HKEx LISTING DECISION

HKEx-LD92-2015 (published in June 2015)

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

Summary	
Parties	Company A to Company P – Main Board and GEM listing applicants whose applications were rejected in 2013 and 2014
Issue	To provide guidance on why the Exchange rejected certain listing applications
Listing Rules	Main Board Rules 2.06 and Chapter 8 GEM Rules 2.09 and Chapter 11
Decision	The Exchange rejected the applications.

PURPOSE

1. This Listing Decision in the Appendix sets out the reasons why the Exchange rejected certain listing applications from 1 January 2013 to 31 December 2014.

APPLICABLE LISTING RULES

2. Chapter 8 of the Main Board Rules and Chapter 11 of the GEM Rules set out detailed eligibility requirements which a new applicant must fulfill and states that both the applicant and its business must, in the opinion of the Exchange, be suitable for listing.

3. Main Board Rule 2.06 and GEM Rule 2.09 state that suitability for listing depends on many factors. Applicants for listing should appreciate that compliance with Listing Rules may not itself ensure an applicant's suitability for listing.

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<table>
<tr><th colspan="2">Rejection cases in 2013</th></tr>
<tr><th>Company</th><th>Rejection reasons</th></tr>
<tr><td>Company A

(a Main Board Applicant)</td><td>Company A was a mining company. Its principal asset was at an exploration stage of a mineral project ("Project") and had not generated any profit.

Company A's first listing application was not approved due to, concerns on (i) its insufficient history and experience in bringing any mineral project to a production stage; and (ii) the early stage of the development of the Project.

Company A completed a pre-feasibility study for the Project and re-submitted its listing application two years after its first application. In the renewed application, Company A had delayed most of its original development plan by more than two years and substantially revised the economic estimates of its Project. As a result, the total capital cost for the Project increased over 100%, with the estimated mine life reduced from 17 years to nine years with a payback period of seven years and an internal rate of return of 6.7%. In addition, Company A only had limited cash balance and had no banking facility which it expected would only be obtained when the Project had completed a bankable feasibility study.

<u>Inability to meet the Main Board Rules 8.05(1) and 18.04</u>

The application was rejected because Company A was not qualified for a waiver under Main Board Rule 18.04 as it had not demonstrated that its principal assets had a clear path to commercial production based on the following observations:

(i) there was high risk concerning the project payback period as the Project was highly sensitive to variations in commodity prices, operating costs, the estimated lengthy payback period and low internal rate of return;

(ii) the proposed funding plan was overly ambitious. The funds to be raised in the proposed offering was insufficient to bring the Project to a stage of commercial production and further fund raising exercises of a considerable scale would be required post-listing; and

(iii) given the outstanding issue regarding the aboriginal rights which the provincial government would need to consult the indigenous groups on before approving or rejecting the Project, there was a high degree of uncertainty as to whether Company A was able to obtain the necessary mining permits and licenses to commence commercial production.</td></tr>
<tr><td>Company B

(a Main Board Applicant)</td><td>Company B was engaged in money lending business.

The application was rejected due to the following observations:

<u>Non-compliances</u>

(i) Company B had not rectified all its non-compliances with local money lending laws before it applied to renew its money lender licence which was still pending.</td></tr>
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<tr><td></td><td>It was therefore uncertain as to whether it would be able to renew its money lender licence;

(ii) there was insufficient information on whether and how the newly implemented internal control measures were effective to prevent future breaches;

<u>Reliance on controlling shareholders</u>

(iii) during the track record period Company B had relied on its controlling shareholders for financial assistances, namely: (a) financing its operation; (b) referring customers with whom Company B had charged higher interest rates; and (c) undertaking to acquire the collaterals for defaulted loans at a consideration no less than the outstanding loans and interests;

(iv) Company B’s track record results did not reflect its true operating results given the undertaking by its controlling shareholders. Further, Company B could only secure financing at a high interest rate from a private lender, as opposed to a commercial bank; and

<u>Directors’ suitability</u>

(v) there were concerns on Company B’s directors’ suitability under Main Board Rules 3.08 and 3.09 - two out of six executive directors (“EDs”) had been involved in non-compliances with the Securities and Futures Ordinance (Cap. 571). Further, five out of six EDs were also directors or senior management of other listed companies and it was questionable whether they would be able to devote sufficient time to manage Company B’s business.</td></tr>
<tr><td>Company C

(a Main Board Applicant)</td><td>Company C was engaged in wholesaling and retailing of goods.

<u>Director’s suitability</u>

The application was rejected due to concerns on director’s suitability under Main Board Rules 3.08 and 3.09 - a director who was also a controlling shareholder had made payments to an ex-government official who was then convicted of receiving bribes by a PRC court. Although no charges had been laid against the director, he was considered unsuitable to be a director of a listed company given that the sponsor had not demonstrated to the Exchange’s satisfaction that the director was able to meet the character and integrity standard requirements under the Main Board Rules based on the submitted facts and circumstances. Even if the director resigned from Company C, he would continue to exert significant influence on Company C’s operation and management since one of the four EDs was his brother, and two out of the three senior management members had worked with the director for more than 10 years.</td></tr>
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Company D (a GEM Applicant)	Company D was engaged in a regulated business. The application was rejected due to the following observations: *Non-compliances* (i) Company D breached the local regulations governing the operation of its business. Company D could not meet the minimum cash flow requirement under GEM Rule 11.12A(1) if the cash flow generated from the non-compliance income was excluded; and *Unsustainable business model* (ii) there were grave concerns on sustainability of business in light of its existing financial outlook: (a) heavy indebtedness with minimal cash at bank and unutilised banking facilities; (b) uncertainty as to whether Company D could obtain independent financing after using up the unutilised banking facilities and ceasing its reliance on its controlling shareholders to guarantee its borrowings after listing; (c) significant trade receivables, and deteriorating and long receivable turnover days; (d) minimal cash and cash equivalents due to cash flow mismatch between settlement of expenses and the long period taken before Company D would be able to bill its major customers; and (e) high concentration of customers which raised doubts as to Company D's bargaining powers with its customers. The combination of these factors raised concerns as to whether Company D was able to continue its business on a going concern basis. Further, there was insufficient disclosure on the competitive landscape to enable investors to understand the prospect of the industry.
Company E (a GEM Applicant)	Company E was a software solution provider. The application was rejected due to the following observations: *Non-compliances* (i) during the track record period, Company E's major subsidiary had been involved in a number of non-compliances which included, among other things, tax evasion; and *Directors' suitability and inability to meet the management continuity requirement* (ii) it was not demonstrated to the Exchange that Company E's directors did not have substantial involvement in the non-compliances. Given that the Exchange considers that tax evasion is a serious matter and the amount involved was material (over 35% of Company E's net assets), the Exchange had serious concerns on the suitability of the directors under GEM Rules 5.01 and 5.02 in overseeing the operation of its subsidiary. As one of the EDs who had been personally involved in the non-compliances was the most relevant person responsible for Company E's operation and management, his resignation from directorship would render Company E unable to satisfy the management

	continuity requirement under GEM Rule 11.12A(3).
Company F (a GEM Applicant)	Company F was engaged in the trading of commodities. The application was rejected due to the following observations: *Reliance on a major customer* (i) Company F had a short business relationship with the single largest customer, contributing to more than 20%, 60% and 75% of Company F's total revenue during the track record period; and reliance on this customer was not demonstrated to be mutual and complementary as there were other suppliers like Company F located at the same area where the customer was based; (ii) the credit period granted to the single largest customer was substantially longer than other customers and therefore it was not demonstrated to be on normal commercial terms, and this had an adverse impact on Company F's working capital sufficiency; and (iii) there was no proven record on Company F's ability to find new customers to reduce reliance on the single largest customer.

Rejection cases in 2014	
Company	**Rejection reasons**
Company G (a Main Board Applicant)	Company G was a mining company in the PRC. Company G had only one mine. The application was rejected because Company G was not qualified for a waiver under Main Board Rule 18.04 (i.e. a mineral company may still apply to be listed even if it is unable to satisfy the eligibility requirement under Main Board Rule 8.05) as it had not demonstrated a path to profitability given that the mine was already in commercial production. Accordingly, Company G failed to satisfy the eligibility requirement of Main Board Rule 8.05: *<u>Inability to meet the Main Board Rule 8.05</u>* (i) Company G's commercial production was suspended by the competent authority at the time of listing application submission due to serious accidents in other mines in the region. Its production had also been previously suspended during the track record period (i.e. 16 out of 36 months). Hence, there was a high degree of uncertainty as to the resumption of its normal operations. Even if Company G could resume its operation, it had failed to address the risks that the provincial government might suspend its operations again as it had in the past; (ii) as Company G had only one mine, any mandatory suspension because of accidents in its mine or other mines in the region would adversely affect its operations and financial position; and (iii) Company G had plans to improve its profitability by increasing the annual production capacity but the funds to be raised in the proposed offering were insufficient to finance its expansion plan. Hence, there was a high degree of uncertainty that its expansion plan could be completed.
Company H (a Main Board Applicant)	Company H's application involved a very substantial acquisition of two companies ("**Target Groups**") which would make up Company H's business upon listing. The Target Groups had been held by different controlling shareholders and managed by different individuals during the track record period. The application was rejected due to following observations: *<u>Inability to meet the Main Board Rule 8.05(1)(c)</u>* (i) Company H failed to demonstrate compliance with the ownership continuity and control requirement during the most recent financial year under Main Board Rule 8.05(1)(c) as (a) there were and would be changes in the legal ownership and control in the Target Groups during the relevant period and upon completion of the very substantial acquisition; and (b) there was no conclusive evidence that Company H's controlling shareholder had been exercising control over the Target Groups during the relevant period through cooperation with the controlling shareholders of the Target Groups; and (ii) Company H was not able to satisfy the profit requirement under Main Board Rule 8.05(1)(a). The Target Groups were able to comply with Main Board

Rejection cases in 2014	
Company	**Rejection reasons**
	Rule 8.05(1)(a) only by aggregating their net profits during the track record period. However, given that (a) the Target Groups only had one common senior management member and did not share any support function during the track record period; and (b) the financial statements of the Target Groups during the track record period were presented in two separate accountants' reports, there was no information to show that the Target Groups had operated and managed as a single group during the track record period to justify the aggregation. Company H's reporting accountant stated that the Target Groups' financial information could not be presented in one accountant's report because there was no common control. The Exchange does not accept the aggregating of the results of separate groups of companies presented in separate accountants' reports for the purpose of Main Board Rule 8.05(1)(a). This is to prevent packaging of businesses where acquisitions are made by a listing applicant solely for the purpose of satisfying the listing requirements.
Company I (a Main Board Applicant)	Company I applied for a transfer of listing from GEM to Main Board. *<u>Inability to meet the Main Board Rule 9A.02(2)</u>* The application was rejected because Company I did not comply with Main Board Rule 9A.02(2), under which an issuer may apply for a transfer of listing of its securities from GEM to the Main Board if, among other things, it complies with GEM Rule 18.03 in sending the issuer's annual report to its shareholders in respect of its first full financial year's results commencing after the date of its initial listing. However, Company I's first full financial year had not ended at the time of its application, and hence its first full financial year's annual report had not been prepared. Company I was listed in January, [*year T-1*] and submitted its application to transfer to the Main Board in May, [*year T*]. As Company I's financial year end date was 31 December, its first full financial year would have ended on 31 December, [*year T*].
Company J (a Main Board Applicant)	Company J was engaged in money lending business. The application was rejected due to the following observations: *<u>Non compliance</u>* (i) there was systemic failure to conduct Company J's business in a compliant manner with regard to certain lending restrictions throughout the track record period and up to the latest practicable date; (ii) there was no compelling reason given why Company J appeared to be the only company given the preferential treatment that it would subject to a more relaxing lending restriction after listing by the local authority and whether this preferential treatment complied with PRC law;

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<tr><td></td><td><u>Directors’ suitability</u>

(iii) concerns on directors’ suitability under Main Board Rules 3.08 and 3.09 – in light of the systemic non-compliances practices in (i) above, the directors had not demonstrated they had the integrity and standard of competence and a level of skill, care and diligence that commensurate with their positions as directors of a listed company; and

<u>Inability to meet the Main Board Rule 8.05(1)</u>

(iv) Company J could not meet the profit requirement under Main Board Rule 8.05(1)(a) if the profits generated from the non-compliant business during the track record period were excluded.

A demonstration period of 18 months (from the date of Company J’s latest audited accounts) was imposed on Company J to demonstrate its ability to operate satisfactorily with the amended lending restrictions.</td></tr>
<tr><td>Company K

(a GEM Applicant)</td><td>Company K was engaged in property leasing business.

<u>Non-compliances</u>

The application was rejected due to non-compliances with local building safety regulations with respect to the majority of Company K’s properties. There was uncertainty as to when the building orders against these properties would be released before listing which may have an impact on its business.</td></tr>
<tr><td>Company L

(a GEM Applicant)</td><td>Company L was engaged in gaming-related business which required a licence from the competent authority.

The application was rejected due to the following observations:

<u>Unsustainable business model</u>

There were concerns over Company L’s business sustainability:

(i) Reliance on one head operator and a few business partners

(a) the heavy reliance on one head operator for income based on spending of customers introduced by Company L at the head operator’s venue. Further, the annual licence renewal was dependent on the continuation of the cooperation agreement with the head operator. Hence, the reliance on the head operator was not mutual given the competition among Company L’s industry peers was keen; and

(b) the heavy reliance on a few business partners to bring in customers whose credits were partly guaranteed by these business partners;</td></tr>
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<tr><td></td><td>(ii) Concerns on risk control - Company L earned interest income for providing loans to its customers, part of which were guaranteed by the business partners. There were concerns over Company L's credit risk control measures for ascertaining the creditworthiness of its business partners and customers. The measures were considered to be insufficient and therefore exposed Company L to high credit risk; and

(iii) Deteriorating financial performance - there was a decrease in Company L's net profit margin during the track record period.</td></tr>
<tr><td>Company M

(a GEM Applicant)</td><td>Company M was engaged in a regulated business.

<u>Sponsor's non-independence</u>

The application was rejected because Company M's sponsor was not independent under GEM Rule 6A.07. The sponsor group had subscribed for Company M's pre-IPO convertible bonds. This was not identified until the application was submitted.</td></tr>
<tr><td>Company N

(a GEM Applicant)</td><td>Company N was a manufacturer and seller of consumer products.

The application was rejected due to the following observations:

<u>Inability to meet the GEM Rule 11.12A</u>

(i) Company N's plant in the PRC which was owned by the controlling shareholder was significant to its business but it had title defect and therefore it was not compliant with GEM Rule 11.19 which requires any new applicant not being a property company or an infrastructure company, where its PRC property is otherwise significant to its activities, to have a long-term title certificate to its property;

(ii) Company N was not able to meet the minimum cash flow requirement under GEM Rule 11.12A(1) if, among other things, an one-off income, the waived directors' emoluments and the waived rental of the plant were excluded;

<u>Unsustainable business model</u>

(iii) concerns over the sustainability of Company N's business in light of (a) the unpredictable non-recurring nature of sales as there had been less than ten transactions during the track record period; (b) the deteriorating financial performance - decreasing net profit and net profit margin during the track record period which Company N failed to explain the reasons for such deterioration; and (c) insufficient disclosure of Company N's future plans and prospects in light of the austerity measures by the local government which directly affect Company N's targeted customers; and</td></tr>
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Rejection cases in 2014	
Company	**Rejection reasons**
	Directors' suitability under GEM Rule 5.02 (iv) four out of five EDs did not have relevant experience in the business before joining Company N and all of them had joined Company N for less than two years at the time of application.
Company O (a GEM Applicant)	Company O was engaged in property sub-leasing business. The application was rejected due to the following observations: *Concerns on the business model* (i) there were concerns on Company O's business model due to the following: (a) as the owner of Company O's leased properties had not obtained the relevant property ownership certificates, it was unclear whether Company O had entered into the lease agreement at a lower than market rent compared to leasing from a property owner with a similar size in the same area but with proper property ownership certificates. It was therefore doubtful whether Company O's track record results would be affected by the lack of property ownership certificates and therefore the results might not be representative of its future performance; (b) it was unusual that Company O was able to terminate the master lease agreement with a property owner without any penalty during the track record period and there was no compelling evidence that such practice was an industry norm; and (c) there were insufficient market comparables to assess the sustainability of Company O's business model; and *Excess competition with controlling shareholder* (ii) the competition between Company O and its controlling shareholder was considered extreme. Although competition between an applicant and its controlling shareholder is not a bar to listing, the Exchange expects effective corporate governance measures to regulate the process of tenant sourcing for the properties owned by the controlling shareholder and those of Company O, which was not evident in this case.
Company P (a GEM Applicant)	Company P was a hotel developer and owner. The application was rejected due to the following observations: *Unsustainable business model* (i) reliance on government discretionary interest subsidies to maintain sufficient cash to meet its debt payments;

Rejection cases in 2014	
Company	**Rejection reasons**
	(ii) a loss-making history which would likely continue in the foreseeable future and would be further aggravated by its proposed business expansion plans; (iii) there was no clear path to profitability for its properties as Company P estimated a long break-even and payback period of over 15 years; and *Deteriorating financial performance* (iv) operating performance and financial results were deteriorating due to travel restriction in the area where Company P operated its business. It was unclear how Company P's marketing strategy and proposed expansion plan could help alleviate its deteriorating performance. Further, Company P did not provide a good basis for its upward trend forecast.