

HKEX LISTING DECISION

HKEX-LD112-2017 (published in October 2017) (updated in October 2019 (Rule amendments))

Parties	Company A – a Main Board issuer Subsidiary B – a company recently acquired by Company A from Mr. C and became a wholly owned subsidiary of Company A Mr. C – a director of Subsidiary B
Issue	Whether Company A would have sufficient operations or assets under Rule 13.24 after a proposed major disposal
Listing Rules	Main Board Rule 13.24
Decision	Company A would not meet Rule 13.24 upon completion of the proposed disposal

FACTS

1. Company A and its subsidiaries (**Group**) have been engaged in the manufacturing and sale of packaging products (**Packaging Business**) since its initial listing on the Exchange in 20x1. The Packaging Business had accounted for the Group's entire revenue and net profit until the Group's acquisition of a company (Subsidiary B) which operates an advisory business (**Advisory Business**) in November 20x6.
2. Subsidiary B was acquired from Mr. C for cash, with the consideration of HK\$250 million determined based on its business prospects and a profit guarantee of HK\$30 million for the year ending 31 December 20x7.
3. Before acquired by Company A, Subsidiary B had recorded total revenue of only HK\$3 million for the 30 months from January 20x4 to June 20x6. This revenue was generated from providing corporate secretarial services. Subsidiary B recorded net losses in 20x4 and 20x5 with net liabilities as at 31 December 20x4 and 20x5 respectively.
4. Subsidiary B's revenue increased significantly from July 20x6 onwards. For the 10 months between July 20x6 and April 20x7, it recorded total revenue of approximately HK\$230 million, resulting in a net profit of HK\$48 million for 20x6 and HK\$19 million for the first four months in 20x7. Of such revenue of HK\$230 million, only 2% was generated from recurring corporate secretarial services with the remaining 98% generated from different types of new services, mostly non-recurring in nature, including advice on financial

accounting, valuation, international private merger and acquisition, loan referral, property agency, project agency services and strategic planning. Of such revenue of HK\$230 million, 70% was derived from one transaction with one client whilst 10% was derived from another transaction with the second largest client.

5. In April 20x7 Company A proposed to sell the Packaging Business to an independent third party for cash (**Disposal**), this was a major transaction and subject to shareholders' approval under the Listing Rules. Company A explained that the profitability of the Packaging Business had persistently decreased for the past three years, and the sale proceeds would be used to settle its liabilities. After the Disposal, the Group's operations and revenue would rely solely on the Advisory Business.
6. Company A submitted that the Advisory Business is a viable and sustainable business such that the Group would meet the Rule 13.24 requirements upon completion of the Disposal because:
 - a. The Advisory Business had recorded substantial revenue and profits since July 20x6;
 - b. It had secured advisory contracts for over HK\$50 million in the next two financial years which would ensure the stability and continuity of the Group's income stream; and
 - c. The sustainability of the Advisory Business depends on its business reputation and the size of its client network, in particular, the established relationship with a number of new clients through Mr. C's personal network and referrals by those new clients.

APPLICABLE LISTING RULES AND GUIDANCE MATERIALS

7. 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.”

[\(Rule 13.24 was amended on 1 October 2019. See Note 1 below.\)](#)

8. Listing Decisions (LD35-2012 and LD88-2015) describe the purpose behind 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.*
- *Where an issuer's shares are trading on the Exchange, the Exchange generally allows those shares to continue to trade as long as the issuer has an operation and meets the continuing disclosure obligations. This is to allow shareholders to have access to the market for share trading as far as possible. The Exchange would exercise its suspension power only in an extreme case.*
- *However, if an issuer takes a corporate action, the Exchange is more likely to suspend the issuer's trading where the issuer fails to satisfy the Exchange that it would have a viable and sustainable business to justify its continued listing after completion of the corporate action. In this case, shareholders would have the opportunity to decide whether to allow the corporate action to proceed, knowing that the Exchange would exercise the suspension power should the corporate action proceed. In that way shareholders' interests are safeguarded through the shareholders' approval process..."*

ANALYSIS

9. 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 is a qualitative test and is assessed case by case.
10. The Exchange considered that Company A would not have sufficient operations or assets to meet Rule 13.24 upon completion of the Disposal. In particular, the Exchange questioned the viability and sustainability of the Advisory Business (which would become the Group's only remaining business after the Disposal):
 - a. The history of Company A's operation and management of the Advisory Business is very short (less than 6 months when the Disposal was proposed).
 - b. Although the Advisory Business had generated substantial revenue and

net profits in recent months, it had recorded minimal revenue and net losses in previous years (i.e. prior to July 20x6). The recent and significant increase in revenue was attributed to a variety of advisory and agency services of different nature bearing no or little correlation with each other. They are operated by a few employees (including Mr. C) and rely on a very small number of clients. Almost all client contracts were one-off and non-recurring. A large majority of the revenue in 20x6 was derived from one client. The Exchange was concerned with the substance of this transaction, and the work performed by Subsidiary B to earn the substantial fees and the basis of determination of such fees.

- c. Subsidiary B relies heavily on Mr. C to source its clients and businesses. The Exchange queried Subsidiary B's ability to carry out the Advisory Business independently of Mr. C.
 - d. Company A has failed to demonstrate the viability and sustainability of the Advisory Business. It has not provided the Exchange with a concrete business plan to develop the Advisory Business.
11. The Exchange also considered that the Group would not have sufficient assets to justify a listing after the Disposal. Almost all of the Group's assets after completion of the Disposal would consist of goodwill from the acquisition of the Advisory Business, a vacant property and some cash. There are no details to demonstrate that these assets would enable the Group to have a viable and sustainable business to maintain a sufficient level of operations going forward.

CONCLUSION

12. The Exchange concluded that Company A would not comply with Rule 13.24 should it proceed with the Disposal.

Notes:

1. 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.