

HKEX LISTING DECISION
HKEX-LD99-2016 (published in March 2016)

Party	Company A – a Main Board issuer Subsidiary B – a wholly owned subsidiary of Company A Mr. C – Company A’s controlling shareholder Mr. D – a third party who agreed on condition to acquire all of Mr. C’s shareholding in Company A
Issue	Whether Company A would have sufficient operations or assets under Rule 13.24 after the disposal
Listing Rules	Main Board Rule 13.24
Decision	Company A would not meet Rule 13.24 upon completion of the disposal

FACTS

1. Company A and its subsidiaries (**Group**) were engaged in the manufacturing and distribution of multimedia and communication products.
2. Subsidiary B was engaged in the manufacturing and distribution of communication products of a major brand of the Group (**Disposal Business**). It accounted for about 90% and 75% of Company A’s revenue and assets. It was loss making in the latest financial year and recorded a profit of over HK\$30 million in each of the past few years.
3. Company A and Mr. C proposed to enter into the following transactions:
 - a. Company A would sell Subsidiary B to Mr. C for cash (**Disposal**). The Disposal constituted a very substantial disposal and connected transaction and was subject to independent shareholders’ approval.
 - b. Mr. C would sell his entire shareholding in Company A to Mr. D who would then make an offer to acquire all the remaining shares in Company A from other shareholders. This transaction was conditional on the completion of the Disposal.

4. Upon completion of the Disposal, Company A would continue its existing business in the manufacturing and distribution of multimedia and communication products, excluding the product line owned by Subsidiary B (**Remaining Business**).
5. Company A submitted that the product line of Subsidiary B was loss making and the Disposal would allow the Group to focus on other product lines with better prospect and more profitable.
6. Company A would use the proceeds from the Disposal as general working capital and for future business opportunities. Company A would record a loss of about HK\$4 million from the Disposal.
7. There was an issue whether Company A would have sufficient operations or assets under Rule 13.24 after the Disposal.
8. Company A was of the view that it would be able to meet Rule 13.24 upon completion of the Disposal because:
 - a. For the latest financial year, the Remaining Business recorded revenue and profit of over HK\$200 million and HK\$4 million.
 - b. Upon the Disposal, the Group would have total assets of about HK\$450 million, including trade and other receivables, cash, inventories, fixed assets and trademark.
 - c. Based on Company A's profit forecast, the Remaining Business would continue to record profit and grow steadily.
 - d. The Group had been engaged in the Remaining Business and the Disposal Business since its listing on the Exchange. The Remaining Business comprised distinct product lines and operated independently from the Disposal Business with its own manufacturing and distribution teams.
 - e. The Disposal would improve the Group's financial performance by disposing of the loss making business.

APPLICABLE LISTING RULES

9. 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.”

10. 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.

...

... 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

11. 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.
12. The Exchange considered that Company A would not have sufficient operations or assets to meet Rule 13.24 upon completion of the Disposal because:
 - (a) Company A proposed to dispose of the Disposal Business, which accounted for 90% and 75% of Company A's revenue and assets. The Disposal would substantially reduce Company A's scale of operations and assets.
 - (b) The Remaining Business recorded only minimal profit for the latest financial year and was loss making in the past few years. It could not demonstrate a proven track record of sustainability and viability. Its

profit forecast also failed to show substantial improvement in its operations and financial performance after the Disposal.

- (c) The assets of the Remaining Business would be insufficient to meet Rule 13.24 because, as mentioned in (b) above, the operations of these assets could not generate sufficient revenue and profits to justify a listing. The other asset of the Group would be the cash proceeds from the Disposal, but Company A could not demonstrate how the cash retained by the Group would enable it to substantially improve its operations.
- (d) The Disposal formed part of the arrangements between Mr. C and Mr. D and was made to facilitate the sale of a controlling interest in Company A. Company A had been engaged in the Disposal Business and Remaining Business since its listing on the Exchange. The Disposal Business accounted for the bulk of Company A's existing businesses and had been profitable in the past except in the latest financial year. While Company A submitted that the Disposal would improve its financial performance, it failed to support its case or demonstrate that the Remaining Business was viable and sustainable.

CONCLUSION

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