

## HKEX\* LISTING DECISION

HKEX\*-LD84-2014 (~~published in~~ February 2014) (Updated in May 2016)

(Updated due to withdrawal of guidance letters superseded by HKEX-GL86-16)

Summary	
Party	Company A to- Company Q (the “Applicants”)
Issue	To provide guidance on why the Exchange returned certain listing applications
Listing Rules	Main Board Rule 9.03(3) and GEM Rules 12.09 and 12.14
Decision	The Exchange returned the applications.

1. This listing decision sets out the reasons the Exchange returned certain listing applications from May 2013 to September 2013. For the reasons listing applications were returned before this period, please refer to Listing Decisions HKEX\*-LD48-2013 and HKEX\*-LD75-2013.

### APPLICABLE RULES, REGULATIONS AND PRINCIPLES

2. Main Board Rule 9.03(3)<sup>1</sup> stated that the Exchange expected to receive an advanced proof of the prospectus with the listing application form that was not the initial proof to enable the Exchange’s review was able to commence immediately upon lodgment 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. If the Exchange considered the draft prospectus submitted with the Form A1 not to be in an advanced form, the Exchange would not commence reviewing the application. All documents, including the Form A1 and the initial listing fee, submitted to the Exchange would be returned to the sponsor(s). The sponsor(s) would be required to resubmit a new Form A1 together with the advanced proof of the prospectus.
3. GEM Rule 12.09<sup>1</sup> stated that the Sponsor must ensure that the draft listing document had been verified in all material respects prior to submission. Note 1 to GEM Rule 12.09 stated that if the Exchange considered that the draft listing document submitted with the listing application form was insufficiently finalised, the Exchange would not commence review of that or any other documents relating to the application.
4. GEM Rule 12.14<sup>1</sup> required that the listing application form must be accompanied by certain documents. The Listing ~~Department~~Division might return to the sponsor any application for listing which it considered to be incomplete, together with the initial listing fee.

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<sup>1</sup> The Main Board and GEM Rules were subsequently amended to complement the new sponsor regulation effective on 1 October 2013.

## ANALYSIS

5. Set out below are reasons the Exchange considered the applications not in an advanced form and returned certain listing applications during the period from May 2013 to September 2013.

### Company A

6. Company A provided construction services. There were a number of deficiencies in disclosure:

(i) Packaging of business

The prospectus disclosed that Company A focused on Business Segment A, and that it would cease its business in Business Segment B upon completion of the last project in this segment although it contributed a significant amount of revenue during the track record period. The prospectus lacked sufficient details of Business Segment B, including why Business Segment B was included in the listing group given the focus on Business Segment A, and the impact on Company A's track record revenue and profit margin had Business Segment B been excluded in the first place.

Moreover, the sponsor had not demonstrated that Company A was able to meet the minimum profit requirement under Rule 8.05(1)(a) after excluding the profit from Business Segment B, and that there was no packaging issue by including Business Segment B in the listing group.

(ii) Connected and related party transactions

Company A subcontracted the construction work to a connected party which resulted in a thin profit margin during the track record period and after listing. The prospectus lacked disclosure on how the pricing of sub-contracted work was determined and whether such continuing connected transaction was conducted on normal commercial terms. The prospectus also lacked disclosure on the basis of the recurring management fee income from a connected person.

(iii) Workplace safety

Company A had not disclosed sufficient information on its workplace safety and related regulatory compliance during the track record period, including:

- the number of accidents and workers involved during the track record period and up to the latest practicable date, the level of severity of the accidents, the amount of compensation paid, Company A's maximum liabilities for the existing and potential claims, and whether Company A's accident rate was comparable to its industry peers;
- the underlying factors leading to the respective accidents and the measures taken by Company A and its subcontractors to improve the safety

standards and to prevent reoccurrence of similar accidents going forward;  
and

- how Company A monitored the performance and workplace safety of its subcontractors.

(iv) Others

The disclosure in the prospectus did not follow the Exchange's guidance letters, including Guidance Letter HKE~~X~~-GL27-12<sup>2</sup> on the Summary section, Guidance Letter HKE~~X~~-GL41-12 on recent development of an applicant's operational and financial performance, Guidance Letter HKE~~X~~-GL54-13<sup>3</sup> on risk factors, and Guidance Letter HKE~~X~~-GL33-12<sup>4</sup> on use of proceeds. **(Updated in May 2016)**

Company B\*

7. Company B was engaged in the entertainment business. The Exchange had raised a number of issues in its reply to Company B's pre-IPO enquiry. However, Company B failed to satisfactorily address these concerns when it submitted its listing application. Non-exhaustive examples of issues raised include:
- the suitability for listing of Company B under GEM Rule 2.06;
  - obtaining an affirmative regulatory assurance that Company B can renew its operation license upon its reorganization, and a legal opinion on whether Company B had to obtain any other approvals under the relevant laws and regulations for its reorganization;
  - whether the contractual arrangements were legal and binding and that Company B had the ability to ensure the sound and proper operation of the contractual arrangements, and providing an explanation on how the contractual arrangements were in line with Listing Decision HKE~~X~~-LD43-3;
  - the sponsor's view, with basis, on the adequacy and effectiveness of Company B's internal control measures to stay clear of anti-social forces and money laundering activities for a reasonable demonstration period; and
  - details of Company B's credit arrangements and a legal opinion on whether the credit arrangements complied with the relevant laws and regulations.
8. In addition, the prospectus had a number of deficiencies in disclosure:

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

<sup>3</sup> Withdrawn in May 2016. Superseded by Section B of Appendix 1 in HKEX-GL86-16.

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

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(i) Sustainability of business due to reliance on major customers and suppliers

Company B relied heavily on its major customers and suppliers. It had a short operating history and had recently moved to a new business premise. The prospectus lacked sufficient disclosure on:

- Company B's sustainability of business taking into account its reliance on a few customers and suppliers;
- whether its track record results was reflective of its future performance given the potential impacts from the relocation; and
- information as required under Listing Decision HKE~~X~~\*-LD107-1, including details of the customer and the suppliers (e.g. background, profile, years of relationship with Company B, circumstances leading to the cooperation, etc.), whether the concentration of customers and suppliers was a common industry practice, plans and measures to mitigate the reliance, the contingency plan if Company B failed to renew the agreements with the customers and the suppliers, and the operational and financial impact of the relocation of the business premise.

(ii) Liquidity and working capital management

Company B recorded operating cash outflows and a substantial increase in accounts receivable and accounts receivable turnover days during the track record period. The prospectus lacked disclosure on:

- Company B's plan to service its indebtedness and development plans, and the basis on which the directors and the sponsor were satisfied that Company B had sufficient working capital to meet its present requirements and future development plans as per Guidance Letter HKE~~X~~\*-GL37-12;
- the subsequent settlement of accounts receivable as at the latest practicable date, reasons for the prolonged accounts receivable turnover days and Company B's provision policy and measures in place to expedite debt collection; and
- whether Company B had experienced any difficulty in obtaining credit facilities, default in its payment obligations or breach of financial covenants.

(iii) Others

The prospectus also lacked disclosure on the following:

- details of Company B's expansion plan and the latest status;
- the latest operational and/ or financial performance subsequent to the track record period, and a commentary on the impact of listing expenses on Company B's financial performance as per Guidance Letter HKE~~X~~\*-GL41-12; and

- details of biographies of the directors and senior management members as required under our standard comments SC-4.5 and 4.6<sup>5</sup>.

### Company C

9. Company C was a financial service provider. There were a number of deficiencies in disclosure:

#### (i) Non-compliances

There were a significant number of non-compliance incidents related to Company C's core business and operations. However, there was insufficient disclosure on the details of these incidents as required under Guidance Letter HKE~~X~~-GL63-13, including:

- how and by whom the non-compliances were detected;
- the period in which the non-compliances occurred;
- the directors' involvement in the non-compliances;
- the operational and financial impacts;
- Company C's compliance record and results of regulatory inspections during the track record period and up to the latest practicable date;
- the rectification and precautionary measures implemented;
- the sponsor's and internal control adviser's views on the adequacy and effectiveness of these internal control measures;
- whether Company C was able to meet the minimum profit requirement under Rule 8.05(1)(a) after excluding the revenue and profit arising from the non-compliances; and
- the sponsor's view on directors' suitability under Rules 3.08 and 3.09.

#### (ii) Business operations

The prospectus lacked a comprehensive description of the key aspects of Company C's business operations:

- procedures for opening new accounts, including customers' credit assessment and collateral valuation, procedures and timing of trade execution and settlement, and the matching mechanism used for trading;

<sup>5</sup> With effect from 1 October 2013, the disclosure requirement on biographies of the directors and senior management members under standard comments SC4.5 and 4.6 were replaced by the requirements set out in paragraphs 3.2 and 3.3 of Guidance Letter HKE~~X~~-GL62-13, which was withdrawn in May 2016. Superseded by Section H of Appendix 1 in HKE~~X~~-GL86-16. (Updated in May 2016)

- details of business arrangements with customers, business partners and hedging partners;
- the number and amount of error trades, the loss incurred and the internal control measures adopted to prevent recurrence; and
- detailed arrangements for the referral of customers and the associated risks, in particular, the revenue model, roles and responsibilities of parties involved, and the internal control measures to monitor and identify high risk customers, abnormal trades and potential laundering activities.

(iii) Hedging

The prospectus lacked sufficient disclosure of Company C's hedging strategy and risk control measures, such as:

- factors considered in making hedging decisions, the effectiveness of the hedging activities during the track record period, the percentage of "exposure" to be hedged and whether the transactions entered into were for hedging or for "speculative" purpose;
- the internal control measures to manage hedging risks, experience of the relevant personnel, and details of the review and reporting system; and
- a detailed analysis of the underlying causes for the fluctuation in income despite the adoption of the hedging activities.

(iv) Money laundering

There were allegations concerning the source of funds used by a customer of Company C. Company C had failed to disclose:

- details and source of the allegations, the investigations conducted by Company C and the related findings, and whether Company C had reported these incidents to the regulatory authorities;
- how Company C settled the trading account, revenue and profit generated from the customer and clients referred to Company C, and the operational and financial impact to the Company C as a result of the termination of relationship with the customer;
- details of internal control measures and whether Company C had enhanced its internal control measures as a result of this incident, in particular, on know-your-clients procedures; and
- the sponsor's view on the adequacy and effectiveness of the enhanced internal control measures and its compliance with all relevant regulatory requirements.

(v) Liquidity and working capital management

Company C recorded operating cash outflow and a significant increase in trade receivables from hedging counterparties. Company C had failed to disclose:

- a detailed analysis of the reasons leading to an increase in receivables;
- the fluctuation in account receivables and accounts payables turnover days, subsequent settlements, and its financing capability to fund its working capital shortfalls; and
- its credit policy and account receivables provision policy.

(vi) Future plans and use of proceeds

Company C proposed to finance its business expansion to new geographical markets with the IPO proceeds. The prospectus lacked disclosure on:

- the expected timeframe of Company C's expansion plan;
- the source of funding in addition to IPO proceeds;
- how the expansion plan might affect Company C's business and risk exposure; and
- the basis of selecting new geographical markets, and the relevant regulatory requirements and compliance procedures.

Company D\*

10. Company D was involved in the provision of financial services.
11. Company D did not comply with the relevant laws and regulations applicable to its core business and operations during the track record period. Following the principles of Listing Decision HKE~~X~~\*-LD19-2011, we normally require a demonstration period of at least 12 months from the date the applicant ceased all non-compliances with the financial results during the demonstration period audited. There should also be full details of the independent consultant's reviews and conclusions on Company D's internal control measures in the prospectus. Company D did not meet the aforesaid requirements in Listing Decision HKE~~X~~\*-LD19-2011. Further, the prospectus also lacked sufficient information on Company D's non-compliances, such as the date of implementation of Company D's enhanced internal control measures, and the sponsor's view on the adequacy of internal control measures and suitability of directors under GEM Rules 5.01 and 5.02.
12. The prospectus also lacked disclosure on:

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- the reason for the change in auditor and whether there was any matter that had to be drawn to our attention to;
- reasons for the significant growth in a particular business segment during the track record period and how Company D generated fee and commission income from this segment;
- more information on the financial assets acquired by Company D at a discount during the track record period (e.g. nature of the financial assets and the acquisition criteria), the background of the party who purchased these financial assets from Company D subsequently and whether Company D recorded any gain/ loss from the disposal of the financial assets;
- specific risk management measures, such as frequency of evaluating the value of collaterals, action taken for any significant decrease in collateral value, value-to-loan ratios, risk management measures for unsecured loans, and details of internal control measures on anti-money laundering activities, etc.; and
- why Company D did not apply for a Main Board listing given that it would be able to meet the minimum profit requirement under Main Board Rule 8.05(1).

#### Company E

13. Company E was an equipment manufacturer. During the track record period, it sold products to a sanctioned country, and there was no disclosure on whether Company E or any parties involved in the listing would be subject to sanctions risk. Further, the directors, the sponsor and the legal advisers had not provided their views, with basis, on sanctions risk, and how it might affect Company E's suitability for listing.

#### Company F

14. Company F was a food manufacturer. It was involved in non-compliant financing activities but did not provide audited financial results for a demonstration period of at least 12 months from the date it ceased all non-compliant financing activities in accordance with Listing Decision HKE~~X~~\*-LD19-2011.
15. In addition, there were a number of deficiencies in disclosure:
  - (i) there was a lack of disclosure of an abandoned listing plan on another exchange, and the reasons for including different entities in the current proposed listing group; and
  - (ii) Company F failed to make the required disclosure on its distributorship business model per Guidance Letter HKE~~X~~\*-GL36-12, such as the relationship and differences between different types of distributors, measures to avoid cannibalization and competition among distributors, and the risk of inventory accumulation at the distributors' level, etc.

## Company G\*

16. Company G was engaged in the processing, manufacturing and sale of certain products. There were a number of deficiencies in disclosure:

### (i) Customers

The prospectus lacked sufficient disclosure on:

- the background of Company G's major customers, and there was no disclosure on the distributorship business model as per Guidance Letter HKE X\* -GL36-12;
- revenue breakdown by customer types and how the change in customer mix had affected/ would affect Company G's financial performance; and
- key terms of sales agreements and framework agreements with different types of customers.

### (ii) History and development

The prospectus lacked details of the commercial rationale behind certain transactions and cooperation agreements between shareholders.

In addition, some of the founders left Company G during the track record period. The directors and the sponsor had yet to demonstrate whether their departures would affect Company G's compliance with the management continuity requirement under GEM Rule 11.12A(3).

### (iii) Financial information

The prospectus lacked meaningful discussion on Company G's fluctuating gross profit margin during the track record period, its cost control measures in managing fluctuations in raw material prices, and whether Company G was able to pass on the increase in purchase costs to its customers.

Company G had significant inventory, prepayments and loans at year end. The prospectus lacked disclosure on the ageing analysis and the provision policy of Company G's inventories, the key terms of prepayments, and the background of the lenders of the loans.

### (iv) Use of proceeds

Company G allocated about half of its IPO proceeds to enhance its production capacity despite a decreasing utilization rate during the track record period. The prospectus lacked disclosure on the justifications for the expansion plan, the current status of the expansion plan, the types of products to focus on, and the selection criteria for acquisition or co-operation target, etc.

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(v) Non-compliance incidents

There was insufficient disclosure on Company G's internal control measures, the identity and qualification of the internal control adviser together with the key findings and recommendations, and whether Company G had implemented the recommendations.

(vi) Industry overview

The prospectus failed to provide market information on Company G's major products and a meaningful discussion on how these products compared with its substitutes in terms of pricing and usages.

Company H\*

17. Company H was a manufacturer. It did not fully address the comments previously raised by the GEM Approval Group before the submission of a renewed listing application. Comments were raised in relation to the impact of certain litigations on the suitability of directors, the minimum cash flow requirement, the significant decline in net profit, the decline in profit margin of new customers, etc.

Company I\*

18. Company I was a manufacturer.
19. During the track record period, Company I was engaged in non-compliant financing arrangements. Based on Listing Decision HKE~~X~~\*-LD19-2011, we require a demonstration period of at least 12 months from the date the applicant ceased all non-compliances with the financial results during the demonstration period audited. Further, there should be full details of the independent consultant's reviews and conclusions on Company I's internal control measures in the prospectus. Company I did not meet the aforesaid requirements in Listing Decision HKE~~X~~\*-LD19-2011. Further, the disclosure on the non-compliant financing arrangements was limited and was not in line with the principles under Listing Decision HKE~~X~~\*-LD19-2011. Non-exhaustive examples of information which should be disclosed include:
- reasons for the non-compliance, the nature and the aggregate amount of non-compliant bills during the track record period and up to the date of cessation of such practice, and the background of the parties to which the bills were endorsed/ discounted;
  - a PRC legal opinion on the legal consequences and maximum penalties to be imposed on Company I, and whether any regulatory assurance had been obtained from competent authorities;
  - the amount of interest expenses saved by adopting the non-compliant financing arrangements, and whether Company I was able to meet the minimum cash flow

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requirement under GEM Rule 11.12A(1) it did not engage in the non-compliant financing arrangements;

- directors' and senior management's involvement in the non-compliance; and
- the sponsor's view on directors' suitability under GEM Rules 5.01 and 5.02 and Company I's suitability for listing under GEM Rule 11.06 taking into account the non-compliance.

20. For Company I's other non-compliances, the following should be disclosed in addition to the information requested under Guidance Letter HKE X\*GL63-13:

- the significance of each of the production facilities with title defects (e.g. revenue contribution, production capacity, GFA, etc.), and their respective carrying values at the end of the track record period; and
- the amount of non-compliance loans extended during the track record period.

#### Company J

21. Company J was a pharmaceutical company. There were a number of deficiencies in disclosure:

(i) Business model - distributorship

Company J distributed most of its products through distributors. The prospectus lacked sufficient information on the Group's distributorship business model as set out as per Guidance Letter HKE X\*GL36-12.

(ii) Transactions with sanctioned countries

Company J planned to export its products to and commence sales activities in sanctioned countries. However, there was insufficient disclosure on the details of these transactions and whether these export activities/ sales would be subject to any sanctions in the prospectus.

(iii) Relocation and subcontracting

Company J engaged a third party subcontractor to produce certain pharmaceutical products due to the relocation of its production facilities. However, the prospectus lacked disclosure on the material details of the subcontracting arrangement and the relocation plan, such as:

- the amount of revenue from the sales of products produced by subcontractors;
- the quality control of subcontracted products and the protection of confidential information;

- salient terms of subcontracting agreements and the availability of alternative subcontractors; and
- reasons for the relocation, the expected timeframe, the capital expenditures incurred and to be incurred, the source(s) of funding, and the expected increase in production capacity.

(iv) Summary

The “Summary” section of the prospectus lacked sufficient information to provide a concise overview of Company J’s business operations and to highlight significant matters as per Guidance Letter HKEX\*GL27-12<sup>2</sup>. Material information that was missing included: **(Updated in May 2016)**

- key aspects of the group’s business by segments, including the respective product features, major customers, major suppliers, sales and distribution channels, and market share of each segment;
- a breakdown of operating income and gross margin by business segments, followed by a high-level discussion on the material changes during the track record period and up to the latest practicable date;
- business relationships with the controlling shareholder, which was also a major supplier, and a commentary on the fluctuation in the level of purchases during the track record period;
- impact of government price controls on Company J’s pharmaceutical products;
- a brief summary of the material business risks faced by Company J;
- recent developments post track record period; and
- the industry and regulatory environments concerned.

(v) Product Quality

Based on the result of our desktop research, the Exchange noted that Company J had failed to disclose sufficient information on certain product quality issues in the prospectus, such as whether it received any complaints or requests for return, whether it had any product liability, the rectification measures taken/ to be taken, and whether the issues suggested poor quality control or reflected negatively on its directors’ suitability.

(vi) Bribery

Based on the result of our desktop research, the Exchange noted that Company J failed to disclose in the prospectus details of a bribery incident, the financial and operational impact of the incident to Company J, the internal control and

anti-bribery measures to prevent the reoccurrence of similar events, and the sponsor's view on directors' suitability under Rules 3.08 and 3.09.

### Company K

22. Company K was a service provider in the PRC.
23. Company K entered into a pre-IPO investment agreement with a number of pre-IPO investors, pursuant to which the pre-IPO investors might put back their shares to Company K or its controlling shareholder when certain conditions were not met. Under Guidance Letter HKE~~X~~\*-GL43-12, put or exit options are disallowed, except when the terms of the pre-IPO investment clearly states that the put or exit option could only be exercised when listing does not take place. To follow the Guidance Letter, Company K would have had to amend the terms of the pre-IPO investment and follow the 180-day requirement set out in the Guidance Letter HKE~~X~~\*-GL29-12 (unless there was a legal opinion that such amendment would not constitute a new agreement), or unwind the pre-IPO investment.
24. In addition, there were a number of deficiencies in disclosure:

(i) Restricted business

Foreign investment in Company K's business in the PRC was restricted by laws and regulations. Company K should have, with the support of a legal opinion, stated clearly what the relevant regulatory requirements were, whether the authority providing an opinion on Company K's compliance with the requirements was the competent authority, and whether Company K had complied with the requirements during the track record period and as at the latest practicable date.

(ii) Ownership of shareholding in subsidiary

Company K had, during the track record period, transferred certain equity interest in a subsidiary to a related party but retained the related shareholder rights. Company K should have clarified, with the support of views from a PRC legal adviser and the reporting accountants, the ownership of the interests and the appropriate accounting treatment under the accounting standards.

(iii) Competition with controlling shareholders

The controlling shareholder of Company K held interest in a business that might compete with Company K. The prospectus lacked disclosure on the competing business as required under Rule 8.10, and on how the potential competition could be dealt with.

(iv) Others

The prospectus also lacked disclosure on:

- one of its business segments to reflect its actual operations;

- a concise overview of Company K's business and highlights of significant matters in the Summary section as per Guidance Letter HKE~~X~~\*-GL27-12<sup>2</sup>; *(Updated in May 2016)*
- measures taken/ to be taken by Company K to monitor and control the quality of services, protect the environment, and maintain a healthy and safe environment for customers and employees;
- the experience of its staff and whether all professional employees performed their jobs within the permitted scope of their licenses;
- suppliers' concentration as per Listing Decision HKE~~X~~\*-LD107-1, whether certain rights provided under the terms of the agreements with suppliers was in accordance with industry practice and highlight the risk of losing such rights;
- a detailed analysis of how the government's regulation over pricing had affected Company K during the track record period;
- salient terms of certain management agreements, basis of determining the rights of each party, revenue/ management fee arrangement, etc.;
- the maximum exposure on short-term investments over the track record period, its treasury and investment policies and related risk control measures, management expertise and experience involved in the risk control measures, and the sponsors' view on whether these risk control measures were adequate and effective; and
- material details of the loan to be repaid by part of the IPO proceeds and the expansion plan.

#### Company L

25. Company L was a mining company. It had not satisfactorily addressed issues raised in the Exchange's guidance letters in response to its pre-IPO enquiries, including why it adopted a corporate structure which would result in numerous connected transactions after listing and why contractual arrangements were adopted when they were not necessary. Besides, Company L failed to follow the disclosure requirements set out in:
- (i) Listing Decision HKE~~X~~\*-LD43-3 on structured contracts. In particular, despite the PRC legal advisers had opined that certain aspects of the structured contracts may not be enforceable, Company L had not taken any action to mitigate or address the issue;
  - (ii) Guidance Letter HKE~~X~~\*-GL52-13 for mineral companies;
  - (iii) Main Board Rule 18.29 regarding the presentation of Company L's mineral resources and reserves;

- (iv) Guidance Letter HKE~~X~~\*-GL41-12 on the latest financial, operational and trading position; and
- (v) Guidance Letter HKE~~X~~\*-GL33-12<sup>4</sup> on the use of proceeds. *(Updated in May 2016)*

26. In addition, there were a number of other deficiencies in disclosure:

(i) Regulations

The prospectus lacked a comprehensive overview of the key provisions of the rules and regulations specifically relevant to Company L and its compliance with such provisions. In addition, there was only minimal disclosure on how Company L intended to increase its production capacity given the restrictions under the regulations.

(ii) Customer concentration

Company L had a high concentration of customer. The prospectus lacked disclosure on the risk of reliance with reference to HKE~~X~~\*-LD107-1, measures to diversify the customer base, reasons for ceasing sales to a top five customer, and how the high level of/ change in customer concentration had affected Company L's business during the track record period.

(iii) Financial information

The accountants' report had not been updated to comply with Rule 8.06. Besides, the "Financial Information" section of the prospectus did not provide sufficient information for investors' assessment of Company L's financial performance and liquidity position, such as its net current liabilities, increasing net losses, high interest costs, reliance on controlling shareholders' guarantee, significant capital expenditures, explanation on the fluctuations in key financial indicators, and how it would secure sufficient funding for its operations and expansion plan.

Company M

27. Company M was a mining company.

(i) Experience of core management team

Among the 10 core management team members identified, we considered that only three of them possessed experience relevant to the exploration and/ or extraction activity of the mineral resource that Company M was pursuing. Company M failed to demonstrate how the experiences of other core management team members on other mineral resources were transferrable to the mineral resource that Company M was pursuing.

(ii) Competition with controlling shareholder

The controlling shareholder of Company M had interests in various other companies which were engaged in mining business. The prospectus lacked disclosure on:

- the extent of competition between Company M and the excluded business (e.g. scale and size of the mines, financial performance, marketing and sales channel, customers and suppliers base, etc.), whether and how Company M's business and products were delineated from those of the excluded business, whether the excluded business would become significant to Company M in the future, and Company M's intention to acquire them going forward; and
- more details on the basis of the proposed arrangements to delineate the businesses between Company M and the excluded business, and how the first right of refusal/ option to acquire the excluded business could work in practice (e.g. criteria to exercise the first right of refusal/ option to acquire, details of INEDs' expertise and experience in approving the exercise of the first right of refusal/ option to acquire, etc.).

(iii) Working capital sufficiency and financial independence from controlling shareholder

Company M recorded net loss, operating cash outflow and significant net current liabilities during the track record period. The controlling shareholder had advanced a substantial amount of funds to finance Company M's operation and provided personal guarantee for its banking facility. Given that part of the advance from the controlling shareholder would be repaid by IPO proceeds and the personal guarantee provided would only be released upon listing, Company M had yet to demonstrate that it could operate financially independently from the controlling shareholder at the time of listing under Listing Decision HKE~~X~~\*LD69-1.

Company N

28. Company N was a service provider. There were a number of deficiencies in disclosure:

(i) Competition with controlling shareholder

The controlling shareholder had certain retained business which also provided the same type of service as Company N. Company N failed to disclose the reasons for excluding the retained business, the size of operation and key financial information of the retained business, whether the controlling shareholder intended to inject the relevant business into the group as required under Rule 8.10(1), the basis and the practicality of the proposed arrangements to delineate the businesses between Company N and the retained business, the corporate governance measures to manage the actual/ potential competition, and the directors and sponsors' views on the adequacy of these measures.

(ii) Structured Contracts

Company N derived a portion of its revenue from online value-added services, which was subject to foreign ownership restriction and was therefore conducted through structured contracts. Besides the foreign ownership restriction, the relevant laws and regulations in the PRC also required foreign investors invested in the provision of online value-added services to meet certain qualification requirement. Based on the disclosure in the prospectus, Company N was unable to fulfill the qualification requirement and thus would not be able to unwind the structured contracts even if the foreign ownership restriction is removed in the future, i.e. unable to follow Listing Decision HKE~~X~~-LD43-3.

The prospectus lacked disclosure on how Company N planned to meet the qualification requirement and whether there was any legal impediment for it to meet the qualification requirement, and other disclosure required under HKE~~X~~-LD43-3.

(iii) Non-compliances

Company N had a number of non-compliances during the track record period. However, it failed to make appropriate disclosure as required under the standard comment SC1.2<sup>6</sup> and Guidance Letter HKE~~X~~-GL63-13 including when the non-compliances will be fully rectified, internal control measures that were adopted specifically to address the non-compliances, and the sponsor's view on directors' suitability under Rules 3.08 and 3.09.

Company O\*

29. Company O was engaged in the provision of certain types of products and services. There were a number of deficiencies in disclosure:

(i) Non-compliances

Company O had a significant number of non-compliances with laws and regulations applicable to its core business and operations. The disclosure on the non-compliance incidents was unclear and insufficient, and should be enhanced to include the causes and reasons for each non-compliance<sup>s</sup>, the involvement of directors and senior management in the non-compliances, the operational and financial impacts on Company O, and the implementation of rectification and precautionary measures and their effectiveness.

Given the significant number of non-compliances, the sponsor should have provided its view on whether the non-compliances had any impact on directors' suitability under GEM Rules 5.01 and 5.02 and Company O's suitability for listing under GEM Rule 11.06. Further, Company O had to demonstrate to our

<sup>6</sup> With effect from 1 October 2013, the disclosure requirement on non-compliances under standard comment SC1.2 was replaced by the requirement set out in paragraph 3.1 of Guidance Letter HKE~~X~~-GL63-13.

\* GEM listing applicant

satisfaction that it was able to meet the minimum cash flow requirement under GEM Rule 11.12A(1) after excluding the relevant cash flow from the non-compliant sales.

(ii) Serious deterioration in recent financial performance

The prospectus lacked detailed discussion on the serious deterioration in Company O's financial performance, including how the changes in regulations and other economic factors would affect Company O's future business and profitability, and the sponsor and directors' views on whether Company O's business was sustainable and suitable for listing under GEM Rule 11.06.

(iii) Strategic arrangements with customers

Company O entered into sales agreements with a major customer and a related customer to sell products to them at a discount. The prospectus lacked sufficient information on these agreements including the duration of the agreements, ranges and basis of discount, payment terms, settlement method, major rights and obligations of the parties, and whether these agreements were entered into on normal commercial terms and in accordance with common industry practice.

(iv) Money laundering

During the track record period, some of Company O's overseas customers settled their invoices through a licensed money exchange house which then transferred the payments to Company O. Company O was not able to identify the source of funds and was therefore exposed to potential money laundering activities. Besides, some of Company O's sales were conducted in cash.

The prospectus lacked detailed disclosure on the arrangements among Company O, its customers and the exchange house, the reasons for the arrangement and the risks involved, whether there were incidents where Company O was suspected or found to be involved in any illegal activities in relation to funds received from overseas, the amount of sales transactions settled in cash during the track record period, and the specific internal control measures adopted by Company O to detect and prevent its bank accounts being used for illicit purpose and cash misappropriation by its employees.

(v) Transactions with related parties

Company O sold and purchased products from a company owned by a shareholder during the track record period. Company O did not disclose in the prospectus whether the transactions with this company were entered into in the ordinary and usual course of its business and on normal commercial terms. The shareholder disposed of his interest in Company O subsequent to the track record period and there was no disclosure on whether the transactions with this company would continue after the disposal and what would be the financial impact on Company O going forward.

## Company P

30. Company P was engaged in the sales of certain products.
31. Company P entered into a pre-IPO investment agreement with a number of pre-IPO investors, pursuant to which the pre-IPO investors might request Company P to redeem all or a portion of their shares when certain conditions were not met. This did not follow Guidance Letter HKE~~X~~-GL43-12 under which any put or exit options are disallowed except when the terms of the pre-IPO investment clearly states that the put or exit option could only be exercised when listing does not take place. To follow the Guidance Letter HKE~~X~~-GL43-12, Company P would have had to amend the terms of the pre-IPO investment and follow the 180-day requirement in the Guidance Letter HKE~~X~~-GL29-12, unless there was a legal opinion that such amendment would not constitute a new agreement, or unwind the pre-IPO investment.
32. In addition, there were a number of deficiencies in disclosure in relation to the sustainability of business and non-compliance matters:

(i) Sustainability of business due to heavy reliance on a customer

- Company P relied heavily on one customer but there was no long-term contract with this customer. The prospectus lacked disclosure required under Listing Decision HKE~~X~~-LD107-1, including whether reliance was mutual and complementary, and what were the measures adopted to reduce reliance;
- industry organizations had imposed limits on the level of supply of the product. Company P failed to disclose whether it had complied with the limit and if not, the amount of revenue and profit generated from sales that exceeded the limit and the maximum potential penalty, the potential impact if more stringent measures were adopted to control the limit, Company P's strategy to maintain its business going forward, and why it would use a majority of the IPO proceeds to expand its capacity given the limit; and
- Company P failed to include a detailed analysis on the significant fluctuations of gross and net profit margins, the relevant sensitivity analysis, the latest operational and financial performance subsequent to the track record period, and the directors' and sponsor's views on Company P's sustainability of business.

(ii) Non-compliances and suitability of directors

During the track record period, Company P had a number of non-compliances. Company P failed to make disclosure as required under standard comment SC1.2<sup>36</sup> and Guidance Letter HKE~~X~~-GL63-13.

### Company Q\*

33. Company Q was a trading company. It had not fully addressed comments previously raised by the Exchange before the submission of a renewed listing application. Comments raised are related to the sustainability of business and the suitability for listing as a result of, among other things, its reliance on a major customer.

### **THE DECISION**

34. The Exchange returned the applications.
35. Subsequently, 11 out of the 17 applicants re-filed their listing applications between 4 to 56 days after the Exchange returned their previous applications. Except for one which was returned again (as certain information requested was still missing), the Exchange accepted the re-filed applications.

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\* GEM listing applicant