

**HKE<sub>x</sub> LISTING DECISION**  
**HKE<sub>x</sub>-LD86-2015 (published in April 2015)**

<b>Summary</b>	
<b>Name of Party</b>	Company A – GEM Board listing applicant
<b>Subject</b>	Whether Company A’s cash flow generated during a period of non-compliance should be counted towards the calculation of minimum cash flow under GEM Rule 11.12A(1)
<b>Listing Rule</b>	GEM Rule 11.12A(1)
<b>Decision</b>	The Exchange determined that the cash flow generated during the period of non-compliance should not be counted towards the calculation of minimum cash flow under GEM Rule 11.12A(1), and Company A was not eligible for listing

**FACTS**

1. Company A was in a business (the “**Business**”) that required compliance with certain regulations (the “**Regulations**”). The Regulations specifically stipulated that no person shall carry on the Business unless all the requirements under the Regulations had been complied with. Any breach of the Regulations was an imprisonable offence. Company A did not comply with the Regulations for 22 months (the “**Period of Non-compliance**”) during its track record period (the “**Incidents**”).
2. Company A would not meet the minimum cash flow requirement under GEM Rule 11.12A(1) if the cash flow generated from the Business during the Period of Non-compliance (the “**Non-compliant Cash Flow**”) was excluded.
3. Despite the fact that Company A did not comply with the Regulations, its legal advisers were of the view that the relevant income generated during the Period of Non-compliance was not illegal as:
  - (i) the Regulations did not stipulate that income generated by an infringing party during the Period of Non-compliance was illegal or will be confiscated; and
  - (ii) the relevant income generated during the Period of Non-compliance would not be rendered illegal under any other legislation.

4. Company A's sponsor believed that the Incidents should not affect the suitability and competence of Company A's directors under GEM Rules 5.01 and 5.02 because:
  - (i) the Incidents were mainly attributable to the directors being unfamiliar with the relevant rules and regulations, including the Regulations. The Incidents did not involve fraudulent act or dishonesty of the directors, and were unintentional. As such, they did not impugn on the directors' integrity or competence; and
  - (ii) the directors had attended a seminar on relevant laws and regulations relating to the Business after the cessation of the Incidents.
5. Company A had enhanced its internal controls, such as (i) engaging a consultant who had over 12 years of experience in the relevant industry to make sure all applicable rules and regulations were complied with; (ii) requiring approval by an executive director and a joint internal compliance coordinator in respect of the Business which were governed by the Regulations; and (iii) implementing specific measures which were to be reviewed by a member of senior management on a monthly basis to ensure compliance with the Regulations.

#### **ISSUE RAISED FOR CONSIDERATION**

6. Whether Company A's Non-compliant Cash Flow should be counted towards the calculation of minimum cash flow under GEM Rule 11.12A(1).

#### **APPLICABLE RULE**

7. GEM Rule 11.12A(1) states that an applicant must have an adequate trading record of at least two financial years comprising a positive cash flow generated from operating activities in the ordinary and usual course of business before changes in working capital and taxes paid. Such positive cash flow from operating activities carried out by the applicant must be of at least HK\$20 million in aggregate for the two financial years immediately preceding the issue of the listing document.

#### **ANALYSIS**

8. The Exchange considered the following in assessing whether Company A was able to meet the minimum cash flow requirement under GEM Rule 11.12A(1):
  - (i) the compliance of the Regulations was fundamental and a pre-requisite for the legal operation of the Business;
  - (ii) any breach of the Regulations was an imprisonable offence, which rendered the breach of the Regulations serious in nature;

- (iii) operating activities in the ordinary and usual course of a business must be carried out generally in accordance with relevant laws and regulations by an applicant, and in the case of Company A, the Regulations; and
  - (iv) the Period of Non-compliance lasted for a substantial part of the Track Record Period (being 22 months).
9. Given that Company A did not comply with the Regulations during the Period of Non-compliance, the Regulations were fundamental to Company A's business, and the breach of Regulations was considered serious in nature which had occurred for a substantial part of the Track Record Period, the Non-compliant Cash Flow could not be regarded as being generated in the ordinary and usual course of Company A's business, and therefore be excluded from the calculation of minimum cash flow under GEM Rule 11.12A(1).

#### **DECISION**

10. Company A was not able to meet the minimum cash flow requirement under GEM Rule 11.12A(1) after excluding the Non-compliant Cash Flow. Therefore, Company A was not eligible for listing.