

HKEx LISTING DECISION
Cite as HKEx-LD51-3 (March 2006)

| Summary | |
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| Name of Parties | Company A - a Main Board listing applicant and its subsidiaries (the 'Group') Parentco – the controlling shareholder of Company A Parentco Group – Parentco and its subsidiaries (other than the Group) |
| Subject | Whether Company A was so dependent on Parentco as to be not suitable for listing given that (1) the executive directors of Company A overlapped with some of the directors of Parentco; (2) Company A and the Parentco Group were in the same industry sector; and (3) common customers were identified? |
| Listing Rules | Listing Rules 8.04, 8.10 (a)(iii); Paragraph 27A of Part A of Appendix 1 |
| Decision | The Exchange did not determine that Company A was unsuitable for listing due to its relationship with Parentco. The issues of reliance on and competition with Parentco were required to be addressed by appropriate disclosures in the prospectus. |

SUMMARY OF FACTS

1. Company A's listing application necessitated a review of the extent of Company A's reliance on Parentco. In particular, the following aspects were considered by the Exchange:
 - a. that common management existed between Company A and the Parentco – three of the four executive directors of Company A would also be directors of Parentco in their capacities as chairman, vice-chairman and a member of the board of directors respectively;
 - b. that Company A was financially dependent on Parentco before listing;
 - c. Company A and Parentco were engaged in different production sectors of the same industry; and

- d. two common customers of Parentco and the Group were identified.
2. In response to comments made during the Exchange's review, the sponsor made the following submissions:

Regarding common management

- a. during the track record period, the day-to-day management, financial decision-making and the operations of the Group had been carried out by Mr. X who is one of the four executive directors of Company A. Mr. X was supported by an experienced full time senior management team comprising more than ten officers. Mr. X was not a director of Parentco and none of the senior officers held any position with the Parentco Group. This management structure ensured independence of the daily management and operations of the Group from that of the Parentco Group;
- b. although three out of four executive directors were also directors of Parentco in their capacities as chairman, vice-chairman and a member of the board respectively, each had his own specific management duties in the Group. All these executive directors devoted not less than 80% of their time on the management of the Group and would continue to do so after listing;

Regarding financial dependence

- c. before listing, all relevant guarantees provided by Parentco would be discharged or substituted by Company A's guarantees and all non-trade balances would be settled with related companies;

Regarding business delineation

- d. Markets: Geographically, more than 80% of the Parentco Group's sales during the last three financial years were derived from sales in Taiwan. However, in the case of the Group its sales derived from Taiwan constituted less than 1% of the Group's turnover during the track record period and Company A intended to focus on markets outside Taiwan;
- e. Products classification: The products supplied by the Group were mainly of higher precision and value which could only be produced by more advanced machinery and automation equipment which presents a barrier for entry by competitors. However, the products supplied by the Parentco Group were mainly lower precision mechanical parts which did not require sophisticated machinery;

- f. Right of First Refusal: to further protect the Group's interest, it was agreed that the Group had the first right of refusal to exploit any business opportunity that could be exploited by either the Group or Parentco. The decision of whether to exploit such business opportunity would be made by non-independent executive directors;

Regarding sales to two common customers

- g. the products sold by Parentco to two common customers of Parentco and the Group were low-end products which the Group neither produced nor intended to produce in the foreseeable future. The products sold by the Group to these two customers were higher-end products with finer precision, and therefore did not overlap with products sold by the Parentco Group. In addition, the sales to one of the customers by Parentco were for delivery in Taiwan exclusively, while those sold by the Group to these customers were without territorial restrictions;
- h. during the last three financial years of Parentco, the combined sales from Parentco to these customers ranged approximately between 1% to 3% of Parentco's sales. However, the combined sales from the Group to these customers ranged approximately between 8% to 15% of the Group's turnover during the track record period and the six months thereafter;

Non-competition undertakings

- i. in order to eliminate competition with the Group, Parentco would sign a non-competition undertaking in favour of Company A upon the listing of Company A. Pursuant to the terms of the non-competition agreement, Parentco would undertake to Company A that it would not directly or indirectly either on its own or together with any other persons
- solicit, interfere with or endeavour to entice away the Group's customers, suppliers or employees who at any time had within the immediate past two years been a customer, supplier or employee of the Group in certain parts of the world where the Group's major markets were located;
 - be engaged or interested in any business which might compete with any business from time to time carried by the Group in certain parts of the world where the Group's major markets were located unless specific written consent was obtained from the independent non-executive directors of Company A.

Disclosure in the prospectus as required under the Listing Rules

- j. relevant disclosures under Rule 8.10 and paragraph 27A of Appendix 1A of the Listing Rules regarding delineation between the respective business of the Group and Parentco and the non-competition undertaking had been made in the prospectus.

THE ISSUE RAISED FOR CONSIDERATION

- 3. Whether Company A was so dependent on the Parentco as to be not suitable for listing given that (1) the executive directors of Company A overlapped with some of the directors of the Parentco; (2) Company A and the Parentco Group were in the same industry sector; and (3) common customers were identified?

APPLICABLE LISTING RULES OR PRINCIPLE

- 4. Listing Rule 8.04 states that:

Both the issuer and its business must, in the opinion of the Exchange, be suitable for listing.

- 5. Listing Rule 8.10(1) states the disclosure requirements:

Where a new applicant has a controlling shareholder with an interest in a business apart from the applicant's business which competes or is likely to compete, either directly or indirectly, with the applicant's business (the "excluded business"):

- (a) the applicant's listing document must prominently disclose the following:
 - (i) reasons for the exclusion of the excluded business;
 - (ii) a description of the excluded business and its management, to enable investors to assess the nature, scope and size of such business, with an explanation as to how such business may compete with the applicant's business;
 - (iii) facts demonstrating that the applicant is capable of carrying on its business independently of, and at arms length from the excluded business;

- (iv) whether the controlling shareholder intends to inject the excluded business into the applicant in future, together with the time frame during which the controlling shareholder intends to or does not intend to inject the excluded business. If there is any change in such information after listing, the applicant must disclose it by way of a press announcement as soon as it becomes aware of such change; and
 - (v) any other information considered necessary by the Exchange;
- (b) if after its listing the applicant proposes to acquire all or part of the excluded business, the enlarged group must meet the trading record requirements of rule 8.05; and
 - (c) all connected transactions between the excluded business and the applicant after listing must strictly comply with the requirements of chapter 14A.
6. Paragraph 27A of Part A of Appendix 1 of the Listing Rules requires disclosure of the following in the prospectus:

Details of any controlling shareholder of the issuer, including the name or names of any such controlling shareholder, the amount of its or their interest in the share capital of the issuer and a statement explaining how the issuer is satisfied that it is capable of carrying on its business independently of the controlling shareholder (including any associate thereof) after listing, and particulars of the matters that it relied on in making such statement.

7. Reference is also made to Listing Decision HKEx-LD51-2 published in March 2006 which sets out how the Exchange regards questions on a listing applicant's independence from its parent in light of the competing businesses between them.

THE ANALYSIS

8. As reported in Listing Decision HKEx-LD51-2 published in March 2006, the Exchange considered that Listing Rule 8.10 requires that where a new applicant has a controlling shareholder with an interest in a business apart from the applicant's business which competes or is likely to compete, either directly or indirectly, with the applicant's business, the applicant's listing document must prominently disclose further information in relation to the excluded business. In particular, pursuant to Listing Rule 8.10(1)(a)(iii), facts demonstrating that the

applicant is capable of carrying on its business independently of, and at arms length from, the excluded business should be disclosed. Paragraph 27A of Appendix 1A also requires a statement explaining how the issuer is satisfied that it is capable of carrying on its business independently of the controlling shareholder after listing.

9. When interpreting the requirements under paragraph 27A of Appendix 1A and Rule 8.10(1)(a)(iii), the Exchange normally requires an applicant to take into account factors relating to the conduct of the applicant's business independently from its controlling shareholder, in areas including financial independence, operational independence and management independence. An applicant may be dependent on its controlling shareholders in one or more of these areas. Where the degree of dependence is excessive, this may translate into a concern about the suitability of an applicant for listing (see Listing Decision HKEx-LD42-1 published in December 2004).
10. Similarly, competition is normally regarded by the Exchange as a disclosure issue and the requirement of Listing Rule 8.10 applies. However, in extreme cases where in the view of the Exchange, there are inadequate arrangements to manage conflicts of interest and delineation of businesses between the applicant and other businesses under common control, the Exchange would consider the impact on the applicant's suitability for listing.
11. A review of whether Company A was or was not capable of carrying on its business independently of Parentco in the light of competing businesses operated by it involved careful balancing of all the relevant factors. The giving of non-competition undertakings by Parentco was a relevant factor but was not decisive. As reported in Listing Decision HKEx-LD51-2 non-competition undertakings may or may not effectively contain competition within acceptable boundaries. Enforceability of non-competition undertakings, in turn, is often dependent on a number of other factors, including but not limited to (a) the effect of exemption clauses on non-competition undertakings, (b) how independently a listing applicant can exercise its right to enforce the non-competition undertakings in light of its own corporate governance and (c) the degree to which the management of the listing applicant and its controlling shareholders are closely connected. If there are indications that a non-competition agreement may not function effectively in light of the facts and circumstances of an individual case, the Exchange may disregard the agreement when determining whether the requirements of the Listing Rules have been satisfied.
12. Based on the above analysis, the Exchange took into consideration the submissions of the sponsor, the nature and enforceability of the non-competition undertakings, the disclosures that were made in the prospectus and decided that the issues of reliance on and competition with the Parentco Group had not been so excessive as to render Company A unsuitable for listing.

THE DECISION

13. Based on the facts and circumstances of the case and the Exchange's analysis of the Listing Rules, the Exchange did not determine that Company A was unsuitable for listing due to its relationship with Parentco. The issues of reliance on and competition with Parentco were required to be addressed by appropriate disclosures in the prospectus