

## **HKEX GUIDANCE LETTER**

**HKEX-GL50-13 (January 2013) (Updated in July 2013 and March 2014) – effective for applications submitted on or after 1 October 2013**

*(Withdrawn in May 2016, superseded by HKEX-GL86-16)*

<b>Subject</b>	<b>Simplification Series – Disclosure in listing documents for IPO cases – the “Business” section</b>
<b>Listing Rules and Regulations</b>	<b>Main Board Rules 2.13(2), 11.07, Paragraphs 28 to 31 of Part A of Appendix 1 and Appendix 27</b> <b>GEM Rules 14.08(7), 17.56(2), Paragraphs 28 to 31 of Part A of Appendix 1 and Appendix 20</b>
<b>Related Publications</b>	<b>HKEX-GL19-10, HKEX-GL26-12, HKEX-GL28-12, HKEX-GL30-12, HKEX-GL36-12, HKEX-GL48-13, HKEX-GL63-13 and HKEX-LD107-1 (Updated in July 2013)</b>
<b>Author</b>	<b>IPO Transactions Department</b>

**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules or this letter.*

### **1. Purpose**

1.1 This letter provides guidance on the extent of disclosure in the “Business” section in listing documents. Specifically, it aims to ensure that the section:-

- is concise, easy to read and in plain language;
- is relevant to an applicant, and provides sufficient information to help investors understand the applicant’s business model.

1.2 The Exchange expects applicants to follow this letter when preparing their listing applications. A listing document that does not follow this guidance may be considered not substantially complete as required under the Listing Rules (*Updated in July 2013*).

### **2. Relevant Listing Rules**

2.1 Main Board Rule 2.13(2) (GEM Rule 17.56(2)) requires that the information contained in the listing document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, an applicant must not, among other things:-

- (a) omit material facts of an unfavourable nature or fail to accord them with appropriate significance;
  - (b) present favourable possibilities as certain or as more probable than is likely to be the case; or
  - (c) present projections without sufficient qualifications or explanation.
- 2.2 Main Board Rule 11.07 (GEM Rule 14.08(7)) sets out an overriding general duty of disclosure in a listing document.
- 2.3 Paragraphs 28 to 31 of Appendix 1A to the Main Board and GEM Rules set out disclosure requirements for listing documents.

### **3. Guidance**

- 3.1 We noted in previous listing documents that applicants included information which was not material and took up many pages. Only information in relation to the business model which investors will need to know to make an informed investment decision should be disclosed. The “Business” section should only explain the material components of an applicant’s business model.
- 3.2 Disclosure should be specific rather than generic, and should tie to other sections of a listing document (e.g. explanations should be given if receivables and payables turnover days in the “Financial Information” section are not commensurate with the credit policy in the “Business” section especially when extended credit policy is given to specific customers).
- 3.3 Applicants should make cross-references to other relevant sections in the listing documents to provide more details on the subject matter and to avoid duplication of information in the listing documents. Information should not be duplicated except in the “Summary” section where information to be highlighted needs to be summarized.
- 3.4 The “Business” section should explain an applicant’s business model. It should also include information on key areas e.g. market and competition, suppliers, customers, production, products and services, etc.
- 3.5 We have set out in Appendix 1 a list of key areas that are generally found in the contents of the “Business” section in listing documents. Applicants only need to make relevant disclosures and not on all key areas and examples mentioned in Appendix 1. Please note that the list is not exhaustive and does not include all disclosure requirements under the Listing Rules and the Companies Ordinance<sup>1</sup> (*Updated in March 2014*).
- 3.6 Applicants should include in the listing documents risk management policies and procedures in place and explain how to mitigate the relevant risks identified:
- description of the existing risk management policies and procedures;

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<sup>1</sup> Retitled as the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) with effect from March 2014.

- corporate governance measures (including board oversight and risk management committees with details of qualification and experiences on those personnel in charge); and
- on-going measures to monitor the implementation of risk management policies and procedures and corporate governance measures.

3.7 Applicants are recommended to present information using tables, charts and diagrams to ensure clear, concise and precise disclosure.

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**List of key areas generally found in the “Business” section**

Key areas	Examples	Reference
Business model	<ul style="list-style-type: none"> <li>• The nature and the major functions of an applicant’s businesses. There should be a balanced disclosure on an applicant’s businesses based on their scale and contribution to an applicant</li> <li>• Any change in the business focus during the track record period (should make cross-references to the key area “Products and services” for details)</li> </ul>	Guidance Letter HKEX-GL26-12 Guidance Letter HKEX-GL28-12
Market and competition <sup>2</sup>	<ul style="list-style-type: none"> <li>• The industry in which it operates (whole market rather than a subset of market), industry maturity and size, and market trends and prospects</li> <li>• Market share and industry ranking, level of competition, whether the market is fragmented or dominated by key players and barriers of entry into the industry</li> </ul>	
Strengths, strategies and future plans	<ul style="list-style-type: none"> <li>• Competitive strengths (e.g. low production cost, high quality products, good relationship with customers and suppliers, etc.) should be substantiated by specific facts in other parts of a listing document</li> <li>• Business strategies (e.g. strengthening sales network, vertical expansion, entering into long-term contracts, etc.)</li> <li>• Expansion plans (e.g. site selection, expected capacity, breakeven period and investment payback period together with the</li> </ul>	

<sup>2</sup> Please refer to HKEx-GL48-13 for similar disclosure required in the “Industry Overview” section in listing documents

Key areas	Examples	Reference
	<p>assumptions, etc.) and how an applicant will implement such plans together with the time frame, capital expenditure requirements, amounts spent/ to be spent, timing for payments, source of funding <i>(Updated in July 2013)</i></p> <ul style="list-style-type: none"> <li>• Whether an applicant has identified any acquisition targets (if not, an appropriate negative statement) and details of the selection criteria</li> <li>• If there is going to be any change in business focus, reasons for the change and the related change in cost structure, profit margins and risk profile</li> </ul>	
Suppliers, raw materials <sup>1</sup> and inventory	<ul style="list-style-type: none"> <li>• Background of material suppliers (e.g. business activities, years of business relationship, whether they are connected persons, credit terms and payment method)</li> <li>• Costs related to an applicant’s five largest and largest suppliers during the track record period</li> <li>• Detailed terms and conditions of any long-term agreements<sup>3</sup> (e.g. duration, minimum purchase commitment and any penalty if an applicant fails to fulfill the requirement, price adjustment provision, renewal and termination clauses) and whether they are legally binding</li> </ul>	

<sup>3</sup>The term “agreement” or “contract” is generally understood to mean that a legally binding relationship has been established between the parties with regard to the performance of certain conduct. If this is not the case, these terms should be avoided so as not to confuse the readers with other terms like “memorandum of understanding”, “memorandum of co-operation” or “letter of intent” which are generally understood to be non-legally binding between the parties. Where an agreement is entered into between the parties, there must be clear description of the extent to which parties are bound (e.g. whether the agreement merely binds the parties to further negotiate the salient terms of the agreement, without promise of agreeing on any terms; or whether it creates commitments that one party may enforce against the other party). There should also be consistent description of the agreements or contracts entered into by the applicant and its business partners throughout the listing document *(Updated in July 2013)*.

Key areas	Examples	Reference
	<ul style="list-style-type: none"> <li>• Major countries from which an applicant purchases its raw materials</li> <li>• Concentration risk and counterparty risk, if any</li> <li>• Sensitivity analysis and breakeven analysis in relation to changes in costs</li> <li>• Any shortage or delay in the supply of raw materials and measures to manage shortage of inventory (e.g. alternative suppliers with comparable quality and prices and substitutes)</li> <li>• Measures to manage fluctuations of raw material prices and whether an applicant can pass on the increase in purchase costs to its customers</li> <li>• Inventory control measures (e.g. purchase on a back-to-back basis upon receipt of orders, level of inventory to be maintained) and provisioning policy</li> <li>• Legality of the source of supply (e.g. parallel import, fur, wood, diamond)</li> </ul>	<p>Listing Decision HKEX-LD107-1</p>
Production	<ul style="list-style-type: none"> <li>• Operation flows, production processes and production time (time for each critical process) in the form of a flowchart</li> <li>• Production facilities, capacity for each major product category and utilization of production facilities (with reasons for fluctuations, low utilization rates or utilization rate exceeding 100% during the track record period)</li> <li>• Major asset and equipment (whether they are leased or owned,</li> </ul>	

Key areas	Examples	Reference
	<p>repair and maintenance, age and time for replacement or upgrade)</p> <ul style="list-style-type: none"> <li>• Justification for planned expansion of production lines, if applicable</li> </ul>	
Subcontracting	<ul style="list-style-type: none"> <li>• Reasons for subcontracting and basis of selecting subcontractors Background of subcontractors, including years of business relationship with an applicant and whether they are independent third parties</li> <li>• Salient terms of the subcontracting arrangements/agreements<sup>2</sup> (e.g. duration, responsibilities of the subcontracting parties, raw materials procurement policy, compliance with relevant quality requirements, basis of determining the subcontracting fees, terms for renewal and termination clauses)</li> </ul>	
Quality control	<ul style="list-style-type: none"> <li>• Composition of the quality control team and their professional qualifications and industry experience</li> <li>• Details of an applicant's quality control measures over the suppliers, subcontractors and its own products</li> <li>• Industry standards (e.g. International Organization for Standardization (ISO)) and other certification, including certification requirements and how an applicant obtained relevant certification (e.g. by application or by entering into a competition)</li> </ul>	
Products and services	<ul style="list-style-type: none"> <li>• Product and service types, product life cycle and seasonality</li> <li>• Pictures of products sold, price ranges by brands and product types,</li> </ul>	

Key areas	Examples	Reference
	<p>and reasons for material fluctuations during the track record period and future price trends</p> <ul style="list-style-type: none"> <li>• Any change in business focus, reasons for the change and the related change in cost structure, profit margin and risk profile</li> </ul>	
Sales and marketing	<ul style="list-style-type: none"> <li>• Direct sales or through distribution channels (e.g. through trading companies and distributors)</li> <li>• Movement of point of sales opened and closed during the track record period and reasons for closure of point of sales</li> <li>• Pricing: fixed price or cost plus policy</li> <li>• Advertising, sales incentive, promotion and discounts</li> </ul>	Guidance Letter HKEX-GL36-12
Customers	<ul style="list-style-type: none"> <li>• Background of major customers (e.g. business activities, years of business relationship, whether they are connected persons, credit terms and payment method)</li> <li>• Revenue from an applicant's five largest and largest customers during the track record period</li> <li>• Detailed terms and conditions of any long-term agreements<sup>2</sup> (e.g. duration, minimum purchase commitment, any penalty if fail to fulfill the requirement, price adjustment provision, renewal and termination clauses) and whether they are legally binding</li> <li>• Whether the suppliers are also an applicant's major customers, or vice versa, and if so, the reasons for this arrangement, the percentage of</li> </ul>	

Key areas	Examples	Reference
	<p>revenue and costs related to them and a breakdown of their gross profit during the track record period</p> <ul style="list-style-type: none"> <li>• Major countries to which an applicant exports its products</li> <li>• Concentration risk and counterparty risk, if any</li> </ul>	<p>Listing Decision HKEX-LD107-1</p>
<p>Product returns and warranty</p>	<ul style="list-style-type: none"> <li>• Product returns policy, whether there is any warranty for products and details of the warranty policy (including warranty terms and time period)</li> <li>• Amount of products returned, the warranty expenses, warranty provisioning policy and the amount of provision during the track record period</li> <li>• Allocation of liability for product defects between an applicant and its suppliers</li> <li>• Any customer complaints, product recalls or product liability claims</li> </ul>	
<p>Insurance</p>	<ul style="list-style-type: none"> <li>• Policies undertaken, risks not being covered and whether the insurance coverage is adequate and is in line with the industry norm</li> </ul>	
<p>Research and development matters</p>	<ul style="list-style-type: none"> <li>• Material technology and technical know-how required for production or the product</li> <li>• Research and development policy (e.g. nature of R&amp;D expenses incurred, when they are expensed or capitalized)</li> <li>• Research and development team, qualifications and experiences of the personnel, expenses on research</li> </ul>	

Key areas	Examples	Reference
	<p>and development</p> <ul style="list-style-type: none"> <li>• Salient terms of cooperation agreements<sup>2</sup> with third parties (including the cost/ profit/ loss sharing arrangement, who owns the intellectual property rights, fees paid to third parties)</li> </ul>	
Health, work safety, social and environmental matters	<ul style="list-style-type: none"> <li>• System of recording and handling accidents and implementation of the policies and the applicant's health and work safety compliance record</li> <li>• Number of material accidents in the course of an applicant's operation, whether there were any claims for personal or property damages, and compensation paid to employees</li> <li>• Occupational safety measures, staff issues and environmental protection policies</li> <li>• Material information about an applicant's environmental obligations under applicable laws and regulations or other voluntarily adopted measures (including the annual cost of compliance with applicable rules and regulations during the track record period and the expected cost of compliance going forward)</li> </ul>	Main Board Rule Appendix 27 and GEM Board Rule Appendix 20
Intellectual property	<ul style="list-style-type: none"> <li>• Material trademarks (including goods marks and service marks), patents registered and pending registration</li> <li>• Any dispute or infringement of trademarks and patents, whether they resulted in any legal actions and the reasons if not</li> </ul>	Guidance Letter HKEX-GL30-12

Key areas	Examples	Reference
Employees	<ul style="list-style-type: none"> <li>• Number of employees by function and geographic location</li> <li>• Training and recruitment policies</li> <li>• Labor unions and disputes</li> <li>• Use of employment agents (with salient terms of arrangements) and whether the applicants or the agents bear the relevant costs of social insurance and housing funds or similar employee benefits in the jurisdiction of employment</li> </ul>	
Properties <i>(Updated in July 2013)</i>	<ul style="list-style-type: none"> <li>• Properties with defective titles, idle land, civil defense projects in the PRC and land resettlement operations in the PRC</li> </ul>	Guidance Letter HKEX-GL19-10
Compliance matters <i>(Updated in July 2013)</i>	<ul style="list-style-type: none"> <li>• Details of material compliance matters</li> </ul>	Guidance Letter HKEX-GL63-13
Bankruptcy, receivership, claims, or litigation <i>(Updated in July 2013)</i>	<ul style="list-style-type: none"> <li>• Whether an applicant is subject to actual or threatened material claims or litigations and their impact on an applicant's operations, financials and reputation</li> <li>• Whether an applicant's directors are involved in the above claims and litigations and if yes, whether they are able to comply with Main Board Rules 3.08 and 3.09 (GEM Rules 5.01 and 5.02)</li> </ul>	
Hedging	<ul style="list-style-type: none"> <li>• Hedging strategy (e.g. percentage of exposure to be hedged, whether an applicant has engaged and/ or will engage in speculative activities, under what circumstances an applicant would adopt each particular type of hedging method, the stop-loss limit)</li> <li>• Nature and duration of each type of contract used and the key terms for each of the contracts entered into during the track record period and</li> </ul>	

Key areas	Examples	Reference
	<p>up to the latest practicable date</p> <ul style="list-style-type: none"> <li>• An applicant’s net hedging position (including the maximum outstanding exposure under its derivative financial instruments and the expiry date)</li> <li>• The detailed risk control measures and identities and experiences of the personnel who are responsible for the approval and monitoring of the activities</li> </ul>	
Licenses & permits	<ul style="list-style-type: none"> <li>• Whether an applicant has obtained all material requisite licenses, permits and approvals for its operation, when they were granted and when they will expire</li> <li>• Status of renewal of licenses, expected timeframe and, with the support of legal opinion, whether there is any legal impediment to renew the licenses</li> </ul>	
Awards	<ul style="list-style-type: none"> <li>• Only material awards should be included and summarized in a tabular format</li> </ul>	