

HKEx REJECTION LETTER
Cite as HKEx-RL14-06 (April 2006)

[Withdrawn in April 2019; Superseded by HKEX-GL45-12]

Summary	
Listing Rule	Listing Rule 8.05(1)(a)
Reason for rejection and the subsequent disposal of the case on review	<p>The Listing Division rejected the listing application of the Company for the reason that the Company was not able to satisfy the minimum profit requirement under Listing Rule 8.05(1)(a) after excluding: (i) the results of the Group's associated companies, (ii) the results of the Group's jointly controlled entities and (iii) deemed gain on dilution of the Group's investment in an associate.</p> <p>The Listing Division's rejection decision was upheld by the Listing Committee.</p>
Contents	<p><u>LETTER 1:</u> Extracts of the decision letter of the Head of Listing, the Stock Exchange of Hong Kong Ltd</p> <p><u>LETTER 2:</u> Extracts of the decision letter of the Acting Secretary to the Listing Committee on hearing of the Company's application to review the decision of the Listing Division</p>

LETTER 1

[Date]

[Name and Address of Sponsor]

Dear Sirs

Re: Application for new listing of a Main Board listing applicant
(the "Company" together with its subsidiary, the
"Group")

We refer to the listing application of the Company dated [**day*month*year*] and various related documents and submissions (the "Submissions") we received. Terms used in this letter have the same respective meanings as defined in your submissions and in the [*draft*] Proof of the prospectus of the Company dated [**day*month*year*] (the "Prospectus"), unless the context requires otherwise.

Based on the information provided, the Listing Division is of the view that the Group is not able to demonstrate to our satisfaction that it has complied with the minimum profit requirements of HK\$30 million in respect of the first two years of the Track Record Period

([comprising Year 1, Year 2 and Year 3]) under Rule 8.05(1)(a) and therefore has decided to reject the listing application of the Company. The analysis and conclusion of the Listing Division have been set out below.

1. Relevant facts

1.1 The Group's business

The Group's business focuses on acting as arranger and agent of structured finance solutions, such as syndicated commercial loans and tax leases. It is also engaged in direct investment in *[certain categories of real and personal properties and other distressed assets]* ("*Direct Investment Assets*") through the establishment of investment funds, and in administering and monitoring such investment portfolios on a non-discretionary basis.

1.1.1 Pages [*] of the Prospectus describe the Group's business model as follows:

"The [*Company's*] business model is to earn:

- Arrangement fees, fees from structuring and arranging debt finance;
- Administrative fees, performance fees, and performance bonuses and brokerage commissions from distressed assets investment business; and
- Interest income and capital gains from proprietary investments in [*Direct Investment Assets*]."

1.1.2 It is noted from the Accountants' Report of the Prospectus that:

- (a) "These [associated companies] are undertakings over which the Group exercises significant influence, which is normally where the Group holds between 20% and 50% of the voting rights, or over which the Group exercises significant influence otherwise, but which it does not control".
- (b) "Jointly controlled entities are collective investment schemes ("CISs") set up to invest in property development projects which are held for sale". The Group's attributable equity interests in these CISs ranged from approximately 3% to 40%.
- (c) It is stated in Note 2(c) of the Accountants' Report that, "the Group's interests in jointly controlled entities are accounted for by the equity method". In addition, the Group's associates are accounted for using the equity method of accounting.

1.2 The Group's profits

1.2.1 It is noted from the Prospectus the following:

	[Year 1] [HK\$'000]	[Year 2] [HK\$'000]	[Year 3] [HK\$'000]
The Group's profits presented in the accountants' report	[19,000]	[27,000]	[62,000]
Items included in the Group's profits:			
Share of results of associates after tax	-	[4,500]	[16,000]
Share of results of jointly controlled entities	[3,000]	[2,500]	-
Deemed gain on dilution of investment in an associate (Note 1)	-	[11,000]	-
Profits after exclusion of the above items – HK\$'000	[16,000]	[9,000]	[46,000]

Note 1: The deemed gain on dilution of investment in an associate arose from the issue of new shares by [Entity X] in [Year 2] which resulted in dilution of the Group's interest in [Entity X] from 100% to [approximately 45%].

2. Applicable Listing Rules and Guidance

- 2.1 Rule 8.05(1) requires a new applicant to have a three-year trading record under substantially the same management and ownership. The Rule specifically provides that the specified minimum profit level (i.e. profit of not less than HK\$20 million in the most recent year and HK\$30 million in aggregate in the two preceding years) must be met by “*the issuer, or its group (excluding any associated companies and other entities whose results are recorded in the issuer's financial statements using the equity method of accounting)*”.
- 2.2 Rule 8.05(1)(a) also states that “*The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business*”.
- 2.3 In the Consultation Conclusions on Proposed Amendments to the Listing Rules relating to Initial Listing Criteria and Continuing Listing Obligations issued by the Exchange in January 2004 (the “Consultation Conclusions”), the following comments were made on the calculation of profits under Rule 8.05(1) in the case of associated companies and jointly controlled entities:
33. *We have maintained our current policy that such post-tax profits should exclude any income generated by activities outside the ordinary and usual course of business, as well as the results of associated companies.*
34. *Given our requirement to demonstrate ownership continuity and control for at least the most recent financial year in the track record period, the results of associated companies should be excluded from the calculation of post-tax profits, as the listing applicant does not have control over these companies.*

35. *In the case of joint ventures under control restrictions or jointly controlled companies, there exist a number of operational issues, such as whether and how they are to be accounted for in the accounts of listing applicants, and whether the listing applicants have “negative control” in the form of the power of veto over certain key areas of operations. For the purposes of determining the appropriate treatment of the results of these entities, we consider that a separate review should be conducted. In the meantime pending the outcome of such a review, we have maintained our existing policy that the results of these entities (over which the listing applicants have not been able to demonstrate “control”) are to be excluded from the calculation of post-tax profits.*

2.4 In the Frequently Asked Questions on Rule Amendments relating to Corporate Governance and Listing Criteria Issues issued by the Exchange on 31 March 2004, a question was raised on how the results of a jointly controlled entity which has been accounted for by the proportional consolidation method under International Auditing Standards should be treated. The Exchange replied in question 17 that “normally, results of jointly controlled entities will be excluded for the purposes of Rule 8.05, unless the issuer can demonstrate positive control over the entities”.

3. Issues

Whether, in light of the above results attributable to associates and jointly controlled entities, and deemed gain on dilution of investment in an associate, the Group complies with the profit requirements under Rule 8.05(1)(a).

4. Sponsor’s submissions

4.1 The Sponsor’s submission dated [*] stated that:

- (a) The act of investing in the “associate” (and realization) is in the ordinary and usual course of business of the Group and the Group’s business is structured in such a way that much of its investments are associated companies. Hence, the elimination of results of associates does not apply to the current situation. Similarly, the results of jointly controlled entities should also not be excluded as they are investment returns.
- (b) The acquisition and sale of defaulted loans and [assets] are often transacted at the level of an investment holding company, such as [Fund A] or [Fund B] for the purposes of ease of transfer, tax liability management and limiting risk exposure.
- (c) Pages [*] of the Prospectus state that the funds are held through investment vehicles (i.e. associated companies) which are held by a charitable trust to ensure the funds functions as a whole as an independent entity in accordance with recognized corporate principles.

4.2 The Sponsor's submission dated [*] further elaborated, among other things, the following:

- (a) Such income [share of results from jointly controlled entities] represented realized investment returns of [Entity X] from its jointly controlled entities engaged in real estate investment. It is submitted that the share of results of jointly controlled entities should be included and not excluded for calculation of the Group's net profits in terms of Rule 8.05(1) of the Listing Rules.
- (b) The deemed gain on disposal of an associate arose from the issue of new shares by [Entity X] that diluted the Group's interest in [Entity X] from 100% to [approximately 45%] in [the middle of Year 2]. The share issue was a genuine fund raising exercise as new funds were raised. The amount of deemed gain on disposal was recorded when [Entity X] technically turned, upon the above share issue, from a subsidiary to an associated company of the Company, and did not directly arise from any associated companies and other entities whose results are recorded in the Group's financial statements using the equity method of accounting. On this basis, the deemed gain on disposal of [Entity X] should be included, rather than excluded, for the purpose of the profit test under Rule 8.05(1).

5. Division's Analysis

5.1 The Listing Division considers the profit requirement under Rule 8.05(1)(a) to be a question of fact. In particular, the Listing Division considers whether the Group is able to fulfill the minimum profit requirement without relying on:

- (a) the results of associated companies and other entities (including jointly controlled entities) whose results are recorded in the Group's financial statements using the equity method of accounting; and
- (b) profit from activities conducted outside the Group's ordinary and usual course of business.

Share of results of associates and jointly controlled entities

5.2 Rule 8.05(1) requires that the profit of the issuer and subsidiary, excluding any associated companies and other entities whose results are recorded in the issuer's financial statements using the equity method of accounting, to meet the minimum profit requirement. The Consultation Conclusions also clarifies the Division's existing policy to exclude the results of jointly controlled entities from the profits test under Rule 8.05(1).

5.3 Rule 8.05(1) contemplates that the new applicant must exercise positive and effective control over its business, and accordingly, refers to the group, which is defined to include the issuer and its subsidiaries (over which it would have control), and excludes its associates and other entities whose results are equity accounted for. The existing policy of the Exchange is also reiterated in the Consultation Conclusions, which stated

that the results of entities (both associated companies and jointly controlled entities) over which the new applicants have not been able to demonstrate control are to be excluded from the calculation of post-tax profits. While not explicitly stated in the Consultation Conclusion, it is the view of the Listing Division that this position would apply to the share of results of the associates and the jointly controlled entities of the Group which have been equity accounted for, regardless of whether or not such results are realized investment returns as a result of distributions by the jointly controlled entities.

- 5.4 Having considered the Sponsor's submissions, it is the Listing Division's view that the clear statements in the Consultation Conclusions should prevail, notwithstanding the views of the Sponsor. Accordingly, the share of results of associates after tax and the jointly controlled entities must be excluded from the Group's track record for purpose of considering the minimum profit requirement under Rule 8.05(1)(a).

Deemed gain on dilution of investment in an associate (the "Deemed Gain")

- 5.5 The Group describes itself as a structured finance arrangement and direct investment firm, whose business model is to earn arrangement fees from structuring and arrangement debt finance, administrative and performance fees from its assets investment business, and interest income and capital gains from proprietary investments in *[Direct Investment Assets]*.
- 5.6 The Listing Division notes that the issue of new shares is part of the Group's capital fund raising activity. It is described on page [*] of the Prospectus that "[in the middle of Year 2], *[Entity X]* raised *[approximately US\$8 million]* in shareholders' equity capital from a number of independent third party investors as part of its strategic expansion. The *[Company's]* shareholding interest was diluted to *[approximately 45%]* as a result." It is also stated in the Sponsor's submission dated [*] that this dilution gave rise to a deemed gain on dilution which is a one off gain and not in the ordinary and usual course of business of the Group.
- 5.7 It is the Division's view that the Deemed Gain represents unrealized gain resulting from the Group's capital fund raising activities, rather than gain generated from activities within the ordinary and usual course of its business. On this basis, profit from the Deemed Gain should be excluded from the profit test under Rule 8.05(1)(a) as the profit did not arise from the Group's usual and ordinary course of business.

Adjusted profit figures for purposes of Rule 8.05

- 5.8 After exclusion of the Group's share of results of associates after tax, its share of results of jointly controlled entities, and the deemed gain on dilution of investment in an associate from its profit, the aggregate profit of the Group for the first two years and the final year of its Track Record Period were approximately *[HK\$25,000,000]* and *[over HK\$45,000,000]* respectively.

6. Conclusion

6.1 On the basis of the Listing Division’s analysis set forth above, the Group is not able to satisfy the minimum profit requirement of HK\$30 million in aggregate in respect of the first two years of the Track Record Period under Rule 8.05(1)(a) of the Listing Rules. Therefore, the Listing Division has decided to reject the listing application of the Company.

[Portion of Letter Purposely Omitted]

Pursuant to Listing Rule 2B.05(1), the Company has the right to have this decision reviewed by the Listing Committee.

[Portion of Letter Purposely Omitted]

Yours faithfully,
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Head of Listing

LETTER 2

[Date]

[Name and Address of Sponsor]

Dear Sirs,

Re: Review Hearing of the Listing Committee
(the “Review Hearing”) regarding the Company
Date of the Review Hearing: [* day* month * year]

On [**day*month*year*], the Listing Committee of The Stock Exchange of Hong Kong Limited conducted a review hearing (the “Review Hearing”) to consider an application from the Company for a review of the decision of the Listing Division set out in [*LETTER 1*] dated [** day*month* year*], (the “Decision”).

The Review Hearing was conducted before the Listing Committee comprising *[names of members purposely omitted]* (the “Committee”).

Note: Terms and expressions used and defined in the written submission of the Listing Division shall have the same meanings when used herein unless otherwise defined.

Decision

The Committee considered the submissions (both written and oral) made by the Company and the Listing Division. The Committee decided to uphold the Decision to reject the Company’s listing application.

Reasons

The Committee arrived at its decision for the following reasons:

1. The Group’s business in jointly controlled entities, which ranged from approximately 3% to 40% were held via *[Entity X]* at the material times, i.e. from the beginning of the track record period until *[the middle of Year 2]*;
2. Rule 8.05(1) excluded the results of the Group’s associated companies and other entities whose results were recorded in the Group’s financial statements using the equity method of accounting;
3. page *[*]* of the Accountants’ Report (appendix I to the Company’s draft prospectus) set out the Group’s accounting policy relating to jointly controlled entities. It stated that the Group’s interests in jointly controlled entities, comprising a significant interest in investment funds which were contractually jointly controlled, were accounted for by the equity method of accounting. Further, *[the Company’s legal adviser]* also submitted at the Review Hearing that the funds has as a matter of accounting treatment been equity accounted for;
4. page *[*]* of the Accountants’ Report provided that the Group’s share of results from jointly controlled entities of *[Year 1]* and *[Year 2]* were in the sums of approximately *[HK\$3 million]* and *[HK\$25 million]* respectively. Such sums, which were equity accounted for, would therefore not be recognized under Rule 8.05(1); and
5. after excluding the share of results of jointly controlled entities for *[Year 1]* and *[Year 2]*, the aggregate profit of the Group was approximately *[HK\$25,000,000]* which fell short of the requirements of Rule 8.05(1)(a). Its application for listing was hence rejected.

The Company had failed to produce cogent reasons or to illustrate exceptional circumstances to convince the Committee to arrive at a decision different from the Division's Decision.

Yours faithfully
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Acting Secretary to the Listing Committee