fail to obtain additional financing on terms that are favourable to us, we will not be able to implement such plans fully. Such financing even if obtained, may be accompanied by conditions that limit our ability to pay dividends or require us to seek lenders' consent for payment of dividends, or restrict our freedom to operate our business by requiring lenders' consent for certain corporate actions.

Further, in the event we raise additional funds by way of a limited placement or by a rights offering through the issuance of new shares, any shareholders who are unable or unwilling to participate in such an additional round of fund raising may suffer dilution in their investment.

##### **4.3.4 As our operations and significant assets are located outside Malaysia, it could be difficult to enforce a Malaysian judgment against our Directors, our officers and us**

Our operations and assets are located in the PRC. We are therefore subject to the relevant laws in the PRC. The Act may provide shareholders with certain rights and protection which may not have corresponding or similar provisions under the laws of the PRC. As such, investors in our Shares may or may not be accorded the same level of shareholder rights and protection that would be accorded under the Act. In addition, all our Executive Directors, as at the LPD, are non-residents of Malaysia and the assets of these persons are mainly located outside Malaysia. As such, there may be difficulty for shareholders to effect service of process in Malaysia, or to enforce a judgment obtained in Malaysia against any of these persons or our Group.

##### **4.3.5 Control by our controlling shareholder, Li Kwai Chun who will beneficially own approximately 54.6% of our enlarged share capital after the IPO, may limit your ability to influence the outcome of decisions requiring the approval of shareholders**

After the completion of the IPO, our controlling shareholder, Li Kwai Chun will beneficially own approximately 54.6% of our enlarged share capital. Such concentration of ownership will place her in a position to significantly affect our corporate actions such as mergers or takeover attempts (notwithstanding that the same may be synergistic or beneficial to our Group) in a manner that could conflict the interest of our public shareholders. As a result, Li Kwai Chun will be able to significantly influence all matters requiring approval by our shareholders, unless she is required by law and/or the relevant authorities to abstain from voting.

In an effort to promote good corporate governance, we have appointed Independent Directors and set up an audit committee, to ensure that, *inter-alia*, all future related party transactions, if any, are entered into on an arm's length basis to minimise any conflict of interest, are commercially viable and are subject to terms not more favourable to our related parties than those generally available to third parties, and not detrimental to our minority shareholders.

##### **4.3.6 Failure / delay in our Listing**

The success of our Listing is also exposed to the risk that it may fail or be delayed due to any of the following reasons, amongst others:-

- (i) The placees under the private placement tranche of the Public Issue fail to acquire the IPO Shares allocated to them;
- (ii) Our Underwriter exercising their rights pursuant to the Underwriting Agreement discharging themselves from their obligations thereunder;

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**4. RISK FACTORS (Cont'd)**

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- (iii) We are unable to meet the public shareholding spread requirements i.e. at least 25% of the total number of our Shares for which Listing is sought must be held by minimum number of 1,000 public shareholders holding not less than 100 Shares each, at the time of Listing; and/or
- (iv) Any force majeure event(s), which are beyond our control before our Listing.

The above risks are mitigated by the following:-

- (i) The identified investors have provided irrevocable undertakings to subscribe for their respective portion of the IPO Shares to be placed to them; and
- (ii) Our Directors and OSK, as the Adviser, will endeavour to ensure that our Group is able to meet public spread requirements by allocating the IPO Shares applied for by the Malaysian Public to the required number of public shareholders during the balloting process. The IPO Shares allocated to the Malaysian Public are fully underwritten.

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