

HKEX GUIDANCE LETTER

HKEX-GL45-12 (November 2012) (Updated in February 2018 and April 2019)

[To include relevant guidance from HKEX-GL32-12 which has been updated, HKEX-RL3-04, HKEX-RL10-06, HKEX-RL14-06, HKEX-RL24-08, HKEX-GL82-15, HKEX-LD39-3, HKEX-LD45-2, HKEX-LD47-2, HKEX-LD47-3, HKEX-LD48-2, HKEX-LD66-1 and HKEX-LD86-2015 which have been withdrawn]

Subject	<u>Trading Guidance on trading record and financial eligibility requirements and disclosure of certain financial information</u>
Listing Rules	<u>Rules 4.04 and 8.05(1) of Main Board Rules 1.01, 2.13, 4.04(1), 4.11, 8.05 and 8.06</u> <u>GEM Rules 1.01, 7.03(1), 7.12, 11.10 and 11.11, 11.14, 11.12A of GEM Rules and 17.56</u>
Related Publications	N/A
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Important note: *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Department on a confidential basis for an interpretation of the Listing Rules, or this letter.*

1. Purpose (updated in April 2019)

- 1.1 This letter provides guidance on matters relating to the trading record requirements under the Main Board Listing Rules requirement, financial eligibility requirement and GEM Listing Rules after several enquiries have been received disclosure of unaudited financial information and stub period comparatives in the listing documents.

2. Background (deleted in April 2019)

~~2.1 The Listing Rules require that a new applicant must have an adequate trading record. The requirement has two limbs: (i) the minimum length of the trading record and (ii) the minimum amount of profits (for Main Board) or cash flows (for GEM) during such period.~~

~~3. The length of the trading record for the purpose of the Main Board Listing Rules is a period of not less than **Relevant Requirements (deleted in April 2019)**¹~~

4. Guidance (updated in April 2019)

Trading record requirement

~~2.2 The trading record requirement of three financial years whereas that for GEM Listing Rules is a period of not less than for Main Board new applicants (two financial years. A financial year for GEM new applicants) under Main Board Rule 4.04(1) (GEM Rules 7.03(1) and 11.10) does not necessarily equal/correspond to a period of twelve months (see paragraphs 4.1 to 4.3 below)~~

~~2.3 Where a new applicant conducts certain preparation activities such as business planning, construction of factory facilities, procurement of raw materials, preliminary negotiations with potential customers and trial production before it commences trading activities, it is questionable whether such activities can be counted towards satisfaction of the trading record requirements.~~

3. Relevant Requirements

~~3.1 Main Board Listing Rule 8.05(1) states, among others, that a new applicant must have an adequate trading record under substantially the same management and ownership. This means that the issuer must satisfy a trading record of not less than three financial years during which~~

¹ ~~This section has been deleted to avoid duplication of the relevant Main Board and GEM Rules. Reference to the relevant Listing Rules is included in the body of the guidance letter.~~

~~the profit attributable to shareholders must, in respect of the most recent year, be not less than HK\$20,000,000 and, in respect of the two preceding years, be in aggregate not less than HK\$30,000,000. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business.~~

~~3.2 GEM Listing Rule 11.12A(1) states, among others, that a new applicant or its group must have an adequate trading record of at least two financial years comprising a positive cash flow generated from operating activities in the ordinary and usual course of business before changes in working capital and taxes paid. Such positive cash flow from operating activities carried out by the new applicant, or its group, that are to be listed, must be of at least HK\$30,000,000 in aggregate for the two financial years immediately preceding the issue of the listing document. **(Updated in February 2018)**~~

~~4. Guidance~~

~~*A financial year does not necessarily cover a calendar year or twelve months*~~

~~4.1 Rule 1.01 of Main Board Listing Rules (Rule 1.01 of GEM Listing Rules) defines a financial year as the three calendar years (two calendar years) because a financial year is a period in respect of which any profit and loss account of a company laid or to be laid before it in a general meeting is made up, whether that period is a year or not, pursuant to Main Board Rule 1.01 (GEM Rule 1.01).~~

~~4.2 Therefore, the trading record requirements of three financial years for Main Board applicants and two financial years for GEM applicants do not necessarily correspond to a period of three calendar years or two calendar years.~~

~~4.34.2 For example, a Main Board new applicant adopts 31 December as its with a financial year end. If the applicant ending on 31 December was only incorporated on 1 April. Although its accounts in the first year, its trading record will cover the of incorporation only comprise financial~~

~~results of~~ nine months ~~from 1 April to 31 December Year 1, the year ended 31 December Year 2 and the year ended 31 December Year 3.~~ Although there is only 9 months in Year 1 of the trading record period, it ~~is~~would still ~~be~~ regarded as a full financial year if ~~the applicant's profit and loss account for that period was~~those accounts were laid before it in a general meeting.

~~Whether preparation activities should be counted towards satisfaction of the trading record requirement~~

~~4.44.3~~ The trading record of ~~ana new~~ applicant refers to the record of ~~the applicant's~~sits trading activities, including its revenue, expenses, cash flows, assets and liabilities arising from ~~theits~~ core businesses ~~of the.~~ ~~Where a new~~ applicant. ~~Where an applicant is still at the preparatory stage and~~² has not yet commenced generating any revenue, ~~theany~~ expenses related to preparation activities ~~such as (e.g. business planning, construction of factory facilities, procurement of raw materials, preliminary negotiations with potential customers or trial production, or ancillary income or revenue generated outside the ordinary and usual course of business should)~~ would not be counted towards ~~the~~ satisfaction of ~~the~~ adequate trading record. The Exchange will accept a shorter trading record period on specific circumstances as per Main Board Rules 8.05A and 8.05B (GEM Rule 11.14).

~~4.5~~ Therefore, ~~where an applicant did not carry out any trading activity during any part of its financial year, that period would not be taken as part of its trading record.~~

~~4.4~~ The Exchange interprets the trading record requirement to refer to the business that forms the subject matter of listing and not the legal entity that forms the new applicant. This means, even if a new applicant's trading record results were presented in two sets of accountants' report pursuant to the relevant accounting standards (e.g. there was a change in control), the new applicant may still meet the trading record requirement if (i) the two accountants' reports together present the historical results of the underlying business that forms the substance of listing for the three or two full financial years, as the case may be; (ii) the

² New Applicants under Main Board Rules Chapters 18 and 18A should refer to Main Board Rules 18.03, 18.04, 18A.02 and 18A.03, respectively.

new applicant could demonstrate that other eligibility requirements under Main Board Rule 8.05 (GEM Rule 11.12A) could be met on the basis of the historical accounts that were presented; and (iii) the reporting accountants confirm that the basis of preparation of the two sets of accountants' report do not have significant difference.

Items counted towards the financial eligibility requirements

4.5 Income/ expenses/ cash flow items that arise from the new applicant's ordinary and usual course of business must be counted towards its satisfaction of the financial eligibility requirements under Main Board Rule 8.05 (GEM Rule 11.12A). The burden of proof is on the new applicant and its sponsor to demonstrate to the Exchange's satisfaction that such items arise from the new applicant's ordinary and usual course of business and the Exchange is not subject to the accounting presentation and judgment made by the new applicant, reporting accountants and other experts, and/or competent authorities, as the case may be.

4.6 The below sets out non-exhaustive examples of past cases where the Exchange determined the revenue/ profit/ cash flow items cannot be included for the purpose of meeting the relevant financial eligibility requirements:

(a) tax refunds attributable to the capitalisation of the new applicant's retained profits and statutory surplus reserves into paid up capital given that the underlying capital restructuring activities were not in the new applicant's ordinary and usual course of business;

(b) fair value changes of preferred shares recorded in accordance with the relevant accounting standards given that equity financing through issuance of the preferred shares was not in the ordinary and usual course of business (as oppose to finance costs from bank borrowings);

(c) fair value gains derived from securities investments activities by a new applicant whose principal business was manufacturing household products;

- (d) interest income derived from cash advances to another company by a new applicant which was not in the money lending/ financing business;
- (e) retrospective downward adjustment of royalty fees to the parent group due to change in parent group's transfer pricing policy as advised by external consultant;
- (f) gain on deemed disposal of a subsidiary which was a one-off and not in the ordinary and usual course of the new applicant's business which was debt financing, assets and proprietary investments; and
- (g) revenue/ profit/ cash flow generated from activities that breached material rules and regulations (e.g. failure to obtain licences that are material or crucial to the core businesses of the new applicant, or illegal income that would be confiscated under relevant laws).

Disclosure of unaudited financial information post trading record period

4.7 Where a new applicant, any of its subsidiaries or its holding company has published, pursuant to the requirements of the applicable rules and regulations of a regulatory authority (e.g. an exchange), unaudited quarterly/ interim financial statements that ends after the end of the trading record period disclosed in the listing document and is material to the new applicant, the new applicant must disclose, where applicable, such published unaudited information in the manner provided below:

- (a) its (or its subsidiary's) revenue and income information for the unaudited quarterly/ interim period;
- (b) in a condensed form with major line items/ components of its (or its subsidiary's) assets, liabilities, equity, income and expenses and cash flows as presented in its latest audited financial statements;
- (c) comparative statements for the corresponding period in the prior financial period or prior year-end balance, as the case may be;

- (d) selected note disclosure that will provide an explanation of events and changes that are significant to an understanding of the changes in its (or its subsidiary's) financial position and performance since the reporting date of the last audited financial information;
- (e) description of any material variation between its (or its subsidiary's) accounting principles, practices and methods used in preparing such unaudited quarterly/ interim financial information and those prepared using the accounting standards pursuant to Main Board Rule 4.11 (GEM Rule 7.12); and quantification of any material variations; and
- (f) the unaudited quarterly/ interim financial information must be at least reviewed by an auditor in accordance with the standards established by the Hong Kong Institute of Certified Public Accountants³ or the International Auditing and Assurance Standards Board⁴ and, include as part of the review, the financial effect of the material differences between the unaudited quarterly/ interim financial information and financial statements prepared using the accounting standards pursuant to Main Board Rule 4.11 (GEM Rule 7.12).

4.8 A new applicant is not required to perform a post listing audit on the unaudited financial information discussed in paragraph 4.7 above given that (i) the publication of the unaudited financial information was due to the requirement of the relevant authority; (ii) disclosure of such information in the listing document is to ensure equal dissemination of the new applicant's financial information; and (iii) the information disclosed in the listing document has been reviewed by an auditor as required in paragraph 4.7(f) above.

4.9 In order to ensure the financial information in the listing document provides relevant and updated information to the investors, the latest

³ Hong Kong Standard on Review Engagements 2400 "Engagement to Review Historical Financial Statements" or Hong Kong Standards on Review Engagements 2410 "Review of Interim Financial Information performed by the Independent Auditor of the Entity".

⁴ International Standard on Review Engagements 2400 "Engagement to Review Historical Financial Statements" or International Standards on Review Engagements 2410 "Review of Interim Financial Information performed by the Independent Auditor of the Entity".

financial period reported on by the reporting accountants must not have ended more than six months before the date of the listing documents pursuant to Main Board Rule 8.06 (GEM Rule 11.11) (“**Stub Period Requirement**”). To be clear, the Stub Period Requirement and other timing requirements for the experts report (e.g. property valuation report under Main Board Rule 5.07 (GEM Rule 8.30) and competent person report under Main Board Rule 18.24(2) (GEM Rule 18A.24A(2)) apply to both the listing document and any supplemental listing document.

4.10 The Exchange will not consider factors such as (a) market conditions; (b) non-compliance with the Stub Period Requirement is unlikely to cause prejudice to the investing public; (c) unexpected delay of hearing date by the Exchange; or (d) unduly burdensome to update the accountants’ report to be reasons for any new applicants to not comply with the Stub Period Requirement and other timing requirements as mentioned paragraph 4.9 above.

4.11 The Listing Rules require a comparison of income statements and cash flow statements for the stub period and the corresponding period in the prior financial year (“**Stub Period Comparatives**”) to be included in accountants' reports. A listing document or circular should contain a discussion and analysis of a group's performance, material trends and seasonal fluctuations during the years and periods (if any) covered by an accountants' report to enable investors to make informed investment decisions.

4.12 The financial information for all financial years or periods included in an accountants' report, except for the Stub Period Comparatives, must be audited. The Stub Period Comparatives, if unaudited, must be clearly identified as unaudited and must at least be reviewed by reporting accountants⁵ and their review opinion for such financial information must be included in the accountants' reports.

⁵ In accordance with the International Standards on Review Engagements 2410 "Review of Interim Financial Information performed by the Independent Auditor of the Entity" issued by the International Auditing and Assurance Standards Board, or with the Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants.
