



A Cat & Mouse Game for Investors

Assessing ESG Disclosure of Supply Chain Listings in Hong Kong

Disclosure – a governance issue

Globalisation - listings in HK on the rise

Notable Trends

Investor perspective: Listing documents

Requirements of global brands
only disclosure on ESG issues?

Changing local regulatory environment

Market access



Environment		
Legislative compliance	95.8	The majority of companies were definitive in assuring legal compliance within the track record period, 16.7% were less authoritative 'believing' that the company was in compliance. 25% indicated some non-compliance.
Electricity shortages	54.2	Recognized instability of electricity supply as a potential risk.
	33.3	Acknowledged being a large consumer of energy.
Environmental management certification ISO 14001	45.8	Often referred to as a quality standard suggesting some misunderstanding of ISO 14001 as an environmental management system standard.
		Scope of the certification lacking, 46% of those companies with ISO 14001 certification did not disclose which companies or operations were certified.
Water	25.0	Indicating water consumption and on occasion water shortages as a concern.
	25.0	Providing information on waste water treatment facilities.
Customer requirements	16.7	Disclosure related to the EU Directive on the Restriction of Hazardous Substances (ROHS), otherwise environmental requirements from customers not cited.

Social		
Payment of social insurance	100.0	Two companies disclosed non-payment of social insurance.
Relationship with employees	75.0	In all cases standard terminology referred to good relations maintained with employees.
Importance of low labour costs	58.3	Recognised the importance of low labour costs.
Labour shortages	20.8	Recognised as potential risks, but no direct experience of these issues during the track record period.
Labour unrest	12.5	
Recognition of social responsibility	12.5	Social responsibility cited by companies in the apparel sector.
Legislative compliance (health and safety)	16.7	Limited disclosure on compliance with health/safety and labour laws.

Governance

Connected Transactions	79.2	Numerous transactions cited, often without sufficient explanation as to why and future arrangements.
Board structure and experience	62.5	Indicate family connections at the board level.

Gaps in disclosure a barrier to informed assessment

- **Limited in scope**
- **Legal orientation obscures**
- **Poor intermediary understanding**
- **One dimensional in nature**
- **Market access represents a fundamental business risk**
- **Labour issues on the move, while disclosure remains static**

Legal orientation obscures rather than enlightens

AAC Acoustics—on ROHS

in the Business Section:

- *We do not expect any difficulties in complying with the ROHS Directive in the future*

in the Risk Factors Section :

Market Access

- *There is no assurance that our products will continue to comply with this (ROHS) Directive andin the future.*

Is it material?

The Cost of Non-compliance with legislation

- Netherlands government seized 1.3 million Sony Playstation game machines
- Estimated value US\$162 million
- Dutch regulation banning cadmium in products since 1999

Rework cost to Sony reputed US\$92 million

Legal orientation obscures rather than enlightens

- **Sandmartin** - directors *believe* that the Group's environmental system and facilities are adequate to comply with applicable national and local environmental protection regulations
- **Foxconn** - Further additional environmental matters may arise in the future at sites where no problem is currently known or at sites that we may acquire in the future
- **Xiwang Sugar** - Our Directors *believe that* our production facilities conform to the applicable environmental protection regulations in the PRC in all material aspects. Nevertheless, *there can be no assurance* that the existing laws and regulations in the PRC will not change in the future. If there is any such change, we may incur additional costs to comply with the new laws and regulations, which could have an adverse impact on our financial position.

Poor intermediary understanding?

Disclosure on ISO 14001

A quality standard?

China Glass state that: *We have been awarded ISO9001:2000, ISO14001 and OHSMS18001 certification for our quality control procedures.*

Global Flex indicate that: *As a result of its stringent quality control, the Group has obtained several accreditations for its quality systems including ISO14001:1996*

Poor intermediary understanding

Disclosure on ISO 14001

Scope is fundamental

EVA – the Group has obtained ISO 14001 certification for environmental management control

China Glass – Our commitment to high standards of environmental protection has resulted in our company receiving ISO 14001:1996 certification for our environmental management systems

Poor intermediary understanding

Misleading Language?

Alltronics in accordance with the production factories' environmental impact report, the production factories do not emit industrial waste water and shall report any changes to the Shenzhen Environmental Bureau

Ju Teng's claim that – save for the production of a small amount of solid waste production materials, our Group's production plants do not discharge waste water nor do they emit smoke from their production processes.

One dimensional disclosure leaves investors guessing

Energy & water

AAC

State that its *production maybe interrupted limited or delayed if it cannot obtain sufficient energy supplies.*

China Glass

Indicate that its *production processes require large amounts of fuel oil electricity and water*
....We source our water from the Beijing – Hangzhou grand canal adjacent to our facilities, for which we are required to pay a water usage fee to the local government

One dimensional disclosure leaves investors guessing

Legal requirements

- **China Ting** Indicates that *for Jiangsu Fuze, the relevant local environmental protection department has issued a confirmation letter on 14 November 2005 that as at the date of issue of such confirmation letter, Jiangsu Fuze was not required to obtain the permit for the treatment and discharge of waste water.*

**One dimensional disclosure leaves investors
guessing**

Use of Proceeds???

Public scandals and legal breaches driving disclosure

Bauhaus an emerging Asian brand

Its prospectus is the only one to almost entirely omit environmental and social disclosures, yet as an apparel manufacturer with production facilities in the PRC, it is exposed to a number of material ESG risks which are commonly addressed by its peers.

Insights can be gained

Metrics

- **cost of labour**
- **breakdown of staff numbers by year/turnover**
- **cost of energy and utilities**
- **capital expenditure on pollution control equipment**
- **payment of pollution control fees**
- **gross profit margins**
- **governance issues**

Governance		
Connected Transactions	79.2	Numerous transactions cited, often without sufficient explanation as to why and future arrangements.
Board structure and experience	62.5	Indicate family connections at the board level.
	62.5	CFO recently appointed (in the two years prior to listing).
	45.8	Independent Non-Executive Directors on the board of four or more other companies, often little disclosure provided to establish suitability/qualifications.
	20.8	CEO and Board Chair noted as the same individual.

□

Fountain Set Group

- 17th August 2006 Wen Wei Po
- **In Dongguan, > 100 companies to be closed down due to non-compliance with environmental standards**
- **Surprise inspection - Fu An emits 20,000 tonnes of waste water daily, without reporting to the authorities**

Fountain Set Group

Aug. 27 (Xinhua)

- Fu An secretly released more than 10 million tons of waste water over the **past two years through a pipe buried underground** - ordered to pay 11.55 million yuan (**1.4 million U.S. dollars**)
- HK Standard 28 Aug 06 "..... About a **third** of production at the Fu An plant is affected, amounting to **13 %** of Fountain Set's capacity.
- CLSA analyst expects the affected orders to be shifted to another plant outside Guangdong.
- Fountain Set is also outsourcing some orders, which will affect margins.
- Last month - fined 210,000 yuan for a similar infraction at the plant, prompting JPMorgan to reduce Fountain Set's sales and recurring profit estimates by **2%** and **9%** respectively.

Fountain Set Group

- Founding Principles "diligence, frugality, sincerity, and integrity"
- www.fshl.com
 - committed to protect the environment.
 - There are sufficient effluent treatment plants efficiently handling the wastewater in compliance with the regulations of the Environmental Protection Bureau of China, Sri Lanka and Indonesia.
 - dedicated to environmental best practice in all of its commercial activities.....
- TDC - Most of the group's cotton spinning mills enjoy ISO 14001 environmental certification,

Comments

- Significant fine – 13% capacity affected
- Hidden underground pipe ! 10m tons of water – not noticed?
- Cost to business of outsourcing, resolving issue, reputation
- Impact main customers?
- Has new plant included “new volumes” in capacity and treatment costs?
- Contradiction - public reporting vs actual practice
- Which plants have ISO14001 ?
- Other plants?

This is a listed company with resources

Inadequate disclosure persists..

The listing rules require that preparation of listing documents must have regard to the following principles:

*the information contained in the document must be **clearly presented** and in the plain language format specified or recommended by the Exchange and/or the Commission from time to time; and*

*the information contained in the document must be accurate and **complete** in all material respects and **not be misleading** or deceptive. In complying with this requirement, the issuer 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;***

*(c) **present projections without sufficient qualification or explanation; or***

*(d) **present risk factors in a misleading way.***

Source : Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Ltd.,
Volume 1 General, Chapter 1 Introduction

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