

## HKE~~XX~~ LISTING DECISION

HKE~~XX~~-LD75-2013 (~~published in~~ July 2013) (Updated in April 2014 and May 2016)

(Updated due to withdrawal of guidance letters superseded by HKEX-GL86-16)

Summary	
<b>Party</b>	Company A, Company B, Company C, Company D, Company E, Company F, Company G, Company H, Company I, and Company J – Main Board listing applicants  Company K, Company L, Company M, Company N, Company O, and Company P – GEM listing applicants  (the “ <b>Applicants</b> ”)
<b>Issue</b>	To provide guidance on why the Exchange returned certain listing applications
<b>Listing Rules</b>	Main Board Rule 9.03(3) and GEM Rules 12.09 and 12.14
<b>Decision</b>	The Exchange returned the applications.

1. This listing decision sets out the reasons why the Exchange returned certain listing applications from December 2012 to April 2013. For the reasons of the return of listing applications before this period, please refer to Listing Decision HKE~~XX~~-LD48-2013.

### APPLICABLE RULES, REGULATIONS AND PRINCIPLES

2. Main Board Rule 9.03(3) states that the Exchange expects to receive an advanced proof of the prospectus with the listing application form that is not an initial proof to enable the Exchange’s review is able to commence immediately upon lodgement of the application. The disclosure of the requisite information as set out in Chapter 11 must be substantially completed in the advanced proof of the prospectus.
3. If the Exchange considers the draft prospectus submitted with the Form A1 is not in an advanced form, the Exchange will not commence reviewing the application. All documents, including the Form A1 and the initial listing fee, submitted to the Exchange will be returned to the sponsor(s). The sponsor(s) will be required to resubmit a new Form A1 together with the advanced proof of the prospectus.
4. GEM Rule 12.09 states that the Sponsor must ensure that the draft listing document has been verified in all material respects prior to submission. Note 1 to GEM Rule 12.09 states that if the Exchange considers that the draft listing document submitted

with the listing application form is insufficiently finalised, the Exchange will not commence review of that or any other documents relating to the application.

5. GEM Rule 12.14 requires that the listing application form must be accompanied by certain documents. The Listing ~~Department~~Division may return to the sponsor any application for listing which it considers to be incomplete, together with the initial listing fee.

## **ANALYSIS**

6. Set out below are reasons why the Exchange considered the applications not in an advanced form and returned certain listing applications during the period from December 2012 to April 2013.

### Company A

7. Company A was engaged in property development projects. There were a number of deficiencies in disclosures:

- (i) Business model

Company A had two business segments, i.e. Segment A and Segment B. The disclosure placed significant emphasis on Segment B which did not accord with the fact that a majority of Company A's revenue during the track record period was from Segment A.

Further, the disclosure on Company A's arrangements with sub-contractors was limited. It was unclear as to which part of the work was outsourced, its liabilities for sub-contractors' work and its control measures to monitor the performance of sub-contractors.

- (ii) Future plans

Company A planned to develop a building and a significant amount of the IPO proceeds would be used for this purpose. More concrete details of the plan should be disclosed in the prospectus including:

- Whether Company A had started the venue identification process;
- The expected timeframe of the development;
- The source of funding in addition to the IPO proceeds; and
- How the plan would affect Company A's business going forward.

- (iii) Non-compliances

Company A was involved in a number of material non-compliances, civil claims, litigations and criminal prosecutions. However, the disclosure was unclear and insufficient. There should be enhanced disclosure on:

- Details and causes of the non-compliances;
- Maximum penalties and liabilities to Company A;
- Specific rectification measures and internal controls; and
- Sponsor’s view on the non-compliances and their impact on Company A and its directors.

(iv) Others

The “Summary” section of the prospectus lacked sufficient information to provide investors with a concise overview of Company A’s operation model and to highlight significant matters as per Guidance Letter HKE~~X~~-GL27-12<sup>1</sup>. **(Updated in May 2016)**

Moreover, the prospectus did not provide a meaningful discussion on Company A’s tight liquidity position and hedging policies.

Company B

8. Company B was a garment manufacturer. There were a number of deficiencies in the following disclosure:

(i) Insufficient information on its major customers, including:

- Their identities and background;
- Salient terms of sales agreements;
- Pricing strategies; and
- Plan and measures to reduce reliance on its major customers.

(ii) Information on suppliers and raw materials, including;

- Number of suppliers;
- Importance of its major suppliers and whether there were plans and measures to reduce reliance on them;
- Reasons for raw materials price fluctuations;
- Policies to manage exposure to rising costs; and
- Whether increases in costs could be passed to customers.

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<sup>1</sup> Withdrawn in May 2016. Superseded by Section A of Appendix 1 in HKEX-GL86-16.

- (iii) Control measures on product design, intellectual property rights protection and the relevant risk exposure were not adequately disclosed.
- (iv) Reasons for the fluctuation of the utilization rate of production facilities during the track record period and details of the new production equipment to be purchased by the net proceeds from the global offering.
- (v) Descriptions on its transfer pricing arrangement and the regulatory, product quality and safety requirements which it may subject to in the major markets it operates in.
- (vi) Information on forward contracts including:
- Reasons for entering into forward contracts;
  - Key terms of these contracts;
  - Maximum potential exposure;
  - Details of investment;
  - Hedging and risk management policies and internal control procedures; and
  - Personnel and senior management involved.
- (vii) The disposal of certain subsidiaries to the controlling shareholders, for example:
- Reasons for the disposal;
  - Whether the disposed entities competed with Company B; and
  - All the information required under Rules 8.10(1)(a) and 8.10(2) (where applicable).
- (viii) Details of the non-compliances were unclear and insufficient and the following should be disclosed:
- Root causes of the non-compliances;
  - Rectification measures and internal controls; and
  - Sponsor's view on the non-compliances and how they might impact on Company B and its directors.
- (ix) The "Summary" section lacked sufficient information to provide investors with a concise overview of Company B's operation model and to highlight significant matters as per Guidance Letter HKE ~~Xx~~-GL27-12<sup>1</sup>. **(Updated in May 2016)**

- (x) In the “Financial Information” section, there was only a pure description of the quantitative changes in the underlying components and no meaningful discussion on Company B’s financial position. There was also no information on how various factors (e.g. the change in product mix, the product pricing model, the fluctuation of prices of major production materials, etc.) affected Company B’s business during the track record period.

### Company C

- 9. Company C was involved in the processing of certain paper products. There was unclear and insufficient disclosure on:
  - (i) Whether Company C was a manufacturer or a trading company based on the description of its business activities in the prospectus;
  - (ii) Customers, such as the background and nature of customers, the degree of Company C’s control over customers, details of rebates provided to customers, and a gross profit margin analysis by product types; and
  - (iii) Average selling prices, sales volume and gross profit margin of new products for investors to assess their performance.
- 10. Furthermore, Company C had only identified two INEDs.
- 11. The “Summary” section lacked disclosure on material information, including the key operating indicators (e.g. production capacity, utilization rates and average selling prices of major products, etc.) and the recent significant drop in revenue from one of the products.
- 12. As for the use of proceeds, there was no detailed disclosure on:
  - (i) Implementation plan and the expected timeframe for the expansion of sales network;
  - (ii) Details of the proposed acquisition (e.g. whether Company C had identified any target and the status of negotiation); and
  - (iii) Products to be developed, the R&D activities involved and the expected time to launch the products.

### Company D

- 13. Company D was involved in the entertainment business. There was insufficient disclosure in relation to:
  - (i) The exact services provided and the extent of involvement in the entertainment operation; and
  - (ii) Salient terms of major agreements, including the rights and obligations of different parties, the allocation of profit and expenses, the duration of the agreements, termination clauses, etc.

14. There was insufficient disclosure to demonstrate that Company D had sufficient and effective risk management and internal control measures to manage its credit risk and that its operation remained clear of corruption and money laundering activities. The prospectus should include:
  - (i) Details of the exposure to credit risks of advances/guarantees, the credit risk control measures and the relevant default rates;
  - (ii) Control mechanism to actively manage the entertainment activities; and
  - (iii) Details of anti-money laundering and anti-corruption policies and related procedures, and the professional qualification and industry experience of the relevant personnel who were in charge of internal control.
15. Given the significant costs of its future plans and the tight liquidity position, there should be more disclosure on:
  - (i) Whether the significant amount due from directors would be settled and the resulting impact on financial position;
  - (ii) further details on Company D's liquidity management;
  - (iii) Expected timing of payment for each of its future plan and the related source of financing;
  - (iv) Details on how to manage its business expansion (e.g. sourcing of suitable expertise, the management of staff, etc.) and the contingency plan should it fail to complete the projects; and
  - (v) Compliance records with all the bank covenants.
16. The disclosure in relation to disputes and legal proceedings should be enhanced, including but not limited to:
  - (i) Circumstances giving rise to each of the disputes and legal proceedings and the maximum potential impact on Company D's operation and financial position; and
  - (ii) Details of control measures to prevent recurrence of these events in the future.
17. The "Summary" section should include material information, including:
  - (i) Company D's major acquisition;
  - (ii) Its reliance on the largest customer;
  - (iii) Its key operating data;
  - (iv) A brief commentary on material fluctuations of revenue and profit;
  - (v) Material disputes and legal proceedings;

- (vi) Major risks; and
  - (vii) Recent development.
18. Company D should update the accounts as required under Rule 8.06, or provide a sponsor's confirmation as set out in Guidance Letter HKE~~X~~-GL6-09<sup>2</sup> upon submission of the new listing application. **(Updated in May 2016)**

#### Company E

19. Company E was a service provider. There were a number of deficiencies in disclosures:

(i) Business model

The prospectus lacked a detailed description on:

- Whether the three business segments of Company E were inter-related or cross-selling;
- Why clients had to engage Company E instead of directly dealing with its operators;
- How products and services were priced;
- How revenue and costs were recognized;
- Sales and marketing strategies;
- Liability clauses for misleading/ inaccurate contents;
- Involvement and role in organizing competitions/ events;
- Salient terms of a major agreement; and
- How and the percentage of free and discounted advertising time slots it obtained.

(ii) Future plans

There was insufficient information on how Company E planned to utilize the proceeds from the global offering to fund its business plan.

(iii) Relationship and reliance on the largest supplier

The single largest supplier accounted for approximately a majority of the total purchases during the track record period. However, there was insufficient disclosure on the relationship with and reliance on this supplier, including:

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<sup>2</sup> Withdrawn in February 2014. Superseded by HKEX-GL6-09A.

- Whether it was an industry norm to rely on a single supplier;
- Measures taken/ to be taken to reduce reliance;
- Renewal status of the agreement with the supplier;
- Salient terms of the agreement; and
- Details of the public auction process to acquire the exclusive right of the advertising time slots.

(iv) Structured Contracts

The disclosure did not fully address the requirement under Listing Decision HKE~~X~~-LD43-3, including that:

- Structured contracts were narrowly tailored to achieve Company E's business purposes and to minimize the potential conflict with relevant PRC laws and regulations;
- Relevant regulatory assurance it obtained regarding their use;
- Details of any insurance purchased to covered the risks relating to the structured contracts;
- The reporting accountants concurred that Company E had the right to consolidate the relevant financial results under the prevailing accounting principles;
- Company E would unwind the structured contracts as soon as the relevant PRC law allowed it to do so;
- Economic risks it bore; and
- Circumstances under which it had to provide further financial support.

(v) Other disclosure matters

There was insufficient information on Company E's business model in the "Summary" section, including:

- Products/ services it produced/ provided in each business segment;
- Revenue breakdown by segments and a related commentary on material fluctuation;
- Reliance on a major supplier; and
- Update on the recent development of its operations and financial performance.

The summary should omit a full list of risk factors and should provide a meaningful discussion on the fluctuation of Company E's track record results and financial positions during the track record period.

20. Company E terminated Firm A as one of its experts and subsequently engaged Firm B. There should be a submission on the circumstances leading to the termination of Firm A's engagement, including:
- (i) Details of the disagreement;
  - (ii) Firm A's clearance letter (if any);
  - (iii) Firm B's confirmation (with basis) on how any disagreement/ unresolved matters with Firm A (if any) were resolved; and
  - (iv) Whether there was any matter regarding the change of the expert which had to be brought to the Exchange's attention.

#### Company F

21. Company F was a wholesaler and retailer of consumer goods. There were a number of deficiencies in disclosure:

(i) Suitability of director

Mr. A, Company F's controlling shareholder, chairman and ED, was implicated in an incident which gave rise to the Exchange's concern on his suitability. The sponsor had not demonstrated to the Exchange's satisfaction that the incident did not affect Mr. A's suitability as a director under Rules 3.08 and 3.09.

(ii) Change in business focus and future plans

The revenue contribution from the property investment segment decreased significantly. However, this business segment, including the fair value gain, accounted for a majority of its net profit. The prospectus did not highlight this issue, and lacked detailed disclosure on the reason(s) for the change in business strategy, and how this change had affected Company F's business risk profile (e.g. cost structure, profitability, liquidity, and credit risks, etc.).

There were also insufficient details on:

- how Company F would expand its wholesale and retail business (e.g. timing and scale of expansion, investment budget, expected time to recoup invested capital, etc.);
- its future intention on the property investment segment; and

- how it would manage its business expansion (e.g. procurement of customers, suppliers and skilled labour, quality control, internal control, etc.).

(iii) Property investment segment

The profit generated by the property investment segment was volatile due to the fair value change. There were deficiencies in disclosure and the following should be included in the prospectus:

- A commentary on the fair value gains during the track record period (e.g. methodology adopted to appraise fair value of assets);
- Adjusted profits excluding the fair value gains;
- Details of acquisition of the property (e.g. consideration, source of funding, conditions attached to the acquisition, property usage before/after the acquisition, any major construction activity conducted for the current use).
- Salient terms of the lease of property from the government and the cooperative agreements;
- How the cooperative agreements correctly reflected the nature of Company F's operations; and
- The cooperative agreements' impact on Company F's business and financial position with meaningful analysis (e.g. average rental per sq.m. and a commentary on material fluctuations, years of relationship with occupiers and their respective gross floor areas rented and rental contribution based on the existing leases).

(iv) Wholesale and retail businesses

- Company F considered its membership with Association A in the PRC as one of its competitive strengths but there was no disclosure on the background of Association A, categories of membership and their basic requirements, obligations and annual fees, the total number of members, and whether Company F's membership was subject to annual review and conditions.
- There was no analysis on the gross profit margin of different types of consumer goods, the proportion of the different types of raw materials used by manufacturing contractors and a detailed cost breakdown by business segment.
- There were no details on Company F's preferential pricing arrangement with one of its largest customers, and the pricing details.
- There should be disclosure on the background information of its top five customers, the salient terms of cooperation with them, reason for the

high customer concentration in the wholesale segment and the plan to mitigate the risk of reliance.

- There was no information on the salient terms of the subcontracting arrangement.
- There were insufficient details on Company F's internal controls.
- There was no background information on the largest and top five suppliers;
- There were insufficient details of the framework agreements and the compensation for either contract parties failing to supply or purchase the minimum purchase amount.
- There was no disclosure on the grades of the inventory, Company F's intention for its inventory and how long it could support its current operations and/or future business expansion, the historical price trends for its raw materials, and whether Company F would need to make any provision for the inventory.

(v) Disclosure not in accordance with Guidance Letters

The disclosure should follow published Guidance Letters, including but not limited to HKE~~X~~-GL27-12<sup>1</sup> on the Summary section, HKE~~X~~-GL30-12 on intellectual property rights, HKE~~X~~-GL33-12 on use of proceeds, HKE~~X~~-GL36-12 on distributors and HKE~~X~~-GL37-12 on indebtedness and liquidity. **(Updated in May 2016)**

Company G

22. Company G was a mining company. It submitted a renewed application without fully addressing the issues the Exchange raised when the previous application lapsed. Non-exhaustive examples included:

(i) Non-compliant incidents

- Company G had not yet obtained the revised production licenses with increased permitted annual mining capacity.
- The mines continued to operate at a capacity in breach of the production volume limit stipulated in its production licenses.
- There was no analysis on why Company G's application for increasing the permitted production volume would not be negatively affected by the government policies to reduce carbon emission and curb coal production.
- There was no information on why the excess production during the track record production would not adversely affect its application for further increases in the permitted annual capacity and renewal of production licenses for the mines.

- The requested disclosure on the operational and financial impact in the worst case scenario (e.g. the application for land use rights was rejected, the production schedule was delayed, applications for increases in production capacities were rejected), and alternative plans remained outstanding.
  - Information demonstrating that Company G would be able to meet the minimum profit requirements under Rule 8.05 after excluding revenue from excess coal production had not yet been provided.
  - The prospectus had also not disclosed Company G's maximum financial exposure in respect of each of the non-compliance incidents.
- (ii) Working capital sufficiency
- The Sponsor and the Reporting Accountants had yet to provide the detailed basis, with the support of a working capital forecast, on which they were satisfied that Company G would have sufficient working capital for 125% of its requirements under Rule 18.03(4).
  - The worst case scenario analysis and sensitivity analysis of changes in major assumptions also remained outstanding.
- (iii) Tax issues
- The full amount of the tax not yet reported was not disclosed.
  - The question on whether Company G had breached any rules of the other exchange on which it was listed was also not yet addressed.
- (iv) Others
- Reasons for the resignation of the three INEDs and the change in the legal advisor were not provided.
  - The question on whether there was any matter which had to be brought to our attention was not yet addressed.

#### Company H

23. Company H was engaged in the automobile industry. It did not fully address comments previously raised by the Exchange before the submission of a renewed application. Non-exhaustive examples include:

- (i) Non-compliances and directors' suitability
- Certain subsidiaries had yet to rectify their non-compliances with the relevant PRC laws, rules and regulations to obtain approvals and licenses for carrying out part of its business.

- Although Company H obtained confirmations from city-level authorities, the authority to order its business suspension rested on authorities of county level or above.
  - The sponsor should disclose:
    - (a) Root causes of each non-compliance;
    - (b) Sponsors' views (with basis) on directors' suitability under Rules 3.08 and 3.09;
    - (c) Adequacy and effectiveness of Company H's internal control measures to ensure ongoing compliance with the PRC laws and regulations; and
    - (d) Basis of the directors' view that the business authorizations were unlikely to be revoked by its suppliers as a result of the non-compliance incidents.
- (ii) Inventory risks, working capital management and business sustainability
- Company H sold certain inventories at prices lower than the procurement costs and reduced selling prices of its products. It was unclear whether these arrangements were in breach of the pricing guidelines of its suppliers and their effect to inventory valuation was not disclosed.
  - There were significant increases in inventory and inventory turnover days and the material decreases in gross and net profit margin during the track record period.
  - A showroom was closed after operating for only one year due to market uncertainty. However, on the other hand, Company H planned to open extensive outlets in the next few years. The financial and operational impact to Company H was not disclosed.
  - The above factors, in totality, posed concerns on Company H's inventory risks, working capital management and business sustainability which had yet to be addressed.
  - The directors and the sponsors had yet to provide the detailed basis, with the support of a working capital forecast, on how they were satisfied that Company H would have sufficient working capital to meet its present requirements under Rule 8.21A, particularly in light of the issues mentioned above.
  - A sensitivity analysis (with basis) of changes in major revenue/ cost drivers and interest rates on the forecast profit remained outstanding.

### Company I

24. Company I was a consumer goods manufacturer. The Exchange had previously accepted its listing application for vetting.
25. Company I planned to purchase more supplies from independent sources (instead of from a connected supplier), and reduce the extent of connected transactions.
26. The Exchange issued a letter requesting Company I to demonstrate whether its track record results had been cushioned by the connected supplier, which might have absorbed the counterparty risks, including volatile prices, late deliveries and cancelled orders, etc. Company I also had to demonstrate whether it had sufficient expertise and whether systems were in place to manage the risk of price volatility and counterparty default risk.
27. The application subsequently lapsed and Company I submitted a new listing application. The Exchange considered that the concerns raised had not yet been satisfactorily addressed.
28. In addition to paragraph 26 above, Company I should disclose details of long supply framework agreements signed or to be signed with the connected supplier and other independent suppliers, the impact of the change to Company I's risk profile, financial position and profitability, and the resulting competition with the controlling shareholders, if any.

### Company J

29. Company J was a supplier of consumer products.
30. The Exchange had previously accepted Company J's listing application for vetting. However, Company J repeatedly refused to disclose certain information for reasons of commercial sensitivity ("**Relevant Information**").
31. The Exchange issued a letter stating its intention to reject the listing application on the grounds that the disclosure of the Relevant Information could adversely affect Company J's relationship with its existing customers and the omission might mislead investors.
32. Also, given that the excluded companies were under the same management and control as the group during the track record period, the Exchange requested the reporting accountants' views on the reasons why the excluded companies' results were not included in Company J's consolidated financial statements during the track record period. However, this was not provided. In addition, certain significant information provided was inaccurate and incomplete.
33. The Exchange issued a letter to the sponsor stating its intention to reject the listing application unless the above issues were resolved and updated accounts were provided.
34. The listing application subsequently lapsed. Company J re-submitted a new listing application. The Exchange considered that Company J had not provided sufficient information to fully address the concerns raised in its previous letter. In particular,

Company J had yet to demonstrate whether its profitability would be affected if the Relevant Information was disclosed to its customers, which would in turn affect the sustainability of its business.

#### Company K

35. Company K was engaged in a heavily regulated business. There were a number of deficiencies in the filing of the listing application, for example, documents required under GEM Rule 12.22 were outstanding and sufficient independent non-executive directors had to be appointed as required under GEM Rule 5.05(1).
36. There were also a number of deficiencies in the disclosure in the prospectus:
  - (i) The disclosure in the “Summary” section on the distribution of products manufactured by Company K and its parent group before and after the delineation was unclear and confusing. Furthermore, reasons for the proposed spin-off were not disclosed.
  - (ii) Company K and its parent group underwent certain steps to better delineate Company K from other members of the parent group and to enhance its independence. However, the prospectus lacked detailed disclosure on how these changes would affect Company K’s future operating performance, cost structure and working capital management.
  - (iii) The sponsor’s views, with basis, on whether Company K could still meet the minimum cashflow requirement under GEM Rule 11.12A(1) should the changes stated in item (ii) above took place throughout the track record period, and whether the track record results were meaningful for investors to assess Company K’s future should also be disclosed.
  - (iv) Company K planned to significantly increase the manufacturing capacities for certain products. However, there was insufficient disclosure on Company K’s expansion plan (e.g. the amount and timing of the estimated capital expenditure and the amount committed as at the latest available date, sources of funding, procurement of sales orders, raw materials and skilled labour, etc.), reasons for this expansion and how the expansion plan would affect its business going forward.
  - (v) Given that Company K was engaged in a heavily regulated business, the prospectus lacked disclosure on details of its internal control measures to ensure compliance with all applicable laws and applications, the quality control measures, the exposure to product liability claims and the scope and extent of its product liability insurance coverage.
  - (vi) There should be a more detailed qualitative and quantitative analysis of major factors affecting Company K’s revenue, gross profit and operating profit during the track record period with related sensitivity analysis (where appropriate), and a meaningful analysis of major financial ratios in the “Financial Information” section.

## Company L

37. Company L was engaged in the provision of certain services. There were a number of deficiencies in disclosure:
- (i) Company L had only completed a few contracts during the track record period. All projects on hand as at the latest practicable date were expected to complete soon. The prospectus lacked information on whether Company L would be able to secure new projects and sustain its business.
  - (ii) Company L was loss making in previous years with net operating cash outflow and net current liabilities. It relied on its controlling shareholder to finance its operations throughout the track record period. The prospectus contained insufficient analysis on whether Company L would be able to raise sufficient independent funding to finance its significant short-term funding needs.
  - (iii) Company L had no previous experience in its business in places other than Hong Kong, but the largest project on hand was non-Hong Kong based. However, there was only minimal disclosure on this project in the prospectus. Moreover, Company L had yet to complete certain registration with the relevant authority in the other country. The prospectus lacked disclosure on the directors' and senior management's previous experience in its business in places other than Hong Kong, Company L's plan with respect to the financing and management of the project, and the likelihood of success and the expected timing of completion of the registration.
  - (iv) The risk factors relating to competition in its industry was very general and the "Business - Competition" section lacked sufficient information to provide investors with an overview of the industry's competitive landscape.

## Company M

38. Company M was a service operator. Enhanced disclosures ~~w~~a~~s~~e~~r~~e required for the following areas:
- (i) How the deed of non-competition could be effectively implemented as (a) the retained group<sup>3</sup> was a listed company and would not be under the controlling shareholders' absolute control and (b) the retained group had the right to decide whether certain products, which might compete with Company M.
  - (ii) How Company M's business could be delineated from the retained group in terms of customer and supplier bases, and the scope of products and services offered.
  - (iii) The basis on which Company M could operate independently from the retained group given the amount of transactions with the retained group going forward, and the respective roles and responsibilities of Company M's two directors in Company M and the retained group.

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<sup>3</sup> The group of companies held by the controlling shareholders but not injected into the group to be listed.

- (iv) A detailed quantitative and qualitative analysis of the significant fluctuations of Company M's track record results, and the background information of its major suppliers and advertising customers, together with the salient terms of the agreements with them.
- (v) Details of the non-compliant short-term financing and the potential maximum penalty.
- (vi) Details of complaints and/or writs, the remedial actions, the relevant internal control measures, and the disclosure as required in Guidance Letter HKE~~X~~-GL30-12 regarding Company M's intellectual property rights.
- (vii) Details of the industry outlook and competitive landscape and how Company M would be able to sustain its business going forward.
- (viii) Details of Company M's structured contract arrangement as required in Listing Decision HKE~~X~~-LD43-3.

### Company N

39. Company N was engaged in the development and sale of certain products. It did not submit all the documents required under GEM Rule 12.22 at the time of the filing of its listing application. Moreover, there were a number of deficiencies in disclosures:

- (i) Business model and future plans
  - Given the changes in the percentage contribution of Company N's revenue streams, it was uncertain whether it had changed its business focus and if so, how this change would affect its business and risk profile.
  - There was also no information on whether the introduction of a new product might change Company N's business model, subject it to a different regulatory environment, and result in potential competition with its customers and the controlling shareholders.
  - The prospectus lacked disclosure on Company N's strategy to ensure the renewal of contracts and the historical renewal rates.
  - Details on how Company N's business strategies will be executed, the source of funding, and how these plans would affect its business and risk profile going forward should be disclosed.
- (ii) Products/ services and various business arrangements
  - There was insufficient disclosure on the functionality of principal products, the revenue model, the business arrangements with strategic partners and customers.

(iii) Customers and suppliers

There should be further disclosure in relation to:

- Major customers and suppliers (e.g. background and business profile of its top five customers and suppliers, number of years of business relationship, salient terms of agreements); and
- Sales and marketing strategies (e.g. how it secured customers, the number of “active” customers, how these strategies would allow Company N to expand its customer base).

(iv) Research and development

The prospectus lacked disclosure on Company N’s product development plans, including:

- How it planned to enhance its existing products;
- Whether the research and development process of various new products had commenced;
- Expected timeframe of development and project milestones;
- Estimated and incurred costs;
- Qualification and experience of development employees;
- Measures to retain qualified personnel; and
- Relevant risk factors.

(v) Intellectual property

Given the business nature of Company N, the prospectus lacked discussion on:

- Whether the current practice of Company N in safeguarding its intellectual property was in line with industry practice;
- Whether it suffered any infringement of its technology in the past;
- Basis on which it concluded that its current level of protection was sufficient, and
- Whether Company N planned to patent any of its products.

(vi) Investment strategy

There was insufficient disclosure on:

- Details of the investments;
  - Treasury and investment strategy; and
  - Relevant risk control measures (e.g. factors considered in selecting financial instruments, the identity and role of the personnel who approved the investment transactions, his/her qualification and experience).
- (vii) Non-compliances under the Hong Kong Company Law requirement (***Updated in April 2014***)

The prospectus had insufficient information on:

- Identity, qualification and experience of the external consultants, their scope of work, key findings and recommendations;
  - How the internal controls would ensure ongoing compliance; and
  - Sponsors' view (with basis) on the sufficiency and effectiveness of these measures.
- (viii) Other disclosures
- The disclosure in various sections of the prospectus did not follow published Guidance Letters HKE~~Xx~~-GL27-12<sup>1</sup> on the "Summary" section, HKE~~Xx~~-GL48-13<sup>4</sup> on "Industry Overview" section, HKE~~Xx~~-GL49-13<sup>5</sup> on the "History and Development" section, HKE~~Xx~~-GL50-13<sup>6</sup> on the "Business" section, and lacked sufficient information to provide investors a concise overview of Company N's business model, history and major events, significant matters and relevant risks. (***Updated in May 2016***)

#### Company O

40. Company O was engaged in the sales of certain consumer products and related services.

(i) Guidance Letter HKE~~Xx~~-GL6-09<sup>2</sup> (***Updated in May 2016***)

Company O had not updated the Accountants' Report in accordance with the principles in the Guidance Letter HKE~~Xx~~-GL6-09<sup>2</sup>.

(ii) Sustainability of the Group's business

- Company O derived over 80% revenue from its top five customers during the track record period. However, there was a substantial decrease in revenue from one of the top five customers recently and a net loss was expected for the current financial year. There should be disclosure on

<sup>4</sup> Withdrawn in May 2016. Superseded by Section C of Appendix 1 in HKEX-GL86-16.

<sup>5</sup> Withdrawn in May 2016. Superseded by Section D of Appendix 1 in HKEX-GL86-16.

<sup>6</sup> Withdrawn in May 2016. Superseded by Section E of Appendix 1 in HKEX-GL86-16.

whether it was common industry practice to rely on only a few major customers and not enter into long term contracts.

- Details of Company O's plan and measures to reduce reliance on the top five customers after listing, the latest financial performance subsequent to the track record period (reviewed by the reporting accountants), and the directors' and the sponsor's view on the future prospects of Company O's business and its sustainability going forward should be disclosed.
- There was a significant trade receivables balance, and receivables turnover days were substantially longer than the credit period granted to its customers. Company O should disclose the aging analysis, the subsequent settlements and the view of the sponsor and the reporting accountants (with basis) on the recoverability of receivables.
- Company O relied on three independent suppliers without any long-term agreement. It should disclose the exposure to counterparty risk and the availability and number of other independent suppliers.
- Company O should disclose reasons for the significant decrease in the Group's forecasted cash and cash equivalents, the worsening gearing and debt to equity ratios, details of plans to improve its working capital, the latest amount of unutilized banking facilities, detailed terms of the financial covenants of the existing bank borrowings, and the compliance record with these covenants. Also the forecast memorandum should be updated to include the latest actual figures.

(iii) Non-compliances and directors' suitability

- Company O was involved in a number of non-compliances during the track record period. The non-compliances had taken place for a prolonged period.
- The Exchange had serious concern on the suitability/ competence of the directors under GEM Rules 5.01 and 5.02 and the suitability of the directors listing on GEM given that the above non-compliance was related to Company O's fundamental operation and business. The sponsor's view, with basis, on the directors' suitability under GEM Rules 5.01 and 5.02 and Company O's suitability for listing should be provided and, where applicable, disclosed.
- There should also be detailed disclosure on the root causes of each non-compliance, reasons for a prolonged period of oversight of the relevant rules and regulations, the maximum amount of penalty/ fine, the background and experience of the internal control consultant, when each of the enhanced internal control policies was implemented and the sponsor's view on the adequacy and effectiveness of the enhanced internal control policies, etc.

(iv) Others

- The “Summary” and “Business” sections should contain more disclosure on Company O’s operation during the track record period and explain the reasons for any material fluctuations.
- The “Business” section should disclose the registration status of trademarks, and the internal control measures including measures to monitor compliance with the relevant laws and regulations.
- The “Regulation Overview” section should cover all relevant rules and regulations.

Company P

41. Company P was engaged in the provisions of certain services in the PRC.
42. Company P was not in compliance with, among others, certain laws applicable to its business in the PRC during the track record period. Although Company P had ceased all non-compliant transactions, it had yet to complete a demonstration period of at least 12 months from the date it ceased all non-compliances with the financial results during the demonstration period audited following the principles of Listing Decision HKE~~X~~-LD19-2011.
43. In addition, there was unclear and insufficient disclosure in relation to information set out in Listing Decision HKE~~X~~-LD43-3 regarding contractual agreement, including arrangements to protect Company P’s interests and arrangements to share losses.

**THE DECISION**

44. The Exchange returned the applications.
45. Subsequently, twelve out of the 16 applicants re-filed listing applications 6 to 70 days after the Exchange returned their previous applications. As they had disclosed and/ or provided the missing information/ documents, the Exchange accepted the re-filed applications.

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