

HKEX LISTING DECISION

HKEX-LD123-2019 (published in July 2019) (updated in October 2019 (amendments to the reverse takeover Rules) and withdrawn in January 2024)

[Streamlined and incorporated into the guidance letter GL104-19 (Guidance on application of the reverse takeover Rules).]

Parties	Company A – a Main Board issuer Mr. X – the former controlling shareholder of Company A Mr. Y – the existing controlling shareholder of Company A Company B – a company controlled by Mr. Y and engaged in property business in the PRC
Issue	Whether the Exchange would impose additional requirements under Rule 2.04 on Company A's proposed continuing connected transaction with Company B
Listing Rules	Main Board Rules 2.04 and 6.01(4)
Decision	The Exchange informed Company A that, should it proceed with the proposed continuing connected transaction, the Exchange would treat it as if it were a new listing applicant under Rule 2.04

FACTS

Background

1. At the time of its initial listing, Company A was principally engaged in the business of leasing and trading of construction machinery in Hong Kong (the **Original Business**). Mr. X was the founder, the chairman and an executive director of Company A.
2. Shortly after the 12 month lock-up period, Mr. X disposed of his 50% equity interest in Company A to Mr. Y, which triggered a general offer for all the remaining shares in Company A under the Takeovers Code.
3. Upon close of the offer, all the directors of Company A at the time of its initial listing resigned. The new directors (including Mr. Y) appointed to the board of Company A did not have experience in the Original Business. A majority of the new directors were also directors of Company B which was controlled by Mr. Y and engaged in property business in the PRC.

4. The first annual results released by Company A after listing showed that its revenue from the Original Business decreased by approximately 30% in that financial year. Company A disclosed that the industry of the Original Business would slow down. It intended to diversify its business by leveraging on the experience of its directors in the PRC.

Proposed continuing connected transaction

5. A few months after the offer, Company A proposed to enter into a framework agreement with Company B for the provision of property management services (the **New Business**) in respect of properties controlled or being developed by Company B.
6. The transaction with Company B would constitute a continuing connected transaction (the **Proposed CCT**). Based on the highest annual cap proposed by Company A, the revenue contributed from the Proposed CCT would represent over 70% of Company A's revenue in the first year after listing.
7. Company A also intended to further expand the New Business and was negotiating similar property management service agreements with independent third parties.

APPLICABLE LISTING RULES AND GUIDANCE MATERIALS

8. Rule 2.04 states that -

“... the Exchange Listing Rules are not exhaustive and that the Exchange may impose additional requirements or make listing subject to special conditions whenever it considers it appropriate...”

9. The Exchange Guidance Letter (GL68-13A) provides guidance on the suitability for listing of new applicants to help prevent shell creation through IPO. The Guidance Letter states that:

“...

1.1 The Exchange notes that there have been a number of listed issuers where their controlling shareholders either changed or have gradually sold down their interests shortly after the regulatory lock-up period following listing. One explanation for this phenomenon is the perceived premium attached to the listing status of such issuers rather than the development of the underlying business or assets.

1.2 *The Exchange believes that such companies (often referred to as "shell companies") will invite speculative trading activities when identified by potential buyers. This can lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market post-listing, none of which is in the interest of the investing public. Furthermore, activities by such companies may be structured so that they are not subject to regulatory scrutiny under Rules 14.06B to 14.06E, our Guidance Letters HKEX-GL104-19 on reverse takeovers, and HKEX-GL105-19 on large scale issues of securities. (See the Note below for the amendments to this paragraph)*

...

4.4 *Once listed, an issuer must ensure that it and its business continues to be suitable for listing. Failing to meet this requirement may lead to the Exchange canceling the issuer's listing under Main Board Rule 6.01(4) ... The Exchange closely monitors the developments of listed issuers. It may have a concern about the suitability of an issuer or its business for continued listing if, for example, the issuer's activities are found to deviate significantly from its original business model or strategy or the commercial rationale for its listing set out in its listing application."*

10. The Exchange Guidance Letter (GL96-18) on a listed issuer's suitability for continued listing cited examples of circumstances where the Exchange may raise concerns about the suitability for continued listing of a listed issuer or its business:

"...

9. *In Guidance Letter GL68-13A, the Exchange noted a number of newly listed issuers whose controlling shareholders either changed or gradually sold down their interests shortly after the regulatory lock-up period following listing. It questioned whether these issuers' listing applications were driven by the perceived premium attached to the listing status rather than the development of their underlying business or assets. These issuers, when identified by potential buyers, would invite speculative trading and create opportunities for market misconduct (e.g. market manipulation or insider trading) and unnecessary volatility in the market post listing..."*

ANALYSIS

11. The Exchange considered that the Proposed CCT would be an attempt to circumvent the new listing requirements having regard to the following:
 - (a) The Exchange was concerned that Company A was engaging in shell activities as indicated by a change in control shortly after the lock-up period. The post-listing developments, including the change in its board of directors, the significant deterioration in the performance of the Original Business after listing and the commencement of the New Business unrelated to the Original Business, appeared to deviate significantly from the disclosures in Company A's IPO prospectus about its business plans and the commercial rationale for its listing. This suggested that Mr. Y acquired Company A for its listing status rather than the developments of its underlying business.
 - (b) The New Business was completely different from the Original Business and its size would be significant to Company A based on the annual cap for the Proposed CCT. The Proposed CCT would lead to a fundamental change in Company A's business and represent an attempt to achieve a listing of the New Business through greenfield operations which had no track record and would not meet the new listing requirements.
12. In response, Company A submitted that the Proposed CCT would not be its major operation based on its projected revenues of the Original Business for the next three years. However, the Exchange noted that such projection was made on the assumption that the Original Business would grow at a compound growth rate of at a certain percentage per annum, which was contrary to the performance of the Original Business after listing, and Company A had not provided any information to support the assumption. The Exchange did not consider this sufficient to address its concern.

CONCLUSION

13. The Exchange considered it appropriate, and informed Company A of its intention, to exercise its right to impose additional conditions on the Proposed CCT under Rule 2.04, by treating Company A as if it were a new listing applicant and requiring it to comply with the requirements for a RTO.

Note:

Guidance Letter GL68-13A was updated to make reference to the amended Rules 14.06B to 14.06E and the new guidance letters on reverse takeovers and large scale issues of securities, which became effective on 1 October 2019. The Rule amendments would not change the analysis and conclusion in this case.