HKEX LISTING DECISION
HKEX-LD93-2016 (published in March 2016)

Party	Company A – a Main Board issuer Newco – Company A's subsidiary proposed to seek a separate listing on the Exchange
Issue	Whether the Company A (excluding its interest in Newco) could rely on the unrealised fair value gains on investment properties to meet the profit requirement under Rule 8.05(1)(a)
Listing Rules	Main Board Rules 8.04, 8.05(1)(a) and Paragraph 3(c) of Practice Note 15
Decision	The Exchange rejected the spin-off proposal as Company A could not demonstrate that its property business was a substantive and sustainable business

FACTS

1. Company A, through its subsidiaries, was engaged in a number of principal businesses, including the manufacture and sale of certain household products (**Manufacturing Business**) and property investment (**Property Business**).

2. Company A proposed to inject the Manufacturing Business into Newco and seek a separate listing of Newco on the Exchange. Company A (excluding Newco) (**Remaining Group**) would continue to carry out the property investment and other principal businesses. Newco would continue to be Company A's subsidiary after the proposed spin-off.

3. Company A submitted that the Remaining Group could satisfy independently the requirements of Chapter 8 of the Rules. In particular, it was of the view that the Remaining Group could meet the profit requirement under Rule 8.05(1)(a).

4. The Exchange noted that the Remaining Group's profits during the track record period were mainly attributable to the unrealized fair value gains on investment properties retained by the Remaining Group. The other businesses retained by the Remaining Group were loss making or generated minimal profits.

5. The Remaining Group held a number of properties in commercial, industrial and residential buildings in Hong Kong and the PRC for leasing and capital appreciation purposes. The Property Business generated rental income in the range of about HK$15 million to HK$30 million for each of the latest three financial years. The Remaining Group did not carry out property development or construction business during the track record period.

6. Company A submitted its plan to expand the investment property portfolio in the next few years, including some potential property acquisitions under negotiation.

7. There was an issue whether the Remaining Group could rely on the fair value gains on investment properties to meet the profit requirement under Rule 8.05(1)(a).

APPLICABLE LISTING RULES

8. Paragraph 3(c) of Practice Note 15 states that:-

> *"The Listing Committee must be satisfied that, after the listing of Newco, the Parent would retain a sufficient level of operations and sufficient assets to support its separate listing status. In particular, it would not be acceptable to the Listing Committee that one business (Newco's) supported two listing statuses (the Parent's and Newco's). In other words, the Parent itself would be required to retain, in addition to its interest in Newco, sufficient assets and operations of its own, excluding its interest in Newco, to satisfy independently the requirements of Chapter 8 of the Exchange Listing Rules."*

9. Rule 8.05(1)(a) provides that a new applicant must have:

> "*a trading record of not less than three financial years (see rule 4.04) during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK$20 million and, in respect of the two preceding years, be in aggregate not less than HK$30 million. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business*".

10. Under Listing Decision LD66-1, for the purpose of the profit test under Rule 8.05(1)(a), the Exchange allows a new listing applicant to include unrealized fair value gains on investment properties as profits where the applicant is a property developer/investor, and the fair value gains are derived from the ordinary and usual course of business.

11. In this connection, Guidance Letter GL68-13 sets out further guidance in situation where an applicant relied on unrealized fair value gains on investment properties to satisfy the profit test. The letter states that:-

> *"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 unrealized 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."*

ANALYSIS

12. In this case, property investment was one of the principal businesses of the Remaining Group. However, the Exchange was not satisfied that the Remaining Group was suitable for listing by relying on the fair value gains on investment properties to meet Rule 8.05(1)(a) because:

(a) As explained in the Exchange Listing Decision LD66-1 and Guidance Letter GL68-13, where an applicant (which is a property developer/investor) meets Rule 8.05(1)(a) by relying on unrealized fair value gains arising from its investment properties, it must demonstrate that it has a substantive property business during the track record period and the business is sustainable going forward before the Exchange considers it suitable for listing under Rule 8.04.

(b) The Remaining Group held a number of properties for leasing and capital appreciation purposes, which only generated annual rental income of about HK$15 million to HK$30 million in the latest three years. The Exchange did not consider this business substantive during the track record period.

(c) The Remaining Group did not have any property projects under developments or significant recurring income to demonstrate the sustainability of the Property Business as described in GL68-13. While Company A submitted that it planned to expand the property portfolio, this was preliminary and did not demonstrate that the Property Business would generate a significant level of recurring income in the future. Company A could not demonstrate that the

Remaining Group had a substantive and sustainable property business.

CONCLUSION

13. The Exchange rejected the proposed spin-off because the Remaining Group could not satisfy Paragraph 3(c) of Practice Note 15.