

HKE_x REJECTION LETTER
Cite as HKE_x-RL23-07 (July 2007)

[Withdrawn in April 2019]

Summary	
Listing Rule	Listing Rule 8.05(1)(a)
Reason for rejection and the subsequent disposal of the case on review	<p>The Listing Division rejected the listing application of the Company for the reason that the Company was unable to comply with the minimum profit requirement under Listing Rule 8.05(1)(a) and the suitability requirement under Listing Rule 8.04.</p> <p>The Listing Division's rejection decision was upheld by the Listing Committee but reversed by the Listing (Review) Committee, subject to certain specified conditions.</p>
Contents	<p><u>LETTER 1:</u> Extracts of the decision letter of the Head of Listing, The Stock Exchange of Hong Kong Limited</p> <p><u>LETTER 2:</u> Extracts of the decision letter of the Acting Secretary to the Listing Committee on hearing of the Company's application to review the decision of the Listing Division</p> <p><u>LETTER 3:</u> Extracts of the decision letter of the Secretary to the Listing (Review) Committee on hearing of the Company's application to review the decision of the Listing Committee</p>

LETTER 1

[Date]

[Name and Address of Sponsor]

Dear Sirs

Re: Application for new listing of a Main Board listing applicant
(the "Company" together with its subsidiary, the
"Group")

We refer to your application Form A1 dated [**day*month*year*] made on behalf of the Company (the "Application"), various submissions and the hearing proof of the Company's prospectus dated [**day*month*year*] (the "Prospectus"). Capitalised terms

used herein shall have the same meanings as those defined in the Prospectus, unless the context otherwise stated.

Based on the information provided, the Listing Division is of the view that the Company is unable to comply with the minimum profit requirement under Listing Rule 8.05(1)(a) and the suitability requirement under Listing Rule 8.04. Accordingly, the Company's listing application is rejected. The Listing Division's analysis and conclusion are set forth below. In forming our view, we have sought guidance from the Listing Committee.

Minimum Profit Requirement under Listing Rule 8.05(1)(a)

A. *Relevant Facts*

The Group's business

1. The Group is engaged in the businesses of merchant banking, asset management and venture capital fund management. The Group also makes direct investments in listed securities.
2. The Group's merchant banking activities focus on corporate situations which are opaque and identifying undervalued assets. The Group's returns are usually based on some form of carried interest or direct equity participation in the restructured assets and may also receive advisory fees and success fees.
3. One of the predominant strategies used by the Group is injecting acquired assets into listed companies which in turn are acquired principally for resale in the near term. Accordingly, investments in such listed companies are classified as "financial assets at fair value through profit or loss" under the International Financial Reporting Standards.

The Group's profits

4. [The majority of the Group's revenue in the third year of the Track Record Period (comprising Year 1, Year 2 and Year 3)] were derived from unrealized gains ("Financial Gains") as a result of increase in the fair value of the Company's investments in [several listed companies] (the "Investee Companies"). The Investee Companies hold [participation interests in natural resources projects in overseas countries] ("Overseas Participation Interests").

B. *Applicable Listing Rules and Guidance*

5. Listing Rule 8.05(1)(a) requires that profit attributable to equity holders of a new listing applicant must, in respect of the most recent year, be not less than HK\$20 million and, in respect of the two preceding years, be in aggregate not less than HK\$30 million. The profit should exclude any income or loss of the new listing applicant, or its group, generated by activities outside the ordinary

and usual course of its business.

6. The Listing Division views the minimum profit requirement under Listing Rule 8.05(1)(a) as an effective indicator of the past performance of the management during the track record period and such requirement, together with appropriate disclosure, should enable investors to make an informed assessment of the listing applicant as contemplated by Listing Rule 2.03(2). When reviewing whether a new listing applicant satisfies the requirement of Listing Rule 8.05(1)(a), the Listing Division ordinarily considers the burden of proof to be on the sponsor and listing applicant to demonstrate compliance. In view of the importance of this listing eligibility standard, in areas where significant judgment is required by directors or their reporting accountants that affects the Listing Division's analysis of Listing Rule 8.05(1)(a), the Listing Division does not rely solely on the judgment of the directors and/or accountants in reaching its conclusions. Instead the Listing Division may reach its own conclusion based on the information presented in order to ensure that the eligibility standards of Listing Rule 8.05(1)(a) are interpreted in a consistent manner and not unduly affected by the views of individual boards of directors and/or reporting accountants.
7. Listing Decision HKEx-LD45-2 states that in determining whether any income can be counted towards satisfaction of the profit requirement of Listing Rule 8.05(1)(a), the Exchange must be satisfied that, based on the facts and circumstances of a particular case, the income arises from the ordinary and usual course of business.

C. *Issue*

8. Whether the Financial Gains should be recognized as profit for the purpose of the minimum profit requirement under Listing Rule 8.05(1)(a).

D. *Listing Division's Analysis*

9. The Listing Division considers the profit requirement under Listing Rule 8.05(1)(a) to be a question of fact. In particular, the Listing Division will consider whether the Group is able to fulfill the minimum profit requirement without relying on profit from activities conducted outside the Group's ordinary and usual course of business.
10. Based on the description of the Company's business in the Prospectus, the main objective of the Group's merchant banking activities is to realize the acquired assets at an opportune time.
11. The Financial Gains are a result of fair value gains and the Listing Division is of the view that these gains should not be regarded as profits for the purpose of

Listing Rule 8.05(1)(a) as such gains could not be regarded as income in the conventional sense, that is, they are not realised, and they do not contribute to the cashflows of the Group.

12. Therefore, any Financial Gains on the Group's investments in the Investee Companies which were recognized in the profit and loss accounts represent incidental income arising from their merchant banking activities and do not form part of the ordinary and usual business of the Group based on our interpretation under Listing Rule 8.05(1)(a). The Company may receive payment for its services in kind for its merchant banking activities. However, any unrealized gains derived before the sale of the [*listed securities*] in question are incidental income.
13. The Listing Division's analysis is likened to a case where an applicant submitted that it was able to meet the profit requirement under Listing Rule 8.05(1)(a) on the basis that the interest income derived from bank deposits were incurred in the usual and ordinary course of business. The Listing Division was of the view that this should not be the case as any income for the purpose of Listing Rule 8.05(1)(a) should be income actively derived from the Company's principal course of business rather than income derived from a source which is incidental to the issuer's business, as indicated by Rejection Letter HKEx-RL3-04.
14. The Company's equity holdings in the Investee Companies which hold the Overseas Participation Interests are [*less than 20%*]. Therefore, the Company has not demonstrated that it controls these companies through beneficial ownership or board control. The Company has in fact submitted that it does not control these companies.
15. Given that the Company holds less than 50% equity interest in each of the investee companies as detailed in the Prospectus and the Company does not have control of the board of these investee companies, the Company has therefore not demonstrated that it had control over the financial and operating policies of these investee companies. We refer to a precedent case, which was rejected by the Listing Division as indicated by Rejection Letter HKEx-RL14-06, the Listing Division had taken the position that where the Company does not maintain control over the associated companies, the results of such entities should be excluded for the purpose of Listing Rule 8.05(1)(a). We are of the view that the same principle should apply here. As the Company's equity investments were not controlling stakes, the Financial Gains should be considered as passive in nature.

Accounting treatment

16. The Company has submitted that the Financial Gains are part of its merchant banking business and these gains should then form part of its operating activities. However, based on the Accountants' Report, the Financial Gains are

not classified as part of Turnover/Revenue but as a separate line in its Consolidated Income Statements. In addition, such Financial Gains are categorised as cash flows from investing activities rather than from operating activities in the Consolidated Cash Flow Statements of the Accountants' Report.

17. Based on the presentation of the Company's consolidated accounts, it would seem to indicate that the Financial Gains did not form part of the Group's usual and ordinary course of business by presenting such gains as "gain on financial assets at fair value through profit or loss", which was separated from "turnover/revenue". The Group's "Turnover/revenue" mainly represented (i) corporate finance and other advisory fees; (ii) fees from placement of shares; (iii) fund management fee income; and (iv) wealth management services fee. As such, the disclosure in the Accountants' Report is inconsistent with the description of the Company's principal businesses in the Prospectus.
18. Therefore, we conclude that the Financial Gains recognized in the profit and loss accounts during the Track Record Period should not be included for the purpose of Listing Rule 8.05(1)(a). When the Financial Gains are excluded, the Company would record a pro-forma loss attributable to equity holders of the Company for each year of the Track Record Period. The Company is thus unable to comply with the minimum profit requirement of Listing Rule 8.05(1)(a).
19. Fair value accounting is increasingly prevalent in accounting. The Listing Division is not disputing how the Financial Gains are recorded in the Company's financial statements as long as the treatment complies with the relevant accounting standards. We believe there is compliance in this regard. However, as set out in our Rejection Letter HKEx-RL10-06, the profit of an issuer for the purpose of Listing Rule 8.05(1)(a) may be treated differently to its accounting profit.

E. Conclusion

20. On the basis of the Listing Division's analysis set forth above, the Listing Division has concluded that the Group is not able to satisfy the minimum profit requirement of HK\$30 million in aggregate in respect of the first two financial years of the Track Record Period and HK\$20 million in respect of the most recent financial year of the Track Record Period under Listing Rule 8.05(1)(a). Accordingly, the Listing Division has decided to reject the Company's listing application.

Pursuant to Listing Rule 2B.05(1), the Company has the right to have this decision reviewed by the Listing Committee.

[Portion of Letter Purposely Omitted]

Yours faithfully,

For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Head of Listing

LETTER 2

[Date]

[Name and Address of Sponsor]

Dear Sirs,

Re: Review Hearing of the Listing Committee (the
“Review Hearing”) regarding the Company Date of
the Review Hearing: [* day* month * year]

On *[*day*month*year]*, the Listing Committee of The Stock Exchange of Hong Kong Limited conducted a review hearing (the “Review Hearing”) to consider an application from the Company for a review of the decision of the Listing Division set out in *[LETTER 1]* dated *[* day* month* year]*, (the “Decision”).

The Review Hearing was conducted before the Listing Committee comprising *[names of members purposely omitted]* (the “Committee”).

Note: Terms and expressions used and defined in the written submission of the Listing Division shall have the same meanings when used herein unless otherwise defined.

Decision

The Committee considered the submissions (both written and oral) made by the Company and the Listing Division. The Committee decided to uphold the Decision to reject the Company’s listing application on the basis that the Company was unable to satisfy the minimum profit requirement under Listing Rule 8.05(1)(a).

Reasons

The Committee arrived at its decision for the following reasons:

1. Pursuant to Listing Rule 8.05(1)(a), the profit attributable to equity holders of a new listing applicant must, in respect of the most recent year, be not less than HK\$20 million, and, in respect of the preceding years, be in aggregate not less than HK\$30 million. The profit should exclude any income or loss of the new listing applicant, or its group, generated by activities outside the ordinary and usual course of its business.
2. The Committee noted the accounting treatment of income under the IFRS and that the Company had shown its gains on financial assets at fair value through profit or loss in the Consolidated Income Statements. The Committee did not dispute the Company's presentation of its financial statements. However, it should be noted that the IFRS are standards adopted by accountants in preparing financial statements while Listing Rule 8.05(1)(a) sets out the profit test which a listing applicant must comply with. The Committee was of the view that gains which were qualified as income under the IFRS did not necessarily mean that they would qualify as income under Listing Rule 8.05(1)(a), which specifically excludes any income of the issuer, or its group, generated by activities outside the ordinary and usual course of its business.
3. The Company was engaged in, among other things, the business of merchant banking and, in return, received both advisory fees and payment for its services in kind which could be realized at a future date. The Committee was not satisfied that the Company's gains arising from their merchant banking activities could be sufficiently and reliably attributed to the Company's ordinary and usual course of business.
4. In particular, the Committee considered that the unconventional nature of the Company's business model made it difficult for the source and derivation of the Company's profits to be sufficiently transparent for the Committee to conclude that Listing Rule 8.05(1)(a) had been satisfied.
5. On the basis of the above, the Committee was not satisfied that the Company complied with Listing Rule 8.05(1)(a).

Yours faithfully
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Acting Secretary to the Listing Committee

LETTER 3

[Date]

[Name and Address of Sponsor]

Dear Sirs,

Re: Review Hearing of the Listing (Review) Committee
(the “Review Hearing”) regarding the Company
Date of the Review Hearing: [* day* month * year]

On [*day*month*year], the Listing (Review) Committee of The Stock Exchange of Hong Kong Limited conducted a review hearing (the “Review Hearing”) to consider an application from the Company for a review of the decision of the Listing Committee of [*day*month*year] and set out in the [*LETTER 2*] dated [* day*month* year] (the “First Decision”).

The Review Hearing was conducted before the Listing (Review) Committee comprising [*names of members purposely omitted*] (the “Review Committee”).

Note: Terms and expressions used and defined in the written submission of the Listing Division shall have the same meanings when used herein unless otherwise defined.

Decision

The Review Committee considered all the submissions (both written and oral) made by the Company and the Listing Division. The Review Committee decided to overturn the First Decision and allow the Company to proceed with its listing application in accordance with the Listing Rules, subject to the following conditions:

1. the Company should make prominent disclosure of the following in the Company’s Prospectus to the satisfaction of the Listing Division:

- (i) full details of all listed investments and all other investments set out in Listing Rule 21.08(15) and an analysis of any provision for diminution in value of investments set out in Listing Rule 21.08(16) as applicable to investment companies;
 - (ii) information about the underlying performance of the shares in each investee company, including performance, track record, breakdown of gains and price movement;
 - (iii) concentration of shares in a few investee companies and the liquidity of such shares; and
 - (iv) valuation of underlying shares in each investee company with detailed figures and the basis of such valuation.
2. no waiver will be given in respect of compliance with Listing Rule 4.04. The accounts of the Group should therefore be updated to [*the balance sheet date of Year 3+1*].

In addition, due to the volatility and nature of the Group's business, the Review Committee recommends that: (a) the annual report and accounts of the Group issued after listing should disclose the information set out in Listing Rule 21.12(1)(a) to (c) as applicable to investment companies; and (b) the Company considers continuing to publish its quarterly results.

The Review Committee wishes to emphasise that this decision is specific to this particular instance and shall not serve to create a precedent for any other companies.

For the avoidance of doubt, should the Company decide to proceed with its application for new listing, such application will be treated strictly on its merits at the material time, and no representation is given, whether express or implied, as to the acceptability of such application if pursued. The new listing application of the Company in its entirety will be subject to the final approval of the Listing Committee.

Yours faithfully
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Secretary to the Listing (Review) Committee