

SIDLEY

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Asia-Pacific**

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The Corporate Communications Division
Hong Kong Exchanges and Clearing Limited

15 December 2022

Re: Consultation Paper on a Listing Regime for Specialist Technology Companies

Dear Sirs,

I. Introduction

1. This is a submission by Sidley Austin (“**Sidley**” or “**we**”) in response to the consultation paper entitled “Consultation Paper - Listing Regime for Specialist Technology Companies” dated October 2022 (the “**Consultation Paper**”).

Sidley participates frequently in technology companies’ listings or dual listings in Hong Kong and/or the U.S. and maintains regular communications with technology companies, investment banks and investors community. Since the publication of the Consultation Paper, we have received inquiries, comments and suggestions from our clients and prospective clients, which we have reflected collectively with our own comments in this submission.

2. Unless otherwise defined,
 - (i) capitalized terms used herein shall have the same meanings as defined in the Consultation Paper; and
 - (ii) references to “Chapter,” and “Rule(s)” are to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Exchange**”).

II. Sidley’s Position

3. Sidley is in support of the Exchange’s proposal, subject to the comments set out in Part III and Part IV of this submission.
4. We set out in Part III our feedback to the specific questions presented in the Consultation Paper and in Part IV our additional comments.

III. Feedback to Specific Questions Presented in the Consultation Paper

Chapter 3A of the Consultation Paper

- Q2. *Do you agree with the list of Specialist Technology Industries and the respective acceptable sectors set out in paragraph 4 of the Draft Guidance Letter (Appendix V to the Consultation Paper)? Please give reasons for your views. If your answer is “No”, please provide alternative suggestions.***

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5. We in general agree with the proposed scope of the Specialist Technology Industries and the respective acceptable sectors as set out in paragraph 4 of the Draft Guidance Letter (Appendix V to the Consultation Paper). However, we have concern that the proposed scope may restrict certain advanced technology companies from being qualified under Chapter 18C for the reasons as elaborated in paragraph 6 and paragraph 7 of this submission.
6. The proposed scope covers only five industries and 19 acceptable sectors. Under the proposed scope, a company that could not be “pigeon-holed” in any of these industries or sectors would not be qualified. A case in point concerns a comment that we have received from a company specialized in “quantum communication.” “Quantum communication” is an interdisciplinary field that seeks to apply quantum physics to the secure transmission of information. The proposed scope includes “quantum computing,” which is a technology that harnesses the laws of quantum mechanics to solve problems deemed too complex for classical computers, and “advanced communication,” which refers to connectivity technologies used in the transfer of information such as 5G wireless communication or satellite communication. However, the proposed scope does not specifically cover “quantum communication”, which is a leading-edge technology field¹. We suggest that “quantum communication” be included as an acceptable sector.
7. Furthermore, the five industries and the corresponding acceptable sectors are evolving rapidly. While the Exchange has anticipated this trend and is mindful to update the scope in the Guidance Letter from time to time, such update might in practice lag behind the evolution and development in these industries and sectors. As a result, quality Specialist Technology Companies that do not otherwise fall squarely within the scope would not be able to apply under the new listing regime.
8. We propose to include a “catch-all” provision at the end of the section headed “Appendix V: Draft Guidance Letter—Guidance—A. Specialist Technology Industries—List of Specialist Technology Industries” in the Guidance Letter, to the effect that the scope will cover “Other Specialist Technology Industries as approved by the Exchange on a case-by-case basis.”²

Chapter 3B of the Consultation Paper

Q8. *Do you agree that a Commercial Company applicant must have a minimum expected market capitalisation of HK\$8 billion at listing? Please give reasons for your views.*

9. We believe that the proposed minimum expected market capitalisation of HK\$8 billion for Commercial Companies is too high. We recommend that the threshold be substantially lowered.
10. For Commercial Companies, the minimum expected market capitalisation of HK\$8 billion at

¹ The Royal Swedish Academy of Sciences awarded the Nobel Prize in Physics 2022 to Alain Aspect, John F. Clauser and Anton Zeilinger for experiments with entangled photons, establishing the violation of Bell inequalities and pioneering quantum information science, which are pertinent to “quantum communication”.

² The Shanghai Stock Exchange Science and Technology Innovation Board (the “**STAR Market**”) has a similar rule providing that “Other industries that conform to the positioning of the STAR Market” can also apply for listing on the STAR Market. See Paragraph 7, Article 4, Interim Provisions on Application and Recommendation of Enterprises for Issuance and Listing on the SSE STAR Market (Shang Zheng Fa[2021] No. 23 Document).

the time of listing combined with an annual revenue threshold of HK\$250 million indicates a price-to-sales ratio (“**P/S Ratio**”) of 32x, which is difficult for technology companies to achieve, especially under the current macro-economic conditions.

11. A study on the STAR Market conducted by CMB International Securities Limited (the “**CMBI Study**”) indicates that less than 20 companies listed on the STAR Market achieved a trailing twelve-month (“**TTM**”) P/S Ratio of 32x as of October 2022, and they accounted for less than 5% of all non-biotech companies listed on the STAR Market.
12. The CMBI Study has also analysed over 350 companies listed on the STAR Market that have revenue of not less than HK\$250 million for the most recent financial year. It has found that their average TTM P/S Ratio was below 10x as of October 2022.
13. According to “The Complete List of Unicorn Companies” published by CB Insights, there were only about 180 private technology companies based in Greater China that had a market valuation of HK\$8 billion or above as of October 2022. These data indicate that most well-established and/or maturing PRC-based technology companies are unable to meet the proposed market capitalisation requirements under the proposed Chapter 18C listing regime.
14. In the past year, the global capital markets have been volatile and many technology companies have experienced significant decreases in valuation. Given the uncertain economic outlook and the downward pressure in the stock markets, many of them are postponing or even cancelling their IPO plans. The overly high market capitalisation requirement set under the proposed Chapter 18C is likely to discourage these companies from seeking listing in Hong Kong.
15. Furthermore, the minimum expected market capitalisation of HK\$8 billion would be a valuation of a “unicorn” and is significantly higher than that set by other major exchanges, thereby rendering the new regime less competitive.

Q9. Do you agree that a Pre-Commercial Company applicant must have a minimum expected market capitalisation of HK\$15 billion at listing? Please give reasons for your views.

16. We believe that the proposed minimum expected market capitalisation of HK\$15 billion for Pre-Commercial Companies is too high. We suggest that the threshold be substantially lowered.
17. For Pre-Commercial Companies, the minimum expected market capitalisation of HK\$15 billion at the time of listing combined with annual revenue of less than HK\$250 million indicates a P/S Ratio of at least 60x. It would be difficult for technology companies with this level of revenue to achieve, especially under the current and foreseeable near-future macro-economic conditions.
18. The CMBI Study analysed 18 companies listed on the STAR Market that have less than HK\$250 million revenue for the most recent financial year, and found that their average market capitalisation was slightly over HK\$5 billion and their average TTM P/S Ratio was 24.5x as of October 2022.
19. Furthermore, the proposed minimum expected market capitalisation of HK\$15 billion would be a valuation of roughly of two “unicorns” and is significantly higher than that set by other major exchanges worldwide, thereby rendering the new regime less competitive.

Q10. Do you agree that a Commercial Company must have revenue of at least HK\$250 million for the most recent audited financial year? Please give reasons for your views.

20. Feedbacks from several prospective Chapter 18C issuers reflect that they believe that the proposed revenue requirement of at least HK\$250 million for the most recent audited financial year to achieve the “Commercial Company” status is too high. We would suggest the threshold be lowered.
21. For investors in the hard-technology sectors, the metric of revenue is not the decisive factor to evaluate the merits of Specialist Technology Companies. It is because these companies usually focus on research and development of innovative technologies rather than short-term profitability or returns.
- Q14. *Do you agree that, (a) for a Commercial Company, its total amount of R&D investment must constitute at least 15% of its total operating expenditure for each of its three financial years prior to listing; and (b) for a Pre-Commercial Company, its total amount of R&D investment must constitute at least 50% of its total operating expenditure for each of its three financial years prior to listing? Please give reasons for your views.***
22. As the starting point, we do not think that it is appropriate to have the R&D Investment calculated on a yearly basis in the three financial years prior to listing. We believe that the R&D investment should be determined on an aggregated basis for the three-financial year period. Companies make R&D investment based on scientific milestones rather than a timeline with reference to each financial year. For instance, a Specialist Technology Company may invest heavily in R&D in Year 1 and Year 2 to develop the prototypes, but slow down and start mass-producing and marketing in Year 3.
23. Subject to paragraph 22 of this submission, we agree with the proposal in Q14(a) with respect to Commercial Companies, in that the 15% threshold of R&D investment to the total operating expenditure would give Commercial Companies sufficient flexibility to operate their businesses, calculated on an aggregated basis, instead of on a yearly basis.
24. With respect to the proposal in Q14(b) on Pre-Commercial Companies, we would suggest the threshold be lowered to 35%, calculated on an aggregated basis, instead of a yearly basis, in the three financial years prior to listing.
25. The CMBI Study analysed 18 companies listed on the STAR Market with less than HK\$250 million revenue for the most recent financial year. It found that their average ratio of R&D expenses to total operating expenses was 40.6%, with only 4 of the 18 companies having an over 50% R&D expense ratio. These data indicate that the 50% threshold might be difficult for most Pre-Commercial Companies to achieve.
- Q19. *If your answer to Question 18 is “Yes”, do you agree with the independence requirements for a Sophisticated Independent Investor as set out in paragraphs 155 to 157 of the Consultation Paper? Please give reasons for your views.***
26. We agree with the proposal. However, the proposal is silent on the point in time at which the independence is to be determined. We suggest that the independence of a Sophisticated Independent Investor be determined at the time when each round of investment is made. An investor could become a core connected person, or a controlling shareholder, of a Specialist Technology Company applicant after such investor makes more than one round of investment.
- Q21. *If your answer to Question 18 is “Yes”, do you agree that as an indicative benchmark for meaningful investment, an applicant should have received third party investment from at least***

two Sophisticated Independent Investors who have invested at least 12 months before the date of the listing application, each holding such amount of shares or securities convertible into shares equivalent to 5% or more of the issued share capital of the listing applicant as at the date of listing application and throughout the pre-application 12-month period? Please give reasons for your views.

27. We agree with the proposal in Question 18. However, we suggest that the third-party investment could be in non-cash form, that is, the third-party investment can be in the form of intellectual property rights and other assets.
28. It is not uncommon for market participants to invest in their upstream or downstream companies in the form of non-cash investment. For example, new food technology companies may have investments from other market participants in the form of intellectual property rights, and advanced materials companies may have investments from other market participants in the form of property, plant and equipment. Market leaders may also invest in Specialist Technology Companies by way of share exchange.

Chapter 3C of the Consultation Paper

Q35. *Do you agree that a Specialist Technology Company seeking an initial listing must ensure that a portion of its issued shares with a market capitalisation of at least HK\$600 million is free from any disposal restrictions (whether under contract; the Listing Rules; applicable laws; or otherwise) upon listing (referred to as its “free float”)? Please give reasons for your views.*

29. We agree with the Exchange’s proposal, but suggest that the portion should decrease inversely with the increase in the market capitalisation of the issuer.

IV. Additional Comments on the Consultation Paper

Overlap & Distinction Between Chapter 18C and Chapter 18A

30. We note the Exchange’s intention to draw a distinction in paragraph 98 of the Consultation Paper between the regime under Chapter 18C and that under Chapter 18A.
31. We believe that it is insufficient to have the single factor of Regulated Product as the basis for the delineation. It is because a Regulated Product can be integrated or closely associated with one or more Specialist Technologies. For instance, it is an increasing trend for medical imaging and diagnostic devices to imbed software with artificial intelligence (“AI”) capabilities and integrate with cloud computing. The boundary between device and software is blurred. These AI-enabled medical devices may be deemed Regulated Products by the Competent Authorities (as defined in Chapter 18A) in certain jurisdictions, but not in others. At the same time, they may also involve cloud-based services, robotics and automation, semiconductors, or advanced manufacturing, all of which, in addition to AI, are acceptable sectors specified under the proposed Chapter 18C.
32. The overlap also arises as biotech companies increasingly use AI in the drug discovery process to develop pharmaceuticals or biologics, most of which are Regulated Products.
33. We suggest that the Exchange take into account the overlap between Chapter 18C and Chapter 18A and provide further guidance on this front.

Specialist Technology Companies with Weighted Voting Rights (WVR)

34. We observe that technology companies would favour the WVR structure, as it allows the founders to retain control after their economic rights are diluted, given that the significant investment required from external investors in the hard-technology sectors.
35. As mentioned in paragraph 13 of this submission, currently only a small number of private technology companies based in Greater China would be able to achieve HK\$8 billion market capitalisation, let alone the HK\$40 billion market capitalisation threshold.
36. We believe that lowering the market capitalisation requirement for Specialist Technology Companies with WVR to the same level for those without WVR would increase the competitiveness of the new listing regime as compared to the peer exchanges such as the Nasdaq.

Definition of Sophisticated Investor

37. Paragraph 160 of the Consultation Paper provides a few examples of a typical “sophisticated investor” for illustrative purpose, which include “(a) an asset management firm with AUM of, or a fund with a fund size of, at least HK\$15 billion.”
38. However, the Consultation Paper defines the term “AUM” as “Assets Under Management” without specifying the details.
39. We suggest that the Exchange specify the methodology of calculating AUM or clarify whether an investor would have the flexibility to adopt its preferred methodology (e.g. a methodology in line with the guidelines published by the Swiss Financial Market Supervisory Authority or another authority or industry association).
40. In addition, we have noted that Paragraph 22 of the Draft Guidance Letter in Appendix V to the Consultation Paper sets forth: “A fund managed by a fund manager that has AUM of an amount that meets the threshold set out in paragraph 20(a), or a wholly-owned subsidiary of an entity referred to in paragraph 20(b), would qualify as a sophisticated investor for the purpose of Rule 18C.04.” It is not clear as to whether the same rationale may apply to investments made by multiple entities that are affiliated with an investor group, so that the investments would be aggregated for purpose of meeting the definition of a sophisticated investor. Clarification on this front would be welcome.

V. General

41. If there is any aspect of this submission that you would like to discuss, please contact [REDACTED].

Your faithfully,

Sidley Austin