



Hong Kong

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NEW HONG KONG STOCK EXCHANGE GUIDANCE FOR LISTING APPLICANTS IN THE INTERNET TECHNOLOGY SECTOR

Introduction

The Stock Exchange of Hong Kong Limited (the **Stock Exchange** or **HKEx**) published Guidance Letter HKEX-GL97-18¹ (the **Guidance Letter**) on 6 July 2018 setting out certain relaxations from the HKEx Listing Rules which it may allow for listing applicants in the internet technology sector or that have internet-based business models (the **IT Sector**).

The issue of the Guidance Letter follows the Hong Kong Stock Exchange's implementation of new Listing Rules in April 2018 to encourage the Hong Kong listing of tech and other emerging and innovative companies. The Guidance Letter is the HKEx's response to calls for adaptations to the Listing Rules to suit the particular characteristics of these types of companies, in particular: (a) the high degree of reliance that internet technology companies often have on the internet platforms operated by their parent companies (or other "connected persons") or major suppliers; (b) internet technology companies' greater need to attract and retain staff through share option schemes; and (c) the difficulties such companies face in demonstrating compliance with relevant laws and regulations when they are not yet fully established in their industry.

The Guidance Letter thus provides that:

- applicants may be able to list with a higher level of reliance on parent companies/connected persons/major suppliers/major customers if they demonstrate certain characteristics;

- waivers may be granted to listing applicants on an individual case basis to allow annual caps for continuing connected transactions according to a formula rather than a monetary amount;
- waivers may be granted to allow: (a) a higher percentage cap on outstanding share options to be granted; and (b) a period longer than the permitted 10 years for securities to be taken up under options; and
- if the laws and regulations relevant to an applicant are still developing and are not expected to be promulgated in the near future, disclosure of the associated risks in the listing document is sufficient, with no requirement for a legal opinion.

The Hong Kong listing regime was amended in April 2018 followed an extensive period of public consultation to allow the listing on the HKEx's Main Board of: (i) pre-revenue biotech companies; and (ii) high growth and innovative companies with weighted voting rights (**WVR**) structures. For further details, please see Charltons' April 2018 newsletters on consultation conclusions on biotech listings² and consultation conclusions on WVR listings³.

¹ http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/g/1gl9718.pdf

² <https://www.charltonslaw.com/new-rules-for-listing-biotech-companies-on-the-hong-kong-stock-exchange/>

³ <https://www.charltonslaw.com/consultation-conclusions-on-wvr-listings/>

Relevant Listing Rules

Main Board Listing Rule 2.13(2) requires information included in an issuer's document to be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, the issuer must not, inter alia:

- a) omit material facts of an unfavourable nature or fail to accord them with appropriate significance; and
- b) present favourable possibilities as certain or as more probable than is likely to be the case.

Main Board Listing Rule 8.04 provides that both the issuer and its business must, in the Hong Kong Stock Exchange's opinion, be suitable for listing.

According to Main Board Listing Rule 11.07, all listing documents must, as an overriding principle, contain such particulars and information which, according to the particular nature of the issuer and the securities for which listing is sought, is necessary to enable an investor to make an informed assessment of the issuer's activities, assets and liabilities, financial position, management, prospects and profits and losses, and of the rights attached to such securities.

Main Board Listing Rule 13A.53 states that the listed issuer must set an annual cap for continuing connected transactions. The cap is required to be expressed in monetary terms, and determined by reference to previous transactions and figures in the published information of the issuer's group. If there were no previous transactions, the cap must be set based on reasonable assumptions.

Note 1 to Main Board Listing Rule 17.03(3) provides that the total number of securities which may be issued upon exercise of all options to be granted under the scheme and any other schemes must not in aggregate exceed 10% of the relevant class of securities of the listed issuer (or the subsidiary) in issue as at the date of approval of the scheme. Main Board Listing Rule 17.03(4) states that unless approved by shareholders, the total number of securities issued and to be issued upon exercise of the options granted to each participant (including both exercised and outstanding options) in any 12-month period must not exceed 1% of the relevant class of securities of the listed issuer (or the subsidiary) in issue. According to Main Board Listing Rule 17.03(5), the period within which the securities must be taken up under the option is required to be not more than 10 years from the date of grant of the option.

Pursuant to the note to Paragraph 27A of Appendix 1A to the Main Board Listing Rules, a listing document must include a statement explaining how the issuer is satisfied that it is capable of carrying on its business independently of the controlling shareholder (including any close associate thereof) after listing, and particulars of the matters that it relied on in making such statement.

Guidance

1. High Degree of Reliance

Numerous companies in the IT Sector rely on their substantial shareholders' main businesses or platform to promote their products or services, which can give rise to extensive connected transactions under the Listing Rules.

Although reliance is usually regarded as a disclosure issue so that an applicant is required to disclose in its listing document reliance upon a substantial shareholder, connected persons, a major supplier or a major customer, the Hong Kong Stock Exchange may have concerns relating to an applicant's suitability for listing where the level of reliance is extreme.

Factors the Stock Exchange takes into account when determining whether an applicant's reliance on a single major supplier or customer is an extreme case which impacts on suitability for listing is set out in Listing Decision HKEX-LD107-1:

- a) whether the applicant's business model can be easily changed to reduce the level of reliance;
- b) whether the level of reliance is likely to decrease in the future;
- c) whether the whole industry landscape is dominated by a few players making it unlikely for companies in the same line of business to break off the reliance;
- d) whether the reliance is mutual and complementary; and
- e) whether the applicant is able to maintain its revenue in the future in view of the reliance.

Many IT Sector companies at the early stage of development extensively use services provided by their parent company, or another connected person, in order to facilitate provision of their own products or services. Companies in the IT Sector

often cannot reduce their high level of reliance on their parent company or another connected person's platform in the foreseeable future due to the nature of their industry and businesses. The reliance is often not mutual and is typically more important to the listing applicant than its parent company, and the listing applicant is unlikely to be able to change to another platform in light of industry competition.

For IT Sector applicants, the Hong Kong Stock Exchange may allow a higher level of reliance on parent companies/connected persons/major suppliers/major customers and place less emphasis on the need to demonstrate a reduction in reliance where the applicant demonstrates the following:

- a) a few players dominate the whole industry landscape, and such players may or may not be the applicant's parent company (or other connected persons/major suppliers/major customers);
- b) it is difficult for the applicant to use the services of a different provider to decrease the level of reliance as the services are provided by a small number of dominant major providers in competition with each other;
- c) there were legitimate commercial reasons for the applicant and its parent company (or other connected persons/major suppliers/major customers) to enter into the transactions, and such transactions were on normal commercial terms in the ordinary course of business of the applicant and the parent company (or other connected persons/major suppliers/major customers) and, for transactions with a connected person, they will be subject to the Listing Rules' continuing connected transaction requirements following listing; and
- d) there are long term agreements between the applicant and the parent company (or other connected persons/major suppliers/major customers) under which the applicant is provided continued access to the parent company's (or other connected persons'/major suppliers'/major customers') platform or services.

A listing applicant must also disclose in its listing document:

- a) the areas of reliance and the reason why its business model results in the reliance;

- b) details of the arrangements (including fees and charges) for the services provided by the parent company/connected persons/major suppliers/major customers;
- c) details of any mitigating factors that decrease the risk of reliance, for example the ability to use a different supplier/service provider; and
- d) risks associated with the reliance, including a description of the "worst case scenario" if the services become unavailable.

In order to promote their own products or services, many companies in the IT Sector leverage on the platform of their parent company, or another connected person, and such arrangements may constitute a continuing connected transaction under the Listing Rules for which an annual monetary cap is required. However, the payment to use such services is sometimes structured as a percentage of the applicant's revenue derived from the connected person's platform. The Hong Kong Stock Exchange assesses connected transactions carefully on an individual case basis. Where continuing connected transactions and/or other connected transactions constitute a significant portion of an applicant's turnover and/or net profit, the Stock Exchange may exercise its discretion to determine that the applicant is unsuitable for listing as there is extreme reliance on other parties even where all of the above-mentioned factors are satisfied.

2. Qualifying Caps for Continuing Connected Transactions

Applicants with a short operating history or in a growth phase may find it impractical to accurately estimate the payment amount required pursuant to a cooperative agreement to use the platform of their parent company or another connected person. Further, arbitrary monetary caps may impose undue burdens on issuers and not be in the interests of shareholders after listing.

The Hong Kong Stock Exchange may, on an individual case basis, grant applicants in the IT Sector waivers from strict compliance with the Listing Rule 14A.53 requirement to set an annual monetary cap, and allow the annual cap to be a formula. The listing applicant must demonstrate the need for such an arrangement in its particular circumstances and the formula must be consistent with historical and prevailing commercial practices. At the time of renewal, the issuer must demonstrate that it merits the continuing connected transaction and that the circumstances continue to justify the grant of the waiver.

3. Extensive Use of Share Investment Schemes

Companies in the IT Sector often grant share options in order to retain and incentivise talented individuals to develop their businesses. Issuers may find the Listing Rule 17.03 requirements of a 10% aggregate cap, a 1% cap on individual participants and a ten-year limit for securities to be taken up, to be unduly restrictive.

The Stock Exchange may, in its discretion and on an individual case basis, grant or reject a waiver from strict compliance with: (i) the percentage cap requirement on outstanding share options under a share option scheme, and allow a higher cap to be imposed; and (ii) the maximum ten-year period within which securities must be taken up under the option, and allow a longer period to be put in place. The applicant should demonstrate the need for a higher cap and/or longer option period, as well as well-defined criteria for granting share options pursuant to the scheme. The listing document must include disclosures of the scheme's material terms and the circumstances in which options may be granted above the 10% cap.

4. Unestablished Regulatory Environment

Laws and regulations governing the sectors in which IT Sector companies operate may still be evolving and/or in draft stage, for example the financial technology (**FinTech**) sector.

Where laws and regulations relevant to a listing applicant are still developing and are not expected to be promulgated in the near future, the associated risks should be disclosed in the listing document, but a legal opinion would not be required to cover compliance with unimplemented laws and regulations. However, where it is evident that draft regulations affecting the applicant's business will be promulgated in the near future, the applicant should demonstrate that, in the event that the draft regulations are promulgated, it is able to comply with the requirements, with the support of a local legal opinion.

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