



Hong Kong

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HKEX LISTING DECISIONS ON SUFFICIENCY OF ASSETS/OPERATIONS FOR CONTINUED LISTING

On 24 November 2017, the Stock Exchange of Hong Kong (the **Exchange**) published three listing decisions. LD 115-2017¹ and LD 116-2017² dealt with the question of whether the issuers had a sufficient level of operations or assets to warrant their continued listing under Main Board Listing Rule 13.24. LD 117-2017³ concerned the ability of a listed issuer to meet the new listing requirements following a spin-off. This newsletter provides a summary of those decisions.

LD 115-2017 Facts

LD 115-2017 concerned a coal mining and trading company and its subsidiaries (**Group A**) which recorded substantial losses (in the range of HK\$25 million to HK\$140 million) and negative operating cash-flows over the previous five financial years. In particular, Group A's loss amounted to HK\$50 million in the latest financial year. When asked about Group A's maintenance of sufficient operations or assets as required under Main Board Rule 13.24, the Group submitted plans to improve its business operations and financial position: these included an intention to increase the number of customers within two years to expand its coal trading business, cutting administrative costs and expenses, and an expectation of a significant increase in revenue from the coal trading business. However, no basis or details were produced to support these intentions.

- 1 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks//d/ld115-2017.pdf
- 2 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks//d/ld116-2017.pdf
- 3 http://en-rules.hkex.com.hk/net_file_store/new_rulebooks//d/ld117-2017.pdf

LD 116-2017 Facts

LD 116-2017 concerned a fashion accessories manufacturing and sales company and its subsidiaries which were involved in the development and sale of software related applications (**Group B**). Group B's fashion accessories business had been gradually scaled down over the previous five financial years resulting in a decrease in revenue from HK\$200 million to HK\$9 million. During the previous financial year, the Group had managed to sell obsolete inventories in an effort to increase the Group's revenue.

In addition, the recent acquisition of a software business company had resulted in some recorded revenue but at a larger impairment loss on goodwill. Group B had recorded net losses and negative operating cash-flows for each of the previous five financial years.

When asked about Group B's maintenance of sufficient operations or assets as required under Main Board Rule 13.24, the Group submitted plans for improvement, including an expectation of a significant increase in revenues due to the recent entering into of sales contracts for its Software Business, and further anticipation of potential customers on new contracts. However, the Exchange noted that Group B did not provide further details or any basis for such business plans or forecasts. Group B also planned to commence certain regulated activities under the Securities and Futures Ordinance and expected to obtain the necessary licences within 3 months and to record revenue of approximately HK\$2.5 million from this business in the next fiscal year.

Relevant Listing Rules

Main Board Rule 13.24 requires that, *“An issuer shall carry out, directly or indirectly, a sufficient level of operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer’s securities.”*

The requirement is thus for listed issuers to maintain a sufficient level of operations or assets of sufficient value to warrant the continued listing of their securities. Without quantitative criteria for sufficiency, this Rule calls for a qualitative test and is assessed on the specific facts and circumstances of individual cases.

Main Board Rule 6.01 provides that, *“Listing is always granted subject to the condition that where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also exercise these powers where:*

“the Exchange considers that the issuer does not have a sufficient level of operations or sufficient assets to warrant the continued listing of the issuer’s securities (see rule 13.24).”

The Analysis

The listing decisions give examples of extreme applications that fall within the scope of Rule 13.24:

- a) “a very low level of operating activities and revenue; for example, the issuer’s business does not generate sufficient revenue to cover its corporate expenses, resulting in net losses and negative operating cash flows;
- b) the current operation does not represent a temporary downturn, the issuer had been operating at a very small scale and incurring losses for years; and
- c) assets do not generate sufficient revenue and profits to support a continued listing.”

The decisions further provide that once an issuer has come within the scope of the Rule and been suspended, “the issuer would be given a remedial period to submit a resumption proposal to demonstrate that it has a viable and sustainable business to re-comply with Rule 13.24. If the issuer fails to do so, it would be delisted according to the delisting procedures under Practice Note 17 to the Rules”.

The Decisions

In both applications of Group A and Group B, the Exchange considered that both Groups had failed to comply with Rule 13.24, and categorised both instances as “extreme cases”:

- a) Both Groups had very low levels of operations. Both had diminished operations and negative approximate cash-flows for a continuous period of the past financial years. In the case of Group A, the recorded revenue was insufficient to cover corporate expenses resulting in a net loss of approximately HK\$50 million. Group B had relied on a one-off sale of obsolete inventories and new businesses (being the Software and Securities Businesses) to support the listing. However, Group B’s new businesses had a very short operating history. Even coupled with the obsolete inventories, revenues generated were insufficient to cover corporate expenses.
- b) When prompted to demonstrate that they had a viable sustainable business model to re-comply with the Rules, statements from both Groups were preliminary and not substantiated. And in the case of Group B, the new source of business (being the Securities Business) was still at the planning stage and had not commenced operations. Even if the business did commence as planned, it would not generate enough income to cover expenses in the next financial year.

The Exchange decided both Groups had failed to maintain a sufficient level of operations or assets of sufficient value to satisfy Rule 13.24. This resulted in commencement of delisting procedures under Practice Note 17 to the Rules. In the case of Group A, the Group was also suspended from trading under Rule 6.01(3).

Facts of LD117-2017

In LD 117-2017, a company (**Company A**) proposed to transfer its current manufacturing business and sale of certain electronic products into a new company (**Newco**). Company A then proposed a separate listing of Newco on the Exchange, as a spin-off. After the spin-off, Company A (excluding Newco) (**Remaining Group**) would continue to carry on a number of businesses, including a securities investment and trading business. The issue was whether the Remaining Group could meet the new listing requirements of the Main Board Rules.

Company A had submitted that during the three-year track record period, the Remaining Group recorded an aggregated profit of approximately HK\$150 million for the first two years, and a profit of about HK\$300 million for the latest financial year. However, it was noted that Company A's investment portfolio comprised primarily of securities in Company B (which was a subsidiary of Company A until around 3 years previously). The revenues and profits of the Remaining Group were mainly attributable to gains derived from the investment in Company B. However, Company A had sold all its investment in Company B during the track record period, and the value of its investment portfolio had significantly decreased from approximately HK\$10 billion to less than HK\$20 million. Despite this, the Remaining Group still contended that it could independently satisfy the new listing requirements of Chapter 8 of the Rules, including the profit requirement of Rule 8.05(1)(a), and other requirements under Practice Note 15. It sought the Exchange's approval for the spin-off proposal. The proposal was based on Company A's further investments in two listed companies with an aggregated value of HK\$10 million, and an allocated budget of HK\$300 million for future investments.

Relevant Listing Rules

Main Board Rule 8.04 requires that, *"Both the issuer and its business must, in the opinion of the Exchange, be suitable for listing"*.

Paragraph 3(c) of Practice Note 15 to the Main Board provides that, *"The Listing Committee must be satisfied that, after the listing of Newco, the Parent would retain a sufficient level of operations and sufficient assets to support its separate listing status. In particular, it would not be acceptable to the Listing Committee that one business (Newco's) supported two listing statuses (the Parent's and Newco's). In other words, the Parent itself would be required to retain, in addition to its interest in*

Newco, sufficient assets and operations of its own, excluding its interest in Newco, to satisfy independently the requirements of Chapter 8 of the Exchange Listing Rules..."

The Listing Decision emphasised the Exchange's broad discretion in interpreting and applying this concept to maintain market confidence by reference to the standards currently acceptable in the market place. In the case of spin-offs, the Exchange retains a discretion to accept or reject the listed issuer's proposal having regard to, among other factors, the suitability of the remaining group and its business for listing under Rule 8.04.

The Decision

The Exchange was not satisfied that the Remaining Group was suitable for listing because:

- a) during the track record period, the Securities Business invested mainly in just one company (i.e. Company B) and its revenues and profits were derived almost entirely from its investment in Company B. This raised concerns that the Remaining Group was not carrying on a business of substance which negatively impacted its suitability for listing.
- b) following the sale of its investment in Company B during the track record period, Company A's investments in two listed companies amounted to only HK\$10 million and no details were provided about its future investment plans. That the Remaining Group's track record was not representative of its business performance going forward called into question whether investors had adequate information to make an informed assessment of the Remaining Group's business after the proposed spin-off.
- c) the scale of the Other Businesses was small and could not have met the profit requirement under Rule 8.05(1)(a). Company A had not demonstrated that these businesses would improve significantly following the proposed spin-off.

The Listing Committee rejected the proposed spin-off since Company A could not demonstrate that its remaining businesses would be sustainable and suitable for listing.

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