

HKEx REJECTION LETTER
Cite as HKEx-RL20-07 (February 2007)

Summary	
Listing Rule	Listing Rule 8.04
Reason for rejection and the subsequent disposal of the case on review	<p>The Listing Committee considered the Company not suitable for listing under Listing Rule 8.04 because the Company’s business model was effectively captive to another company which was both the source of its principal raw materials and its principal customer channel during the Track Record Period. The Listing Committee considered this to be an extreme case that could not be adequately addressed by corporate governance measures alone given the conflicting roles of the Company’s controlling shareholder.</p> <p>The Listing (Review) Committee decided to uphold the decision of the Listing Committee.</p>
Contents	<p><u>LETTER 1:</u> Extracts of the decision letter of the Secretary to the Listing Committee</p> <p><u>LETTER 2:</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”) 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 defined in the Prospectus, unless the context otherwise requires.

At the Listing Committee meeting held on [**day*month*year*], [*names of members purposely omitted*] attended to consider the Application. Having considered all relevant

facts and circumstances in totality, which include, inter alia, the business model of the Company, the Director's conflicting roles and the corporate governance measures adopted by the Company, the Listing Committee considered that the Company is not suitable for listing as required by Listing Rule 8.04. Accordingly, the Company's listing application is rejected. Further reasons for the Listing Committee's decision are set forth below.

Captive business model

The Company's business model is captive in a way that the sourcing of its principal raw materials (*over 90%*) of total purchase of principal raw materials during the Track Record Period) and its principal customer channel (*approximately 60%*) of total sales during the Track Record Period) are dominated by the same party, [Entity X]. The pricing of the purchases from and the sales made to [Entity X] are not in line with market prices, where the purchases are made at 10% to 45% and sales are made at 5% to 35% higher than market prices. [Entity X] acts as a "middle-man" between the Company and its largest ultimate customer [Entity Y], at a pre-determined commission rate.

The Listing Committee considered that the Company's application was an extreme case. There were concerns about the Company's reliance on a major customer which was also the Company's major supplier. There had been instances in the past of high reliance on a customer or high reliance on a supplier, but none where there was high reliance on one party as both supplier and customer. The Company's relationship with [Entity X] is fundamental to its business and the Company has not shown that it is capable of carrying on its business independently of [Entity X]. This has translated into a concern about the suitability of the Company for listing for the purposes of Listing Rule 8.04.

Mr. Q's conflicting roles

[Mr. Q], the Company's chairman, executive director and controlling shareholder, had been a senior management member of the predecessor of [Entity X] prior to the establishment of the Company and has maintained a good relationship with [Entity X]. Although the Directors and the Sponsor confirmed that [Entity X] is an independent third party of the Company and does not have any common shareholder or management to that of the Company, during the vetting process the Listing Division noted that [Mr. Q] had signed [*a number of*] technical agreements in relation to the technical standards required by [Entity Y] ("Technical Agreements") in the capacity of [Entity X]'s representative. As evidenced by the opinion of the PRC legal advisers to the Company, [Mr. Q] is not duly authorised to sign on behalf of [Entity X].

With [Entity X]'s endorsement of the Technical Agreements signed by [Mr. Q], it has appeared that [Mr. Q] may have acted as an agent for both the Company and [Entity X] in conducting relevant transactions. In the case of the Company which operates in a captive business model, where both the sales and supplies are dominated by the same independent third party, [Mr. Q]'s dual role raises concerns as to whether [Mr. Q] will act in the best interests of the Company and its shareholders as a whole, and avoid any potential conflict of interests and duty as required under Listing Rules 2.03 and 3.08.

On the other hand, if [Mr. Q] did not act as an agent for both the Company and [Entity X], [Mr. Q]'s signing of the Technical Agreements with [Entity Y] on behalf of [Entity X] and the Sponsor's submissions demonstrates an unusually close relationship between the Company and [Entity X]. In this regard, although there is no evidence of common shareholding and management between the two parties, the Listing Committee remains concerned as to (i) transfer pricing practices between the two parties; (ii) potential conflicts of interests between the two parties; and (iii) how the performance of the Company may be independently evaluated, given that there were no specific corporate governance measures in place during the Track Record Period to ensure that the business transactions were carried out on normal commercial terms.

Conclusion

The Listing Committee considered that the Company's application raised issues that could not be addressed by corporate governance measures alone and resolved that the Company was not suitable for listing under Listing Rule 8.04. Accordingly, the Company's listing application is rejected.

Pursuant to Rule 2B.07(1) of the Listing Rules, the Company has the right to have this decision reviewed by the Listing (Review) Committee.

[Portion of Letter Purposely Omitted]

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

[Signed]

Secretary to the Listing Committee

LETTER 2

[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 1*] 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”).

Decision

The Review Committee considered the submissions (both written and oral) made by the Company and the Listing Division. The Review Committee decided to uphold the First Decision to reject the Company’s listing application on the basis that the Company was not suitable for listing under Rule 8.04 of the Listing Rules.

Reasons

The Review Committee arrived at its decision for the following reasons:

1. The Review Committee noted that the Company operated in a captive business model. There was high reliance on one supplier for its raw materials and at the same time, high reliance on one distributor for the distribution network to one customer. The Review Committee agreed with the Listing Committee at first instance that the Company’s application was an extreme case. The Review Committee had concerns about the Company’s reliance on a major customer which was also the Company’s major supplier. The Review Committee believed that the Company should show that it was capable of carrying on its business independent of [*Entity X*] which was acting as a “middle-man”.

2. The Review Committee was of the view that the Company and its directors lacked understanding of the importance of corporate governance. The Review Committee noted that [Mr. Q] had signed [a number of] Technical Agreements in the capacity of [Entity X]'s representative and that, as evidenced by the PRC legal advisers' opinion, [Mr. Q] was not duly authorised to sign on behalf of [Entity X]. The Review Committee was concerned that [Mr. Q] had conflicting roles.

With [Entity X]'s endorsement of the Technical Agreements signed by [Mr. Q], it appeared that [Mr. Q] might have acted as agent for both the Company and [Entity X] in conducting relevant transactions. In the case of the Company which operated in a captive business model, where both the sales and supplies were dominated by the same independent third party, [Mr. Q]'s dual role raised concerns as to whether [Mr. Q] would act in the best interests of the Company and its shareholders as a whole, and avoid any potential conflict of interests and duty as required by Rules 2.03 and 3.08.

On the other hand, if [Mr. Q] did not act as an agent for both the Company and [Entity X], [Mr. Q]'s signing of the Technical Agreements with [Entity Y] on behalf of [Entity X] and the Sponsor's submission demonstrated an unusual close relationship between the Company and [Entity X]. In this regard, although there was no evidence of common shareholding and management between the two parties, the Review Committee was concerned as to (i) transfer pricing practices between the two parties; (ii) potential conflicts of interests between the two parties; and (iii) how the performance of the Company might be independently evaluated, given that there were no specific corporate governance measures in place during the Track Record Period to ensure that the business transactions were carried out on normal commercial terms.

3. On the basis of the above, the Review Committee was not satisfied that the Company was suitable for listing under Rule 8.04.

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.

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

[Signed]

Secretary to the Listing (Review) Committee