

[Withdrawn in April 2019; Superseded by HKEX-GL45-12]

Summary	
Category	Interpretive Letters- Rejection Letter (RL3-04)
Listing Rule	Rule 8.05
Reason for rejection	Failure to satisfy the profit requirements of Rule 8.05
Contents	Extracts of the response of the Head of Listing, the Stock Exchange of Hong Kong Ltd

[Name and Address Sponsor]

Dear Sirs,

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

We refer to the listing application of the Company dated [**day*month*year*], your letters dated [**day*month*year*] (the “Letters”) and 1A Proof of the prospectus of the Company dated [**day*month*year*] (the “Prospectus”).

Based on the facts and submissions provided to us, the Division is of the view that the Group is not able to demonstrate that it has complied with the profit requirements of HK\$20 million in respect of the most recent year (i.e. for financial year 2003) under Rule 8.05 of the Listing Rules. We would like to take this opportunity to explain in detail our reasoning in reaching this conclusion.

As stated in the Prospectus and the Letters, we understand the following:

1. *The Group’s business*

The Group’s business is provision of distribution and value-added services to [***] industry in the [*certain Asia regions*].

2. *Other interest income – under “other revenue”*

2.1. Profit attributable to shareholders of the Group was [*over HK\$100 million*], [*over HK\$100 million*], and [*approximately HK\$22 million*] respectively for the three financial years ended [**day*month*] 2003 (“Track Record Period”).

- 2.2. During financial year 2003, other interest income (“Interest Income”) of *[approximately HK\$8 million]* which was included under “other revenue” had been recognized by the Group for the purpose of Rule 8.05.
 - 2.3. Company X from which the Interest Income is derived, is a fellow subsidiary of the Company, and serves as a vehicle for the central treasury function of Parent X, the parent company of the Group, and its subsidiaries (“Parent X Group”).
 - 2.4. It has been the practice of the Group to maintain cash balances with Parent X Group since *[a date well beyond the Track Record Period]*. The cash advanced to Company X was under normal commercial terms and the interest rate charged by the Group for financial year 2003 was approximately *[*]* per cent, representing 3-month prevailing LIBOR plus a *[*]* per cent margin. Such rate has not been changed since *[the commencement of the cash deposit practice with Company X]*.
 - 2.5. The cash flows relating to the advances to Company X were classified as investing activities and not operating activities during the Track Record Period in the combined cash flow statements in the Prospectus.
 - 2.6. It is the view of the directors of the Company that cash advances to Company X in connection with Parent X Group’s central treasury function (i.e. cash deposited with Company X) constitute the ordinary and usual course of business of the Group.
 - 2.7. According to a memorandum from the legal advisers to the sponsor of the Company and the underwriters, it seems clear to the legal advisers that, from a legal stand point, the placing of deposits (and the receipt of interests thereon) constitutes the ordinary and usual course of business of the Group.
3. *Royalty fees – under “corporate charges”*
- 3.1. Royalty fees (“Royalty Fees”) were the payments made to Parent X Group for the use of certain trademarks, logos and domain names. The amount of the Royalty Fees decreased significantly from approximately *[HK\$40 million]* in financial year 2002 to *[approximately HK\$11 million]* in financial year 2003.
 - 3.2. Parent X Group engaged professional advisers to advise the rate of the Royalty Fees. The objective of engaging professional advisers to do so was to determine the arm’s length level of royalties to be charged by Parent X to its subsidiaries in order to comply with applicable transfer pricing regulations of the *[certain foreign tax authorities]*. By following the recommendations made by these professional advisers, Parent X can

satisfy itself that the Royalty Fees it charges its subsidiaries have been set at an arm's length level, thus reducing the likelihood of the *[relevant]* tax authorities making transfer pricing adjustments to the income of Parent X.

- 3.3. Prior to financial year 2003, the Royalty Fees were charged at a rate of 0.5 per cent of the Group's turnover ("Old Rate"). This rate was based on the recommendation of Adviser *[W]*, an adviser engaged by Parent X Group in 2000. The Royalty Fees were charged at this rate for financial years 2000, 2001 and 2002.
- 3.4. Adviser *[Y]* has been engaged by Parent X Group since *[the last quarter]* of financial year 2002 to advise it on its transfer pricing policy. The Group continued to accrue for the Royalty Fees at the Old Rate in financial year 2003. Adviser *[Y]* was specifically requested to review the level of Royalty Fees charged by Parent X Group in *[the early part]* of financial year 2004 and the new range of 0 per cent to 0.7 per cent of the Group's turnover was recommended by them in *[the early part]* of financial year 2004. The new level of 0.2 per cent of the Group's turnover was fixed in *[the early part of]* financial year 2004 upon further negotiation between the Group and Parent X Group. Such new level of the Royalty Fees was retroactively applied with effect from the beginning of financial year 2003 by adjusting the amount of Royalty Fees in the last quarter of financial year 2003.

After reviewing the information stated in the Prospectus and the Letters, the Division offers the following comments and views:

4. *Other interest income – under "other revenue"*

- 4.1. It is stated under Rule 8.05 that the profit should "exclude" any income or loss of the issuer, or its group, generated by activities "outside the ordinary and usual course of its business".
- 4.2. The business of the Group is the provision of distribution and value-added services to *[*]* industry in the *[certain Asia regions]*, which does not include any form of lending activities such as money lending and/or provision of financing to third parties. In other words, the money lending activity should not be considered as part of the Group's principal business or of the ordinary and usual course of its business for the purposes of interpretation of Listing Rule 8.05.
- 4.3. Having considered your submissions, we are of the view that the Group has not demonstrated that the Interest Income should be considered as part of the income generated from the ordinary and usual course of business of the Group for the purpose of Rule 8.05. Accordingly the Interest Income

should be disregarded for purposes of the calculation of attributable profits under Rule 8.05. Once the Interest Income of [approximately HK\$8 million] (net of the related tax effect, if any) is excluded, the net profit of the Group for financial year 2003 is not able to satisfy the minimum profit requirement of HK\$20 million in respect of the most recent year under Rule 8.05 of the Listing Rules.

5. *Royalty Fees – under “corporate charges”*

We note that the charge rate for Royalty Fees in financial year 2003 was fixed in [early part of financial year] 2004 by reference to the recommendation from Adviser [Y] and in addition upon further negotiation between the Group and Parent X Group taking into account the substantial decrease in turnover, gross profit margin and operating profit of the Group in financial year 2003. We are concerned about the retrospective basis of determination of Royalty Fees for financial year 2003, and the positive adjustment to the Group’s trading record arising from the reduction of the Royalty rate from 0.5% to 0.2% after the period end. The effect of this adjustment again makes a significant difference to compliance with the profit requirement under Rule 8.05.

Based on the observations above and having considered the information submitted, the Division is of the view that the Group is not able to demonstrate that it has complied with the profit requirement under Rule 8.05 of the Listing Rules for financial year 2003. On this basis, Division has decided to reject the listing application of the Company.

Please note that the above does not represent the only material issue identified by the Division which may affect the proposed listing of the Company’s shares on the Exchange. In fact, as set out in our earlier correspondence, the Division has not considered it appropriate to proceed any further with the listing application of the Company as the above fundamental issue on the profit requirement under Rule 8.05 has not been resolved to our satisfaction.

[Portion of Letter Purposely Omitted]

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

[signed]

Head of Listing