

HKE_x LISTING DECISION
HKE_x-LD107-1 (October 2010)

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| Parties | Company A – a Main Board listing applicant Customer X – Company A’s major customer |
| Issue | Whether heavy reliance on a major customer would render Company A unsuitable for listing |
| Listing Rules | Rule 8.04 |
| Decision | The Exchange considered that the reliance issue could be dealt with by way of disclosure |

FACTS

1. Company A was mainly engaged in manufacturing products using the technology provided by Customer X. The products sold to Customer X would be assembled into electronic products. Sales to Customer X accounted for 98%, 93%, 99% and 79% of its revenue during the last four financial years.
2. Company A had had a long-term business relationship with Customer X for over 10 years. However, there was no long term sale and purchase agreement between them. While there was a licence agreement to use Customer X’s technology in manufacturing process, there was no arrangement for technology transfer from Customer X to Company A.
3. The Exchange initially considered that Company A might not be suitable for listing.

APPLICABLE LISTING RULES

4. Rule 8.04 requires both the issuer and its business, in the opinion of the Exchange, must be suitable for listing.

ANALYSIS

5. There is no bright line test to determine whether an applicant's reliance on a single major supplier or customer is an extreme case which impacts on suitability for listing. In assessing a case of reliance on single supplier or customer, the Exchange will take into account:
 - (a) whether the applicant's business model can be easily changed to reduce the level of reliance. For example, the Exchange will consider its ability to find substitute suppliers or customers and whether it has the necessary skill, technology or network to break off the reliance;
 - (b) whether the level of reliance is likely to decrease in the future. For example, whether the applicant has plans to diversify its business focus to reduce its reliance on single supplier or customer;
 - (c) whether the whole industry landscape is dominated by a few players (e.g. the computer technology industry) making it unlikely for companies in the same line of business as the applicant to break off reliance on a major supplier or customer. Under these circumstances, the Exchange will be more ready to deal with the issue by disclosure since the risk of reliance is not specific to the applicant;
 - (d) whether the applicant can demonstrate that the reliance is mutual and complementary. For example, whether the supplier or the customer also relies heavily on the applicant; and
 - (e) whether the applicant is capable of maintaining its revenue in the future in light of the reliance. The Exchange will take into account the overall prospects of the industry to assess the viability of the applicant's business. If the whole industry is showing a downward trend, the Exchange will have greater concerns about suitability.

6. In response to the Exchange's concerns, Company A submitted that:
 - a. its reliance on Customer X was decreasing and in the last quarter of the track record period, its revenue derived from sales to Customer X dropped to about 60% (as compared to over 90% in previous years). The decrease in sales had been due to: (i) increase in demand for other products from other customers; (ii) expansion of its production capacity for other products; and (iii) expansion of the sales and marketing force for other products;

- b. Customer X was the market leader for the electronic products using components provided by Company A, accounting for approximately 60% of the annual worldwide sales during Company A's track record period;
- c. it was Company A's commercial decision not to enter into any long term binding contract with Customer X to maintain flexibility with other customers, which was in line with the Customer X's industrial practice; and
- d. appropriate disclosure would be made in the prospectus regarding: (i) the business and mutual reliance relationship between Company A and Customer X; (ii) the profile and background of Customer X; (iii) the risk involved in reliance on Customer X; and (iv) the short track record of Company A's diversification into other new products.

CONCLUSION

- 7. The Exchange considered that the reliance issue could be dealt with by way of disclosure on the basis that:
 - a. there was a decreasing trend in Company A's reliance on its single largest customer;
 - b. Company A had made considerable effort to reduce its reliance on Customer X by adopting a diversification strategy and expanding its sales and marketing network; and
 - c. sufficient disclosure about the reliance issue would be made in the summary, risk factors, business and financial information sections of the prospectus.