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THE CHAMBER OF HONG KONG LISTED COMPANIES

31 August 2018

Hong Kong Exchanges and Clearing Limited
10th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

BY EMAIL AND BY POST

Dear Sir / Madam,

Re: Submission to Consultation Paper on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments

The Chamber of Listed Companies is pleased to submit its response to the Consultation Paper of the Stock Exchange of Hong Kong Limited (the Exchange) on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments.

We understand the Exchange's intention is to raise the threshold for backdoor listing and make it difficult for assets or businesses that do not fulfil the listing requirements in the first place to get listed and to prevent issuers that are not suitable for listing from being used as "shells" or be maintained as such as the vehicle for backdoor listings.

In principle we could agree that backdoor listings that attempt to circumvent the listing requirements be restricted and to channel any such backdoor listings to the formal listing application process as a reverse takeover (RTO). Many of the proposed rule changes in this consultation paper, such as the codification of the assessment criterion for RTOs, treatment for extreme VSA etc., are also acceptable since they are already in practice.

There is however one area that we disagree with and that is to do with the proposed rule changes dealing with issuers that have failed to comply with Rule 13.24 (13.24 issuers). We are of the view that those changes may actually hurt the interests of minority shareholders and cause instability to the market, contrary to what this consultation exercise sets out to achieve.

Proposal A (6) (a) suggests to amend Rule 14.54 to impose additional requirement that for a 13.24 issuer to undertake an RTO and extreme transactions, each of the acquisition target(s) and the enlarged group must meet all the new listing requirements in Chapter 8 of the Listing Rules. In many instances, a 13.24 issuer would resort to asset injection, be it RTO or not, as a means to revive their business in order to re-comply with Rule 13.24. Under the new proposed rule, this has become more challenging as it is no longer sufficient for the injected assets themselves to meet the listing requirements, but they must have big enough profits to cover existing losses, if any. We believe this is a tall order. The main objective of the RTO proposals is to prevent assets or businesses that are not suitable for listing from getting listed. If the injected assets themselves can fulfil the listing requirements, such worry does not exist – there is no "circumvention of new listing" to speak of. Although the enlarged group may still fall short of the full listing requirements, particularly Rule 8.05, the asset injection signifies an important first step towards corporate recovery and should not be hindered.

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If this proposed rule is to stand, we foresee negative effects to the market.

Many 13.24 issuers would not be able to come up with an asset injection proposal that could salvage them from their present situation and they would face the eventual fate of delisting. That would not be in the best interests of their minority shareholders. There are many reasons a company fails to fulfill Rule 13.24, such as a receding industry; intensifying trade wars, or a change of market environment which makes the original products or services obsolete. The original majority shareholders may lack the will or resources to develop a new business. Without new assets or businesses injected into them, be it RTO or not, it is difficult for these issuers to revive themselves and the minority shareholders would have no hope to recoup their investments. Forcing these issuers to delisting would mean depriving the minority shareholders of any residual value of their original investments.

We have seen in the past when suspended companies, many of them 13.24 companies, resumed trading after an asset acquisition, their share price registered a positive gain, thus providing a favorable chance for minority shareholders to exit.

Set out below is the share price performance of prolonged suspended companies (many of them 13.24 companies) which had successfully resumed trading in their shares on the Stock Exchange after injection of new assets or businesses which fulfills Rule 13.24 through RTO since 1 January 2013. Their performance is better, and way less volatile, than most IPOs. This type of rescued listed issuers should not be the target for delisting.

Issuer (stock code)	**New asset/ business injected through RTO**	**Share price performance after resumption as compared with issue prices of securities issued as consideration for the RTO**			
		1st Day	90th Day	1st Year	As at 1 Aug 2018
Daqing Dairy Holdings Limited (1007) *Note1*	PRC hotpot chain	182.9%	NA	NA	143.9%
Jiande International Holdings Limited (865)	PRC property developing business	82.3%	32.3%	53.8%	32.3%
China Display Optoelectronics Technology Holdings Limited (334)	LCD module manufacturing business	734.3%	288.6%	85.7%	82.9%
Fullshare Holdings Limited (607)	PRC property developer business	196.0%	420.0%	960.0%	6,480.0%
Z-Obee Holdings Limited (948) *Note2*	Reactivation of business	45.8%	109.9%	NA	93.1%
	Average	**248.3%**	**212.7%**	**366.5%**	**1,366.4%**

Note:

1. *Trading in the shares of Daqing Dairy Holdings Limited resumed on 6 July 2018.*

2. *Trading in the shares of* Z-Obee Holdings Limited *resumed on 30 November 2017 through reviving the existing business of the issuer to satisfy Rule 13.24, which did not constitute a RTO.*

By a rough estimate, there are about 100 issuers at present not fulfilling Rule 13.24, or on the verge of being so. If they all end up being delisted, the number of shareholders affected will not be small, in hundreds of thousands. The degree of market, or even social, instability caused by delisting should not be underestimated.

We would like to reiterate that the Exchange has the responsibility of protecting the interests of minority shareholders, which is also one of the objectives of this round of consultation. Forcing a large number of issuers to delisting by imposing onerous requirements defy this responsibility.

Any means to stop backdoor listing should not be done at the detriment of minority shareholders.

We would also like to add that, while the Exchange wishes to stamp out backdoor listings, most of them are not evil in nature. On the contrary, quite a number of prominent listed issuers came to the Hong Kong stock market through RTO, even for state-owned enterprises, such as Sinofert Holdings Limited, CIMC Enric Holdings Limited, Shanghai Industrial Urban Development Group Limited as well as a few blue chip companies like Geely Automobile Holdings Limited, the predecessor of Citic Limited and the predecessor of PCCW Limited. They now operate substantial business without causing any market mishaps. Even the consultation paper states that the issues of backdoor listings and shell activities are limited to a small segment of the market. We believe that such limited problematic cases can be dealt with by targeted enforcement. The effects will be direct and focused and not cause collateral damage on a whole lot of other issuers that have no ill-intentions.

On this basis, we answered the other questions in the questionnaire, separately enclosed.

Yours sincerely,
For and on behalf of
The Chamber of Hong Kong Listed Companies

Mike Wong
Chief Executive Officer

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below that are raised in the Consultation Paper downloadable from the HKEX website at:
http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/June-2018-Backdoor-and-Continuing-Listing/Consultation-Paper/cp201806.pdf

Where there is insufficient space provided for your comments, please attach additional pages.

1. Do you agree with the proposal to codify the assessment criteria under the principle based test in a Note to the proposed Rule 14.06B?

   ☑ Yes

   ☐ No

   If your answer is "No", please give reasons for your views.

   When applying the assssment criteria, the Exchange is urged to take an overeall approach but not just focus on one single criterion. For example, an issuer may choose to embark on a greenfield project in response to the rapidly changing market conditions in order to sustain the company. It may need to hire a new CEO or even appoint new directors who are familiar with the new business ventures. Such business development and change of personnel are necessitated by genuine business needs and may not necessarily signal a change of control of de facto control and therefore should not be deemed as an attempted RTO.

2. Do you agree with the proposal to extend the current criterion "issue of restricted convertible securities" in the principle based test to include any change in control or de facto control of issuers?

   ☑ Yes

   ☐ No

   If your answer is "No", please give reasons for your views.

3. (a) As regards the "series of arrangements" criterion, do you agree with the proposal to include transactions and arrangements that take place in reasonable proximity or are otherwise related and normally within a three-year period?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

We believe that 24-month period will be a sufficient anti-avoidance period and 36-month period is too long. If the objective is to kill off all shell activities, we have aruged in our cover letter that not all shell activities are evil but may provide an exit to minority shareholders. The Exchange must strike a balance.

(b) Do you agree with the proposal to amend the RTO Rule 14.06B to clarify that a series of acquisitions may include proposed and/or completed acquisitions?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

4. (a) Do you agree with the proposal to retain the bright line tests under Rules 14.06(6)(a) and (b) in a Note to the proposed Rule 14.06B?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(b) Do you agree with the proposal to extend the aggregation period from 24 months to 36 months under the bright line test currently set out in Rule 14.06(6)(b)?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

We believe that 24-month period will be a sufficient anti-avoidance period and 36-month period is too long. If the objective is to kill off all shell activities, we have aruged in our cover letter that not all shell activities are evil but may provide an exit to minority shareholders. The Exchange must strike a balance.

5. (a) Do you agree with the proposed changes to Rule 14.92 (proposed Rule 14.06E) as described in paragraph 56 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

We believe that 24-month period will be a sufficient anti-avoidance period and 36-month period is too long. If the objective is to kill off all shell activities, we have aruged in our cover letter that not all shell activities are evil and may provide an exit to minority shareholders. The Exchange must strike a balance.

(b) Do you agree with the proposal to add a Note to proposed Rule 14.06E as described in paragraph 59 of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

6. (a) Do you agree with the proposal to add a new Rule 14.06C for "extreme transactions" as described in paragraph 62 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

1) For an acquisition or a series of acquisitions of assets to be classified as "extreme transaction", one of the conditions is the issuer has been operating a principal business of a substantial size (Rule 14.06C (1)(a) -- having annual turnover or total asset value of HK$1 billion or more as defined in paragraph 64 of the Consultation Paper. Such HK$1 billion threshold is very high. Even the revenue test for new listing is being set at half a billion HK$. The implication here is that smaller companies could be seen as "shells" and are more likely to have their deals classified as RTOs and made subject to more stringent listing approval process. This is not fair. A rough estimate shows that around 700 listed issuers on the Stock Exchange at present are below the HK$1 billion mark. The Exchange must not be overly discriminating when assessing the transactions of these smaller companies and classify them as shell activities readily, restricting their business developemnet and expansion. ***2) We note in draft Rule 13.87B (under Appendix I) that the financial adviser appointed must hold a Type 6 license and "permitted under its license or certificate of registration to undertake the work of a sponsor" – this last qualification will make many financial advisers not qualified to advise and undertake due diligence for extreme transactions. Given that this is not an IPO, the financial adviser may be normal financial adviser holding Type 6 license but not sponsor license.***

(b) Do you agree with the disclosure requirements for circulars of extreme transactions set out in proposed Rules 14.53A(1) and 14.69?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(c) Do you agree with the due diligence requirements for extreme transactions under proposed Rule 14.53A(2)?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

7. (a) Do you agree with the proposal to amend Rule 14.54 and to add Rule 14.06C(2) as described in paragraph 69(i) of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(b) Do you agree with the proposal to amend Rule 14.54 to impose additional requirements on RTOs proposed by Rule 13.24 issuers as described in paragraph 69(ii) of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

We believe the amendment is too harsh and make it very difficult for 13.24 companies to meet the continuous listing requirements again via a RTO. We believe it is more reasonable to require that the acquisition targets to fulfil the listing requirements, or the enlarged group, but not both.

8. (a) Do you agree with the proposed Rule 14.57A to clarify the track record requirements for extreme transactions and RTOs that involve a series of transactions and/or arrangements?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(b) Do you agree with the proposed Rule 4.30 that sets out the requirements for preparing pro forma income statement of all the acquisition targets in the entire series of acquisitions (where applicable, would include any new business developed by the issuer that forms part of the series) for the track record period?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

9. Do you agree with the proposal to add a new Rule 14.06D to codify, with modification, the practice under Guidance Letter GL84-15 as described in paragraph 81 of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

10. Do you agree with the proposal to require issuers to have 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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

We caution the Exchange to be careful when assessing the amount of assets held by issuers. Many businesses have become asset-light, particularly for those operating in the new economy, e.g. online booking platforms, or co-sharing economy, yet they operate a high level of operation. So just by looking at the amount of assets may not be a reliable assessment. We do not wish to see companies being discrminated just by how they choose to operate their business.

11. (a) Do you agree with the proposal to add a Note to the proposed Rule 13.24(1) as described in paragraphs 107 to 109 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

It is important that the Exchange takes a more holistic view when assessing whether an issuer is compliance with Rule 13.24. It is however not always a clear-cut matter to tell if a business has substance or is viable or sustainable or not, expecially when the assessor is not familiar with business running. If this is a qualitative test, it is important the Exchange executives be equipped with knowledge about the intricacies of the specific industry that they are dealing with. But this is not always easy for an outsider. While the onus is on the issuer to explain they are in compliance, the Exchange also needs to be open minded and sensible in understanding the business intracacies of the issuer.

(b) Do you agree with the proposal to remove the Note to Rule 13.24 as described in paragraph 112 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Further to our thinking in the answer to the previous question, an assessment based solely or mostly on qualitative judgement might lack in clarity and be prone to disputes. The existing Note to Rule 13.24 at least provides some objective and measurable parameters which allow for better clarity and predictability of the rules. It is important that a balance be struck between qualitative and quantitative assessements.

12. Do you agree with the proposal to exclude an issuer's securities trading and/or investment activities (other than a Chapter 21 company) when considering the sufficiency of the issuer's operations and assets under Rule 13.24?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

13. Do you agree with the proposal to extend the definition of short-dated securities in the cash company Rules to cover investments that are easily convertible into cash ("short-term investments")?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

The proposed definition is too loose, and some of the characteristics described are hard to pin down, e.g. "notes which have maturiy of over 1 year and are intended to be held for less than 1 year", "investments that are readily realizable or convertible to cash". In the former case, how can the Exchange determine the "intention"? The latter case can apply to many types of investments, including properties held for investment, for in a free market, properties are readily divestible to willing buyers if the price is right. Under this proposed definition, many issuers would easily be deemed as cash companies and unsuitable for listing. This is very dangerous.

14. Do you agree with the proposal that the exemption under Rule 14.83 shall only be confined to clients' assets relating to the issuer's securities brokerage business?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

15. Do you agree with the proposal to confine the revenue exemption to purchases and sales of securities only if they are conducted by banking companies, insurance companies and securities houses within the listed issuers' group?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

16. Do you agree with the proposal to require issuers to disclose in their annual reports details of each securities investment that represents 5% or more of their total assets (as described in paragraph 134 of the Consultation Paper)?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

17. Do you agree with the proposal to codify the requirements set out in Listing Decision LD75-4 (as described in paragraph 137 of the Consultation Paper) for significant distribution in specie of unlisted assets into the Rules?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

18. Do you agree with the proposal to require disclosure on any subsequent change and the outcome of any financial performance guarantee of a target acquired by the issuer in a notifiable or connected transaction as set out in paragraph 140 of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

19. (a) Do you agree with the proposal to require disclosure on the identity of the parties to a transaction in the announcements and circulars of notifiable transactions?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(b) Do you agree with the proposal to require the disclosure on the identities and activities of the parties to the transaction and of their ultimate beneficial owners in the announcements of connected transactions?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

20. Do you agree with the proposal that if any calculation of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14 or 14A?

☑ Yes

☐ No

If your answer is “No”, please give reasons for your views.

- End -