

HKEx LISTING DECISION

HKEx-LD31-2012 (published in May 2012)

Summary	
Party	<p>Company A – a Main Board listing applicant</p> <p>Mr. X – a former controlling shareholder and former Director of Company A</p> <p>Company B and Company C – new controlling shareholders of Company A after acquiring the equity interest of Company A held by Mr. X</p>
Issue	<p>Whether disclosures relating to the allegations in the complaint against certain person(s) whose surname(s) was/ were identical to those of Company A’s previous management members were adequate and whether a waiver from Rule 18.04 should be granted to Company A in view of the lack of a clear path to commercial production</p>
Listing Rules	<p>Listing Rules 2.13(2)(a), 8.04, 8.05(1) and 18.04</p>
Decision	<p>The Exchange considered that the disclosures relating to the allegations in the complaint were unclear and limited. The Exchange also decided that the application for waiver of Rule 8.05(1) under Rule 18.04 should not be granted because the Company had not demonstrated to the Exchange’s satisfaction that it has a clear path to commercial production.</p> <p>Subsequently, Company A progressed to the stage of commercial production. It re-submitted a new listing application with enhanced disclosures to address the Exchange concerns relating to the allegations in the complaint. Company A also commenced to prepare a detailed mining plan with a detailed production schedule. Based on the enhanced disclosures, the Exchange agreed to grant a waiver under Rule 18.04 to Company A and the listing was permitted to proceed.</p>

FACTS

1. Company A was a Mineral Company under Chapter 18 of the Rules which focused on one operating mine (the “**Operating Mine**”).
2. There was an anonymous letter alleging that certain member(s) of the Company A’s management with surname “[X]” was/ were involved in a legal action (“**Complaint**”) filed by an overseas regulator relating to illegal share sale and price manipulation of an unrelated company listed on an overseas exchange. The then sponsors had been unable to

conclude definitively on the accuracy or applicability of the allegations in the Complaint. Company A had not proceeded with the listing and the application then lapsed.

3. Later, Mr. X, the former controlling shareholder of Company A who had the same surname as the alleged persons in the Complaint, sold his entire equity interest in Company A to Company B and Company C, who then became Company A's new controlling shareholders. Mr. X and Mr. X's cousin with the same surname also resigned as directors of Company A.
4. Company A re-filed a new listing application to the Exchange with new sponsors appointed. As in the first application, Company A applied for a waiver under Rule 18.04 as it was unable to comply with the requirements of minimum profits, management continuity and ownership continuity under Rule 8.05(1).
5. Based on the total investment cost paid by Company B and Company C to Mr. X, the investment cost represented a discount of over 70% to the proposed Offer Price.

APPLICABLE RULES, REGULATIONS AND PRINCIPLES

6. Rule 2.13(2)(a) states that the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, the issuer must not, among other things, omit material facts of an unfavourable nature or fail to accord them with appropriate significance.
7. Rule 8.04 states that an issuer and its business must, in the opinion of the Exchange, be suitable for listing.
8. Rule 18.04 states that if a Mineral Company is unable to satisfy, among others, the profit test in Rule 8.05(1), it may still apply to be listed if it can establish to the Exchange's satisfaction that its directors and senior managers, taken together, have sufficient experience relevant to the exploration and/ or extraction activity that the Mineral Company is pursuing.
9. As stated in HKEx Guidance Letter HKEx-GL22-10 and paragraph 6 of Consultation Conclusions on New Listing Rules for Mineral Companies published in May 2010, "*While we expect most applicants taking advantage of Rule 18.04 will still be at the development stage, those who are already in the production stage are not necessarily precluded. This is because Mineral Companies in production may have junior assets that are yet to be developed. Waivers from the financial standard requirements are only likely to be considered favourably where Mineral Companies demonstrate a clear path to commercial production*".

ANALYSIS

Clear Path to Commercial Production

10. Notwithstanding that there were disclosures relating to Company A's expected time of commencement of commercial production and Company A's future plans for expanding production capacity for the Operating Mine, the Exchange noted from the "Risk Factors" section and other sections of the Prospectus that:

- (i) **Limited trial production:** the Operating Mine was in its expansion stage and only limited trial production had occurred as of the date of the Independent Technical Report;
- (ii) **Stripping activities and costs:** no detailed mine plan had been completed for the Operating Mine. The Independent Technical Advisor had noted that the annual strip ratios in the production plan were not based on a detailed production schedule, and recommended that Company A conduct a detailed production schedule to derive the real waste stripping needs for the early years of the mine life;
- (iii) **Lack of geotechnical study and use of preliminary grade study:** the Independent Technical Advisor had noted that geotechnical studies had not been completed to determine the appropriate pit slopes and the grade model used for pit optimization. The Independent Technical Advisor believed that a geotechnical study should be carried out for the project and a more detailed grade model should be used for pit optimization and ore reserve estimation; and
- (iv) **Framework agreements:** the framework agreements, although stated as legally binding, appeared little more than undertakings to negotiate on the amounts and quantities to be purchased, the price and other terms. Disclosures relating to the framework agreements should have been presented in plainer language that could readily be appreciated by investors as the disclosures appeared to place more importance on the framework agreements than warranted.

Change in Controlling Shareholders

11. The Exchange noted that the disclosures in the Prospectus relating to the allegations in the Complaint were unclear and limited. The Exchange questioned Mr. X's willingness to sell his interest in Company A for a large discount and whether Mr. X and his cousin were associated with Company B and Company C. The following disclosures should have been made:
- (i) clear and detailed disclosure of the Complaint;
 - (ii) how the new controlling shareholders became aware of Mr. X's proposed sale of his interests in Company A;
 - (iii) an explanation for the apparent low sales price (i.e. a discount of over 70% to the proposed Offer Price) and why the new controlling shareholders were willing to acquire Company A despite the Complaint;
 - (iv) an explicit statement by the Directors that Mr. X and his cousin retained no economic or other interests in Company A;
 - (v) an explicit statement by the Directors that the current controlling shareholders and Company A were independent of Mr. X and his cousin, including a discussion of what due diligence was performed to be comfortable with the acquisition of Company A;

- (vi) an explicit statement by the Directors that the allegations in the Complaint had no impact on Company A's financials and operations;
- (vii) the steps taken by the Sponsors to satisfy themselves that Mr. X and his cousin retained no economic or other interest in Company A and that the current controlling shareholders and Company A and their respective associates are independent of Mr. X and his cousin and their respective associates; and
- (viii) the steps taken by the current controlling shareholders to satisfy themselves that there were no other issues arising from the allegations that should be addressed.

THE DECISION

12. The Exchange concluded that the application for the waiver of Rule 8.05(1) under Rule 18.04 should not be granted as Company A had not demonstrated to the Exchange's satisfaction that it had a clear path to commercial production. Accordingly, Company A would not be able to satisfy the eligibility requirements under Rule 8.05(1). The Exchange also considered that the disclosures relating to the allegations in the Complaint were unclear and limited.
13. Subsequently, Company A progressed to commercial production. It re-submitted a new listing application with enhanced disclosures to address all the Exchange's concerns relating to change in controlling shareholders as set out in paragraph 11 above. Company A also commenced to prepare a detailed mining plan with a detailed production schedule. The independent Technical Report was also updated to clarify that the pre-feasibility study had been properly performed and therefore it was not essential to have completed additional geotechnical or grade studies in order to conduct profitable mining operations. Plain language was also used to accurately describe the nature of framework agreements. Based on the revised disclosures, the Exchange agreed to grant a waiver under Rule 18.04 to Company A and the listing was permitted to proceed.