

~~HKEX~~HKEX GUIDANCE LETTER  
~~HKEX~~HKEX-GL68-13 (December 2013) (Updated in June 2015 and March 2019)

*Updated to include relevant guidance from HKEX-GL-63-13 which have been simplified, and guidance from HKEX-LD46-1, HKEX-LD46-2, HKEX-LD51-1, HKEX-LD69-1, HKEX-LD92-1, HKEX-LD96-1, HKEX-LD97-1, HKEX-LD107-1, HKEX-LD19-2011, HKEX-LD30-2012, HKEX-LD34-2012, HKEX-LD37-2012, HKEX-LD73-2013, HKEX-RL12-06, HKEX-RL19-07 and HKEX-RL21-07 which have been withdrawn*

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| Subject                       | Guidance on suitability for listing<br><u>for new applicants</u>  |
| Listing Rules and Regulations | Main Board Rules <u>2.06, 3.08, 3.09, 8.04, 2.06 and Chapter 14A</u><br>GEM Rules <u>2.09, 5.01, 5.02, 11.06, 2.09 and Chapter 20</u>   |
| Related Publications          | <p><del>HKEX-LD8-2; HKEX-LD43-3; HKEX-LD46-1; HKEX-LD46-2; HKEX-LD50-5; HKEX-LD51-1; HKEX-LD51-3; HKEX-LD69-1; HKEX-LD92-1; HKEX-LD96-1; HKEX-LD97-1; HKEX-LD107-1; HKEX-LD19-2011; HKEX-LD30-2012; HKEX-LD37-2012; HKEX-LD73-2013; HKEX-LD92-2015; HKEX-RL12-06; HKEX-RL19-07; HKEX-RL20-07; HKEX-RL21-07; and HKEX-RL25-09.</del></p> <p><u>Listing Decision HKEX-LD43-3 (“LD43-3”)</u></p> <p><u>Guidance Letter HKEX-GL63-13 – Guidance on disclosure of non-compliance incidents in listing documents (“GL63-13”)</u></p> <p><u>Guidance Letter HKEX-GL73-14 – Guidance on pricing policies for continuing connected transactions and their disclosure (“GL73-14”)</u></p> <p><u>Guidance Letter HKEX-GL96-18 – Guidance on listed issuer’s suitability for continued listing (“GL96-18”)</u></p> <p><u>Guidance Letter HKEX-GL97-18 – Guidance for new applicants in the internet technology sector or that have internet-based business models (“GL97-18”)</u></p> |
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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

~~4.1—This letter provides guidance on thenon-exhaustive factors that the Exchange would take into consideration when assessing whether an (i) non-compliances that involve fraud, deceit or dishonesty (such as tax evasion or bribery) (the “Integrity Non-compliances”); (ii) material non-compliances<sup>1</sup> by a new applicant and, its director(s) or controlling shareholder(s) (the “Material Non-compliances”); (iii) uncertainties regarding business are suitable for listing sustainability; and (iv) the use of contractual arrangements would affect a new applicant’s suitability for listing under Main Board Rule 8.04 (GEM Rule 11.06).~~

~~1.1 The Exchange considers a number of factors when assessing an applicant’s suitability for listing. We have published various listing decisions and rejection letters, as referred to above, to provide transparency to the market. This letter is intended to assist applicants and their advisers by consolidating the factors included in these listing decisions and rejection letters. **(Updated in June 2015March 2019)**~~

~~1.2—This letter sets out examples of factors that have been considered by the Exchange in the past and published as guidance on the Exchange’s website, and they are not exhaustive. **(Added in June 2015)**~~

~~1.2 (Deleted in March 2019)~~

~~1.3 (Deleted in March 2019)~~

~~2. Relevant Listing Rules **(Deleted in March 2019<sup>2</sup>)**~~

~~3. **Guidance**~~

~~4.1—Main Board Rule 8.04 (GEM Rule 11.06) states that both the applicant and its business must, in the opinion of the Exchange, be suitable for listing.~~

~~4.2—As stated under Main Board Rule 2.06 (GEM Rule 2.09) states that suitability for listing depends on many factors., there is no bright line test in determining what would render an issuer and its business unsuitable for listing. Applicants for listing should appreciate that compliance with Listing Rules may not of itself ensure an applicant’s suitability for listing.~~

~~4.3—GEM Rule 11.06 also states, by way of example, that an applicant whose assets consists wholly or substantially of cash or short-dated securities (i.e. securities such as bonds, bills or notes which have less than one year to maturity) would not normally be regarded as suitable for listing, except where the applicant or group is solely or mainly engaged in the securities brokerage business.~~

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<sup>1</sup> As defined in GL63-13, these refer to the non-compliance incidents which, individually or in aggregate, have had or are reasonably likely to have in the future, a material financial or operational impact on the new applicant.

<sup>2</sup> 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.

## ~~2. Guidance on suitability~~

- ~~2.1 When vetting a listing application, the Listing Department focuses on an applicant's eligibility for listing (e.g. whether the financial requirements are met; compliance with law, rules and regulations), suitability for listing (e.g. whether matters on sustainability of the business; reliance on a parent company; suitability of directors, including potential persons of substantial influence are satisfactorily addressed), and whether there are any material disclosure deficiencies. (Updated in June 2015)~~
- ~~2.2 There is no hard and fast rule in determining what would render an applicant and its business not suitable for listing. Each case is determined on its own individual factual circumstances.~~

### ~~(1) suitability of director and controlling shareholders~~

~~Having a past non-compliance or conviction record does not necessarily mean that a person cannot be accepted as a director of a listed company.~~

~~However, in the case where the past record or conviction raises serious concern on an individual's integrity, and the individual is likely to exert substantial influence on the applicant after listing (e.g. a controlling shareholder and director), there may be concern as to the applicant's suitability for listing and the suitability of the individual to act as a director under Main Board Rules 3.08, 3.09 and 8.15 (GEM Rules 5.01, 5.02 and 11.07(1)). (Updated in June 2015)~~

~~Where a person is a controlling shareholder, his majority vote as a controlling shareholder is likely to be decisive in the appointment of the directors of the applicant. It will accordingly be highly likely that he will be able to exert substantial influence over the operation and management of the applicant even if he is not formally appointed as a director, or has previously resigned as a director. The issue of the applicant's suitability therefore may not be solved by that person refraining from acting as the applicant's director. (Updated in June 2015)~~

~~Relevant listing decision: HKEx-LD96-1~~

### ~~(2) non-compliances~~

~~The Exchange considers that systematic, intentional, and/or repeated breaches of laws and regulations by an applicant may affect its suitability for listing. The Exchange will take into account the following sets out non-exhaustive examples of factors in determining the impact of non-compliance on an applicant's listing:~~

- ~~(i) the nature, the extent and the seriousness of the breaches;~~
- ~~(ii) the reasons for the breaches, whether they were intentional, fraudulent, due to negligence or recklessness;~~
- ~~(iii) impact of the breaches on the applicant's operation and financial~~

~~\_\_\_\_\_ performance;~~

~~(iv) — rectification measures adopted; and~~

~~(v) — precautionary measures put in place to avoid future breaches.~~

~~In cases such as non-compliant bill financing arrangements, that the Exchange will expect the applicant to have demonstrated for a reasonable period (normally 12 months) that (a) it would be financially sound and could operate without reliance on the non-compliant bill financing arrangements; and (b) it has effective internal control to avoid future non-compliance of a similar nature.~~

~~In other cases where the non-compliances do not have a direct impact on the financial position of the applicant (e.g. failure to obtain the necessary licence, approval or complete the necessary registration required by law), where the non-compliances had been serious, listing was only approved after the applicants had demonstrated continued compliance for a reasonable period of time.~~

~~Where it is determined that the material non-compliance incidents can be resolved by way of disclosure, the Exchange expects the applicant to follow Guidance Letter HKEx-GL63-13.~~

~~Relevant listing decisions: HKEx-LD50-5; HKEx-LD97-1; and HKEx-LD19-2011~~

### ~~**(3) — deteriorating financial performance**~~

~~The Exchange is of the view that the assessment of suitability is a continuous process and that the applicant must remain suitable for listing at the time of listing, taking takes into account the actual performance after the latest audited period, profit forecast and such other projected information submitted by the applicant in relation to its business and financial position after listing.~~

~~Examples of deteriorating financial performance that may give rise to a concern as to suitability include:~~

~~(i) — deteriorating financial performance subsequent to the track record period~~

~~Even if the applicant can meet the relevant requirements of Main Board Rule 8.05 during the track record period, any deteriorating financial performance subsequent to the track record period may be a strong indicator of a fundamental deterioration of commercial or operational viability, which goes to the heart of sustainability and suitability for listing.~~

~~Relevant listing decision : HKEx-LD73-2013~~

~~(ii) — track record results are not indicative of future performance in light of significant profit drop in its profit forecast~~

~~A significant decline in the applicant group's forecast profit together with an~~

engagement in new business through acquisition may also render the applicant not suitable for listing, as the track record results may not be indicative of the applicant's business going forward.

— Relevant rejection letter : HKEx-RL19-07

*(Updated in June 2015)*

#### (4) — reliance on parent group / connected persons / major customer

When reviewing a reliance issue, the Exchange will take into account the degree of dependence. Where the degree of dependence is excessive, this would translate into a concern on suitability for listing.

Examples of reliance that may give rise to a concern as to suitability include:

- (i) — reliance on a parent group for certain important functions such as sales and procurement functions; or financial and operational reliance on the applicant's parent.

— Paragraph 27A of Appendix 1A to the Main Board Rules (Paragraph 27A of Appendix 1A to the GEM Rules) provides that the listing document should include a statement explaining how the applicant is satisfied that it is capable of carrying on its business independently of the controlling shareholder after listing, and particulars of the matters that it relied on in making such statement.

When reviewing whether an applicant can carry on its business independently of its controlling shareholder, the Exchange ordinarily considers the applicant's specific circumstances, including financial independence, operational independence and management independence;

— Relevant listing decisions / rejection letter : HKEx-LD46-1; HKEx-LD46-2; HKEx-LD51-1; HKEx-LD69-1; HKEx-LD30-2012; and HKEx-RL12-06

- (ii) — dependence on the parent consideration when there are overlapping directors, the applicant and its parent are in the same industry sector, and there are inadequate arrangements to manage conflicts of interest and delineation of businesses.

— Main Board Rule 8.10(a)(iii) requires that where the controlling shareholder has a business which is likely to compete with the applicant's business, the listing document must disclose the facts demonstrating that the applicant is capable of carrying on its business independently of, and at arm's length from the competing business of the controlling shareholder.

— In contrast, GEM Rule 11.03 provides that an applicant would not be rendered unsuitable for listing on the grounds that any director or shareholder has an interest in a competing business;

—— Relevant listing decision / rejection letter : HKEx-LD51-3 and HKEx-RL21-07

(iii) ~~the applicant derives a significant portion of its turnover and net profit from transactions with closely related parties and connected persons.~~

—— ~~Although profits from transactions with connected persons or closely related parties do not necessarily have to be disregarded in assessing whether the requirements of Main Board Rule 8.05 are met, when these transactions are excessive, this may raise a concern as to whether the applicant is suitable for listing.~~

3.1 ~~Firstly, the risk involved in connected transactions is substantially a new applicant's suitability for listing pursuant to Main Board Rule 8.04 (GEM Rule 11.06). They should not be construed as being definitive and applicable to all cases as we consider all relevant facts and circumstances in each case. New applicants should also refer to the listing decisions and guidance letters published by the Exchange from time to time which explain how the Exchange assesses the suitability requirement in different from transactions with independent third parties, and hence it will be uncertain whether the applicant's business is relying on the connected person and is sustainable without these connected transactions. cases. (Updated in March 2019)~~

~~Secondly, significant connected transactions will also give rise to a concern as to whether they are designed to enable the applicant to meet the requirements of Main Board Rule 8.05;~~

—— Relevant listing decision : HKEx-LD8-2 and HKEx-LD92-1

(iv) ~~heavy reliance on a major customer.~~

~~When the applicant's reliance on a single major customer is extreme, the applicant may suffer a material and adverse financial impact if it loses that customer or there is a change in the business relationship.~~

~~In assessing whether a case of reliance on single customer is an extreme case which impacts on suitability for listing for an applicant, the Exchange will take into account the applicant's ability to find substitute customers, the likelihood for the level of reliance to decrease in the future, the industry landscape, whether reliance is mutual and complimentary, the existence of any long-term contractual arrangements and whether the applicant is capable of maintaining its revenue and profitability in the future in light of the reliance;~~

—— Relevant listing decision: HKEx-LD107-1

(v) ~~a captive business model, i.e. the sourcing of the applicant's principal raw materials and its principal customer channel are dominated by the same party.~~

—— ~~When the applicant's supply and sales are dominated by the same party, the~~

applicant's relationship with this party will be fundamental to its business. If the applicant is unable to demonstrate that it is capable of carrying on its business independently of this party, it will translate into a concern about the suitability of the applicant for listing.

Relevant rejection letter: HKEx-RL20-07

#### **(5) — gambling**

Applicants which engage in gambling business will be considered not suitable for listing unless they satisfy the requirements in the Exchange's announcement on "Gambling Activities Undertaken by Listing Applicants and/or Listed Issuers" and Listing Committee Report 2006.

Relevant rejection letter: HKEx-RL25-09

#### **(6) — contractual arrangements (VIEs)**

Applicants adopting contractual arrangements of the nature described in Listing Decision HKEx-LD43-3 may be considered not suitable for listing unless they satisfy the conditions set out in that Listing Decision, including closely tailoring the use of such arrangement to the applicant's needs.

Relevant listing decision: HKEx-LD43-3.

#### **(7) — reliance on unrealised fair value gains to meet profit requirement**

The Exchange is of the view that even if an applicant is able to satisfy the profit test under Main Board Rule 8.05(1)(a) by relying on the unrealised fair value gains of its investment properties, if the applicant is loss-making after such gains are excluded and it did not have a substantive business during its track record period, the applicant would have to demonstrate that it has a sustainable business before the Exchange considers it suitable for listing.

The demonstration of a sustainable business can include the existence of property projects under development as at the date of the listing document, or significant recurring income (e.g. rental income) generated in the applicant's ordinary and usual course of business during the track record period which is expected to continue after listing.

#### **(8) — Unsustainable business model**

Where a company's business model is believed to be unsustainable, the Exchange will consider it unsuitable for listing. A business model may be considered unsustainable due to a combination of factors, e.g. significant and recent changes in the revenue model such that its trade record is not representative of its past

~~performance; changing regulatory environment and industry outlook; deteriorating financial performance during the track record period and no sign of improvement in the forecast period and beyond; one-off windfall profits unlikely to be recurring. While none of the factors alone may necessarily be detrimental, the Exchange will consider the combined impact of such factors on the applicant's business.~~

~~Relevant listing decisions: HKEx-LD37-2012, Company D, Company L, Company N, Company O and Company P of HKEx-LD92-2015~~

~~**(Added in June 2015)**~~

### ~~3.5 **(Deleted in June 2015)**~~

3.2 –In general, the Exchange expects all professional parties and experts named in the listing document to have performed sufficient due diligence to support their views on the relevant matters in relation to the listing application. Where there are red flags identified during the vetting process (e.g. materially inconsistent disclosure or submissions), the Exchange will apply a higher standard of review and expect the sponsors and experts (as the case may be) to provide a higher level of assurance on the relevant matters to ensure the new applicant's compliance with the Listing Rules. **(Added in March 2019)**

### **Integrity Non-compliances (Updated in March 2019)**

3.3 Integrity Non-compliances will likely render the new applicant, as well as the culpable director, being not suitable for listing or not suitable to be a director of a listed company, as the case may be. Integrity Non-compliances impugn a culpable director's character and integrity in contravention of the standards required under Main Board Rules 3.08 and 3.09 (GEM Rules 5.01 and 5.02).

3.4 If a controlling shareholder is culpable for the Integrity Non-compliances, so long as such controlling shareholder has the ability to exert substantial influence over the new applicant, the new applicant will not be suitable for listing because it would be subject to substantial influence by such controlling shareholder. The assessment of substantial influence will be determined on a case-by-case basis, taking into account non-exhaustive factors such as the controlling shareholder's (i) economic interest in the new applicant; (ii) relationship with the other shareholders, directors and members of senior management of the new applicant; or (iii) involvement in the operation and management of the new applicant's business.

3.5 The Exchange will take into account all relevant facts and circumstances (including the underlying reasons for the Integrity Non-compliances and relevant mitigating factors, their operational and financial impact, the culpable person's influence on the new applicant's operations, internal controls and trading record results, and whether any effective internal control measures have been implemented (and for how long) to avoid re-occurrence of similar Integrity Non-compliances) in determining whether such Integrity Non-compliances would render the new applicant unsuitable for listing. Where Integrity Non-compliances



are involved, the Exchange expects the culpable director or controlling shareholder to cease being a director or controlling shareholder of the new applicant, as the case may be, before listing. Such culpable director or controlling shareholder should seek guidance from the Exchange before they become the controlling shareholder or accept the nomination to be a director of a listed issuer. Listed issuers should refer to GL96-18 on suitability issues concerning directors or persons with substantial influence.

3.6 With respect to the operational and financial impact of the Integrity Non-compliances, the Exchange may request the new applicant to demonstrate that it could still meet the relevant eligibility requirements under the Listing Rules after adjusting its trading record results for the impact of the Integrity Non-compliances, and that there would not have been any material adverse impact on its business and financial performance had it complied with the relevant rules or regulations and going forward.

### **Material Non-compliances (Updated in March 2019)**

3.7 Material Non-compliances that raise concerns regarding the competency of any director who was involved in the Material Non-compliances or was on the board when such non-compliances occurred, leading to issues of his/ her suitability as a director which cannot be addressed by disclosure may also affect a new applicant's suitability for listing.

3.8 With respect to revenue/ profit/ cash flow generated from activities that constitute Material Non-compliances, on a case-by-case basis, the Exchange may request the new applicant to demonstrate that it could still meet the relevant eligibility requirements under the Listing Rules after adjusting its trading record results for the impact of such Material Non-compliances, and that there would not have been any material adverse impact on its business and financial performance had it complied with the relevant rules or regulations and going forward.

### **Sustainability of business (Updated in March 2019)**

3.9 There are many factors that affect a new applicant's sustainability and the Exchange considers the facts and circumstances of each applicant in determining the materiality and the likelihood of the adverse factors. We set out below examples from past cases we have encountered. We emphasize that these examples are non-exhaustive, and may not be applicable to every new applicant.

#### **Deteriorating financial performance**

3.10 Even if a new applicant meets the relevant eligibility requirements under Main Board Rule 8.05 (GEM Rule 11.12A) at the time of filing, if it recorded deteriorating revenue and profit, and/ or material losses during or after the trading record period, there may be concerns on the sustainability of its business. Factors we consider include:

(a) how susceptible the new applicant's financial performance is to changes beyond its control (e.g. any small increases in operating costs, such as raw material costs, which cannot be fully passed on to their customers may result in net

losses). This is particularly relevant for new applicants that marginally meet the minimum profit requirement under the Main Board Rules (minimum cash flow requirement under GEM Rules), have no-recurring revenue source and a thin profit margin, or have large cash flow mismatch and have not gone through a full collection cycle;

- (b) the underlying causes of the deteriorating financial performance and whether such downward trend is expected to continue (e.g. change in consumer preferences or sunset industries), or whether it is the cyclical nature of the industry; and
- (c) whether the new applicant had demonstrated that it is able to effectively mitigate its exposure to the relevant risks or to turn around the business (e.g. by diversifying its revenue sources, expanding its customer base, or cutting costs).

#### Material reliance on various parties

3.11 Material reliance on another party (a “**Relevant Counterparty**”)<sup>3</sup> may threaten a new applicant’s business sustainability if it is likely that the relationship with such party may materially adversely change or terminate. Examples of material reliance include:

- (a) high customer or supplier concentration, or both (e.g. captive business model);
- (b) dependence on a limited number of distribution channels, such as through an e-commerce site or social media platform, to market its products (see paragraph 3.13 below for exceptions); or
- (c) dependence on another party, such as the controlling shareholder and its close associates (the “**Controlling Shareholder Group**”) for critical functions, such as sales/ distribution/ procurement.

3.12 If a new applicant materially depends on a Relevant Counterparty, we will assess the likelihood that the relationship with the Relevant Counterparty will materially adversely change/ terminate. Some non-exhaustive factors that we consider are:

- (a) whether the Relevant Counterparty is mutually dependent on the new applicant. For example, if the new applicant is (i) the sole supplier of the Relevant Counterparty for a highly bespoke product; or (ii) the sole/ major customer of the Relevant Counterparty, the risk is lower that the Relevant Counterparty will terminate the relationship; or
- (b) whether the new applicant has an established relationship/ long-term agreement with the Relevant Counterparty.

3.13 Some Relevant Counterparties dominate the industries in which they operate due

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<sup>3</sup> If the Relevant Counterparty is a connected person as defined under the Listing Rules, new applicants must comply with the relevant requirements on continuing connected transactions in Chapter 14A of the Main Board Rules (Chapter 20 of GEM Rules) and should also refer to GL73-14 for relevant guidance.

to regulatory restrictions, high entry barriers or other factors. As applicants that operates in such industries are unlikely to diversify or reduce its reliance on the Relevant Counterparties (i.e. such reliance is an industry norm), the Exchange will examine whether there are any red flags indicating its relationships with the Relevant Counterparties are likely to be terminated or otherwise materially adversely change, as stated above. New applicants in the internet technology sector or that have internet-based business models should also refer to GL97-18 for further assessment on the nature of reliance on the Relevant Counterparties and other matters for companies in this sector.

3.14 A new applicant may be able to demonstrate that despite its material reliance on a Relevant Counterparty, any change in the relationship will not have a material adverse impact on its business because it is/ will be able to effectively mitigate its exposure (e.g. decrease in sales, increase in raw material costs and/ or production time, cost of business disruption). For example, if the Relevant Counterparty is a supplier for raw materials that are readily available or for which there are reasonable substitutes, the new applicant may easily procure such raw materials from a different supplier at a similar price or substitute with another product.

3.15 A new applicant's material reliance on a Relevant Counterparty is a matter of disclosure if, absent red flags to indicate otherwise, (i) the relationship with the Relevant Counterparty is unlikely to materially adversely change or terminate; or (ii) the new applicant is/ will be able to effectively mitigate its exposure to any material adverse changes to or termination of its relationship with the Relevant Counterparty. The disclosure in the listing document should, as relevant, include:

- (a) the background of the Relevant Counterparty;
- (b) the business relationship, the nature of reliance and details of the arrangements between the new applicant and the Relevant Counterparty;
- (c) basis that the likelihood that the relationship with the Relevant Counterparty will materially adversely change/ terminate is low; or
- (d) basis that the new applicant is/ will be able to effectively mitigate its exposure to any material adverse changes to or termination of the relationship with the Relevant Counterparty.

*Financial assistance from its Controlling Shareholder Group*

3.16 A new applicant may receive material financial assistance (e.g. loans, guarantees or other forms of collateral or security) from the Controlling Shareholder Group ("**Financial Support**")<sup>4</sup>. Given the practical difficulty in assessing to what extent the Controlling Shareholder Group's incentive to provide Financial Support will be

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<sup>4</sup> We have come across situations where Financial Support was provided by a director of the new applicant (who is not a controlling shareholder) or an independent third party such as a customer or supplier. However, such situations are not common and therefore, not meaningful as guidance.

reduced after listing, the Exchange will presume such Financial Support will be withdrawn (absent evidence to the contrary) in assessing the sustainability of the new applicant.

3.17 To demonstrate that its business is sustainable without Financial Support, some new applicants in the past have chosen to settle all loans or release all guarantees from the Controlling Shareholder Group at listing. To be clear, settlement of Financial Support is not required. The Exchange has also taken into account the following non-exhaustive factors to assess whether the new applicant's business will be sustainable without Financial Support:

- (a) whether the new applicant is able to obtain independent financing (e.g. without Financial Support) on comparable terms; or
- (b) whether the new applicant has sufficient liquid assets on hand to meet its financial needs.

*Material changes that may adversely affect the company's prospect*

3.18 Concerns on a new applicant's sustainability of business will also arise if it faces changes which imminently threatens its operations, such as:

- (a) changes in regulatory requirements which may result in the new applicant being unable to continue to operate its business in its current form or at its current profitability level; or
- (b) development of new technology which renders its business obsolete.

3.19 To address these concerns, the Exchange expects the new applicant to affirmatively demonstrate that such changes are unlikely to materialize or will not affect the sustainability of the new applicant's business.

*Substantial reliance by property companies on fair value gains on investment properties*

3.20 Fair value gains may be included in profit calculations of a property company for the purposes of satisfying the minimum profit requirement under the Listing Rule 8.05(1)(a) (the "Profit Test"). However, if a substantial portion of a new applicant's profit is derived from fair value gains arising from its investment properties, there are concerns on the practical sustainability of such new applicant. For example, in a market downturn, its properties may record fair value losses which may result in the new applicant becoming loss making. As such, the Exchange considers the business of a new applicant in the property business unsustainable and not suitable for listing if it:

- (a) cannot satisfy the Profit Test after excluding unrealised gains of its investment properties; and
- (b) did not have any substantial business during its trading record period (e.g. sales of properties or recurring rental income).

3.21 In all cases that give rise to sustainability concerns, the Exchange will closely scrutinise the new applicant's profit and cash flow forecasts, applicable sensitivity or breakeven analysis, and any inconsistent growth with the industry and/ or peers. We also expect the sponsors to provide details of their due diligence work that satisfy themselves on the reasonableness of the underlying assumptions.

**Contractual arrangements (Updated in March 2019)**

3.22 A new applicant is only permitted to use contractual arrangements due to foreign ownership restrictions and if the related risks of contractual arrangements are sufficiently mitigated. Otherwise, it may not be suitable for listing. New applicants should refer to LD43-3 for relevant guidance.

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