

SFC fines and revokes the licence of Mega Capital (Asia) Company Limited

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The Securities and Futures Commission (SFC) has revoked Mega Capital (Asia) Company Limited's (Mega Capital) licence to advise on corporate finance and fined it \$42 million for failing to discharge its sponsor's duties in relation to the listing application of Hontex International Holdings Company Limited (Hontex) in 2009 (Notes 1 & 2).

Following the commencement of High Court proceedings by the SFC against Hontex for disclosing materially false or misleading information in its prospectus dated 14 December 2009 (IPO Prospectus), the SFC has investigated into the practices and procedures adopted by Mega Capital in acting as the sole sponsor of the listing application of Hontex (Note 3).

The SFC's investigation revealed that Mega Capital failed to discharge its sponsor's duties. The SFC's main findings are as follows:

1. Inadequate and sub-standard due diligence work

The principal businesses of Hontex and its subsidiaries (the Group) are fabric sales and garment manufacturing (on an Original Equipment Manufacturing basis for apparel owners and for Hontex's franchisees). Proper due diligence on the Group's customers, suppliers and franchisees was crucial to the assessment of the authenticity of the Group's business performance. However, Mega Capital's due diligence work was inadequate and sub-standard.

For example, material information (like transaction figures with the Group) was missing from questionnaires that Mega Capital completed with suppliers and customers; Mega Capital failed to follow-up on the missing information; a number of interviews with suppliers and customers were conducted over the phone in haste on the very day that Hontex filed its listing application; franchisees information provided by Hontex (name, address and turnover of each franchisee) was not properly verified and transaction records between franchisees and the Group were not obtained.

2. Failure to act independently and impartially

Important aspects of Mega Capital's due diligence work on Hontex's suppliers, customers and franchisees were sourced from Hontex without independent scrutiny, displaying inappropriate reliance on the issuer.

For example, Mega Capital acceded to Hontex's request that it should not approach the Group's suppliers, customers and franchisees directly. Accordingly, all interviews were arranged by Hontex and conducted in the presence of Hontex's representatives. Mega Capital also accepted Hontex's representation, without any inquiries, that some of its suppliers/customers refused to have face-to-face interviews with Mega Capital.

In addition, Mega Capital accepted the arrangement to have telephone interviews with such suppliers/customers arranged by Hontex.

Finally, written confirmations from franchisees confirming that they were independent from Hontex were obtained through Hontex.

3. Inadequate audit trail of due diligence work

Mega Capital did not adequately document their due diligence planning and significant aspects of their due diligence work. For example, there are no records showing what background or other due diligence searches had been conducted by Mega Capital on the suppliers, customers and franchisees of the Group.

4. Inadequate supervision of its staff

Most of the due diligence work was handled by junior and inexperienced staff of Mega Capital without adequate supervision. Each of the two responsible officers of Mega Capital who were the sponsor principals in relation to Hontex's listing application denied that they were responsible for the listing application (Note 4).

5. Breach of sponsor's undertaking and filing untrue declaration with The Stock Exchange of Hong Kong Limited (SEHK)

As a sponsor for Hontex's listing application, Mega Capital was required and submitted an undertaking and a declaration to SEHK on 23 July 2009 and 15 December 2009 respectively, confirming that Mega Capital would/had made reasonable due diligence inquiries and believed that all information provided to the SEHK during the listing

application process of Hontex, including the information contained in the IPO Prospectus, was true in all material respects and did not omit material information. In view of various apparent failures and deficiencies of Mega Capital's due diligence work identified above, it would appear that Mega Capital was in breach of the undertaking given to the SEHK by failing to use reasonable endeavours to ensure that all information provided to SEHK during Hontex's listing application did not omit any material information. It would also appear that various declarations made to SEHK, for example, that it had made reasonable due diligence inquiries, were not true.

Many of Mega Capital's failures and deficiencies in discharging its sponsor's duties, as identified above, echo the deficiencies in the work performed by some sponsors that are noted in the Report on Sponsor Theme Inspection Findings published by the SFC in March 2011.

The SFC found no evidence that Mega Capital was involved in any fraud and took into account Mega Capital otherwise had a clean record.

Mega Capital denies all allegations of wrongdoing.

"Mega Capital's failure in discharging its sponsor's duties prejudiced the regulatory assessment of Hontex's suitability for listing and jeopardized the interests of the investing public," the SFC's Executive Director of Enforcement, Mr Mark Steward said.

"Given the important role played by sponsors, these failures must be regarded most grimly. The sanctions imposed on Mega Capital should make it clear that the SFC condemns such failure in the strongest terms," he added.

The SFC acknowledges that there is no evidence that Mega Capital's parent company in Taiwan, Mega Securities Co., Ltd, was involved in Mega Capital's sponsorship work on Hontex's listing application.

The SFC's disciplinary proceedings against Mega Capital are completed but the SFC's investigation in relation to the listing of Hontex and all other relevant circumstances is continuing.

End

Notes:

1. Mega Capital is licensed under the Securities and Futures Ordinance (SFO) to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The SFC has revoked the Type 6 licence of Mega Capital. There is a licensing condition on Mega Capital's Type 1 licence that it shall not engage in dealing activities other than those relating to corporate finance.
2. Hontex was listed on the Main Board of SEHK on 24 December 2009. Mega Capital was its sole bookrunner, lead manager and sponsor and KPMG was its auditors and reporting accountants.
3. Please see SFC's press releases dated 8 April 2010, 7 September 2010, 12 November 2010, 19 May 2011, 15 June 2011, 8 August 2011, 3 October 2011, 28 November 2011 and 12 December 2011 for further details about the SFC's case against Hontex. The Hontex trial is scheduled to commence on 4 June 2012.
4. Pending the completion of the SFC's investigation, the SFC will not publicly identify the responsible officers and sponsor principals of Mega Capital.