

## **HKEX GUIDANCE LETTER**

**HKEX-GL59-13 (July 2013) (Updated in March 2014)– effective for applications submitted on or after 1 October 2013**

*(Withdrawn in May 2016, superseded by HKEX-GL86-16)*

<b>Subject</b>	<b>Guidance on management discussion and analysis on the historical financial information (“MD&amp;A”) in listing documents</b>
<b>Listing Rules and Regulations</b>	<b>Main Board Rules 2.13(2), 11.07, Paragraph 34 of Appendix 1A, Paragraphs 32 and 47(2) of Appendix 16</b>  <b>GEM Rules 14.08(7), 17.56(2), 18.41</b>  <b>Paragraph 3 of the Third Schedule to the Companies Ordinance<sup>1</sup></b>  <b>Paragraph 17.8 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Code of Conduct”)</b>
<b>Related Publications</b>	<b>HKEX-GL37-12 – Guidance on indebtedness, liquidity, financial resources and capital structure disclosure in listing documents</b>  <b>HKEX-GL38-12 – Guidance on the Latest Practicable Date and the latest date for Liquidity Disclosure in listing documents</b>
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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 Division on a confidential basis for an interpretation of the Listing Rules or this letter.*

### **1. Purpose**

1.1 This letter provides guidance on the expected disclosure in the MD&A in listing documents. Specifically, it aims to ensure that the MD&A:-

- is concise, easy to read and in plain language, and
- provides meaningful discussion and analysis of an applicant’s financial information to help investors understand an applicant’s past performance, present position and future prospects.

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<sup>1</sup> Retitled as the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) with effect from March 2014.

- 1.2 The Exchange expects applicants to follow this guidance letter when preparing their listing applications. An Application Proof that does not follow this guidance may be considered not substantially complete as required under the Listing Rules.

## **2. Applicable Rules and Regulations**

### ***Listing Rules***

- 2.1 Main Board Rule 2.13(2) (GEM Rule 17.56(2)) requires that the information in a listing document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this rule, an applicant must not, among other things: -
- (a) omit material facts of an unfavourable nature or fail to accord them with appropriate significance;
  - (b) present favourable possibilities as certain or as more probable than is likely to be the case; or
  - (c) present projections without sufficient qualification or explanation.
- 2.2 Main Board Rule 11.07 (GEM Rule 14.08(7)) requires that all listing documents issued by an applicant must, as an overriding principle, contain particulars and information which, according to the particular nature of an applicant and the securities for which listing is sought, is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities, financial position, management and prospects of the applicant and of its profits and losses and of the rights of the securities.
- 2.3 Paragraph 34(1) of Appendix 1A to the Main Board Rules requires all listing documents to include (a) general information on the trend of the business of the group since the date to which the latest audited accounts of an applicant were made up; (b) a statement as to the financial and trading prospects of the group for at least the current financial year, together with any material information which may be relevant, including all special trade factors or risks (if any) which are not mentioned elsewhere in the listing document and which are unlikely to be known or anticipated by the general public, and which could materially affect the profits; and (c) the state of the group's order book (where applicable) and prospects for new business including new products and services introduced and announced.
- 2.4 Paragraph 47(2) of Appendix 16 to the Main Board Rules requires all listing documents to include a discussion and analysis of the group's performance during the period covered by the accountants' report covering all those matters set out in paragraph 32 of Appendix 16 to the Main Board Rules.
- 2.5 Paragraph 32 of Appendix 16 to the Main Board Rules requires disclosure on the discussion and analysis of the group's performance and the material factors underlying its results and financial position and that the disclosure should emphasize trends and identify significant events or transactions during the years under review.

- 2.6 GEM Rule 18.41 requires all listing documents to include, among others, (a) a discussion and analysis of the group's performance and the material factors underlying its results and financial position, with an emphasis on trends and significant events or transactions during the years under review; (b) the state of the group's order book (where applicable) and prospects for new business including new products and services introduced and announced; and (c) comments on changes in market conditions, new products and services introduced or announced and their impact on the group's performance and changes in turnover and margins.

### ***Companies Ordinance<sup>1</sup> (Updated in March 2014)***

- 2.7 Paragraph 3 of the Third Schedule to the Companies Ordinance<sup>1</sup> requires a prospectus to contain sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the shares and the financial condition and profitability of the company at the time of the issue of the prospectus, taking into account the nature of the shares being offered and the nature of the company and the nature of the persons likely to be consider acquiring them.

### ***Code of Conduct***

- 2.8 Paragraph 17.8 of the Code of Conduct requires that a sponsor should in conjunction with the management of an applicant and its other advisers prepare relevant, adequate and comprehensible MD&A that should:
- (a) avoid excessive or irrelevant disclosure that may overwhelm investors and act as an obstacle to identifying and understanding material matters and critical information;
  - (b) focus on matters that materially impacted upon historical financial performance or condition;
  - (c) analyse and explain material fluctuations in the financial items and amounts with specific and substantive reasons;
  - (d) discuss material factors or events that are likely to impact future financial performance or condition; and
  - (e) identify and discuss from an investor's perspective any exceptional items or unusual accounting treatments that require further enquiry or disclosure by, amongst other things, making reference to disclosure or treatments adopted by comparable companies.

## **3. Guidance**

- 3.1 Listing documents must include the MD&A because the financial statements alone do not provide all the information that investors need to make investment decisions. The financial statements mainly disclose the financial effects of past events and do not provide non-financial measures of performance or a discussion of future prospects and plans. The MD&A is to provide discussion and analysis of an applicant's past performance and main trends and factors that are likely to affect its performance,

position and prospects in order to enable investors to see the applicant through the eyes of management.

- 3.2 To meet the above objectives, companies are expected to disclose not only past events or information responsive to specific requirements of the Listing Rules, but also an analysis that explains management's view of the implications to an applicant's future and the significance of that information.

### ***General Principles***

- 3.3 The following are the general principles which should be observed in preparing the MD&A:
- (a) disclosure should be clear, straightforward, consistent with its related financial statements and focus on the most important and material information. In addition, there should be a balanced discussion of all major businesses and segments (both existing and planned) including both positive and negative circumstances of an applicant. Generic discussions that do not provide insight into an applicant's past performance and prospects should not be included;
  - (b) integrated information should be provided to create a context to interpret an applicant's financial position, financial performance and cash flows;
  - (c) cross-references to other relevant sections of the listing document should be made to provide more details on the subject matter and to avoid duplication of information within the listing document. For example, the disclosure on forward looking statements and matters affecting an applicant's future performance can be cross-referenced to the "Future Plans and Prospects" section of the listing document; and
  - (d) presenting information using tables, charts and diagrams is recommended to ensure clear, concise and precise disclosure.

### ***Guidance and Principles on Specific Disclosure***

- 3.4 Below are some guidance and principles on specific disclosure generally found in the MD&A. These are not exhaustive and do not include all disclosure requirements under the Listing Rules.

#### ***Key Factors Affecting the Results of Operations***

- 3.5 This part of the MD&A should highlight key events or factors that management considers most important in driving the changes in an applicant's operating results, financial position and cash flows, which may include the following information where appropriate, and not a detailed description or repeating information from the "Business" section:
- economic and regulatory factors that affect the industry and market in which an applicant operates;

- an applicant's lines of business, locations of operations, principal products and services and product mix;
- business process (e.g. sales and distribution channels/methods, pricing policy, production facilities and arrangements, procurement, etc.) and how an applicant creates value, earns revenue and income and generates cash; and
- significant relationships, opportunities, challenges and specific risks that are likely to affect an applicant's performance, financial position, liquidity and cash flow.

*Critical Accounting Policies and Estimates*

- 3.6 This part of the MD&A should disclose an applicant's critical accounting policies, accounting estimates and assumptions made in applying such policies. It should supplement, and not duplicate, the description of accounting policies disclosed in the notes to the financial statements which at times are too generic. For example, instead of reciting the accounting policy that revenue is recognized upon transfer of risks and title, an applicant should clearly state at which point of time revenue is recognized (upon delivery of goods and/or issue of invoice to customers) and whether there is any delay due to time required for inspection and acceptance by the customers.
- 3.7 For critical accounting estimates and assumptions (eg. estimated useful life and residual values of property, plant and equipment; bad debt provisions; valuation of investment properties and impairment assessment), an applicant should disclose:
- the procedures and methods used by management in making accounting estimates;
  - how accurate the estimates (or underlying assumptions) have been in the past by comparing with actual results;
  - how the estimates (or underlying assumptions) have changed in the past; and
  - whether the estimates (or underlying assumptions) are likely to change in the future and the reasons for this.

*Review of Historical Results, Financial Position and Cash Flows (“**Financial Information**”)*

- 3.8 This part of the MD&A should provide information about the quality of, and potential variability of, an applicant's Financial Information, so that investors are able to understand whether an applicant has delivered results in line with expectations and, implicitly, how well management has understood the applicant's market, executed its strategy and managed its resources.
- 3.9 Disclosure should provide clear descriptions of an applicant's financial and non-financial performance, such that it is indicative of the future performance and management's assessment of an applicant's prospects, how resources that are not presented in the financial statements affected an applicant's operations, how non-financial factors have influenced the information presented in the financial statements, and explanations for the significant items in the financial statements and their material fluctuations during the track record period. Presenting a summary of the key financial ratios of an applicant during the track record period and a management discussion on the material fluctuations of these ratios can provide investors a better understanding of an applicant's performance and an easier comparison with those of its industry peers.

- 3.10 The analysis of significant changes in the Financial Information should not recite financial statement information in narrative form with little or no meaningful explanation of the events causing the fluctuations in an applicant's financial performance, or presenting boilerplate discussions that do not provide insights into an applicant's past performance and future prospects.

Examples of explanations we DO NOT consider meaningful: explaining the changes in operating cash flows by reciting the cash flow movements in narrative form without providing the underlying causes for the changes; the decrease in accounts receivables turnover days is due to the increase in sales (i.e. in terms of the calculation formula without providing the reasons/ explanation of the events causing the fluctuations).

- 3.11 Where there have been significant changes in the world's condition such as global financial crisis, material changes to commodities prices and political unrest or where an applicant's operations have been affected by recent natural disasters, appropriate commentary should be made in the MD&A on the extent of actual and potential impact on an applicant's operations, financial position and performance and cash flows.
- 3.12 Explanations of management's perspective of an applicant's direction, targets and prospects, in addition to explanations of past events can help investors develop expectations about an applicant from its past performance and current state. Such explanations must possess the qualitative and quantitative characteristics, including faithful representations, and thus must be neutral.
- 3.13 Specific disclosures on the following items should be made in the MD&A:
- (a) Details of related party loans, advances, guarantees and/or pledges of securities to/from an applicant including the terms, and the intentions of these arrangements after listing;
  - (b) Details of material related party transactions during the track record period, the directors' views on whether they were conducted on an arm's length basis, and whether they would distort an applicant's track record results or make the historical results not reflective of its future performance;
  - (c) Applicable tax rate (and details of any preferential tax treatments, tax benefits or special tax arrangements) which an applicant is subject to and when these tax benefits or special tax arrangements will expire. [Note. If within one year, a risk factor in the "Risk factor" section is recommended];
  - (d) Details on whether an applicant has paid all relevant taxes and details of any disputes/unresolved tax issues with the relevant tax authorities; and
  - (e) Post balance sheet events (including share subdivision, share consolidation and declaration and payment of dividend). The sponsor and reporting accountants must ensure the information in a listing document is complete and accurate by confirming that proper adjustments and disclosure, if necessary, have been made

in the listing document and the accountants' report, including relevant financial indicators such as earnings per share.

*Liquidity and Capital Resources*

3.14 This part of the MD&A should provide a clear picture of an applicant's ability to generate cash and to meet existing and known or reasonably likely future cash requirements which usually include the following:

- historical information regarding sources of cash and significant expenditures;
- an evaluation of the amounts and certainty of cash flows;
- the existence and timing of capital expenditures and commitments;
- expected changes in the mix and relative cost of capital resources;
- indications of which balance sheet or income or cash flow items should be considered in assessing liquidity;
- prospective information regarding sources of and needs for capital; and
- material covenants relating to outstanding debts, guarantees or other contingent obligations.

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