

HKEX LISTING DECISION
HKEX-LD121-2019 (March 2019)

Summary	
Parties	Company A to Company X – Main Board and GEM listing applicants whose listing applications were rejected by the Exchange in 2018 ¹
Issue	To provide guidance on why the Exchange rejected certain listing applications
Listing Rules	Main Board Rule 2.06 and Chapter 8 GEM Rule 2.09 and Chapter 11
Related Publications	HKEX-GL68-13, HKEX-GL68-13A, HKEX-GL99-18, HKEX-LD92-2015, HKEX-LD100-2016, HKEX-LD107-2017 and HKEX-LD119-2018
Decision	The Exchange rejected the listing applications

BACKGROUND

1. The Exchange notes that there has been a marked increase in the number of applications rejected in 2018 over previous years. This reflects the higher level of scrutiny by the Exchange in its assessment of suitability for listing, and exercise of its discretion to determine whether there are facts and circumstances to form a reasonable basis to believe that an applicant is likely to invite speculative trading upon listing or to be acquired for its listing status as discussed in our Guidance Letter HKEX-GL68-13A.
2. The Exchange's vetting process is qualitative and the review on the suitability of each applicant is holistic. Whilst a number of factors are taken into account, a greater level of scrutiny is now placed as to an applicant's (i) commercial rationale for listing, and thus a genuine need for funding; and (ii) valuation and the methodology used.

REASONS FOR REJECTION

3. A summary of the factors taken into consideration by the Exchange in rejecting the applications is set out below. Details as to the individual backgrounds of the rejected applications can be found at Appendix 1.

¹ This does not include two GEM listing applications which were rejected by the Securities and Futures Commission under section 6(2) of the Securities and Futures (Stock Market Listing) Rules.

4. Suitability:

- (i) *Lack of commercial rationale for listing with respect to 15 applicants and thus no genuine funding needs*²
 - a. Failure to substantiate the commercial basis for the proposed expansion. Moreover, the applicants' proposed expansion plans were not commensurate with their previous business strategies and financial performance.
 - b. Failure to explain how application of the IPO proceeds makes commercial sense; where the applicants intended to use the net IPO proceeds to acquire land/property for use as a showroom, office premises or retail outlets, it was noted that the cost savings derived from owning versus leasing the properties was immaterial.
 - c. Failure to demonstrate a genuine funding need as the applicants had previously relied upon internally generated funds to finance their operations during the track record period and would be able to fund its proposed expansion plans with internal resources and/or debt financing.

- (ii) *Unsupported valuation for three applicants*³

Failure to justify why the forecasted price-earnings (“P/E”) ratios were higher than those of industry peers, the basis on which the peers were chosen; and how such valuations were reasonable in light of the applicant’s history and profit forecasts.

- (iii) *Packaging*

Failure by one applicant to demonstrate that different companies recently restructured under the listing group had operated as a single economic unit during the track record period, leading to the view that the applicant’s reorganisation had been done solely to meet the eligibility requirements of the Listing Rules.

- (iv) *Deterioration of financial performance*

One applicant had showed a significant deterioration in its financial performance during the track record period and there was insufficient basis to believe that its situation would improve as its diversification into a

² This rationale did not apply to two rejected applicants — one was listing by introduction and not raising funds and the other cited shareholder diversification and increased liquidity as its rationale for listing.

³ This was the sole basis for rejection for one applicant, while lack of commercial rationale also applied to the other two applicants.

new segment was recent and long term prospects of the new business were uncertain.

(v) *Suitability of director/person of substantial interest or controlling shareholder with respect to three applicants*

The director/person of substantial interest or controlling shareholder of the respective applicants had previously been convicted of offences relating to dishonesty and as they had significant influence on the operations and management of the applicants during the track record period which rendered the applicants unsuitable for listing.

(vi) *Sustainability of business*

A substantial portion of the applicant's revenue during the track record period was derived from a separate business operated by the applicant's controlling shareholder. The delineation of the applicant's business from its controlling shareholder did not conform with industry norms, the arrangements with the controlling shareholder were not on normal commercial terms and there was uncertainty whether arrangements with independent customers would generate similar amount of sales.

5. Eligibility:

(i) *Failure to meet the minimum net profit requirements after excluding non-ordinary course income.*

(ii) *Failure to meet the qualification requirements for transfer from GEM to Main Board.*

6. Others:

(i) *Failure by the sponsor to satisfy the independent requirement.*

Applicant backgrounds

Consumer Services		
Company	Background	Reasons for Rejection
Company A	<p>Company A leases and operates a stand-alone high-end shopping centre in the PRC. Company A derived the majority of its income from (i) subleasing of retail units in the shopping centre; and (ii) providing property management services to tenants. In the last year of the track record period, Company A had also started offering consultancy services to property developers in the PRC.</p> <p>During the track record period there had been a significant deterioration in Company A's performance. Company A's attempts to turn around performance were ineffective as a result of the relatively inferior location of Company A's shopping centre and there was also an expectation of increased competition from newer shopping centres. Although Company A had attempted to diversify its revenue streams, the relevant revenue contribution from its consultancy business was small, uncertain and highly volatile given its short operating history and project-based nature.</p>	Deterioration of financial performance during the track record period and insufficient basis to believe situation will improve.
Company B	<p>Company B operates retail outlets of multi-brand maternity, baby and child-care products in Singapore. Its planned use of proceeds was to (i) partially fund its local expansion plans; (ii) pursue strategic acquisitions; and (iii) upgrade existing outlets. There was a view that listing in Hong Kong would raise Company B's profile amongst Chinese tourists to Singapore.</p> <p>During the track record period, Company B's revenue and profit had declined and there was a concern that its operations would continue to suffer as a result of falling market demand and competition from online retailers. Additionally, given its deteriorating financial performance, Company B failed to substantiate its need to significantly expand its retail network and pursue acquisitions and it had substantial cash and/or banking facilities available to fund its expansion plans.</p>	Lack of commercial rationale, thus no genuine funding needs.
Company C	<p>Company C supplies electronic car parking systems in Singapore.</p> <p>Company C's initial application lapsed without providing a satisfactory commercial basis for its proposed use of proceeds. In its renewed application, Company C amended its use of proceeds to include purchasing property in Hong Kong as part of its expansion into Hong Kong. In response to our</p>	Lack of commercial rationale.

	<p>comments, it subsequently decided to rent property in Hong Kong instead and amended its use of proceeds several times during the vetting process. The changes in use of proceeds and the failure of Company C to explain the rationale of such changes cast doubt on the veracity of Company C's expansion strategy and its rationale for listing.</p>	
Company D	<p>Company D provides laundry and linen management services to customers in Singapore.</p> <p>Company D could not justify the basis of its significantly high forecast P/E ratio. During the track record period Company D recorded limited growth in revenue and profit and was unable to demonstrate its ability to grow at a level commensurate with that of the industry. In addition, Company D was unable to address questions around whether there would be an adequate market for its securities.</p>	Unsupported valuation.
Company E	<p>Company E (i) leases vehicles to car-hailing service providers in the PRC; and (ii) assists car purchasers in their applications for license plates and mortgage loans (the "Agency Services").</p> <p>Over 90% of Company E's profits during the track record period was derived from the Agency Services. These Agency Services were primarily provided to customers of a dealership operated by Company E's controlling shareholder (the "Connected Stores"). During the track record period, the Agency Services business relied on staff of the Connected Stores to solicit customers. Without the contribution from the Agency Services, Company E would have recorded net losses in the track record period. In addition, the Agency Services were common ancillary services provided by dealerships, rather than a separate entity.</p> <p>The delineation of the Agency Services did not conform with industry norms and the terms of the arrangement with the Connected Stores were not on normal commercial terms as evidenced by cooperation agreements Company E entered into with independent dealerships. As such, concerns regarding Company E's sustainability were not resolved and Company E was determined to be not suitable for listing.</p>	Business sustainability concerns due to off-market arrangements.
Company F	<p>Company F provides obstetrics and gynaecology healthcare services in Hong Kong.</p> <p>Mr. X (Company F's controlling shareholder, founder, chairman, executive director and chief executive officer) had previously been investigated for tax evasion. Although he had reached a settlement with the relevant tax authorities, they nonetheless issued a letter stating that he had acted willfully with the intent to evade tax.</p>	Unsuitability of director due to prior misconduct.

	In assessing the suitability of Mr. X, the Exchange considered the following: (i) the penalties levied by the relevant authority on Mr. X – representing 118% and 104% of the tax undercharged; and (ii) that the tax audit spanned a period of five years, during which time Mr. X was unable to substantiate to the tax authorities that he did not willfully intend to evade tax. In light of these facts, it was determined that Mr. X did not have the requisite level of honesty and integrity expected of company directors.	
Company G	<p>Company G owns and operates one hotel in Hong Kong. Its proposed listing was by way of spin-off from its parent.</p> <p>Company G provided only boiler-plate reasons for its listing, including financing flexibility for any future acquisition or refurbishment. During the track record period, Company G had (i) sufficient operating cash flows; (ii) substantial cash and bank balances and (iii) unutilised banking facilities.</p>	Lack of commercial rationale.

Properties & Construction		
Company	Background	Reasons for Rejection
Company H	<p>Company H manufactures and sells steel products for construction projects and provides related construction and ancillary services in Hong Kong and Macau. Its planned use of proceeds was for the acquisition of land to allow for expansion of its production facilities.</p> <p>During the track record period, Company H's financial performance deteriorated and it had excess production capacity. Yet its use of proceeds was to fund expansion, which was not supported by increased demand. In addition, Company H's valuation in relation to its peers was questionable and it had substantial cash and/or banking facilities available to fund its expansion plan.</p>	Lack of commercial rationale, thus no genuine funding needs; unsupported valuation.
Company I	<p>Company I had previously been suspended and sought to resume trading through the acquisition of another company, that company being involved in the development and sale of residential and commercial properties in the PRC (the "Target Group").</p> <p>Prior to the track record period, the Target Group had received a one-off subsidy from the PRC government for use in the development and operation of a training institute. However, demand for the training institute fell short of expectations and the Target Group sold part of the development to a third party and recognised a gain on this disposal (the "Disposal Gain"). The Disposal Gain was</p>	Failure to meet the minimum net profit requirements.

	<p>recorded as “Other Income”.</p> <p>As (i) the subsidy, construction of the training institute and subsequent disposal did not form a part of the Target Group’s ordinary course of business and were non-recurring; and (ii) the one-off subsidy and Disposal Gain were accounted for differently than the rest of the Target Group’s developments, the Disposal Gain was not included to satisfy the requirements of Main Board Listing Rule 8.05(1).</p>	
Company J	<p>Company J provides fit-out services for commercial and residential properties in Hong Kong and Macau. Its planned use of proceeds was for the acquisition of new commercial premises in Hong Kong and the PRC. It had previously leased such premises.</p> <p>Company J claimed, but could not substantiate, how the new properties will materially improve the Company’s tender success rates and the extent owning its premises would benefit its customers. Any cost savings from owning instead of leasing premises was uncertain as Company J’s analysis did not take into account repair and maintenance costs and interest expenses.</p>	Lack of commercial rationale, thus no genuine funding needs.
Company K	<p>Company K is a sub-contractor of formwork erection works and ancillary services in Hong Kong. Its planned use of proceeds was for the acquisition of (i) new commercial premises; and (ii) equipment to facilitate its expansion plan.</p> <p>Company K claimed that owning its own premises would improve its image with its customers, but as customers would not know it owned its premises, Company K could not show a clear competitive advantage in owning a property. Other objectives, such as capturing market demand and enhancing its corporate governance practices, could be achieved without listing. In addition, net savings from owning its premises and certain equipment was unclear as Company K did not take into account relevant depreciation charges.</p>	Lack of commercial rationale, thus no genuine funding needs.
Company L	<p>Company L is a sub-contractor for plumbing, sanitary and gas works in Singapore. Its planned use of proceeds was for the acquisition of (i) commercial premises; and (ii) equipment and machinery.</p> <p>Company L had a substantial cash balance, unutilised bank facilities and significant trade and other receivables. It was noted that the amounts immediately available to Company L from its own sources would be sufficient to pay the expenses incurred through its proposed expansion. In addition, (i) as the proposed property acquisition was not on the immediate horizon, Company L would have additional resources that could be used to fund its acquisition plan; and (ii) given that</p>	Lack of commercial rationale, thus no genuine funding needs.

	debt financing is available for the acquisition of property, in light of the low interest environment, the commercial rationale for listing was unconvincing.	
Company M	<p>Company M sells building and home furnishing products in Hong Kong and the PRC. It planned to use a substantial portion of the proceeds to diversify into new products and open new retail stores (the “Expansion Plan”).</p> <p>Company M failed to substantiate the basis of the Expansion Plan as (i) the quantum and magnitude of working capital required for the business in new products were uncertain; and (ii) the number of Company M’s retail stores was decreasing during the track record period and it had adopted a distributorship model which allowed it to expand its business in regions where it had no self-operated physical store without incurring significant cost.</p> <p>Company M expected its valuation at the time of listing to be higher than that of its peers. However, this was not supported considering its flat historical, flat forecasted profit growth and that during the track record period, the average revenue generated from each of Company M’s stores had decreased.</p>	Lack of commercial rationale and unsupported valuation.
Company N	<p>Company N is a sub-contractor for foundation works in Hong Kong.</p> <p>Company N was jointly founded by Mr. and Mrs. Y in 1994. They collectively ran Company N until Mr. Y’s retirement in 2014. Post-retirement from Company N, Mr. Y maintained directorships of two of Company N’s operating subsidiaries and also served as a senior consultant to Company N.</p> <p>Mr. Y had previously been convicted of bribery and was imprisoned. Although the conviction had occurred over 20 years ago, the charges related to the provision of kick-backs to benefit Company N and reflected badly on Mr. Y’s character and integrity.</p> <p>In coming to its decision, the Exchange further considered that Mr. Y was: (i) the spouse of one of Company N’s executive directors; (ii) a co-founder of Company N; (iii) the settlor of the family trust that held Company N’s shares; and (iv) a director of Company N’s two major operating subsidiaries. Additionally he had maintained a position as a member of senior management of Company N and had long-standing work history with other members of Company N’s senior management.</p>	Unsuitability of director due to prior misconduct.
Company O	Company O provides plumbing and drainage services in Hong Kong. It proposed to use proceeds to acquire a large parcel of land as part of its expansion plan.	Lack of commercial rationale, thus

	<p>Company O had previously provided its services on leased property and owning land for a warehouse was not commensurate with its past business strategies. It also failed to substantiate its claim that its expansion plan would result in additional revenue from emergency services and capture additional market share. In addition, Company O could not explain why it needed such a large parcel of land as it only had plans to use approximately half of the land.</p>	<p>no genuine funding needs.</p>
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Industrials		
Company	Background	Reasons for Rejection
<p>Company P</p>	<p>Company P provides electrical and mechanical engineering services in Macau. It proposed to use proceeds primarily for the expansion of its workforce and acquisition of premises for a warehouse and workshop.</p> <p>Company P had failed to substantiate the business need for expansion of its workforce or the acquisition of warehouse premises as (i) the industry outlook and Company P's project backlog, the reasons for its proposed expansion were unclear; and (ii) it had historically been able to grow its business without providing the additional services that required having a workshop.</p>	<p>Lack of commercial rationale, thus no genuine funding needs.</p>
<p>Company Q</p>	<p>Company Q provides port logistics services in Singapore.</p> <p>Mrs. Z was the founder, controlling shareholder, chairlady and executive director of Company Q. Mr. Z was the founder of Company Q's sole operating subsidiary (the "Subsidiary"). Although he no longer had a role in Company Q or the Subsidiary, he had been a director for 15 years of and authorised to sign payment vouchers and cheques for the Subsidiary. In 2010, Mr. Z was convicted of an offence of dishonesty involving the misappropriation of funds of another company, giving rise to concerns regarding his integrity.</p> <p>Given Mr. Z's various prior roles in the Subsidiary and his relationship with Mrs. Z and other senior management, the Exchange concluded that Mr. Z was a person of substantial interest. His misconduct rendered him unsuitable to be a director.</p>	<p>Lack of suitability of director/person of substantial interest due to such person's prior misconduct.</p>
<p>Company R</p>	<p>Company R is a Hong Kong based property agency that markets overseas properties to Hong Kong buyers. Its proposed use of proceeds was to fund expansion into the PRC.</p> <p>As Company R had no prior experience of operating in the</p>	<p>Lack of commercial rationale.</p>

	<p>PRC and did not provide any basis by which to determine (i) whether it would be able to overcome the entry barriers to operate in the PRC; or (ii) how the assumptions and breakeven analysis had been achieved.</p>	
Company S	<p>Company S leases out crane and platform lorries in Hong Kong. It proposed to use proceeds to acquire of a large parcel of land as part of its expansion plan (the “Expansion Plan”).</p> <p>Company S had historically operated its business without owning property and was unable to substantiate the financial benefits from owning a centralised parking space. In addition, the Expansion Plan was inconsistent with industry practice. Company S had relatively low debt-to-equity ratio. Taken together with its substantial cash balance, Company S had failed to demonstrate that the Expansion Plan could not be funded by other means.</p>	<p>Lack of commercial rationale, thus no genuine funding needs.</p>

Consumer Goods		
Company	Background	Reasons for Rejection
Company T	<p>Company T sources and sells integrated circuit products and provides application solutions and design services to customers in Hong Kong and the PRC. Company T had five major subsidiaries split between Hong Kong and the PRC, namely the “HK Group” and the “PRC Group”.</p> <p>Company T’s profit attributable to its controlling shareholders during the track record period marginally met the minimum requirements under Rule 8.05(1)(a) and neither of its HK Group or PRC Group was eligible for listing on a stand-alone basis.</p> <p>Prior to a reorganisation of Company T, the HK Group was wholly owned by Mr. A, whilst the PRC Group was wholly owned by Mr. and Mrs. B. Following a reorganisation in 2017, interests in the HK Group and the PRC Group were transferred to Company T; and Company T was owned 90% by Mr. A and 10% by Mrs. B.</p> <p>A confirmation deed was executed in the third year of the track record period (the “Confirmation Deed”) by Mr. A, Mr. B and Mrs. B, acknowledging their cooperative business arrangements since 2011 and that they had historically acted in concert in managing the affairs of each group.</p> <p>Notwithstanding the Confirmation Deed, the Company T could not otherwise demonstrate that the HK Group and the PRC Group had in fact been operating as an integrated group,</p>	<p>Packaging.</p>

	given that the respective controlling shareholder of each group company did not hold any equity interest, directorship or managing role in the other group company, and no formal agreements were available to evidence the rights of either controlling shareholder in any profit / losses in the other group company.	
Company U	<p>Company U distributes vehicles and provides related services in Hong Kong and the PRC. It was listed on GEM and applied to transfer to the Main Board (the “Transfer Application”).</p> <p>In the 12 months prior to the Transfer Application, Company U had been the subject of a disciplinary investigation by the Exchange in relation to serious breaches of the GEM Listing Rules. Thus it did not meet the transfer qualification requirements under Main Board Listing Rule 9A.02(3).</p>	Failure to meet qualification requirements for transfer from GEM to Main Board.
Company V	<p>Company V supplies electronic components and was listed on GEM. It applied to transfer to the Main Board.</p> <p>Sponsor Firm A acted as the sole sponsor in respect of Company V’s GEM Listing and thereafter also acted as Company V’s compliance adviser. Sponsor Firm A then acted as sole sponsor to Company V’s transfer application from GEM to the Main Board of the Exchange. Although Sponsor Firm A did not have any business relationships with Company V apart from acting as its compliance adviser, there would nonetheless be a perception that Sponsor Firm A cannot objectively assess the Company V’s compliance records role as this would require Sponsor Firm A to review its own work while it acted as Company V’s compliance adviser. This scenario is specifically discussed in our Guidance Letter HKEX-GL99-18.</p>	Lack of sponsor independence.

Financials		
Company	Background	Reasons for Rejection
Company W	<p>Company W’s primary business is providing financial advisory and taxation solution services in the PRC.</p> <p>During the track record period, Company W relied on internally generated funds to finance operations, with no bank borrowings for the three years prior to its listing application. Company W planned to use the listing proceeds to (i) acquire commercial premises in other cities in the PRC (the “Target Markets”) to establish a presence; (ii) produce a series of promotional videos; and (iii) establish a “knowledge hubs” nationwide to promote its services.</p>	Lack of commercial rationale, thus no genuine funding needs.

	Given that Company W had historically been able to develop a customer base in the Target Markets without representative offices and consistently generated positive operating cash flows throughout the track record period, it could not substantiate its rationale to acquire property and its funding needs.	
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Materials		
Company	Background	Reasons for Rejection
Company X	<p>Company X is a gold mining company with operations in Malaysia. Its shares are listed on a Singapore exchange and it sought a dual primary listing on the Main Board to expand its shareholder base and create meaningful liquidity in its shares.</p> <p>Company X asserted that Hong Kong investors would find it an attractive investment alternative to PRC mining companies as it offered investors an opportunity to diversify geographically. However, institutional investors in Hong Kong are already able to invest in Company X on its current exchange and shares to be listed in Hong Kong would be fungible with its existing listed shares. In addition, as compared to Company X's profitable self-selected peers, it recorded lower net profit margin before interest and tax in 2017. This undermined its argument that it would be a more attractive investment.</p> <p>With respect to liquidity, Company X submitted that its average daily trading volume as a percentage to total issued shares was higher than the average of 12 PRC gold mining companies listed in Hong Kong. This obviously contradicts the explanation that listing in Hong Kong will increase the liquidity of its shares.</p>	Lack of commercial rationale.