

HKEX LISTING DECISION

HKEX-LD118-2018 (published in March 2018) (Updated in August 2018, October 2019 (Rule amendments) and withdrawn in January 2024)

[Streamlined and incorporated into the guidance letter GL106-19 (Guidance on sufficiency of operations).]

Party	Company A – a Main Board issuer
Issue	Whether Company A had a sufficient level of operations or sufficient assets to meet Main Board Rule 13.24
Listing Rules	Main Board Rules 6.01(3), 6.10 and 13.24
Decision	Company A had failed to maintain a sufficient level of operations or sufficient assets to meet Main Board Rule 13.24. Accordingly, the Exchange commenced the delisting procedures under Rule 6.10

FACTS

1. Company A and its subsidiaries (**Group**) were principally engaged in retail sales of second-hand motor vehicles (the **Second-hand Vehicles Business**), involving the Group purchasing through sale agents second-hand motor vehicles and putting them up for sale in a showroom or on the internet in Hong Kong. It had also started a money lending business (the **Money Lending Business**) about two years ago. The Group operated these businesses by a small number of employees.
2. Over the past five years, the Group's business performance and financial position had been deteriorating. The Group's revenue decreased by near 95% to less than HK\$5 million. The Group had recorded net loss and negative operating cashflow. As at the latest financial year end, the Group had total assets and net assets of HK\$50 million and HK\$40 million respectively. Its assets comprised mostly cash, loan and interest receivables and a prepaid lease payment.
3. The Exchange queried whether Company A was maintaining sufficient operations or assets as required under Main Board Rule 13.24.

4. In response, Company A submitted that it was able to satisfy Rule 13.24 because:
- (a) Following relaxation of the relevant PRC regulation a few months ago, the Group commenced a business of wholesale distribution of new branded motor vehicles in the PRC (the **Vehicles Wholesale Business**). It sourced new branded motor vehicles in fleet from overseas suppliers and sold them to a small number of car dealers in the PRC on an indent basis.
 - (b) According to Company A's forecasts, the Vehicles Wholesale Business would significantly increase Company A's revenue for the second half of the current financial year and the revenue from this business would triple for the next financial year. This was based on a few confirmed orders, non-legally binding framework agreements with a few customers, and an assumption about the average monthly increase in the sales volume during the forecast periods (for which Company A did not provide a clear basis). Company A expected to incur a loss for the current financial year and only record a minimal profit in the next financial year.
 - (c) For the existing businesses, Company A would cease the Second-hand Vehicles Business and reallocate its resources to the Vehicles Wholesale Business. It would continue to generate minimal revenue from the Money Lending Business.

APPLICABLE LISTING RULES AND GUIDANCE MATERIALS

5. Main Board Rule 2.03 states that-
- “The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and”*
6. Main Board Rule 13.24 states that-
- “An issuer shall carry out, directly or indirectly, a sufficient level of operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer's securities.”*
7. Main Board Rule 6.01 states that-

“Listing is always granted subject to the condition that where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also do so where:—

...

(3) the Exchange considers that the issuer does not have a sufficient level of operations or sufficient assets to warrant the continued listing of the issuer's securities (see rule 13.24)...”

(Rules 6.01(3) and 13.24 were amended on 1 October 2019. See Note 1 below.)

8. Main Board Rule 6.10 states that-

“There may be cases where a listing is cancelled without a suspension intervening. Where the Exchange considers that any circumstances set out in rule 6.01 arise, it may:

(1) publish an announcement naming the issuer and specifying the period within which the issuer must have remedied those matters which have given rise to such circumstances. Where appropriate the Exchange will suspend dealings in the issuer's securities. If the issuer fails to remedy those matters within the specified period, the Exchange will cancel the listing. The Exchange may treat any proposals to remedy those matters as if they were an application for listing from a new applicant for all purposes, in which case, the issuer must comply with the requirements for new listing applications as set out in the Listing Rules; or

...”

9. Listing Decisions (LD35-2012 and LD88-2015) describe the purpose behind Main Board Rule 13.24 and provide guidance on the application of the Rule:

“ ... Rule 13.24 is intended to maintain overall market quality. Issuers that fail to meet this Rule are "blue sky companies" where public investors have no information about their business plans and prospects. This leaves much room for the market to speculate on their possible acquisitions in the future. To allow these issuers' shares to

continue to trade and list may have an adverse impact on investor confidence.

...

When applying Rule 13.24 to issuers whose shares are trading on the Exchange, the Exchange generally allows their shares to continue to trade as long as they have an operation and meet the continuing disclosure obligations. If the Exchange were to suspend these issuers because of their low level of activities or assets values, public shareholders would have no access to the market for trading the issuers' shares. To balance the public shareholders' interests with the need to maintain market quality, the Exchange suspends trading only in extreme cases.

...”

10. Listing Decisions (LD115-2017 and LD116-2017) elaborate the criteria that the Exchange would consider to assess an issuer's compliance with the Rule:

“... Rule 13.24 requires issuers to maintain a sufficient level of operations or assets of sufficient value to warrant the continued listing of their securities. Without quantitative criteria for sufficiency, this Rule calls for a qualitative test and is assessed based on the specific facts and circumstances of individual cases.

... to balance public shareholders' ability to access the market to trade in the security with the need to maintain market quality, the Exchange would suspend trading only in an extreme case. When making the assessment, the Exchange takes into account the current regulatory concerns and the acceptable standards in the market. ”

The Exchange treated cases with the following characteristics as extreme cases:

“ ...

- (a) *a very low level of operating activities and revenue; for example the issuer's business does not generate sufficient revenue to cover its corporate expenses, resulting in net losses and negative operating cashflows;*
- (b) *the current operation does not represent a temporary downturn, the issuer had been operating at a very small scale and incurring losses for years; and*

- (c) *the assets do not generate sufficient revenue and profits to support a continued listing.*

In these cases, the issuers are not operating substantive businesses, and the value of the businesses (excluding the listing status) is minimal, if any. There is a question whether the Rule requirement to carry on a sufficient level of operations or have assets of sufficient value is met. The Exchange considers it necessary to apply Rule 13.24 in these cases with a view to maintaining investors' confidence and overall market quality.

Once suspended, the issuer would be given a remedial period to submit a resumption proposal to demonstrate that it has a viable and sustainable business to re-comply with Rule 13.24. If the issuer fails to do so, it would be delisted according to the delisting procedures under Rules 6.01(3) and 6.10..."

ANALYSIS

11. Rule 13.24 imposes a continuing obligation on an issuer to maintain a sufficient level of operations or assets to warrant its continued listing. To meet this obligation, an issuer must satisfy the Exchange that it has a viable and sustainable business. For this purpose, an issuer must provide the Exchange with sufficient empirical evidence or compelling supportive information to support its case (for example, a track record of its business).
12. In this case, the Exchange considered that Company A had failed to comply with Rule 13.24 and this was an extreme case:
 - (a) The Group's existing level of operations had, for years, remained very low and recorded net losses and negative operating cashflows. Company A would cease the Second-hand Vehicles Business and did not expect the Money Lending Business to grow substantially in the future.
 - (b) Company A sought to rely on the Vehicles Wholesale Business and its revenue forecasts for the next two financial years to meet Rule 13.24. However, the Exchange noted that:
 - (i) The business model of the Vehicles Wholesale Business was substantially different from that of the Second-hand Vehicles Business. The Vehicles Wholesale Business was a business of wholesale distribution of new branded motor vehicles in the PRC conducted on an indent basis relying on a small number of car dealers, compared to the Second-hand Vehicles Business involving retail sales in Hong Kong of second-hand

motor vehicles selected and acquired by the Group. The Vehicles Wholesale Business was, therefore, a new business of Company A, which commenced only a few months ago and lacked a track record.

- (ii) The development of the Vehicles Wholesale Business was preliminary with uncertain potential. The customer base for the Vehicles Wholesale Business was limited. It was not clear how Company A would source new customers or enter into new sales agreements to support the business growth.
 - (iii) A significant portion of the revenue projections from the Vehicles Wholesale Business was based on non-legally binding framework agreements and assumptions about the monthly increases in sale volume which were not supported by signed agreements, committed sales orders or otherwise.
- (c) Based on its latest financial report, the Group had total assets of HK\$50 million and net assets of HK\$40 million only, which comprised mainly cash, receivables and a prepayment. As noted above, the Group's assets had not generated sufficient revenue and profits to ensure Company A to operate a viable and sustainable business. Nor had Company A demonstrated that its assets would enable it to substantially improve its operations and financial performance.

CONCLUSION

13. The Exchange decided that Company A had failed to maintain a sufficient level of operations or assets of sufficient value to meet Rule 13.24. Accordingly, the Exchange commenced the delisting procedures under Rules 6.01(3) and 6.10.

Subsequent development

14. According to Company A's subsequent submissions, a significant portion of the committed sales orders under the Vehicles Wholesale Business (noted in paragraph 4(b) above) was not delivered on schedule. The actual revenue from the Vehicles Wholesale Business for the corresponding period was substantially lower than its projected sales.

Notes:

1. *The amended Rule 6.01 states that:*

“Listing is always granted subject to the conditions where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also do so where:-

...;

(3) the Exchange considers that the issuer does not carry on a business as required under rule 13.24; or

...”

The amended Rule 13.24 states that:

“(1) An issuer shall carry out, directly or indirectly, a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuer’s securities.

Note: Rule 13.24(1) is a qualitative test. The Exchange may consider an issuer to have failed to comply with the rule in situations where, for example, the Exchange considers that the issuer does not have a business that has substance and/or that is viable and sustainable.

The Exchange will make an assessment based on specific facts and circumstances of individual issuers. For example, when assessing whether a money lending business of a particular issuer is a business of substance, the Exchange may consider, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base and loan portfolio and internal control systems of the money lending business of that particular issuer, taking into account the norms and standards of the relevant industry.

Where the Exchange raises concerns with an issuer about its compliance with the rule, the onus is on the issuer to provide information to address the Exchange’s concerns and demonstrate to the satisfaction of the Exchange its compliance with the rule.

(2) ...”

2. *Rule 13.24(1) makes it clear that an issuer must carry out a business with a sufficient level of operations to warrant its continued listing. The issuer must also have sufficient assets to support its operations.*

The Rule amendments would not change the analysis and conclusion in this case.