

**HKEX GUIDANCE LETTER
HKEX-GL103-19 (April 2019)**

Subject	Guidance for applicants on the presentation of the non-GAAP financial measures in a listing document and any relevant documents pursuant to the Exchange's Listing Rules
Listing Rules	Main Board Rules 2.13 and 11.07 GEM Rules 14.08(7) and 17.56
Relevant Publications	N/A
Author	IPO Vetting Team

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 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 provides guidance on the presentation of the non-GAAP financial measures in a listing document.

2. Relevant Listing Rules

2.1 Main Board Rule 11.07 and GEM Rule 14.08(7) state 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.

3. Non-GAAP financial measures and common types of non-GAAP financial measures

3.1 A non-GAAP financial measure is a numerical measure of a listing applicant's current, historical or future performance, financial position or cash flow that is not a GAAP measure¹. Listing applicants often disclose non-GAAP financial measures in sections such as 'Summary' and 'Financial information' of a listing document.

3.2 Common types of non-GAAP financial measures presented by listing applicants include earnings before interest, taxes, depreciation and amortisation ("EBITDA"); adjusted EBITDA; and adjusted net profit (that is, net profit excluding one or more expense items such as add back of listing expenses, etc.).

¹ GAAP measures are based on Hong Kong Financial Reporting Standards ("HKFRS") or International Financial Reporting Standards ("IFRS") or China Accounting Standards for Business Enterprises ("CASBE")

4. Guidance

- 4.1 Sponsors should ensure the presentation of the non-GAAP financial measures is not misleading. Reference can be made from the below principles and the IOSCO's 'Statement on Non-GAAP Financial Measures'². The following elements, if present, would contribute to the reliability and comparability over time of non-GAAP financial measures and reduce the potential for misleading disclosure.

(a) Defining the Non-GAAP Financial Measure

- (i) Define each non-GAAP financial measure presented and provide a clear explanation of the basis of calculation.
- (ii) Non-GAAP financial measures should be clearly labelled in a way such that they are distinguished from GAAP measures. Labels should be meaningful and should reflect the composition of the measure.
- (iii) When labeling a non-GAAP financial measure, a listing applicant must not use titles or descriptions that are the same as, or are confusingly similar to, titles or descriptions used for GAAP measures. It would be inappropriate to label a non-GAAP financial measure with a name that may convey a measure that it does not actually represent.
- (iv) To avoid investors' confusion, a listing applicant should not characterise or label the non-GAAP financial measure as earnings before interest and taxes ("EBIT") and EBITDA if the measure does not meet these traditional definitions. Instead, the listing applicant should distinguish the measure from EBIT or EBITDA by using a title such as "adjusted EBITDA".
- (v) Explain the reason for presenting the non-GAAP financial measure including an explanation of why the information is useful to investors, and for what additional purposes, if any, management uses the measure. A listing applicant should avoid providing boilerplate disclosures related to the usefulness and purpose of the measure.
- (vi) Explicitly state that the non-GAAP financial measure does not have a standardised meaning prescribed by the listing applicant's GAAP and therefore may not be comparable to similar measures presented by other issuers.

(b) Unbiased Purpose

- (i) Non-GAAP financial measures should not be used to avoid presenting adverse information to the market.
- (ii) A listing applicant should not exclude certain non-recurring charges but do not exclude non-recurring gains (for example, "cherry picking" non-GAAP adjustments to achieve the most positive measure).

² The "Statement on Non-GAAP Financial Measures" was published by the International Organisation of Securities Commissions (the "IOSCO") in June 2016, available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD532.pdf>

- (iii) A listing applicant should not use individually tailored accounting principles, including certain adjusted revenue measures (for example, a non-GAAP financial measure that reflects revenue recognised over the service period under GAAP on an accelerated basis as if the listing applicant earned revenue when it billed its customers).

(c) Prominence of Presentation of GAAP Measures versus Non-GAAP Financial Measures

- (i) When a listing applicant presents non-GAAP financial measures, those measures should not be presented with more prominence than the most directly comparable measure calculated and presented in accordance with GAAP. Presentation of non-GAAP financial measures, including information provided for reference, should not in any way confuse or obscure the presentation of the GAAP measures.
- (ii) If GAAP and non-GAAP financial measures are presented in a particular section of a document, the GAAP measures should be presented before the non-GAAP financial measures. For example, if a listing applicant wants to use certain non-GAAP financial measures in its discussion of results of operations, it should discuss the GAAP results before the non-GAAP financial measures.
- (iii) A listing applicant should not present a non-GAAP financial measure in more detail, or emphasise it more, than the comparable GAAP measure. For example, use of phrases such as “exceptional” or “record” in a discussion of the non-GAAP financial measure would place undue emphasis on that measure if such phrases were not used to describe the comparable GAAP measure.
- (iv) The disclosures related to non-GAAP purpose and use should not state or imply that the non-GAAP financial measures are superior to, provide better information about, or more accurately represent the results of operations than GAAP measures.
- (v) Certain presentations that give undue prominence to non-GAAP financial measures, such as a full non-GAAP income statement, are prohibited.

(d) Reconciliation to Comparable GAAP Measures

- (i) Provide a clear and concise quantitative reconciliation from the non-GAAP financial measure to the most directly comparable GAAP measure presented in the financial statements. The adjustments should be explained.
- (ii) If the reconciling items are derived from items reported in the GAAP measures, they should be reconcilable to the financial statements. When a reconciling item cannot be extracted directly from the financial statements, the reconciliation should show how this figure is calculated.
- (iii) Such reconciliation should be quantitative and is generally presented as a table, although it may be disclosed in another clearly understandable format.
- (iv) The reconciliation should begin with the GAAP measure and be reconciled to the non-GAAP financial measure, rather than the other way around.
- (v) Reconciling adjustments from the GAAP measure to the non-GAAP financial measure should be separately quantified and appropriately labeled.

(e) Presentation of Non-GAAP Financial Measures Consistently Over Time

- (i) If a listing applicant chooses to present non-GAAP financial measures, it should provide the measure for comparative periods.
- (ii) The non-GAAP financial measures presented by a listing applicant should generally be presented consistently from period to period. Further, if a listing applicant chooses to change the composition of the non-GAAP financial measure, the listing applicant should explain any changes and the reason for making them, and provide comparative figures for the prior period with such figures adjusted to reflect the change in composition.
- (iii) If a listing applicant determines it will no longer present a particular non-GAAP financial measure, the reason for this determination should be explained.
- (iv) A listing applicant should consider whether its non-GAAP financial measures are consistent with standard measures used in its industry or by its peers and, if they are not, how the differences may affect comparability with other companies. A listing applicant's non-GAAP financial measures may differ from those used in its industry or of its peer companies. However, the listing applicant should consider explaining such differences.

(f) Recurring Items

- (i) In presenting non-GAAP financial measures, listing applicants sometimes seek to adjust for items that are reasonably likely to recur in the foreseeable future, or are activities that affected the entity in the recent past. Such items should not be described as non-recurring, infrequent or unusual without sufficient explanation.
- (ii) A listing applicant should not remove costs necessary to generate revenues or normal, recurring charges.
- (iii) The following items³ should not be described as non-recurring, infrequent or unusual without sufficient explanation:
 - a. Restructuring and acquisition costs for a listing applicant with recurring restructuring charges or frequent business acquisitions;
 - b. Pre-opening costs incurred in certain industries, such as the restaurant and retail industries;
 - c. Certain marketing expenses that were considered normal recurring operating expenditures;
 - d. Expenses that a listing applicant has incurred over several successive quarters or years that appear to be necessary for operating its business;
 - e. Share of profits or losses of associates and joint ventures when they relate to the normal activities of the listing applicant; and
 - f. Impairment of trade receivables relating to a listing applicant's normal business.
- (iv) A listing applicant should use judgement in determining what constitutes a normal, recurring operating expense.

³ This list is not exhaustive

(g) Treatment of Tax Adjustments

- (i) A listing applicant should present its reconciling adjustments on a gross basis before tax. The overriding objective is to avoid double counting of any amount. Income taxes should be shown as a separate adjustment and clearly explained.

(h) Access to Associated Information

- (i) The information that listing applicants provide regarding non-GAAP financial measures should be readily and easily accessible to investors and other users of financial information. Information is readily and easily accessible if it accompanies the non-GAAP financial measure or a reference is provided to where the information is available.

4.2 In vetting a listing document, the Listing Department may raise the following comments when non-GAAP financial measures are presented by a listing applicant:

- (i) Is the measure misleading?
- (ii) Is the non-GAAP financial measure presented necessary and appropriate for investors to understand the performance of the listing applicant?
- (iii) Is the measure presented with the most directly comparable GAAP measure and with no greater prominence than the GAAP measure?
- (iv) Is the measure appropriately defined and described, and is it clearly labeled as non-GAAP financial measure?
- (v) Does the reconciliation between the GAAP and non-GAAP financial measure clearly label and describe the nature of each adjustment, and is each adjustment appropriate? The reconciliation should begin with the GAAP measure (such as, profit for the year) and be reconciled to the non-GAAP financial measure.
- (vi) Is there transparent and company-specific disclosure of the substantive reason(s) why management believes that the measure is useful for investors and the purpose for which management uses the measure?
- (vii) Is the measure balanced (that is, does it adjust not only for non-recurring expenses but also for non-recurring gains)?
- (viii) Does the measure appropriately focus on material adjustments and not include immaterial adjustments that would not seem to be a focus of management?
- (ix) Do other listing applicants present this measure or similar measures? If not, why is this measure important to the listing applicant but not its peers?

5. Responsibilities of sponsors, reporting accountants and other experts on the presentation of non-GAAP financial measures

5.1 Sponsors, reporting accountants and other experts are reminded to perform appropriate level of due diligence to ensure accurate presentation of non-GAAP financial measures in a listing document, including but not limited to, the accuracy of the reconciling items and the reasonableness of the adjustments (for example, whether the adjustments would result in double counting).

6. Application of the principles in this letter to listed issuers

- 6.1 With reference to Main Board Rule 2.13 and GEM Rule 17.56, the above-mentioned guidance should also be applied when listed issuers present non-GAAP financial measures in any documents pursuant to the Exchange's Listing Rules (such as financial reports, announcements and circulars).

HKEX GUIDANCE LETTER
HKEX-GL102-19 (April 2019)

Subject	Guidance on accounting policies and stock-taking procedures performed by the reporting accountants
Listing Rules	Main Board Rules 4.03, 4.08(3), 4.11, 4.12 and 19.39 GEM Rules 7.02, 7.08(3), 7.12, 7.13 and 7.16
Related Publications	Joint policy statement regarding the listing of overseas companies published by the Exchange and the SFC in September 2013 (updated in April 2018) (“JPS”)
Author	IPO Vetting Team

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1. Purpose

1.1 This letter provides guidance on the Exchange’s approach with respect to (i) change of accounting standard/ policy; (ii) adoption of accounting standards other than those as set out in Main Board Rule 4.11 (GEM Rule 7.12); and (iii) stock-taking procedures performed by the reporting accountants.

2. Guidance

2.1 The information disclosed in the listing document of a new applicant must enable investors to easily understand its business, financial position, management and prospects, etc.. Accordingly, irrespective of how certain matters/ transactions are accounted for, the Exchange encourages new applicants to disclose information in listing documents beyond those required under the applicable accounting standards to the extent necessary to fulfil the above purpose.

Change of accounting standard/ policy

2.2 If a material change in accounting standard/ policy is expected, new applicants should disclose in the listing document sufficient and meaningful information on the effect of the adoption of such change to enable investors to assess its financial results. Such information should not be a restatement of financial statement information in a narrative form or a tabulation of financial data without analysis, and should include the following, where applicable:

- (i) in the “Summary”, “Risk Factors” and “Financial Information” sections of the listing document, any announced/ possible amendments to the accounting

standard¹/ policy and the expected effective date; underlying reasons for the change in the applicant's accounting policy; and qualitative and quantitative assessment on the potential impact of the changes; and

- (ii) in the management discussion and analysis section and/ or notes to the financial information in the applicant's annual or interim report after listing, an analysis of the relevant financial results at a level of details similar to what would be presented in the listing document.

Adoption of accounting standards other than those as set out in Main Board Rule 4.11 (GEM Rule 7.12)

- 2.3 New applicants that are applying for a secondary listing on the Main Board or seeking dual primary listing on GEM and NYSE or NASDAQ are allowed to use US GAAP². New applicants incorporated in acceptable overseas jurisdictions are allowed to adopt other accounting standards as set out in paragraph 64 of the JPS.
- 2.4 Other new applicants that propose to adopt accounting standards other than those as set out in Main Board Rule 4.11 (GEM Rule 7.12) ("**R4.11 Accounting Standards**") would need to apply for a waiver from the Exchange, which is only granted in exceptional circumstances and on a company-specific basis. The Exchange will impose, at a minimum, the following conditions for such waiver:
- (i) the applicant's annual/ interim/ quarterly reports (where applicable) after listing must include a reconciliation statement showing the financial effect of the use of different accounting standards ("**Reconciliation Statement**"), which should be audited (for accountants' report and annual reports) or reviewed (at least equivalent to International Standard on Assurance Engagements 3000 or Hong Kong Standard on Assurance Engagements 3000) (for interim/ quarterly reports); and
 - (ii) the new applicant must revert to R4.11 Accounting Standards as soon as practicable if there is a change in the circumstances under which the waiver was granted (e.g. a Main Board applicant adopted US GAAP at the time of listing because it was dual listed in Hong Kong and U.S. but was subsequently delisted from the US stock exchange).
- 2.5 In all cases where a new applicant's accounting reports are drawn up in conformity with accounting standards other than the R4.11 Accounting Standards, the new applicant should disclose in the listing document, where applicable, (i) a description of the material differences between the accounting standard adopted and the R4.11 Accounting Standards; and (ii) a Reconciliation Statement³.

¹ New applicants should refer to paragraphs 30 and 31 of International Accounting Standards 8/ Hong Kong Accounting Standards 8 which relates to new and revised standard that has been issued but is not yet effective.

² Main Board Rule 19.39 and GEM Rule 7.13, respectively.

³ Main Board Rule 4.12 (GEM Rule 7.16).

- 2.6 In case of a spin-off, if the new applicant's parent is a listed issuer on the Exchange and the new applicant adopts different accounting standards (e.g. US GAAP and IFRS) from its parent, the parent should include a Reconciliation Statement in its circular, if any, in connection with the spin-off proposal.

Stocktaking procedures performed by the Reporting Accountants

- 2.7 The Exchange expects the reporting accountants appointed for the purpose under Main Board Rule 4.03 (GEM Rule 7.02) to conduct significant and substantive work in the preparation of the accountants' report for the purpose of listing. This work would necessarily entail the reporting accountants gathering sufficient and appropriate evidence to support their opinion through a variety of procedures including inspection, observation and direct confirmation.
- 2.8 If the reporting accountants were appointed during or after the trading record period, they are not able to perform physical count of inventory to ascertain the inventory balances at particular dates prior to their engagement. In those circumstances, it is acceptable for the reporting accountants to adopt roll-back procedures to ascertain inventory balances for the periods prior to their engagement. The directors of the new applicant and the sponsors must be satisfied that it is justifiable for the reporting accountants to adopt the alternative auditing procedures.
- 2.9 The Exchange usually does not find it compelling for the reporting accountants to adopt roll-forward procedures to ascertain the inventory level as at the end of the stub period/ financial year after they were appointed, as it is within the reporting accountants' control to attend/ schedule stocktakes. Even if, for whatever reason, a stocktake could not be arranged on those dates, the reporting accountants should (i) attend one additional stocktake after the end of the relevant period; (ii) perform roll-back procedures to ascertain the inventory balance as at the end of the relevant period; and (iii) compare the stocktake records as at end of the relevant period to the roll-back analysis.

**HKEX GUIDANCE LETTER
HKEX-GL101-19 (March 2019)**

Subject	Guidance on Sanctions Risks
Listing Rules	Main Board Rules 2.13(2) and 8.04 GEM Rule 11.06
Related Publications	HKEX-GL96-18
Author	IPO Vetting Team

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1. Purpose

- 1.1 Certain overseas jurisdictions may from time to time impose trade or economic sanctions on specific countries, governments, entities or persons by restricting their nationals from making assets or services available, directly or indirectly, to them, dealing with their assets or otherwise conducting commercial transactions with them. Some sanctions may even have (i) extra-jurisdictional effect, i.e. are imposed on persons who are not nationals of the relevant jurisdiction or entities which are not incorporated or located in the relevant jurisdiction, and do not otherwise have any nexus with that jurisdiction; and/or (ii) implications on activities or investments which may be regarded as financing, facilitating or contributing to the enhancement of the ability of a sanctioned country, government, entity or person to develop certain specific products or industries.
- 1.2 This letter provides guidance on actions required to be taken by a listing applicant if its activities expose the Relevant Persons (as defined below) to any risk as a result of sanctions under any law or regulation of any Relevant Jurisdiction (as defined below) and how such risk may affect its suitability for listing and should be dealt with.

2. Relevant Listing Rules

- 2.1 Main Board Listing Rule 2.13(2) requires that the listing applicant must not, among other things, omit material facts of an unfavourable nature or fail to accord them with appropriate significance in the listing document.
- 2.2 Main Board Listing Rule 8.04 (GEM Listing Rule 11.06) requires that both the listing applicant and its business must, in the opinion of the Exchange, be suitable for listing.

3. Guidance

Definitions

- 3.1 For the purposes of this Guidance Letter, the following terms are defined as follows:

“Primary Sanctioned Activity” means any activity in a Sanctioned Country or (i) with; or (ii) directly or indirectly benefiting, or involving the property or interests in property of, a Sanctioned Target by a listing applicant incorporated or located in a Relevant Jurisdiction or which otherwise has a nexus with such jurisdiction with respect to the relevant activity, such that it is subject to the relevant sanctions law or regulation.

“Relevant Jurisdiction” means any jurisdiction that is relevant to the listing applicant and has sanctions related law or regulation restricting, among other things, its nationals and/or entities which are incorporated or located in that jurisdiction from directly or indirectly making assets or services available to or otherwise dealing in assets of certain countries, governments, persons or entities targeted by such law or regulation.

“Relevant Persons” means a listing applicant, together with its investors and shareholders and persons who might, directly or indirectly, be involved in permitting the listing, trading, clearing and settlement of its shares, including the Exchange and related group companies.

“Sanctioned Activity” means Primary Sanctioned Activity and Secondary Sanctionable Activity.

“Sanctioned Country” means any country or territory subject to a general and comprehensive export, import, financial or investment embargo under sanctions related law or regulation of the Relevant Jurisdiction.

“Sanctioned Target” means any person or entity (i) designated on any list of targeted persons or entities issued under the sanctions-related

law or regulation of a Relevant Jurisdiction; (ii) that is, or is owned or controlled by, a government of a Sanctioned Country; or (iii) that is the target of sanctions under the law or regulation of a Relevant Jurisdiction because of a relationship of ownership, control, or agency with a person or entity described in (i) or (ii).

“Sanctioned Trader” means any person or entity that does a material portion (10% or more) of its business with Sanctioned Targets and Sanctioned Country entities or persons.

“Secondary Sanctionable Activity” means certain activity by a listing applicant that may result in the imposition of sanctions against the Relevant Person(s) by a Relevant Jurisdiction (including designation as a Sanctioned Target or the imposition of penalties), even though the listing applicant is not incorporated or located in that Relevant Jurisdiction and does not otherwise have any nexus with that Relevant Jurisdiction.

Three scenarios

3.2 This Guidance Letter considers three different scenarios:

- (a) a listing applicant has engaged in Primary Sanctioned Activity;
- (b) a listing applicant has engaged in Secondary Sanctionable Activity; and
- (c) a listing applicant is a Sanctioned Target, is located, incorporated, organised or resident in a Sanctioned Country, or is a Sanctioned Trader.

It also sets out certain circumstances under which the Exchange may find an applicant not suitable for listing.

Primary Sanctioned Activity

3.3 The listing applicant must obtain a reasoned analysis from its legal adviser on whether each Primary Sanctioned Activity conducted by the listing applicant (i) violates any applicable law or regulation in the Relevant Jurisdiction(s); and/or (ii) results in any material sanctions risk¹ to the Relevant Persons. The listing applicant must also assess the impact of any cessation of Primary Sanctioned Activity on its financial position and business operations. The listing applicant must cease all

¹ When assessing materiality, both the likelihood of the imposition of potential sanctions and the severity of the potential sanctions are taken into account.

Primary Sanctioned Activities prior to listing if its legal adviser has confirmed that such activities violate applicable law or regulation.

Depending on the facts and circumstances, the listing applicant should adopt appropriate measures to deal with any material sanctions risk identified (see paragraphs 3.6 and 3.7 below).

Secondary Sanctionable Activity

- 3.4 The listing applicant must obtain a reasoned analysis from its legal adviser on whether each Secondary Sanctionable Activity conducted by the listing applicant would likely result in the imposition of any sanctions against the Relevant Persons (including designation as a Sanctioned Target and/or the penalties which might be imposed).

Depending on the facts and circumstances, the listing applicant should adopt appropriate measures to deal with any material sanctions risk identified (see paragraphs 3.6 and 3.7 below).

Applicant is a Sanctioned Target, is located, incorporated, organised or resident in a Sanctioned Country or is a Sanctions Trader

- 3.5 Depending on the facts and circumstances, the Exchange may determine that such a listing applicant is not suitable for listing due to reputational risk or impose other restrictions (e.g. the listing applicant might be required to ensure that its shares are not offered to nationals of the Relevant Jurisdictions).

Measures to be adopted

Listing applicant subject to material sanctions risk

- 3.6 The listing applicant which is subject to material sanctions risk should implement effective and adequate internal control measures before listing to control and monitor its and other Relevant Persons' exposure to sanctions risks. Depending on the specific nature of the sanctions risk involved and the materiality of the Sanctioned Activity to the listing applicant's business, these measures might include an undertaking from the listing applicant and/or its shareholders to the Exchange:
- (a) not to directly or indirectly apply the IPO proceeds and any other funds raised through the Exchange to (i) finance or facilitate any Sanctioned Activity; or (ii) pay any damages for terminating or transferring the relevant contracts that constitute Sanctioned Activity;

- (b) to terminate before listing all obligations under the relevant contracts that constitute the Sanctioned Activity and have measures in place to ensure compliance with the Undertakings; and/ or
- (c) to disclose in its annual, interim and quarterly reports (if any) (i) details of any new and/ or existing Sanctioned Activity; (ii) its efforts in monitoring its business exposure to sanctions risks; and (iii) the current status of, and the anticipated plans for, any new and/ or existing Sanctioned Activity.

Any breach of such undertaking may lead to a possible delisting of the listing applicant's securities from the Exchange.

3.7 Depending on the specific nature of the sanctions risk involved and the materiality of the Sanctioned Activity to the listing applicant's business, the listing applicant may be required to prominently disclose the following in the "Summary", "Risk Factors" and "Business" sections of its listing document:

- (a) details of the Sanctioned Activities, including but not limited to (i) the nature and size of the listing applicant's projects/ businesses involved in the Sanctioned Activities; (ii) whether the listing applicant and/ or its counterparties were or have reasons to believe they will be deemed to be Sanctioned Targets; and (iii) background of the counterparties, the revenue recognized from Sanctioned Activities during the track record period and the current status of such activities;
- (b) the legal adviser's reasoned analyses under paragraphs 3.3 and 3.4 above;
- (c) a description of any known material contingent liabilities in relation to the Sanctioned Activities in accordance with the applicable accounting and legal standards;
- (d) if it has engaged in Primary Sanctioned Activities that violate any applicable law or regulation, (i) when such activities ceased; (ii) details of the financial and operational impact; (iii) any disclosure made to the relevant governments and responses to, and the status of, any such disclosure; and (iv) the legal consequences (including maximum penalties (if any)) on the Relevant Persons as a result of such cessation;

- (e) if it intends to undertake any new Sanctioned Activity after listing, details of such intention and the parameters or criteria that the listing applicant will consider when determining whether to undertake such venture; and
- (f) (i) the internal control measures and the views of its sponsor(s) and directors on the adequacy and effectiveness of the internal control measures to protect the interests of the Relevant Persons; (ii) the Undertakings; and (iii) a risk factor on the possible delisting of the listing applicant's securities if any undertaking to the Exchange as described in paragraph 3.6 is breached.

Circumstances which may render an applicant not suitable for listing

- 3.8 The Exchange is unlikely to approve the listing if (a) any sanctions risks to or sanctions imposed on the applicant materially undermine its ability to continue its operations; (b) an applicant states that the funds are raised to finance Sanctioned Activities; or (c) its listing would cause a significant risk to the Relevant Persons or reputational risk to the Exchange (see also paragraph 3.5 above). Whether a listing would cause a significant risk to the Relevant Persons depends on the specific facts and circumstances.

No current Sanctioned Activity or no material sanctions risk

- 3.9 If there is no apparent or material sanctions risk, no specific risk mitigating measures need to be adopted and no disclosure on sanctions is required.

Suitability for continued listing

- 3.10 Please refer to paragraphs 25-28 of GL96-18 regarding the Exchange's guidance on listed issuer's suitability for continued listing due to trade or economic sanctions.

Latest developments

- 3.11 Since sanctions-related laws and regulations change from time to time, whether a listing applicant is subject to any sanctions risk depends on the facts and circumstances at any particular point in time. A listing applicant should therefore obtain legal advice as necessary to ensure it is kept abreast of all the latest developments.

HKEX GUIDANCE LETTER
HKEX-GL100-19 (March 2019)

Subject	Guidance on competition between the businesses of a new applicant and its controlling shareholder
Listing Rules	Main Board Rules 8.04, 8.10 and Paragraph 27A of Part A of Appendix 1 to the Main Board Rules GEM Rules 11.04, 11.06 and Paragraph 27A of Part A of Appendix 1 to the GEM Rules
Author	IPO Vetting Team

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Purpose

1. This letter provides guidance on how the Exchange assesses competition between a new applicant and its controlling shareholder, including any business in which the controlling shareholder has an interest in (other than the new applicant and its subsidiaries) (collectively, the “**Controlling Shareholder Group**”).

Guidance

2. Main Board Rule 8.10 (GEM Rule 11.04) does not set a materiality threshold on the level of competition. As such, regardless the extent of competition, the new applicant is required to (i) disclose the information as required under Main Board Rule 8.10(1)(a) (GEM Rule 11.04) in its listing document, which should include relevant financials and operating data (e.g. revenue, gross and net profit, gross and net profit margins, number of stores, etc.) to give investors a sense as to the extent and materiality of the competing business to both the Controlling Shareholder Group and the new applicant; and (ii) demonstrate that it is capable of carrying on its business independently of, and at arms’ length from, the excluded business under Main Board Rule 8.10(1)(a)(iii) (the “**R8.10 Independence Requirement**”)¹.
3. In most cases, the new applicant and the Controlling Shareholder Group have directors and/ or senior management in common; therefore, we look at how actual or potential conflicts of interest are managed in assessing the R8.10 Independence Requirement.
4. Where measures to manage such conflicts of interest are not effective, they can give

¹ Note to Main Board Rule 8.10(1)(a) (Note 4 to GEM Rule 11.04) refers to paragraph 27A of Part A of Appendix 1 to the Main Board Rules (and the GEM Rules), which requires a statement explaining how the issuer is satisfied that it is capable of carrying on its business independently of the controlling shareholder and its close associate after listing, and particulars of the matters that it relied on in making the statement.

rise to concerns on the new applicant's ability to make commercial decisions independently and in the interests of its shareholders as a whole, which will affect the suitability of the new applicant pursuant to Main Board Rule 8.04 (GEM Rule 11.06).

5. Examples of how conflicts of interest may be effectively managed if there is competition and how the new applicant's business can be delineated from the Controlling Shareholder Group's businesses to avoid competition are discussed below. Readers should note that the guidance and examples provided herein are purposely broad. There may be facts and circumstances specific to a new applicant, although not stated or stated to the contrary in this guidance letter, that would result in different conclusions on the effectiveness of conflict of interest management measures or bases for delineation, as the case may be.

Effective conflicts of interest management

6. If the new applicant's business competes or is likely to compete, directly or indirectly, with those of the Controlling Shareholder Group, there will be conflict of interest between the parties. The greater the possibility of actual or potential conflicts² of interest, the greater the need for enhanced conflicts of interest management measures to ensure management independence. Non-exhaustive examples of conflict of interest management measures include:
 - (a) restricting the members of senior management of the new applicant from participating in the management of the competing business, and vice versa;
 - (b) limiting the number of overlapping directors holding executive roles in both the new applicant and the Controlling Shareholder Group;
 - (c) having a sufficient number of independent directors, who have requisite knowledge, industry experience and expertise, on the new applicant's board to advise on the conflicted transactions and business decisions, as overlapping directors would abstain from voting; and
 - (d) engaging additional independent consultants to provide advice to the independent non-executive directors where needed.

Business Delineation and Non-Compete Undertakings

7. If the businesses of the Controlling Shareholder Group are clearly delineated from those of the new applicant, there is no competition and the risk of potential conflicts of interest is comparatively low. For clarity, if the new applicant's business competes or is likely to compete, directly or indirectly, with those of the Controlling Shareholder Group, the new applicant must fulfil the R8.10 Independence Requirement.

² The assessment of the possibility of actual or potential conflicts of interest will depend on facts and circumstances, including the extent of competition between the new applicant's business and its Controlling Shareholder Group's businesses, and the industry in which the new applicant and the Controlling Shareholder Group operate.

8. With respect to a spin-off (as defined in Practice Note 15 to the Main Board Rules (Practice Note 3 to GEM Rules)), a new applicant's business should be clearly delineated from the remaining business of the parent³.
9. The following are non-exhaustive examples of ways past applicants have distinguished themselves from the excluded business(es) of the Controlling Shareholder Group:
 - (a) different business models under which the new applicant and the Controlling Shareholder Group sell same/ similar products but to different customers (manufacturing vs. retail of same products, or wholesalers selling to distributors vs. retailers selling to end customers);
 - (b) produces non-substitutable products or provides non-substitutable services in the same industry (e.g. highly specialised bespoke products vs. mass-produced standardised products; foundation construction company vs. decoration and fitting out company). In contrast, companies selling substitutable products via different channels (e.g. online vs. physical stores) or platforms (e.g. e-commerce vs. social media) are not considered fully delineated as their products are substitutes for each other and their potential customers have a high degree of overlap; or
 - (c) operates in different geographical locations (e.g. waste treatment plants in different locations; power generation companies in different municipalities selling to the same power grid; or drugs approved and sold in the PRC vs. drugs approved and sold outside PRC).
10. To delineate the business of the new applicant from that of the Controlling Shareholder Group, controlling shareholders of some new applicants have (i) provided an enforceable⁴ non-competition undertaking in favour of the new applicant; (ii) granted a right of first refusal to the new applicant if it is aware of a new business opportunity relating to the new applicant's business or intends to dispose of the competing business; and/ or (iii) granted a call option to the new applicant to acquire the competing business in the future (the "**Undertakings**").
11. The Undertakings are not mandatory, but may be helpful to ensure continued delineation of the Controlling Shareholder Group from the competing business or limit the extent of competition between the new applicant and the Controlling Shareholder Group after the listing and is one way to address potential conflict of interest between the Controlling Shareholder Group and the new applicant.

³ New applicants listing under spin-off proposals pursuant to Practice Note 15 to the Main Board Rules (Practice Note 3 to GEM Rules) should also comply with the requirements set forth therein.

⁴ We assess enforceability of the Undertakings on a number of other factors, including (i) the effect of exemption clauses on the Undertakings; (ii) how independently a new applicant can exercise its right to enforce the Undertakings in light of its own corporate governance; and (iii) the degree to which the management of the new applicant and its controlling shareholders are closely connected.