

## **HKEX~~x~~ LISTING DECISION**

**HKEX~~x~~-LD91-2015 (~~published in June 2015~~) (Updated in May 2016)**

**(Updated due to withdrawal of guidance letters superseded by HKEX-GL86-16)**

<b>Summary</b>	
<b>Parties</b>	Company A to Company L – Main Board and GEM listing applicants whose applications were submitted after the commencement of the new sponsor regulation and returned by the Exchange
<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.

### **Purpose**

1. This Listing Decision sets out the reasons why the Exchange returned listing applications from 1 October 2013 to 31 December 2014 after commencement of the new sponsor regulation.

### **APPLICABLE RULES, REGULATIONS AND PRINCIPLES**

2. With effect from 1 October 2013 when the new sponsor regime was introduced, Main Board Rule 9.03(3) was amended to require an applicant to submit a listing application form, an Application Proof and all other relevant documents under Main Board Rule 9.10A(1), and the information in these documents must be substantially complete except in relation to information that by its nature can only be finalised and incorporated at a later date. If the Exchange decides this information is not substantially complete, the Exchange will not continue to review any documents relating to the application. All documents, including the Form A1 (Form 5A for GEM cases) (except for the retention of a copy of these documents for the Exchange's record) submitted to the Exchange will be returned to the sponsor (GEM Rule 12.09(1) and 12.09(2)).

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## Listing Applications received from 1 October 2013 to 31 December 2014

**Company A (a GEM Applicant)**

1. Company A was engaged in the sale of consumer products.
2. There was insufficient disclosure on the business model and insufficient information for the Exchange to assess the impact of the disputes and complaints relating to Company A's products, the suitability of directors, the sustainability of business and whether the management continuity requirement could be met.

Insufficient disclosure on business model

3. The disclosure in the Application Proof on the sales channels and customers was incomplete and did not follow the relevant provisions of Guidance Letter HKE~~XX~~-GL36-12, HKE~~XX~~-GL50-13 and Listing Decision HKE~~XX~~-LD107-1.
4. The disclosure in the Application Proof on the raw material and purchases was incomplete and did not follow the relevant provisions of Guidance Letter HKE~~XX~~-GL50-13.
5. The Application Proof lacked disclosure on the product life cycle and shelf life for each product/ product line. The disclosure did not support Company A's claim that all of its products were self-developed.

Insufficient information to assess impact of disputes, complaints and negative comments

6. The disclosure in the Application Proof did not follow the relevant provisions of Guidance Letters HKE~~XX~~-GL30-12 and HKE~~XX~~-GL50-13 on intellectual property rights and it lacked disclosure of the relevant risk factors to enable the Exchange to make assessment of how the trademark dispute impacted Company A's business.
7. The Application Proof lacked disclosure on the directors' basis for concluding that the negative public comments on certain of Company A's products were unsubstantiated.

Insufficient information to assess suitability of directors under GEM Rules 5.01 and 5.02

8. A director was involved in personal bankruptcy and two directors were involved in winding up of companies of which they had been directors. One of the directors was also under investigation by the relevant authority for suspected breach of ethical conduct. However, the Application Proof did not have information of these incidents.

Insufficient information to assess sustainability of business

9. There was significant deterioration in the financial results. The cash flow from operating activities decreased by about 50% in the stub period, as compared to the previous corresponding period. There was no explanation on the substantial

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deterioration of the financial results during the track record period and the expected substantial improvement in the forecast period.

10. The Application Proof lacked clear disclosure of the above in the “Summary” section with reference to the relevant provisions of Guidance Letters HKE~~X~~-GL27-12<sup>1</sup> and HKE~~X~~-GL41-12, and a relevant risk factor. (Updated in May 2016)

**Company B (a Main Board Applicant)**

11. Company B was a service provider in Hong Kong.
12. The information submitted was not substantially complete because the financial information included in the Application Proof did not follow Guidance Letter HKE~~X~~-GL6-09A.
13. Company B’s trading record period comprised [year T-2], [year T-1] and [year T]. As set out in our Guidance Letter HKE~~X~~-GL6-09A, the Exchange would accept a listing application with financial information for the first two financial years and a stub period of at least nine months for the third financial year if the applicant files, among other things, an application within two calendar months after the end of its trading record period. The financial information in the Application Proof only covered the period [year T-3], [year T-2] and [year T-1] and stub period of six months of [year T].
14. Further, Company B filed the application *before the end* of the trading record period. According to Guidance Letter HKE~~X~~-GL6-09A, the earliest time Company B could file its application is *after the end* of its three-year trading record period which it would be using for the purpose of its listing.

**Company C (a Main Board Applicant)**

15. Company C was a manufacturer in the PRC.
16. The Application Proof and documents submitted together with Company C’s application form were not substantially complete as substantial details of its non-compliant bill financing activities were not disclosed. This prevented the Exchange from assessing whether Company C was suitable for listing, given that the non-compliant transactions were material.

**Company D (a Main Board Applicant)**

17. Company D provided hygiene care products in the PRC.
18. There was insufficient disclosure in Company D’s Application Proof on the business model and material non-compliances.

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

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Business model

19. The information in the Application Proof was skewed towards a small segment of its business and therefore the Exchange considered that the description of Company D's business to be inadequate, unclear and potentially misleading to investors.
20. The Application Proof did not clearly and sufficiently highlight Company D's market position in respect of its export and domestic sales, ODM/ OEM and own-branded sales, respectively.
21. Company D had two distinct business segments, but the Application Proof did not disclose any segment analysis on gross profit and gross profit margin, major product category, and pricing policy.

Non-compliance

22. Company D received excessive tax rebates due to its incorrect filing of goods exported during the track record period. It was under investigation by the relevant tax authority. However, the Application Proof lacked details of this non-compliance in accordance with the relevant provisions of Guidance Letter HKE~~X~~-GL63-13.

Distributors

23. Company D sold its products through distributors who then resold them to sub-distributors and/ or ultimate retailers. However, the Application Proof did not disclose material information on the distributorship business model as required by the relevant provisions of Guidance Letter HKE~~X~~-GL36-12.

Others

24. There was insufficient information in the Application Proof on Company D's hedging measures it used to monitor foreign exchange risks which was critical to its business. The Application Proof did not provide sufficient information on Company D's substantial reliance on its major customer, including (i) how it would reduce its reliance on the major customer or demonstrate it was not extreme as required under Listing Decision HKE~~X~~-LD107-1; (ii) material details of the long term agreement with such major customer as required under the relevant provisions of Guidance Letter HKE~~X~~-LD50-13<sup>2</sup>; and (iii) the operational and financial impact of the major customer's proposed business plan, in particular, during the aforementioned contract period with the major customer. Further, there was no clear justification disclosed for the use of proceeds on a business segment which showed a declining trend in terms of revenue during the track record period.  
**(Updated in May 2016)**

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<sup>2</sup> Withdrawn in May 2016. Superseded by Section E of Appendix 1 in HKEX-GL86-16.

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**Company E (a Main Board Applicant)**

25. Company E offered financial services in the PRC.
26. The Application Proof and the related documents submitted together with Company E's application form failed to disclose material guaranteed transactions entered into by the connected persons, borrowers and Company E, and the circumstances leading to the entering into these transactions. The details of these were only disclosed in the revised listing document. This material information should have been included in the Application Proof. The application was returned after the response to the Exchange's first comment letter which disclosed the material connected transactions for the first time.

**Company F (a GEM Applicant)**

27. Company F was a property company in the PRC. There was insufficient information for the Exchange to assess whether the competition with and reliance on the controlling shareholder had been properly addressed, the impact of an arrangement with the controlling shareholder and the implications of a leased property with defective title.

**Insufficient information to assess the competition with and reliance on its controlling shareholder**

28. Upon listing, the controlling shareholder would have interests in other properties and property-related businesses which would not be included in listing group.
29. The Application Proof lacked (i) sufficient information for the Exchange and investors to assess the level of current and potential competition with the controlling shareholder (GEM Rule 11.04) and (ii) details of the properties operated by Company F and the controlling shareholder, how the non-competition undertaking given by the controlling shareholder would operate, and what were the measures to manage the current and potential competition between Company F and the controlling shareholder in area where the non-competition undertaking would not apply.

**Insufficient disclosure on the impact of an arrangement with the controlling shareholder after listing**

30. Some services were provided by Company F to the controlling shareholder without any charges during the track record period, whereas Company F would charge for these services after listing. The change in Company F's business model was not well articulated in the Application Proof and the Exchange had concerns on this arrangement. The Application Proof did not provide investors with any information to indicate Company F's financial position if it charged its controlling shareholder a fee in the normal and usual course of business for these services, and the basis of the annual fee after listing. The Exchange considered that the information included in the Application Proof was not substantially complete to enable a reasonable investor to make a fully-informed investment decision.

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Insufficient information to assess the implications of the leased property with a defective title

31. Company F had a significant project with a property owner for sub-leasing the owner's properties. Some properties did not have property titles. There was no information on why the property owner did not obtain proper titles to the relevant properties, whether the rent paid to the property owner would have been more than it was if the relevant properties had proper titles, and hence, whether Company F's financial performance would have been significantly affected.

Company G (a Main Board Applicant)

32. Company G's application involved a very substantial acquisition of two companies ("Target Groups").
33. The Exchange considered that the information disclosed in the Application Proof was not substantially complete, since the Application Proof failed to include such material information as (i) conviction of the controlling shareholder; (ii) sufficient information to demonstrate how ownership continuity requirement was satisfied; (iii) sufficient information to assess compliance with the minimum profit requirement; and (iv) updated liquidity disclosure.

Mr. X's conviction

34. Mr. X was disclosed as Company G's controlling shareholder but had no shareholding of the Target Groups. The Application Proof disclosed that the controlling shareholders of the Target Groups (Mr. X's relatives) followed the wishes of Mr. X in respect of the management and development of the Target Groups, and in exercising their rights as shareholders of the respective Target Groups. Given Mr. X's relationship with Company G and the Target Groups, Mr. X was considered to be a person with substantial influence.
35. The Exchange noted from newspaper articles and the website of a local court that Mr. X was found guilty of violating certain laws and regulations before the track record period. Mr. X received a jail sentence and was prohibited from operating certain business. Although the decision was under appeal at the relevant time, there was no information regarding Mr. X's conviction disclosed in the Application Proof or other related documents.

Rule 8.05(1)(c) – ownership continuity

36. There was insufficient information to demonstrate Company G satisfied the ownership continuity requirement during the last year of the track record period. There was no information on how (i) the controlling shareholders of the Target Groups followed the wishes of Mr. X in exercising their rights as shareholders of the Target Groups; and (ii) Mr. X exercised control over the Target Groups through cooperation with the controlling shareholders of the Target Groups.

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Insufficient information to assess compliance with the minimum profit requirement under Rule 8.05(1)(a)

37. The two Target Groups were two separate groups with different shareholdings and their historical financial information were included in two separate accountants' reports in the Application Proof. Although the sponsor had argued that the Target Groups aggregated net profits would be able to satisfy Rule 8.05(1)(a), there was no information in the Application Proof to show that the Target Groups operated and managed as a single group during the track record period.

Liquidity disclosure

38. According to the relevant provisions of the Guidance Letter HKE~~X~~-GL38-12, the liquidity disclosure in an Application Proof should be as of a date no more than two calendar months before the date of the Application Proof. The liquidity disclosure of the Target Groups in the Application Proof was more than two calendar months before the date of the Application Proof.

**Company H (a Main Board Applicant)**

39. Company H was a securities firm based in the PRC. The Application Proof did not include the required liquidity disclosure, and there was uncertainty as to Company H's issuance of corporate bonds.

Liquidity disclosure

40. Company H's liquidity disclosure was more than two calendar months old before the date of the Application Proof which was contrary to the relevant requirements of Guidance Letter HKE~~X~~-GL38-12.

Insufficient disclosure on proposed issuance of corporate bonds

41. Company H submitted in its pre-IPO enquiry that it planned to issue (over 35% of its net asset value) corporate bonds in the PRC to fund its working capital requirements, and that the controlling shareholder would provide a guarantee for the corporate bonds which would not be released before Company H's listing. However, no information on issuance of corporate bonds was disclosed in the Application Proof such as the terms and conditions, the amount to be issued etc., the cash flow forecast memorandum took into account the cash inflow from the issuance of the corporate bonds to demonstrate, among other things, sufficiency of working capital.
42. It would appear that if Company H had no intention to issue the corporate bonds, the disclosure on its sufficiency on working capital which was based on the issuance of the corporate bonds would not be accurate. If Company H intended to issue the corporate bonds, material information was not included in the Application Proof on the issue. In either case, the Application Proof or the cash flow forecast memorandum was not substantially complete.

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**Company I (a GEM Applicant)**

43. Company I was a service provider in the PRC. The Application Proof did not include the information as required by the 3-day checklist (see paragraph 44 for details). Further, the sponsor did not provide the confirmation requested by the Exchange in previous application to address cashflow concerns which was not reflected in the Application Proof.

**Liquidity and other disclosure**

44. The liquidity disclosure in the Application Proof was more than two calendar months before the date of the Application Proof, which was not in compliance with the requirement of the relevant provisions of Guidance Letter HKE~~XX~~-GL38-12. In addition, the cover of the Application Proof did not include the sponsor's name and the company secretary's address as required in the 3-day checklist (Note: this 3-day checklist is no longer in use as of 1 October 2014).

**Insufficient information to assess compliance with minimum cash flow requirement under GEM Rule 11.12(A)**

45. Company I went through a reorganisation under which certain business (the "**Excluded Business**") was transferred to the controlling shareholder during the track record period. As such, the accountant's report included the financial information of the Excluded Business before the completion of the reorganisation. Given the cash flow of Company I's business was aggregated with that of the Excluded Business, there was no information to show Company I's cashflow independently and it was unclear whether Company I could meet the minimum cash flow requirement under GEM Rule 11.12A(1) if the contribution from the Excluded Business was excluded.

**Lacking sufficient disclosure on the business under GEM Rule 2.06(2)**

46. As Company I's accountant's report contained the financial information of the Excluded Business before the completion of the reorganisation, the Application Proof did not fully reflect the performance of Company I. Given that Company I's financial information before and after the exclusion of the Excluded Business were not comparable, additional disclosure should have been included to enable investors to assess the performance of Company I. The sponsor also failed to provide a confirmation previously requested by the Exchange to address cashflow concerns (see Guidance Letter HKE~~XX~~-GL56-13).

**Company J (a GEM Applicant)**

47. Company J was a service provider with operations in Hong Kong and the PRC. The information submitted was not substantially complete because the financial information included in the Application Proof did not follow the relevant provisions of Guidance Letter HKE~~XX~~-GL6-09A.
48. The financial information in the Application Proof covered the two financial years T-2 and T-1 and a stub period of seven months of year T. Based on Company J's



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proposed listing timetable of which the listing date was three months after year T, Company J's trading record period in the Application Proof should cover the two financial years T-1 and T. As set out in the relevant provisions of Guidance Letter HKE~~XX~~-GL6-09A, the Exchange would accept an application with financial information for the first financial year and for a stub period of at least nine months for the second financial year if an applicant files, among other things, an application within two calendar months after the end of its trading record period.

**Company K (a GEM Applicant)**

49. Company K was a manufacturer in the PRC. The document required to be submitted together with the listing application was not substantially complete because under GEM Rule 12.22(14b), Company K should provide a profit forecast memorandum covering the period up to year ending [*year T+1*] at the time of filing the Form 5A. However, its profit forecast memorandum only covered the year ending [*year T*].

**Company L (a Main Board Applicant)**

50. Company L was a mineral company under Chapter 18 of the Rules, engaging in exploration activities in the PRC.
51. Company L did not comply with Rule 18.24(2) and the relevant provisions of Guidance Letter HKE~~XX~~-GL56-13 which requires an applicant to provide a Competent Person's Report which must have an effective date (being the date when the contents of the Competent Person's Report are valid) less than six months before the date of publishing the listing document. Question 10B of the Exchange's Frequently Asked Questions Series 12 provided guidance that the validity date of the contents of a Competent Person's Report should be the date of the appraisal (i.e. the date when resources and reserves are estimated or valued) and not the date when the Competent Person's Report is signed.