HKEx LISTING DECISION
Cite as HKEx-LD51-2 (Published in March 2006)

Summary	
Name of Parties	Company A – a Main Board listing applicant and its subsidiaries (the "**Group**") Parentco – the controlling shareholder of Company A and its subsidiaries (other than the Group) (the "**Parentco Group**")
Subject	Whether the respective businesses of the Group and the Parentco Group were adequately delineated and whether the disclosure made in the prospectus regarding the Parentco Group's engagement in businesses that competed or were likely to compete with the business of the Group was adequate?
Listing Rules	Listing Rule 8.10 (a)(iii); Part A of Appendix 1, Paragraph 27A
Decision	The Exchange determined that there was adequate delineation between the respective businesses of the Group and the Parentco Group and that adequate disclosure had been made in accordance with Listing Rule 8.10 in respect of the Parentco Group's engagement in businesses that competed or were likely to compete with the business of the Group.

SUMMARY OF FACTS

1. At the time of listing, the Group was principally engaged in Business A.

2. Following a reorganisation of the Group, Business B was separated from the Group as a discontinued business and undertaken by the Parentco. Business B contributed approximately 60%, 50% and 5% to the total turnover of the Group respectively for the three financial year track record period prior to the separation. Since the completion of the transfer of Business B to the Parentco, the Group had focused on Business A.

3. In support of the case that Business B had been delineated from Business A, the sponsor and Company A submitted the following:

   Business A and Business B were clearly segregated

   a. during the track record period, Business A and Business B had been organised into separate profit centres managed by separate divisions within the Group. The segregation of Business B from Business A was to allow them to run as different responsibility/ accountability centres for

management purposes. This reorganisation enabled the Group to concentrate its efforts and resources on Business A;

b. Business A and Business B occupied different specialised segments of the same industry, and did not compete and were not likely to compete with each other;

Product classification

c. in terms of product lines, the Group manufactured finished products which could be sold independently by Business A; whereas the products manufactured by the Parentco through Business B could not be sold separately and had to be integrated into another product;

Product facilities

d. the factory premises of the Group and Parentco situated in two different and distinct factory blocks. There was no sharing of production lines or manufacturing space between the Group and Parentco;

Technologies

e. the production technologies employed for Business A and Business B were completely different in all essential respects. These technologies, which required the use of different machinery, were used to manufacture different products. The technologies, expertise and machinery that the Group and Parentco utilised could not be used to manufacture each other's products;

Management and board composition

f. the Group and Parentco had its own management teams at both the executive and operational levels. Although the Group and Parentco shared common directors, no directors held executive roles in both groups at the same time. Furthermore, the common directors who were executive directors were mainly paid by the respective companies in which they served as executive directors during the track record period;

Staff

g. there was a complete separation of staff and the respective staff members of the Group and Parentco were not on the payroll of the other;

h. the Group and Parentco had separate major customer and supplier bases with separate sales and marketing staff conducting independent sales and marketing activities;

Non-competition undertaking

i. to safeguard the interest of the Group, the Parentco signed a non-competition undertaking in favour of Company A upon the listing of Company A. Pursuant to the terms of the non-competition agreement, the Parentco would undertake to Company A, among other things, that it would not, either on its own or together with any subsidiaries, associates or third party invest, participate or engage in any business which might compete with any core business of the Group or any business proposed to be carried on by the Group as disclosed in the prospectus, or have any interest in such business;

Disclosure in the prospectus as required under the Listing Rules

j. relevant disclosure under Rule 8.10 and paragraph 27A of Appendix 1A of the Listing Rules in respect of the delineation between Business A and Business B and the non-competition undertaking had been made in the Prospectus; and

k. a risk factor had been included in the prospectus to draw the attention of investors to potential competition between the Group and Parentco.

THE ISSUE RAISED FOR CONSIDERATION

4. Whether the respective businesses of the Group and the Parentco Group were adequately delineated and whether the disclosure in the prospectus regarding the Parentco Group's engagement in businesses that competed or were likely to compete with the business of the Group was adequate?

APPLICABLE LISTING RULES OR PRINCIPLE

5. Listing Rule 8.10(1) states 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 "**excluded business**"):

(a) the applicant's listing document must prominently disclose the following:

(i) reasons for the exclusion of the excluded business;

a. 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;

b. facts demonstrating that the applicant is capable of carrying on its business independently of, and at arms length from the excluded business;

c. 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

d. 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. Part A of Appendix 1, Paragraph 27A 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 close associate[1] thereof) after listing, and particulars of the matters that it relied on in making such statement.

THE ANALYSIS

7. 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.

8. When interpreting the requirements under paragraph 27A of Appendix 1A and

[1] *Rule amended in July 2014.*

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 independence is excessive, this may translate into a concern about the suitability of an applicant for listing.

9. 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.

10. A review of whether the applicant is or is not capable of carrying on its business independently of its controlling shareholder in the light of competing businesses operated by controlling shareholder therefore involves careful balancing of all the relevant factors in the applicant's case. The giving of non-competition undertakings by controlling shareholder on a voluntary basis is a relevant factor but is not decisive. 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 scope 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.

11. Based on the above analysis, when reviewing whether Company A was capable of operating independently of the Parentco in light of the competing businesses operated by the Parentco Group, the Exchange took into consideration the following factors:

    a. the submissions given by the sponsor on behalf of Company A on different aspects of the operation of Company A;

    b. the non-competition undertakings given by the Parentco; and

    c. the nature of the information disclosed on the competing businesses of the Parentco Group in the prospectus including a review of the prominence and clarity of the disclosure and the use of a risk factor to highlight the associated risks.

THE DECISION

12. Based on the above analysis and having regard to the material facts, the Exchange determined that there was adequate delineation between the respective businesses of the Group and the Parentco Group and that adequate disclosure had been made in accordance with Listing Rule 8.10 in respect of the Parentco Group's engagement in businesses that competed or were likely to compete with the business of the Group.