

Xiaomi Admits Current Suppliers Violated Environmental Regulations for the First Time

On June 14, 2018, the “Xiaomi Publicly Issued China Depository Receipt Prospectus¹ (Draft Submitted June 14, 2018)” was published on the China Securities and Regulatory Commission (CSRC) website.² In this document, Xiaomi disclosed that “some current suppliers of the company have violated environmental regulations.”

This is the first time Xiaomi publicly acknowledged that current suppliers have violated environmental regulations. Many environmental organizations have repeatedly questioned the environmental impact of Xiaomi’s supply chain over the past four years, but the company has consistently evaded its management responsibilities and only once, via Weibo, indicated that it would follow up with suppliers.

Xiaomi also stated in the prospectus that “The aforementioned suppliers have no significant impact on the company. As of the signing date of this prospectus, these suppliers have corrected their violations of environmental regulations. Currently, they are in compliance with their supplier agreements.”

Environmental groups involved in the supervision and promotion of this issue expressed approval for Xiaomi’s first recognition in four years that environmental violations exist in its supply chain. However, the environmental organizations have doubts about Xiaomi’s claim that the suppliers in question “have corrected their violations of environmental regulations,” because it is inconsistent with public media reports and information obtained through research.

In particular, the severity of polluting practices by Ichia Electronics (Suzhou) Co., Ltd. shocked the organizations participating in this research. Public reports indicate that Ichia Electronics’ electroplating and etching workshop was temporarily shut down by the local environmental protection bureau (EPB). Additionally, Lvse Jiangnan recently learned from the Suzhou High-Tech Zone EPB that the Jiangsu Province Department of Ecology and Environment was greatly concerned about Ichia Electronics’ heavy metal pollution and would soon expand its requirements for the rectification. The local EPB is conducting a comprehensive investigation including groundwater and soil excavation tests to conduct a risk assessment and propose restoration recommendations.

Clearly Ichia Electronics’ pollution problems are not completely solved, and the severity of its long-term impact is still being evaluated. Environmental organizations thus wrote to Xiaomi

¹ <http://www3.hkexnews.hk/listedco/listconews/sehk/2018/0625/ltn20180625033.pdf>

² http://www.csrc.gov.cn/pub/zjhpublic/G00306202/201806/t20180614_339903.htm

to inquire about evidence supporting the statement that “suppliers have corrected their violations of environmental regulations.”

Additionally, Xiaomi mentioned the “specific situation of the company’s primary business” in the prospectus: “The company’s environmental policy involves all relevant internal departments, outsourcing partners and other suppliers. According to this policy, suppliers must commit to providing raw materials and components in accordance with the environmental policy, and suppliers must establish relevant internal control systems to monitor the use of pollutants or hazardous substances.”

In its prospectus, Xiaomi also introduced its requirements on environmental, health, safety and social factors when selecting potential new suppliers for smartphones and laptops, including the requirement to inspect potential suppliers’ compliance with national and local environmental regulations, as detailed in Annex 1.

In the report *Ignoring Severe Supply Chain Pollution: Xiaomi Suspected of Violating IPO Disclosure Requirements*, environmental organizations pointed out that Xiaomi’s prospectus issued on the Hong Kong Stock Exchange (HKEX) on May 3, 2018 violated the disclosure requirements stipulated in the Environmental and Social Supply Chain Risk Management Policies section of HKEX’s Listing Rules. This time around, Xiaomi disclosed its supply chain’s environmental and social risk management policies for the first time, a step approved by environmental organizations.

However, there is a significant difference between the prospectus issued to the HKEX on May 3, 2018 and the recent Xiaomi statement on supply chain environmental violations in the documents provided to the CSRC. In light of this difference, six environmental organizations including the Institute of Public and Environmental Affairs (IPE), Lvse Jiangnan, Friends of Nature, Huanyou Technology, Green Hunan and Green Qilu wrote to Xiaomi requesting that they correct the HKEX prospectus documents to protect the rights and interests of investors.

It should be pointed out that after reviewing Xiaomi’s policy, we believe that these changes may have been made largely to protect the company against liabilities. For instance, Xiaomi emphasizes that “the company has established environmental protection policies, requiring that procurement agreements with suppliers include the supplier’s commitment to comply with relevant environmental regulations and compensate Xiaomi for any and all losses caused by violations of these environmental regulations.”

Given that Xiaomi’s claim that “these suppliers have corrected their violations of environmental regulations and are now in compliance with their supplier agreements” is inconsistent with public information on the offending suppliers, we have reason to question these policies. Xiaomi may have hastily formulated these policies to meet the disclosure

requirements for supply chain environmental and social risk policies stipulated in the HKEX listing rules, and it is difficult to achieve effective outcomes in risk management and control for related procurement.

In our letter to Xiaomi, we strongly recommended that the company requires suppliers with environmental violation records to publicly explain the reasons for these violations, provide a summary of corrective measures and their results, and provide credible third-party confirmations. We hope that Xiaomi can use this as a basis to effectively control the environmental risks in its supply chain and gradually build social trust in its environmental management.

Annex 1. Excerpt from the Xiaomi Publicly Issued China Depository Receipt Prospectus (Draft Submitted June 14, 2018)

Health, Safety and Environmental Matters

We engage outsourcing partners to assemble our hardware products developed in-house and rely on partners to supply finished ecosystem hardware products. We do not operate any manufacturing

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or assembling facilities. We only operate some of the key warehouses and engage third parties for delivery of our products. Therefore, we are not subject to significant health, safety or environmental risks. To ensure compliance with applicable laws and regulations, from time to time, our human resources department would, if necessary and after consultation with our legal advisors, adjust our human resources policies to accommodate material changes to relevant labor and safety laws and regulations. During the Track Record Period and up to the Latest Practicable Date, we had not been subject to any material fines or other penalties due to non-compliance with health, safety or environmental regulations.

Our *Policy on Management of Pollutants*, or the Policy, has been distributed to our relevant internal departments and external outsourcing partners and other suppliers. Pursuant to the Policy, suppliers shall undertake to provide raw materials and components in accordance to the requirements of the Policy and that the suppliers shall establish relevant internal control systems to monitor and supervise the use of any pollutants/hazardous substances. Suppliers are also required to submit (i) a signed declaration, where the suppliers shall undertake to, among others, notify us should there be any changes to their raw materials, components, production method and sites, and any products failing to satisfy the standards as set forth in the Policy; (ii) a third-party precision analysis report and (iii) a list of the substance/raw materials used.

In terms of the assessment of potential new suppliers for our smartphones, in addition to assessment of the quality of raw materials, components and services supplied, we also give significant weight to the following four factors: (i) environmental protection management, (ii) health and safety management, (iii) information security management, and (iv) social responsibility management. For environmental protection management, we have a 17-prong test to assess various aspects of the environmental protection procedures and capabilities of prospective new suppliers for our smartphones. In terms of the assessment of potential new suppliers for our laptops, we carry out on-site examination of the production facilities of prospective suppliers in order to determine whether (i) they are in compliance with national and local environmental protection laws and regulations, (ii) whether they regularly conduct internal environmental compliance audit and whether the results of such audits are properly recorded, (iii) whether environmental protection is a consideration in their design and production processes, and (iv) whether their production facilities have enough safeguards for environmental protection and labor safety compliance.

In terms of proposed construction and leasehold improvement projects, we engage independent qualified consultant agencies to produce reports on energy conservation, environmental and ecological impact, as well as socio-economic impact, as part of our holistic feasibility study procedure.

For our warehouses, offline retail stores and offices, we have internal policies that require each employee to use best efforts to conserve energy and minimize waste of office supplies. Furthermore, we strive to only purchase environmentally friendly fixtures, appliances and office supplies for our physical facilities.

Certain current suppliers of the Group have experienced historical environmental non-compliance incidents. Such suppliers in the aggregate are not, and were not, during the Track Record Period, material to the Group. Such suppliers have rectified their historical environmental non-compliance incidents, and are currently in compliance with the relevant supply agreements that we have in place with them. Our internal control policies on environmental issues dictate that our supply contracts with suppliers contain covenants from suppliers that they will abide by the relevant

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environmental laws and regulations, as well as to indemnify us for any loss incurred by us that results from any environmental non-compliance by the suppliers. We will comply with Rule 13.91 of Listing Rules regarding Environmental, Social and Governance (“ESG”) disclosure after the Listing.