

HKEx LISTING DECISION

HKEx-LD42-2 (December 2004) (Updated for rule reference in September 2009)
(withdrawn in November 2012)

[The Listing Decision is withdrawn. The new GEM regime, implemented in July 2008, requires a GEM listing applicant to demonstrate that it is capable of carrying on its business independently of the controlling shareholder under paragraph 27A of Appendix 1A. The factors which the Exchange will consider in determining the GEM listing applicant's financial independence of its controlling shareholder are set out in Listing Decision HKEx-LD69-1.]

Summary	
Category	Listing Decisions Series 42-2 (LD42-2)
Name of Party	Company A and its subsidiaries (the "Group") – a GEM listing applicant
Subject	Whether existing financial assistance from the controlling shareholders of a GEM listing applicant, in the form of guarantees or security in support of borrowings, should be permitted to continue on and after the date of listing?
Listing Rules	GEM Listing Rules 11.12 ¹ , Note 3; 20.65(4)
Decision	Based on the facts and circumstances of the case, the Exchange considered that the guarantees and security from the controlling shareholders were not required to be released at the time of listing of Company A's shares on GEM. However, the Exchange required the controlling shareholders to provide an undertaking to Company A that it would not withdraw or release the guarantees and security that it had issued for the purpose of Company A's borrowings unless and until prescribed conditions had been fulfilled.

SUMMARY OF FACTS

1. Company A applied for listing on the GEM Board. It was submitted that part of the Group's borrowings would continue to be guaranteed or secured by the controlling shareholders ("Parentco") of Company A, at no cost to Company A, on and after listing of its shares on GEM. Parentco was expected to hold over 60% of Company A's shares after listing. As at the latest audited balance sheet date, the loans guaranteed by Parentco represented over 50% of the Group's total bank borrowings and over 90% of its net assets.

2. The directors of Company A submitted that the provision of financial assistance from Parentco was of critical importance to the Group. If Parentco ceased providing the guarantees and security, the Group would be required to repay the related loans due to some third parties. It was submitted that such immediate repayment would have an adverse effect on the operations and the implementation of the business objectives of the Group.
3. Parentco had provided an undertaking (the “Undertaking”) to Company A that it would not withdraw or release the guarantees and security that it had issued for the purpose of Company A’s borrowings unless and until the Group had fully repaid any outstanding loans and that the independent non-executive directors of Company A were of the view that such repayment of loans and release of guarantees and/or securities would not adversely affect the operations of the Group and the implementation of business objectives.

THE ISSUE RAISED FOR CONSIDERATION

4. Whether existing financial assistance from the controlling shareholders of a GEM listing applicant, in the form of guarantees or security in support of borrowings, should be permitted to continue on and after the date of listing?

APPLICABLE GEM LISTING RULES

5. Note 3 to GEM Listing Rule 11.12 requires a GEM listing applicant to demonstrate that it has a business of both substance and potential throughout the active business pursuit period.¹
6. GEM Listing Rule 20.65(4) states that financial assistance provided by a connected person for the benefit of a listed issuer on normal commercial terms (or better to the issuer) where no security over the assets of the listed issuer is granted to the connected person are not subject to the reporting, announcement, and independent shareholders’ approval requirements.

THE ANALYSIS

7. The Exchange noted that there is an established practice for Main Board listing applicants to release or repay any guarantees or loans provided by their controlling shareholders on or before listing in order to demonstrate that the listing applicant is financially independent. In the present case, the Exchange was required to decide whether, on the facts and circumstances as presented, Company A, a GEM listing applicant, should be required to comply with such a requirement.
8. Before arriving at a decision in this case, the Exchange considered the following factors

in favour of a complete release of all forms of financial support provided by the controlling shareholders before approving a listing on the GEM Board:-

- a. Although there is no profit track record requirement for initial listing on GEM, a GEM listing applicant is required to demonstrate that it has a business of both substance and potential¹. The ability of a GEM listing applicant to obtain banking facilities and loans based on its own guarantees and /or pledges of its assets is a good indicator of the substance and potential of its business. If a GEM applicant is not able to obtain banking facilities and loans independently it would be difficult for such GEM applicant to demonstrate that it has the required financial stability to support its profit track record and this would translate into a concern on the suitability of its listing on GEM; and
 - b. In a case where a listing applicant records net liabilities and its ability to operate as a going concern is dependent on the continuing financial assistance provided by its shareholders, it is also preferred that outstanding shareholders loans be capitalized before listing so as to improve the financial position and enlarge the capital base of such a listing applicant.
9. The Exchange also considered the following factors to be relevant when assessing whether to require a complete release of all forms of financial assistance from parent before approving a listing on the GEM Board:-
- a. There are fundamental differences in the nature of GEM companies as compared to their Main Board counterparts. In particular, Main Board companies are required to have proven track record of profitability. There is sufficient commercial reason for financial institutions to refuse to grant loans to GEM applicants and/or not to grant loans without their controlling shareholders providing the necessary guarantees. It is therefore not always commercially practicable to require a GEM listing applicant to release the guarantees or repay the loans before it is listed on GEM;
 - b. The GEM Listing Rules do not impose specific restrictions on financial assistance given by connected persons, provided that they are unsecured and on normal commercial terms (or better) (GEM Listing Rule 20(65)(4));
 - c. A request for a complete release of guarantees given by controlling shareholders for loans or security granted by financial institutions would interfere with financial institutions' commercial judgment to extend whatever credits and security to their customers as they deem fit. The fact that the financial institutions require personal guarantees for loans granted to GEM applicants do not necessarily mean that the GEM applicants are not financially viable; and
 - d. Loans are decided entirely upon agreements reached between the listing applicant and its shareholders. As long as the arrangement is fully disclosed, investors would have been adequately informed for the purposes of making investment decisions.

10. After considering the above factors, in particular recognising the special characteristics of GEM issuers, the Exchange decided that it was inappropriate to impose the Main Board practice on GEM Board listing applicants.
11. However, in the present case where the operations of the GEM listing applicant are mainly financed by banking facilities that are guaranteed by controlling shareholders/substantial shareholders and such guarantees are not released before listing or that loans from controlling shareholders are not capitalized or repaid before listing, the Exchange considered it appropriate to require the GEM listing applicant to satisfy certain conditions before approving its listing application. These conditions are to ensure that the issuer's operations would not be affected by the loss of such financial support until it recorded a more positive cash flow and retained earnings. The relevant conditions are:-
 - a. Each of the relevant shareholders shall provide an undertaking that it/he/she would not demand release of the guarantees or repayment of the loans if such release or repayment would adversely affect the listing applicant's operations and implementation of its business objectives as set out in the prospectus;
 - b. The loans should not be repaid unless the issuer records a positive cash flow and retained earnings in a financial year; and
 - c. The loans should not be repaid unless each of the independent non-executive directors has given an opinion that such repayment would not adversely affect the issuer's operations and the implementation of its business objectives.
12. Having considered the amount of the outstanding loans that would remain to be guaranteed or secured by Parentco at the time of listing of Company A, the disclosure in the prospectus which included a risk factor disclosure, the Exchange decided that, subject to the conditions mentioned in paragraph 11 above, the financial assistance from Parentco in the form of guarantees and security was not required to be released or withdrawn by Parentco at the time of listing of Company A's shares on GEM.

THE DECISION

13. Based on the above analysis and the material facts, the Exchange considered that the guarantees and security from Parentco were not required to be released at the time of listing of Company A's shares on GEM.
14. However, the Exchange required Parentco to provide an undertaking to Company A that it would not withdraw or release the guarantees and security that it had issued for the purpose of Company A's borrowings unless and until:-
 - a. the Group had fully repaid the loans; and

- b. the independent non-executive directors of Company A were of the view that such repayment of loans and release of guarantees and/or securities would not adversely affect the operations of the Group and the implementation of the business objectives.

Note:

- 1. *GEM Rule 11.12 was repealed on 1 July 2008. The requirements to demonstrate that the GEM listing applicant has a business of both substance and potential throughout the active business pursuit was removed. (Added in September 2009)*