HKEx GUIDANCE LETTER
HKEx-GL28-12 (January 2012)

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Important note: This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules, or this letter.

1. Purpose

1.1 This letter gives guidance on disclosure of matters in listing documents of applicants engaged in the restaurant business.

2. Relevant Listing Rules

2.1 Main Board Rule 2.13(2) (GEM Rule 17.56(2)) provides that the information contained in an issuer’s document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, the issuer must not, among other things:

(a) omit material facts of an unfavourable nature or fail to accord them with appropriate significance; and

(b) present favourable possibilities as certain or as more probable than is likely to be the case.

2.2 Main Board Rule 11.07 (GEM Rule 14.08(7)) states that as an overriding principle, all listing documents must contain such particulars and information which, according to the particular nature of the issuer and the securities for which listing is sought, is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities, financial position, management
and prospects of the issuer and of its profits and losses and of the rights attaching to such securities.

3. Guidance

3.1 There has been increasing interest from restaurant operators seeking to list on the Exchange. We have from time to time received pre-IPO enquiries for guidance on disclosure regarding various aspects relevant to the restaurant operation. Set out below are the issues that we consider should be discussed and disclosed in detail in listing documents **to the extent they are material** to the matters set out in paragraphs 2.1 and 2.2.

**Suppliers, Sources and Prices of Raw Materials**

3.2 A restaurant business depends on reliable sources of food raw materials which are subject to price fluctuations caused by supply and demand in the market. The listing document should disclose, **if material**:-

(i) the price fluctuation and market price trends of the applicant’s major food ingredients during the track record period and the resultant impact on its track record results;

(ii) how the applicant monitors and controls the costs of major food ingredients and a sensitivity analysis for its major food ingredients (where appropriate);

(iii) the sources of the applicant’s major food ingredients, their shelf life and how the applicant ensures that the quality of the ingredients is adequate;

(iv) the number of the applicant’s authorized suppliers during the track record period and their average years of relationship with the applicant, and measures to prevent any kickback arrangements with the suppliers; and

(v) any incidents of food supply interruption, early termination of contractual arrangements with suppliers or failure to secure sufficient quantities of food materials during the track record period.

**Same Stores Sales and Table/ Seat Turnover Rate**

3.3 A ramp up period is normally required to allow a restaurant to generate stable income and break even. Same stores sales and table/ seat turnover rate are key indicators to analyze the performance of a restaurant/ business. The listing document should discuss in detail:-

(i) same store sales and table/ seat turnover rate during the track record period and appropriate commentary on any changes in those rates in the relevant sections of the listing document;
(ii) average spending per customer and average daily revenue for each restaurant, and appropriate commentary on changes in that information; and

(iii) the time period normally required for a restaurant to break even.

**Cash Management**

3.4 Most customers settle their restaurant bills in cash and the applicant’s staff may need to receive and handle large amounts of cash as part of the restaurant’s daily operations. As such there will be a risk of cash misappropriation or embezzlement. The listing document should discuss in detail:-

(i) the applicant’s internal control system and procedures to prevent cash misappropriation/ embezzlement by the applicant’s employees and collusion among employees; and

(ii) if material, whether the applicant encountered any incidents of cash misappropriation/ embezzlement during the track record period, and if so, details of these incidents.

**Trademarks**

3.5 The applicant’s trademarks may be important to its business operation. If so, the listing document should clearly disclose whether the applicant owns the trademarks and whether they have been duly registered. The applicant should also address in appropriate sections of the listing document the possible damage, and/ or damages actually suffered during the track record period by the applicant as a result of restaurants passing themselves off as part of the applicant group by using the same or similar names to those of the applicant group’s restaurants.

**Expansion**

3.6 An aggressive growth in sales can be achieved by rapid expansion through organic growth of self-operated restaurants or franchise arrangement. Profits arising from new restaurants may not be sustainable as there are too many competing restaurants in the market.

3.7 To enable investors to appraise the sustainability of the applicant’s business, the listing document should disclose, if material:-

(i) the number and movement of restaurants during the track record period, including clear explanation of the reasons for termination or replacement of restaurants;

(ii) the applicant’s site selection criteria for new restaurants and measures to prevent the applicant’s new restaurant(s) competing with its existing restaurant(s) such that the increase in the new restaurant’s customer traffic
will not result in a reduction of customer traffic in the existing restaurant(s);

(iii) details of the applicant’s future expansion plans including (1) the number of restaurants to be opened, the expected investment cost, amounts incurred and committed as at the latest practicable date, sources of funding, locations and types of restaurants; and (2) how the applicant would manage its business expansion (e.g. procurement of supplies, management of human and other resources, quality control, management reporting, etc.);

(iv) the applicant’s competitive landscape including the existing competitive situation such as the number of similar brands and restaurants in the applicant’s market(s)/target market(s), the competitive threats the applicant is facing, and how it compares with its major competitors including market position, market share, brand name, characteristics, and operating environments, etc.; and

(v) the applicant’s growth strategy to sustain its growth (i.e. organic growth, through franchise arrangement or acquisition) and the factors taken into account to determine which strategy to adopt.

3.8 Where the applicant’s growth is through franchise arrangements, the listing document should discuss:

(i) the salient terms of the franchise agreements (e.g. the roles and obligations of the contracting parties, consideration paid and related basis, settlement term, minimum number of restaurants to be opened, minimum investment amounts, termination clauses, etc.), and whether there was any breach of franchise agreements during the track record period;

(ii) the significance of the franchising operation to the applicant (e.g. percentage of the revenue and net profit contributed to the applicant during the track record period); and

(iii) the applicant’s measures to ensure that the franchised restaurant(s) operate(s) according to the applicant’s standards.

Pricing Policy

3.9 The pricing policy of a restaurant is important information for investors. The listing document should discuss:

(i) the factors to determine the pricing policy of a restaurant (e.g. market trends, level of brand awareness, prices of competitors, etc.); and

(ii) whether similar prices are charged across different restaurants of the applicant and if not, the factors considered when charging different prices across different restaurants (e.g. target customers, market position, location of restaurant, etc.).
Food Safety, Quality Control and Complaints

3.10 Food safety is a significant issue for applicants engaging in the restaurant business. As such, sponsors should consider including material information on the procedures adopted by an applicant, including:

(i) the applicant’s quality control measures to ensure food safety from point-to-point (starting from the purchase of raw materials, semi-processed foods to storage, cooking and serving of foods);

(ii) the identity of senior management responsible for food safety and the number of staff engaged in quality control with their level of seniority, experience and background;

(iii) the frequency and the basis of inspections carried out on suppliers by the applicant, and whether other inspection and testing agencies are involved in carrying out these inspections; and

(iv) whether the applicant has been subject to any investigation regarding the hygiene of its food/restaurant(s) by any government authorities.

3.11 Restaurants may be subject to occasional complaints about foods and services provided. The sponsors are expected to check with the relevant consumer protection organizations regarding any customer complaints/claims against the applicant. The listing document should disclose, if material:-

(i) the nature and number of complaints received by the applicant and their merits during the track record period;

(ii) the applicant’s procedures and measures to record and handle customers’ complaints; and

(iii) whether any incident (e.g. food poisoning) occurred during the track record period, and if so, details of the incident including the number of customers involved, reasons, penalties charged and the measures adopted by the applicant to remedy and prevent reoccurrence of similar incident.

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