

HKEX GUIDANCE LETTER

HKEX-GL97-18 (July 2018) (Updated in March 2019)

[Updated due to withdrawal of LD107-1 which is superseded by HKEX-GL68-13]

Subject	Guidance for new applicants in the internet technology sector or that have internet-based business models (collectively, “Relevant Sectors”)
Listing Rules	Main Board Rules 2.13(2), 8.04, 8.10, 11.07, 14A.53, 17.03 Paragraph 27A of Appendix 1A to the Main Board Rules
Relevant Publications	HKEX-LD107-1 – Whether heavy reliance on a major customer would render Company A unsuitable GL68-13 – Guidance on a suitability for listing for new applicants (“LD107-1GL68-13”)
Author	IPO Advisory and Projects

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~~**Department** on a confidential basis for an interpretation of the Listing Rules, or this letter. Unless otherwise specified, defined terms in the Listing Rules shall have the same meanings in this letter.

1. Purpose

1.1 This letter gives guidance on the Exchange’s approach to companies in Relevant Sectors with reference to the characteristics of such companies to facilitate their listing within the existing regulatory framework.

2. Relevant Listing Rules

2.1 Main Board Rule 2.13(2) provides that the information contained in an issuer’s document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, the issuer must not, among other things:

- (a) omit material facts of an unfavourable nature or fail to accord them with appropriate significance; and
- (b) present favourable possibilities as certain or as more probable than is likely to be the case.

2.2 Main Board Rule 8.04 states that both the issuer and its business must, in the opinion of the Exchange, be suitable for listing.

- 2.3 Main Board Rule 11.07 states that as an overriding principle, all listing documents must contain such particulars and information which, according to the particular nature of the issuer 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 issuer and of its profits and losses and of the rights attaching to such activities.
- 2.4 Main Board Rule 14A.53 states that a listed issuer must set an annual cap for continuing connected transactions. The annual cap must be expressed in monetary terms, determined by reference to previous transactions and figures in the published information of the listed issuer's group, or if there were no previous transactions, set based on reasonable assumptions.
- 2.5 Note 1 to Main Board Rule 17.03(3) states that the total number of securities which may be issued upon exercise of all options to be granted under the share option scheme must not in aggregate exceed 10% of the relevant class of securities of the listed issuer. The note to Main Board Rule 17.03(4) states that the maximum entitlement of each participant under the share option scheme must not exceed 1% of the relevant class of securities in issue unless separately approved by the shareholders. Main Board Rule 17.03(5) states that the period within which securities must be taken up under the option is limited to ten years from the date of grant of the option.

~~2.6 Paragraph 27A of Appendix 1A to the Main Board Rules states that a listing document for a new applicant should include a statement explaining how the applicant is satisfied that it is capable of carrying on its business independently of its controlling shareholders (including any of the controlling shareholders' close associate) after listing.~~

~~2.6 (Deleted in March 2019)~~

3. Guidance

High Degree of Reliance

3.1 Many companies in Relevant Sectors (especially internet-based companies) provide tailored products or services and leverage on their substantial shareholders' main businesses or platform to promote its products or services. This reliance can lead to extensive connected transactions under the Listing Rules.

~~3.2 The Exchange normally considers reliance to be a matter of disclosure issue and requires a new applicant to disclose in its listing document details of its material reliance upon various parties, such as a substantial shareholder, connected persons, a major supplier or a major customer in its listing document. However, where the degree of reliance is extreme, the Exchange may have a concern on whether the applicant is suitable for listing.~~

~~(a) Listing Decision HKEX-LD107-1 sets out factors the Exchange considers when assessing whether an applicant's reliance on a major customer or supplier is so material as to impact suitability:~~

~~(b) whether the applicant's business model can be easily changed to reduce the level of reliance;~~

~~3.33.2 whether the level of reliance is likely to decrease. (Updated in March 2019)~~

~~(c) whether the whole industry landscape is dominated by a few players making it unlikely for companies in the same line of business to break off the reliance;~~

~~(d) whether the reliance is mutual and complementary; and~~

~~(e) whether the applicant is able to maintain its revenue in the future in light of the reliance.~~

~~3.3 (Deleted in March 2019)~~

3.4 The Exchange notes that the business models of many companies in Relevant Sectors at the early stage of their development often extensively use the services offered by the businesses of their parent company, or another connected person, to facilitate the sales and marketing of their own products or services. For example, a new applicant may promote its products or services using the internet based social network platform of its parent company. Companies in Relevant Sectors often have a high degree of dependence/reliance on their parent company or another connected person's platform ~~and~~. Given the nature of their industry and businesses, new applicants are usually unable to reduce their level of reliance in the foreseeable future ~~given the nature of their industry and businesses. The~~. Further, such reliance is typically not mutual and complementary and is usually more important to the new applicant than the parent company at the time of listing. It is also unlikely that the new applicant will be able to switch to using another platform, given the competition in the industry.

~~3.5 Given their nature, the Exchange is prepared to accept a higher level of reliance on parent companies / connected persons / major suppliers / major customers and place less emphasis on the need to demonstrate a reduction in reliance in relation to applicants in Relevant Sectors if the applicant is able to demonstrate the following characteristics:~~

~~(a) the whole industry landscape is dominated by a few players that may or may not be the applicant's parent company (or other connected persons / major suppliers / major customers);~~

~~(b) the services that the applicant relies on are provided by a small number of dominant major providers in competition with each other; therefore, it is difficult for the new applicant to use the services of an alternative provider to reduce the level of reliance;~~

~~(c) there were legitimate commercial reasons for the applicant and its parent company (or other connected persons / major suppliers / major customers) to enter into the transactions, and these were on normal commercial terms in the ordinary course of business of the issuer as well as the parent company (or other~~

~~connected persons / major suppliers / major customers), and will (in the case of transactions with a connected person) be subject to continuing connected transaction requirements under the Listing Rules after listing; and~~

~~(d) there are long term agreements in place between the applicant and the parent company (or other connected persons / major suppliers / major customers) to provide continued access to the parent company's (or other connected persons / major suppliers / major customers) platform or services.~~

~~3.6 Such applicant would also be required to disclose in its listing document:~~

~~(a) the areas of reliance and the reason for the applicant's business model that results in the reliance;~~

~~(b) details on the arrangements (including fees and charges) for the services rendered by the parent company / connected persons / major suppliers / major customers;~~

~~(c) details of any mitigating factors to reduce the risk of reliance (e.g. the ability to use a different supplier / service provider); and~~

~~(d) risks associated with such reliance, including a description of the "worst case scenario" if the services are no longer available.~~

3.5 Notwithstanding the above, the Exchange will not consider such new applicant to be unsuitable for listing if there are no red flags indicating its relationships with the parent company or another connected person are likely to be terminated or otherwise materially adversely change. New applicants should refer to GL68-13 for factors the Exchange considers in evaluating whether operational reliance on another party would affect the new applicant's suitability and relevant disclosure requirements. **(Updated in March 2019)**

3.6 **(Deleted in March 2019)**

3.7 The business models of many companies in Relevant Sectors often leverage on the platform of their parent company, or another connected person, to facilitate sales and marketing of their own products or services. Such an arrangement constitutes a continuing connected transaction under the Listing Rules, for which ~~the new applicant~~ issuers are required to set a monetary annual cap. However, in such cases it is ~~not uncommon~~ common for the new applicant to structure the payment for the use of such services as a percentage of the new applicant's revenue generated through the connected person's platform. The Exchange evaluates connected transactions carefully on a case-by-case basis. ~~When an applicant derives a significant portion of its turnover and / or net profit from continuing connected transactions and / or other connected transactions, the Exchange has the discretion to decide that the applicant is unsuitable for listing because there is an extreme reliance on another parties even if it meets all the factors in paragraph 3.5 of this guidance letter.~~ **(Updated in March 2019)**

Quantifying Caps for Continuing Connected Transactions

- 3.8 There may be cases in which it is impractical for the new applicant to accurately estimate the amount of payment required under a cooperative agreement for the use of the platform of ~~the applicant's~~ parent company or another connected person where the payment is based on transaction volume as ~~they~~ it may have a short operating history or be in a growth phase such that historical revenues would not be ~~very~~ reliable for estimating future transaction volume. Imposing an arbitrary monetary cap may be unduly burdensome and not in the interests of the new applicant's shareholders after listing.
- 3.9 In relation to new applicants in Relevant Sectors, the Exchange proposes to grant waivers from strict compliance with the requirement to set a monetary annual cap under the Listing Rules and allow the annual cap to be set as a formula on a ~~case-~~by ~~-case~~ basis, provided that the new applicant demonstrates the necessity for such an arrangement in the circumstances of its case and the formula to be adopted is in line with historical and prevailing commercial practices. The issuer will demonstrate to the Exchange that it merits the continuing connected transaction at the time it is to be renewed and that the circumstances continue to justify the granting of the waiver (~~for~~ ~~example~~ e.g. if the business volume over the platform has sufficiently stabilised at that point so as to allow a monetary cap to be set).

Extensive Use of Share Incentive Schemes

- 3.10 Companies in Relevant Sectors often place greater emphasis on retaining and incentivising talented persons in order to develop their businesses. This is often achieved through the grant of share options. These companies, particularly those in the stage of rapid growth, may find the existing 10% overall cap and the one percent cap on individual participants under Listing Main Board Rule 17.03 to be unduly restrictive and burdensome. Some companies may also find the limit of ten years for the securities under the option to be taken up to be too restrictive to allow them the flexibility to incentivise talents.
- 3.11 Based on facts and circumstances of individual new applicant in Relevant Sectors, the Exchange may at its discretion, grant or reject a waiver from strict compliance with (i) the percentage cap requirement on outstanding share options under a share option scheme and allow a higher cap to be set; and (ii) the ten year limit within which securities must be taken up under the option and allow a longer period to be set.
- 3.12 ~~An~~ new applicant that applies for such waiver should demonstrate the necessity for a higher cap ~~-/~~ longer option period in its case and clear criteria for granting share options under the scheme. The Exchange also requires ~~an~~ new applicant to disclose, in its listing document, the material terms of the scheme and the circumstances when it may grant options beyond the 10% cap under the Main Board Rules.

Unestablished Regulatory Environment

- 3.13 Companies in Relevant Sectors often operate in sectors (e.g. Financial Technology, or FinTech) for which local laws and regulations are still evolving, and are still being drafted. Some new applicants are uncertain as to how to demonstrate to the

Exchange that they are in compliance given the evolving regulatory environment in which they operate.

3.14 If the relevant laws and regulations applicable to ~~ana~~ new applicant are still developing and are not expected to be promulgated in the near future, the Exchange would normally expect disclosure of the associated risks in the listing document to be sufficient. In these circumstances, we would not expect ~~ana~~ new applicant's legal opinion regarding the new applicant's compliance with local laws and regulations ~~that it submits to support its application~~ to cover ~~the applicant's~~ sits compliance with the unimplemented laws and regulations.

3.15 However, if it is clear in the circumstances of the case that draft regulations affecting the new applicant's business will be promulgated in the near future, the Exchange would normally expect the new applicant to demonstrate, with the support of a local legal opinion, that it is able to comply with the requirements (and any guidelines) of the draft regulations in the event that the draft regulations are promulgated in the form as set out in public notices of the regulations (e.g. in a government gazette).

~~***~~

~~—End—~~