



## THE STOCK EXCHANGE OF HONG KONG LIMITED

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)  
(the “Exchange”)

4 March 2013

**The GEM Listing Committee of The Stock Exchange of Hong Kong Limited (“GEM Listing Committee”) criticises China Railway Logistics Limited (“Company”) (stock code: 8089) for its breach of Rule 17.56(2) of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (“GEM Listing Rules”).**

On 29 January 2013, the GEM Listing Committee conducted a hearing into the conduct of the Company in relation to its obligations under the GEM Listing Rules.

Having considered the written and oral submissions of the Listing Division (“**Division**”) and the Company, the GEM Listing Committee made the findings of fact and breach set out below.

### **Findings of fact**

According to the Company’s announcement of 22 March 2007, Dragon Billion Limited, its wholly-owned subsidiary, entered into an agreement with a vendor on 12 March 2007 for acquiring the entire share capital of Eternity Profit Investments Limited for a total consideration of \$681,450,000 (“**Acquisition**”).

Through the Acquisition and subsequent reorganisation, it was intended that the Company would, through a joint venture company (“**JV Co. A**”), own 49 per cent equity interest in China Railway Television Freight and Logistics Transport Co. Ltd. (“**PRC Subsidiary**”), which would manage and operate a railway transportation and related logistics business in the PRC.

The reorganisation process would involve converting the PRC Subsidiary from a PRC domestic company to a Chinese-foreign cooperative joint venture company (“**Cooperative JV**”).

### Events

In August 2007, the Company became aware of problems with its investment in the PRC Subsidiary. It discovered that, contrary to its understanding, the joint venture agreement which was approved by the Ministry of Commerce (“**MOC**”) of the PRC did not allow the Group to have majority control over the PRC Subsidiary’s board of directors (“**PRC Board**”) (“**Event A**”).

The Company also became aware in August 2007 that the PRC Subsidiary had not been registered with the State Administration for Industry and Commerce (“SAIC”) and had not obtained its business licence to operate as a Cooperative JV. On 4 February 2008, it was advised by its PRC lawyers that the PRC Subsidiary had not been converted from a domestic company to a Cooperative JV (“Non-Conversion” or “Event B”) (together with Event A, the “Events”).

On 6 December 2007, the Company received a copy of a complaint letter from a group of shareholders to the Division (the “Complaint”), raising concerns about the PRC Subsidiary, including the Non-Conversion. On 8 December 2007, the Board discussed the Complaint at a Board meeting.

On 28 February 2008 (at 8:18 pm), the Company published a voluntary announcement (“Voluntary Announcement”) disclosing the Events. On the next trading day, the Company’s share price closed at \$3.22, a drop of 17.22 per cent from \$3.89 on 28 February 2008. The trading volume was 50,328,000, 1.29 times the past 10-day average.

#### Standard Announcements

Despite the Company’s knowledge of the Events and the Complaint, from 5 September 2007 to 28 February 2008, the Company published the following Standard Announcements under GEM Listing Rule 17.11, each stating, among other matters, that the Board was not aware of (a) any reasons for the unusual trading movements on that date, and (b) any matter discloseable under the then GEM Listing Rule 17.10, which was or might be of a price-sensitive nature (“Confirmation”):

	<u>Date</u>	<u>Time</u>
1. Standard Announcement 1	5 September 2007	8:12 pm
2. Standard Announcement 2	11 September 2007	3:03 pm
3. Standard Announcement 3	3 October 2007	12:47 pm
4. Standard Announcement 4	10 October 2007	6:26 pm
5. Standard Announcement 5	28 November 2007	2:29 pm
6. Standard Announcement 6	19 December 2007	3:45 pm
7. Standard Announcement 7	7 January 2008	7:16 pm
8. Standard Announcement 8	11 January 2008	12:17 pm
9. Standard Announcement 9	28 January 2008	3:51 pm
10. Standard Announcement 10	18 February 2008	7:43 pm
11. Standard Announcement 11	20 February 2008	2:36 pm
12. Standard Announcement 12	21 February 2008	2:31 pm
13. Standard Announcement 13	27 February 2008	3:08 pm
14. Standard Announcement 14	28 February 2008	6:09 pm

The Company’s share price dropped significantly (79.2 per cent) from the closing price of \$15.5 on 1 August 2007 to \$3.22 on 29 February 2008. The Hang Seng Index increased 8.36 per cent from 22,455.36 on 1 August 2007 to 24,331.67 on 29 February 2008.

## Company's share repurchase on 28 January 2008

Further, on 28 January 2008 when the Standard Announcement 9 was published, the Company repurchased 2 million of its shares between the price of \$1.40 and \$1.87 per share. The Company admitted that the share repurchase should have been, but was not, disclosed in the announcement.

### **Relevant Rules**

GEM Listing Rule 17.56(2) provides that information in any announcement required under the GEM Listing Rules must be accurate and complete in all material respects and not be misleading or deceptive. The issuer must not omit material facts of an unfavourable nature or fail to accord them with appropriate significance.

### **Findings of breach**

#### Breach of GEM Listing Rule 17.56(2)

The GEM Listing Committee concluded that the Standard Announcements were not accurate and complete in all material respects and were misleading because:

- (1) They contained the Confirmation and did not disclose the Events which the GEM Listing Committee considered to be information discloseable under the then GEM Listing Rule 17.10 for the reasons set out below;
- (2) On 5 September 2007, 28 November 2007 and 7 January 2008, the Company's share price dropped. The Events might have been relevant to the unusual trading movements in the Company's shares on these dates under GEM Listing Rule 17.11. They amounted to "material" information under GEM Listing Rule 17.56(2) regarding the Standard Announcements; and
- (3) The Standard Announcement 9 also failed to disclose the Company's repurchase of 2 million of its shares conducted on that day. The Company's share repurchase was 14.3 per cent of its trading volume of 13,971,990, and might have been relevant to the unusual trading volume movements on that day.

#### Events fell within the then GEM Listing Rule 17.10 and were material facts

The GEM Listing Committee found that the Events were discloseable under the then GEM Listing Rule 17.10, and were material facts which should have been disclosed in the Standard Announcements, for the following reasons:

- (1) Before publication of the Voluntary Announcement, there was nothing in the public domain which informed shareholders and the market of the Events and/or that the Company was facing any problems regarding the PRC Subsidiary. On the contrary, the Company published various announcements which suggested that the PRC Subsidiary had been converted to a Cooperative JV and/or had started its business. The Events were therefore not within the market's expectations.

- (2) The Events were important and material information relating to the Group which (a) were necessary to enable investors and shareholders to appraise its position (under the then GEM Listing Rule 17.10(1)), and (b) might be reasonably expected materially to affect market activity in and the price of the Company's securities (under the then GEM Listing Rule 17.10(3)), taking into account the following matters and evidence:
- (a) The Company, through JV Co. A, had injected a significant sum (RMB147 million) into the PRC Subsidiary (approximately 12.85 per cent of the Company's total net assets as at 30 June 2007).
  - (b) The loss of control of the PRC Board deviated from the Company's original intention. It also meant that the Company would not have control over the substantial sum which it invested into the PRC Subsidiary.
  - (c) The evidence available suggests that the Acquisition was the Company's biggest project, and the Events had a significant impact on the Company. If the PRC Subsidiary was not registered, it could not obtain a business licence and the railway transportation and related logistics business could not operate.

The Events therefore fell within the scope of, and were discloseable under, the then GEM Listing Rule 17.10. They were material facts which might have been relevant to the unusual trading movements in the Company's shares on the day when each of the Standard Announcements was made.

*The Company had knowledge of the Events in August 2007*

The GEM Listing Committee is satisfied from the materials available that the Company had been aware of the Events in August 2007. The GEM Listing Committee highlights, amongst other matters, that:

- (1) The Voluntary Announcement contained the Company's express statement that it became aware of Event A in or around August 2007. The Company also submitted that it was aware in August 2007 that the PRC Subsidiary had not been registered with the SAIC and had not obtained its business licence to operate as a Cooperative JV.
- (2) Before the Standard Announcement 6 was published on 19 December 2007, the Board discussed the Complaint at the Board meeting on 8 December 2007 (attended by 11 Directors), and the Company received the Division's enquiry letter regarding the Complaint on 13 December 2007.
- (3) Between 20 December 2007 and 28 January 2008 (during which the Standard Announcements 7 to 9 were published), the Company had held three Board meetings to discuss matters relating to the PRC Subsidiary. At the 8 January 2008 Board meeting, the Board was aware that a meeting held on 4 January 2008 with the JV partners was adjourned without reaching any agreement by the parties. At the 25 January 2008 Board meeting, the Board realised the disagreement between the JV partners was difficult to resolve. The Company should have disclosed Event A in at least Standard Announcements 9 to 14.

- (4) On the dates when the Standard Announcements 10 to 14 were made, the Company had already received PRC legal advice about the Non-Conversion on 4 February 2008.
- (5) On 27 February 2008, when the Standard Announcement 13 was published, the Company's legal advisers wrote to the Division regarding the Events, with a draft Voluntary Announcement.
- (6) The Standard Announcement 14 was published at 6:09 pm on 28 February 2008, about two hours before the Company published the Voluntary Announcement.

Standard Announcements not accurate and complete in all material respects, and misleading

Not only did the Company omit disclosure of the Events (and the share repurchase in respect of the Standard Announcement 9), it included the Confirmation in each of the Standard Announcements. The announcements were therefore not accurate and complete in all material respects, and misleading.

The Company therefore breached GEM Listing Rule 17.56(2) on 14 occasions in respect of each of the Standard Announcements.

Inadequate internal controls

The GEM Listing Committee also found that the Company did not at the relevant time, and still does not, have adequate and effective internal controls for procuring GEM Listing Rule 17.56(2) compliance:

- (1) There was a lack of structure to ensure that (a) information that may be discloseable under the then GEM Listing Rule 17.10 could be identified by its staff, senior management and Directors in a timely manner, and escalated to the entire Board for discussion from a GEM Listing Rule compliance perspective; and (b) relevant information in the Company's possession was disclosed to the Division in response to its GEM Listing Rule 17.11 enquiries.
- (2) Apart from the Company's alleged adherence to "*a set of internal control procedures*" (details and copies of which were not given to the Division), and its reference to the Guide on Disclosure of Price-Sensitive Information published by the Exchange, the Company does not have any written procedures to ensure its compliance with the then GEM Listing Rules 17.10, 17.11 and 17.56(2).

**Settlement**

As a consequence of a settlement, the Company admitted the breaches asserted by the Division and found by the Committee as set out above, and accepts the sanctions and directions imposed on it by the GEM Listing Committee as set out below.

**Sanction**

The GEM Listing Committee criticises the Company for its breaches of GEM Listing Rule 17.56(2) on a total of 14 occasions.

There was active trading in the Company's shares from 1 August 2007 to 28 February 2008. The Company's shareholders and the investors trading during this period did not have access to the information regarding the Events. They had been deprived of material information about the development of a significant project of the Group and its financial implications to enable them to properly appraise the Group and to make informed investment decisions.

The GEM Listing Committee considers that the failure to disclose the Events in the Standard Announcements had an adverse market impact, and the Company's multiple breaches of GEM Listing Rule 17.56(2) were therefore serious.

The Company's breaches of GEM Listing Rule 17.56(2) are serious and warrant a public sanction.

### **Directions**

Further, given the GEM Listing Committee's concerns about the adequacies and effectiveness of the Company's internal controls for procuring GEM Listing Rule 17.56(2) compliance, the GEM Listing Committee directs that:

- (1) the Company:
  - (a) retain within two weeks from today an independent professional adviser satisfactory to the Division ("Adviser") to conduct a thorough review of and make recommendations to improve the Company's internal controls to ensure compliance with GEM Listing Rule 17.56(2);
  - (b) provide the Division with the Adviser's written report containing such recommendations within two months from today. The Company is to submit the proposed scope of retainer to the Division for comment before appointment of the Adviser;
  - (c) furnish the Division with the Adviser's written report on the Company's full implementation of the Adviser's recommendations within a further period of two months; and
  - (d) appoint within two weeks from today an independent Compliance Adviser (as defined in Chapter 6A of the GEM Listing Rules, namely an entity licensed or registered under the Securities and Futures Ordinance for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as a sponsor) satisfactory to the Division on an ongoing basis for consultation on GEM Listing Rule compliance for two years. The Company is to submit the proposed scope of retainer to the Division for comment before such appointment. The Compliance Adviser shall be accountable to the Company's Audit Committee;

- (2) the Company publish an announcement to confirm full compliance with each of the directions set out in (1)(a) to (d) above within two weeks after the respective fulfillment of each of the directions. The Company is to submit drafts of the announcements for the Division's comment and may only publish the announcements after the Division has confirmed it has no further comment on them. The last announcement required to be published under this requirement is to include a confirmation that all directions in (1) above have been complied with.

For the avoidance of doubt, the Exchange confirms that the above sanction and directions apply only to the Company and not to any past or present member of the Company's Board of Directors.