HKEX LISTING DECISION

HKEX-LD126-2020 (June 2020)

[Streamlined and incorporated into the Guide for New Listing Applicants in January 2024]

Summary	
Parties	Company A to Company R – Main Board and GEM listing applicants whose listing applications were rejected by the Exchange in 2019
Issue	To provide guidance on why the Exchange rejected certain listing applications
Listing Rules	Main Board Rule 2.06 and Chapter 8 GEM Rule 2.09 and Chapter 11
Related Publications	HKEX-GL68-13, HKEX-GL68-13A, HKEX-GL99-18, HKEX-LD92-2015, HKEX-LD100-2016, HKEX-LD107-2017, HKEX-LD119-2018 and HKEX-LD121-2019
Decision	The Exchange rejected the listing applications

BACKGROUND

1. In comparison with the previous year, the percentage of applications rejected in 2019 has remained stable (6 % versus 6.45% in 2018). 17 applications were rejected for suitability under guidance letter HKEX-GL68-13A in 2019 as compared to 20 in 2018.

2. The Exchange's vetting process is qualitative and the review of the eligibility and suitability of each applicant is holistic. Whilst a number of factors are taken into account, a greater level of scrutiny is placed on an applicant's commercial rationale for listing, which forms the bases for an applicant's proposed use of listing proceeds, in cases where the Exchange has reason to believe that a listing applicant is listing for a purpose other than the development of its underlying business or assets, or that its size and prospects do not appear to justify the costs or purposes associated with a public listing, i.e., there is a likelihood of it becoming a "shell company". It is in this context that the Exchange evaluates whether there is a genuine need for funding, rather than as a separate requirement.

3. This means that if a company is able to demonstrate a commercial rationale for its use of proceeds, the Exchange will not examine availability of internal sources of funding or banking facilities. Applicants with healthy balance sheets and/or strong cash flows will not be at a disadvantage so long as their commercial rationale for listing has been sufficiently substantiated.

REASONS FOR REJECTION

4. A summary of the factors taken into consideration by the Exchange in rejecting the applications is set out below. Details as to the individual backgrounds of the rejected applications can be found at Appendix 1.

5. Suitability:

(i) *No commercial rationale for listing with respect to 16 applicants, and thus no genuine funding needs*
Applicants failed to substantiate the commercial basis for their proposed expansion plans. Moreover, the applicants' proposed use of listing proceeds were not commensurate with their previous business strategies and the deviation was not clearly explained.

(ii) *Insufficient support for valuation for three applicants*[1]
Where an applicant has failed to substantiate its commercial rationale for listing, the Exchange may also consider its valuation as part of the determination on suitability. These applicants failed to justify why the forecast price-earnings ("**P/E**") ratios were higher than those of industry peers, the basis on which the peers were chosen; and how such valuations were reasonable in light of the applicant's historical financial performance and profit forecast.

(iii) *Suitability of director/ person of substantial interest or controlling shareholder for one applicant*

6. Eligibility:

(i) *Failure to meet the minimum profit requirement after excluding non-ordinary course income for one applicant.*

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[1] This was not the sole basis for rejection for any of the applications.

Applicant backgrounds **Appendix 1**

Consumer Goods		
Company	**Background**	**Reasons for Rejection**
Company A (a GEM Applicant)	Company A sells lighting products and provides lighting support and installation services for building construction and building renovation projects in Hong Kong. It was raising funds to (i) acquire the supplier for a key component of emergency lighting products (the "**Supplier**"); (ii) acquire an additional production plant; and (iii) hire additional sales and marketing, and procurement of staff. Company A's proposed expansion did not make commercial sense given that (i) the Supplier was only able to produce key components for one type of product sold by Company A, and the revenue contribution during the trading record period from sales of this product was relatively low (10% - 20%); (ii) the annual cost savings expected from the additional plant was marginal (less than 1% of the Company's estimated net profit (after excluding the listing expenses) of the forecast for the forthcoming financial year) and (iii) the proposed hiring of additional staff, which would serve to almost double the number of employees in the relevant teams, was not justified based on the expected industry growth. As it failed to substantiate its use of proceeds, Company A was unable to demonstrate its commercial rationale for listing.	No commercial rationale.
Company B (a Main Board Applicant)	Company B is a motor vehicle dealer in Singapore. It proposed to use proceeds primarily for the acquisition of a new showroom to replace the current one, which would be twice as large as the current one. In light of the 5.9% decline in the automotive retail industry in Singapore from 2018 to 2022, Company B failed to substantiate there would be sufficient demand to support the expansion. As it failed to substantiate its use of proceeds, Company B was unable to demonstrate its commercial rationale for listing.	No commercial rationale; insufficient support for valuation.
Company C (a GEM Applicant)	Company C provides commercial and industrial kitchen equipment solutions in Singapore. Its shares are listed on the Singapore Stock Exchange and it sought a dual primary listing on GEM. It planned to use 90% of its listing proceeds to establish a new manufacturing facility in Malaysia to produce a certain product. In addition, a significant portion of the listing	No commercial rationale.

	proceeds would be used to pay the Company's listing expenses. As sales of that product had contributed to less than 5% of revenue during the trading record period, Company C did not adequately explain why it was pursuing an increase in production for such product. In addition, that product had a small market and low forecast industry growth. As such, it had not demonstrated a commercial rationale for listing.	
Company D (a GEM Applicant)	Company D operates three restaurants in Hong Kong. It planned to use a substantial portion of its listing proceeds to open two more restaurants in Hong Kong. Company D had only opened three restaurants during its long operating history of 12 years. It proposed to expand relatively aggressively by opening two restaurants despite the fact that its overall business performance from restaurant operations had remained relatively flat. Company D's expected valuation was in line with its comparables, but questionable given that (i) Company D recorded minimal growth from its restaurant operations during the trading record period while its comparables were significantly larger in terms of operating scale and revenue; and (ii) its consultancy income – which was taken into account in arriving at the valuation – was non-recurring. As it failed to substantiate its use of proceeds, Company D was unable to demonstrate its commercial rationale for listing.	No commercial rationale; insufficient support for valuation.

Consumer Services		
Company	**Background**	**Reasons for Rejection**
Company E (a Main Board Applicant)	Company E is a specialty chain store retailer selling apparel and houseware products in Malaysia. In addition to its retail sales income, the Company also generated rental income, which was determined to not be in the Company's "*ordinary and usual course of business*", as required under Main Board Rule 8.05(1)(a). After excluding such rental income and the relevant costs for its investment properties, the Company failed to comply with the minimum profit requirement.	Failure to meet the minimum profit requirement.

Industrials		
Company	**Background**	**Reasons for Rejection**
Company F (a Main Board Applicant)	Company F (i) manufactures and sells cold-rolled steel bars and steel wire products; (ii) processes and sells hot-rolled steel bars; and (iii) trades building materials and accessories in Malaysia. Company F planned to establish new production facilities for steel bars and wires despite the fact that (i) the Company had forecast its revenue to grow at 5% in FY19, significantly slower than revenue growth of 27.5% in 2018; and (ii) it was unable to substantiate the projected increase in demand of steel bars and wires for the construction demand it was trying to capture through the new production facilities, and the projected increase in demand is in conflict with the flattish industry outlook. Therefore, Company F failed to demonstrate the commercial rationale for its expansion plan, and therefore its listing. In addition, Company F's valuation did not sufficiently support the bases for its valuation, given the significant deceleration of Company F's profit forecast, and its proposed valuation in terms of P/E ratio was 80% above the industry peers' average P/E, as provided by the Company.	No commercial rationale; insufficient support for valuation.
Company G (a Main Board Applicant)	Company G supplies optical components in Singapore. Its proposed use of proceeds was to fund an expansion plan that included the purchase of additional machinery, recruitment of additional staff and acquisition of manufacturer suppliers. Company G was unable to justify its expansion plan as the proposal to acquire a supplier to reduce concentration risk was inconsistent with its disposal of the entire interest it held in a major supplier during the trading record period, and Company G was unable to explain the reasons for, and the circumstances leading to, such change in strategy. Additionally, Company G was unable to change manufacturer suppliers without prior approval from its customers. As such it was unclear why Company G wanted to pursue the proposed acquisition. Separately, Company G had made minimal additions to its plant and machinery and stated that this was due to a lack of financial resources. However, it was evident that Company G did have sufficient financial resources as it consistently generated operating cash flows during the trading record period, and it would only have taken six months for to generate sufficient funding for its proposed expansion plan. Company G also planned to increase its workforce by approximately 80% to devise new	No commercial rationale.

	testing plans and equipment calibrations for new equipment. However, it failed to explain why there was a need to significantly increase the number of new technicians, given that the new testing plans and equipment calibration should not require substantial ongoing effort once set up. Company G could not demonstrate its commercial rationale for listing as it failed to substantiate its use of proceeds.	
Company H (a Main Board Applicant)	Company H is a subcontractor for electrical and mechanical engineering services for building service systems in Hong Kong. It planned to use its listing proceeds to (i) procure systems to allow for direct supply to its customers, rather than having subcontractors supply the systems, which had been the practice during the trading record period; and (ii) to enhance its internal capabilities through the acquisition of equipment and hiring of additional staff. Company H failed to substantiate sufficient demand for its expansion plan – it did not have a strong contract backlog and there was a downward trend in the value of new projects obtained during the trading record period. Company H was also unable to substantiate the projected cost savings from procuring the systems itself as compared to its previous practice. As such, Company H could not demonstrate its commercial rationale for listing. In addition, Company H's valuation was not supported by its profit forecast, which projected a decline in adjusted net profit, and its forecast P/E ratio was higher than that of its peers.	No commercial rationale; insufficient support for valuation.
Company I (a Main Board Applicant)	Company I formulates, develops and supplies polymer materials used in the manufacturing of specialty cables in Southeast Asia. Company I planned to use its listing proceeds to pursue a strategic investment in an upstream compounder and establish an in-house product development centre. Company I had a stable supply of polymer compounds as it had long term relationships with upstream compounders and it is in a niche market with few players so customers and suppliers have relatively sticky relationships. During the trading record period, Company I's sales volume of the relevant product was low (less than 200 tonnes) relative to the production capacity of the proposed acquisition (6,000 tonnes) and was forecast to decline. Company I had operated for over 18 years without its own in-house development centre and could not substantiate the material benefits of having one. Therefore, Company I did not seem to have a commercial rationale to invest in an upstream	No commercial rationale.

	compounder and establish an in-house development centre, and therefore lacked commercial rationale for listing.	
Company J (a GEM Applicant)	Company J provides container depot management services and container maintenance services in Hong Kong and the PRC. Company J proposed use of its listing proceeds to replace machinery, recruit additional staff and establish a new depot in one city in the PRC, which would increase the total capacity of Company J's existing depot in this city by 100%. Company J was unable to demonstrate that there would be sufficient demand for the new depot, and also was able to fund its expansion plans through deployment of its then-available cash or bank-borrowings. It therefore could not demonstrate its commercial rationale for listing as it failed to substantiate its use of proceeds.	No commercial rationale.

Properties & Construction		
Company	**Background**	**Reasons for Rejection**
Company K (a Main Board Applicant)	Company K rents and sells construction equipment in Southeast Asia. It planned to use 22% of the listing proceeds for the construction of integrated premises in Singapore. Company K failed to justify its business need for the integrated premises in light of (i) the declining revenue contributed from the relevant business; and (ii) the scale of the new premises was expected to be 70% larger than the existing premises, even though Company K only planned to expand its rental fleet by 12-13%. In addition, the increase in aggregate depreciation and amortization resulting from the integrated premises would be higher than the existing rental expenses borne by the Company. Company K could not demonstrate its commercial rationale for listing as it failed to substantiate its use of proceeds.	No commercial rationale.
Company L (a Main Board Applicant)	Company L is a main contractor focusing on public civil engineering projects in Singapore. The Company's planned use of proceeds was to expand its operations through acquisition of new machinery and equipment, hiring of additional labour and payment for performance bonds. The Company's expansion plan was not supported by demand. During the trading record period, Company L's revenue grew at a CAGR of less than 3%, and its gross profit margin had remained relatively stable. The average project size of the contracts secured by the Company decreased	No commercial rationale.

	over the trading record period. In addition, Company L's backlog had decreased by around 40% over the course of the trading record period and it had not been awarded any new projects since the end of the latest financial year. As such, it did not demonstrate a commercial rationale for listing.	
Company M (a GEM Applicant)	Company M supplies fixtures and furniture, and decoration materials in Hong Kong. Its planned use of proceeds included establishment of a showroom, expansion into the PRC, and the payment of upfront costs for certain projects. Whilst Company M claimed that the new showroom would increase the sales of one product, it had previously recorded increasing sales of such product without the new showroom during the trading record period. Therefore, the claim that the benefits from the proposed establishment of a new showroom was unsubstantiated. Further, Company M's expansion plan into the PRC was not supported by any customer feasibility study. Company M also consistently generated cashflows and was unable to explain why it required funding for payment of upfront costs of projects that had already commenced. As such, Company M failed to demonstrate a commercial rationale for listing.	No commercial rationale.
Company N (a GEM Applicant)	Company N sells and leases out real estate in Japan and planned to use its listing proceeds to expand its real estate portfolio. As real estate investment is capital intensive, Company N provided that the listing would significantly enhance its capital base and financial position. However, given that its net listing proceeds represented only 4% increase of the book value of Company N's property portfolio, Company N's claim that the listing would substantially enhance its capital base and financial position was unsubstantiated and Company N was unable to sufficiently demonstrate its commercial rationale for listing.	No commercial rationale.
Company O (a Main Board Applicant)	Company O provides property management services in Macau. It planned to use 41% of its listing proceeds to renovate certain existing car parks (the "**Renovation**"). Company O did not provide a reasonable explanation for the need for the Renovation as the relevant concession agreements did not require Company O to undertake the Renovation and none of the tenders it had won during the trading record period required any Renovation. Further, Company O was able to increase parking tariffs without the Renovation. As such, it did not appear that the Renovation would materially benefit Company O by increasing its	No commercial rationale.

	chances of renewing its concession agreements, applying for parking tariff increments or increasing its overall competitiveness. Thus, Company O was unable to demonstrate a commercial rationale for the listing.	
Company P (a Main Board Applicant)	Company P is a contractor providing fitting-out and alteration and addition services in Macau. The Company proposed to use 60% of its listing proceeds to fund the acquisition of a mechanical and electrical ("**M&E**") works contractor (the "**Strategic Acquisition**") as well as acquire additional machinery and equipment. The Strategic Acquisition involved a change in business model and strategy from Company P's previous role as a project manager to taking up the role of an M&E contractor – a role that was labour intensive, and which was not Company P's expertise. Company P could not demonstrate how the benefits of the Strategic Acquisition outweighed the costs of outsourcing, or internally developing a stand-alone M&E practice. In addition, Company P did not substantiate the need to acquire machinery and equipment as utilization rates of the same type of machinery it already owned was low and it historically subcontracted work which required such machinery/equipment and required its subcontractors to provide them. Based on the above, Company P was unable to demonstrate a commercial rationale for its listing.	No commercial rationale.
Company Q (a Main Board Applicant)	Company Q (i) provides pavement supply and lay services, largely for infrastructure projects; and (ii) sells asphalt premix products in Singapore. Company Q planned to use about 25% of the listing proceeds to invest in a new asphalt plant and to purchase new machinery and equipment; and 65% of the listing proceeds to repay bank loans. Company Q commenced operations shortly before its trading record period and hence, had a short operating history. During the trading record period, a substantial portion of Company Q's revenue was derived from one large-scale non-recurring project, which was approaching completion. Company Q had not secured other contracts of similar size after the trading record period. Further, due to a slowdown in the industry, there were fewer projects being tendered and the value of new projects secured after the trading record period had been steadily decreasing.	No commercial rationale.

	As a result, Company Q did not expect its revenue and profit to grow in the near future due to the limited visibility in Company Q's project pipeline. Given the uncertainty over Company Q's business prospects, as these were dependent upon whether Company Q would win a potential project, Company Q was unable to demonstrate a commercial rationale for listing as it failed to explain its need for capital for business expansion.	
Company R (a Main Board Applicant)	Company R develops and sells residential properties in the PRC. During the trading record period, Company R created a number of short-term inter-company loans on which it subsequently defaulted. The inter-company lender then assigned such defaulted loans to a distressed asset lender ("**Distressed Asset Lender**") with no discount on the principle. The Distressed Asset Lender could only purchase distressed debt (i.e., for which default has already occurred). The financing arrangements with the Distressed Asset Lender accounted for substantially all of Company R's borrowings during the trading record period. Company R explained that when it first commenced operations, it was only able to obtain financing from the Distressed Asset Lender, but failed to explain why it continued to turn to the Distressed Asset Lender after its business was more established and it could obtain financing from other financial institutions. As borrowing from the latter did not require an associated default, there would be no adverse impact to Company R's credit in that respect. Company R could not demonstrate that the Distressed Asset Lender provided better terms than other commercial lenders; nor that the Distressed Asset Lender was the only available lender. In fact, loans from the Distressed Asset Lender, incurred higher interest rates and additional financial advisory fees. Company R could not provide an explanation for the commercial rationale of these financing arrangements, which appeared to lack discernible benefit to the Company and seemed engineered to allow the Distressed Asset Lender to acquire the debts at the expense of Company R. Thus, Company R could not demonstrate its commercial rationale for listing. These issues also gave rise to concerns on the suitability of the directors and whether they had acted in the best interests of Company R and its shareholders when seeking financing for the Company.	No commercial rationale; directors' suitability.

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