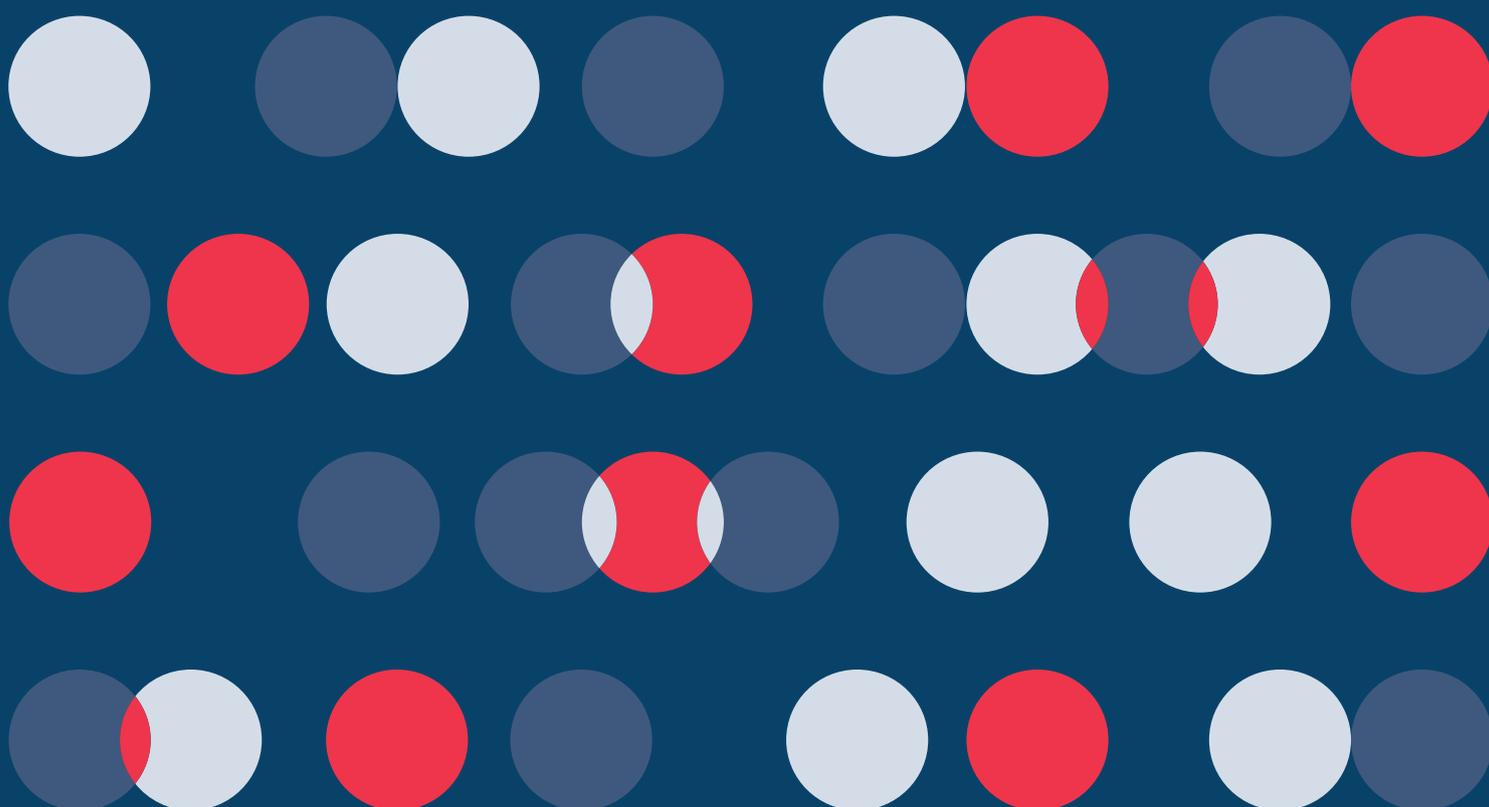


September 2019

RESEARCH REPORT

INITIAL PUBLIC OFFERING (IPO) AND
LISTING PROCESS ON THE SEHK
WITH HIGHLIGHTS



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SUMMARY

This paper presents in a succinct way the initial public offering (IPO) and listing process of enterprises on the Stock Exchange of Hong Kong, i.e. on the securities market operated by the Hong Kong Exchanges and Clearing Limited. Enterprises, in particular Mainland enterprises, seeking a listing in Hong Kong may decide on a choice among various shareholding structures.

Apart from the listing requirements of the Main Board and GEM, the paper also introduces the professional services that an enterprise requires in the IPO and listing process, and the ways for equity re-financing after listing.

1. GENERAL REQUIREMENTS FOR LISTING IN HONG KONG

In general, companies in any business sector seeking a listing on the Main Board of the Stock Exchange of Hong Kong Limited (the “SEHK”, or the “Exchange”)¹ shall comply with the set of conditions set out in Chapter 8 of the *Rules Governing the Listing of Securities on the Exchange* (the “Listing Rules”, or the “Rules”). It should be noted that the Exchange retains an absolute discretion to accept or reject an application for listing and that compliance with the relevant conditions may not of itself ensure an applicant’s suitability for listing.

1.1 Main Board listing conditions

The Main Board market in Hong Kong is designed for more established companies with a certain level of market capitalisation/revenue/profit scale. Listed companies range from conglomerates, banks, property developers to Internet companies and healthcare service providers. Companies applying for listing on Main Board shall meet the following basic conditions:

(1) Financial requirements (to meet at least one of the following three sets of test)²

Profit test

- the profit attributable to shareholders must, in respect of the most recent financial year before listing, be not less than HK\$20 million;
- the profit attributable to shareholders must, in respect of the two preceding years, be in aggregate not less than HK\$30 million; and
- a market capitalisation of at least HK\$500 million at the time of listing³.

Market capitalisation/revenue test

- revenue of at least HK\$500 million for the most recent financial year before listing; and
- a market capitalisation of at least HK\$4 billion at the time of listing.

Market capitalisation/revenue/cash flow test

- revenue of at least HK\$500 million for the most recent financial year before listing;
- positive cash flow from operating activities that are to be listed of at least HK\$100 million in aggregate for the three preceding financial years; and
- a market capitalisation of at least HK\$2 billion at the time of listing.

(2) Other requirements

Apart from the above financial requirements, companies applying for listing in Hong Kong shall also meet a set of basic requirements in relation to the business history, public float, management and control, including the following:

- trading record period of at least three financial years (a shorter trading record period may be considered in exceptional cases⁴);

¹ Unless otherwise stated, references in this paper to “listing” means an initial public offering (IPO) and listing on the Main Board of the SEHK.

² See Listing Rule 8.05.

³ See Listing Rule 8.09(2).

⁴ See Listing Rule 8.05A.

- minimum public float (usually 25%, but may be reduced to 15% at discretion if the market capitalisation at the time of listing is more than HK\$10 billion);
- there must be at least 300 shareholders at the time of listing⁵;
- no change to the management in the three preceding financial years;
- no change to the ownership and control of the company in the most recent financial year;
- there must be at least three independent directors representing at least one-third of the board⁶;
- at least one independent non-executive director (INED) must be ordinarily resident in Hong Kong in the case of H-share applicant;
- at least two of the executive directors must be ordinarily resident in Hong Kong⁷;
- a relevant professional be appointed to discharge the functions of a company secretary⁸;
- the latest financial period reported on by the reporting accountants must not have ended more than six months before the date of the listing document.

1.2 Shareholding structures for listing in Hong Kong

1.2.1 Jurisdictions acceptable as place of incorporation

Applicants seeking to list in Hong Kong must first be incorporated in an “acceptable jurisdiction”⁹ admitted by the Exchange. According to the Listing Rules, companies incorporated in Hong Kong, Mainland China, Cayman Islands and Bermuda are eligible to apply for listing. And as of 30 June 2019, there are 27 other “acceptable jurisdictions” for overseas companies, including England & Wales, the British Virgin Islands, France, Italy, Russia, Japan, Singapore, Australia, etc. Overseas applicants shall demonstrate that the standards of shareholder protection of its place of incorporation are at least equivalent to those provided in Hong Kong, or they may have to vary its constitutive documents to provide an equivalent protection.

1.2.2 Shareholding structures of Mainland companies seeking to list in Hong Kong

For applicants based in Mainland China and with principal businesses there, the SEHK accepts a number of various shareholding structures, including:

- **Red-chip structure** — The listed entity is an offshore holding company injected with domestic equity or assets to achieve an indirect overseas listing. The red chip structure includes two modes:
 - (1) **State-owned red-chip** — The actual controller of the Mainland enterprise, assets or businesses is usually a government entity.
 - (2) **Private red-chip** — The actual controller of the Mainland enterprise, assets or businesses is usually an individual.

⁵ See Listing Rule 8.08.

⁶ See Listing Rules 3.10 and 3.10A.

⁷ See Listing Rule 8.12.

⁸ See Listing Rule 3.28.

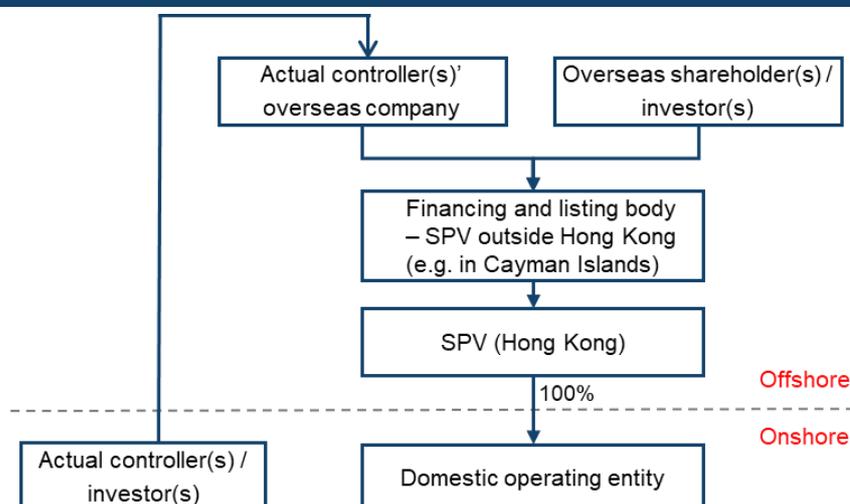
⁹ See “List of Acceptable Overseas Jurisdictions” on HKEX’s official website for details.

- **H-share structure** — The listed entity is a joint-stock company incorporated in Mainland China which has its domestic equity directly listed on the SEHK. H-share listings can be done in four ways:
 - (1) **First A and then H** — an A-share company already listed in the Mainland to dually list in Hong Kong;
 - (2) **First H and then A** — a company already listed on the SEHK seeking an A-share dual listing in the Mainland;
 - (3) **A+H at the same time** — a company seeking to list its A-shares in the Mainland and H-shares on the SEHK simultaneously;
 - (4) **NEEQ + H** — a company already listed on the National Equities Exchange and Quotations (NEEQ) market in the Mainland to list on the SEHK as well without prior delisting from the NEEQ.
- **Spin-off** — companies already listed in Hong Kong, Mainland China or overseas may spin off a subsidiary or certain businesses for a listing in Hong Kong.

1.2.3 Red-chip structure

Under the red-chip model, an offshore holding company, i.e. a special-purpose vehicle (SPV), is formed and injected with assets and interests of a Mainland enterprise and then listed overseas in its name for fund-raising purpose. Red-chips are commonly classified into “state-owned red-chips” and “private red-chips”. Statistics show that most of the overseas-listed Mainland enterprises adopt the red-chip model, especially the private ones.

Figure 1. Private red-chip (shareholding) structure



Note: For illustration only. There may be differences in practice.

1.2.4 Variable Interest Entity (VIE) structure

The SEHK adopts a disclosure-based approach in reviewing listing applications submitted under the VIE structure, considering major factors including the following:

- The VIE structure shall be “narrowly tailored” and only be used to address limits on foreign ownership, such that the contractual arrangements shall be terminated when those limits no longer exist¹⁰;
- Minimise the potential of conflict with relevant laws and regulations of the People’s Republic of China (PRC);
- Where practicable, appropriate regulatory assurance should be obtained from the relevant regulators by the listing applicant;
- Terminate the contractual arrangements as soon as the law allows the business to be operated without them;
- Ensure that the contractual arrangements: (1) include a power of attorney by which the domestic operating entity’s shareholders grant to the listing applicant’s directors and their successors the power to exercise all rights of the domestic operating entity’s shareholders, and ensure that the power of attorney does not give rise to any potential conflicts of interest; (2) contain dispute resolution clauses; (3) encompass the power to deal with the domestic operating entity’s assets;
- Consider the latest developments in the Foreign Investment Law in China.

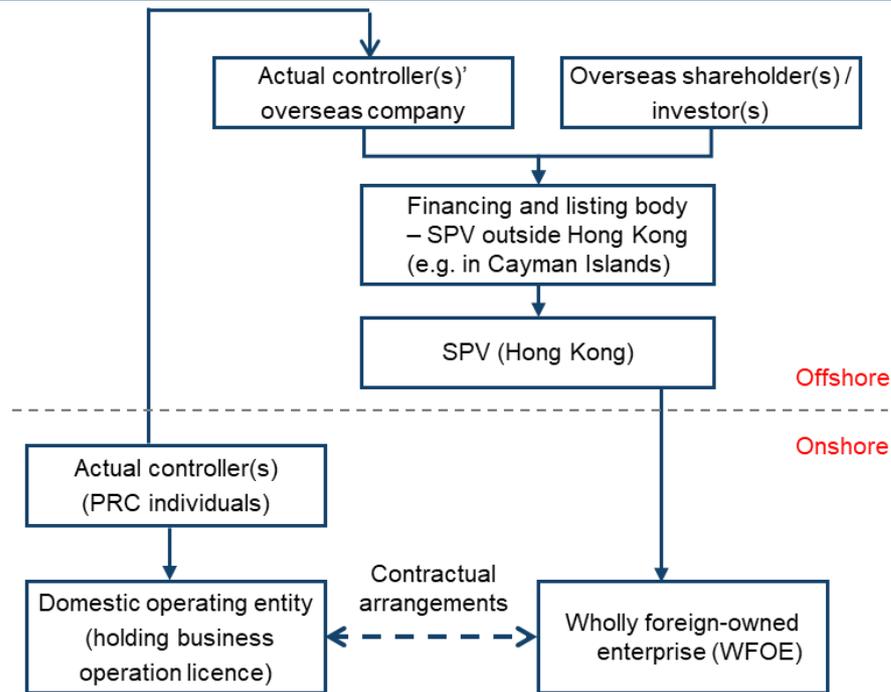
When reviewing the application documents, the SEHK requires:

- A confirmation from the applicant’s sponsor that the applicant is eligible for listing, and shall disclose details of the contractual arrangements and related risks in the prospectus as required;
- An affirmative opinion from the applicant’s legal advisor;
- A confirmation from the applicant’s reporting accountant that the consolidation of the domestic operating entity’s financial results is in line with current accounting standards.

Companies seeking to list with a VIE structure with novel issues are recommended to conduct pre-listing consultation and communications (Pre-A1 Submission) as early as possible and adjust their listing structure accordingly.

¹⁰ See HKEX Listing Decision HKEX-LD43-3.

Figure 2. Variable Interest Entity (VIE) structure



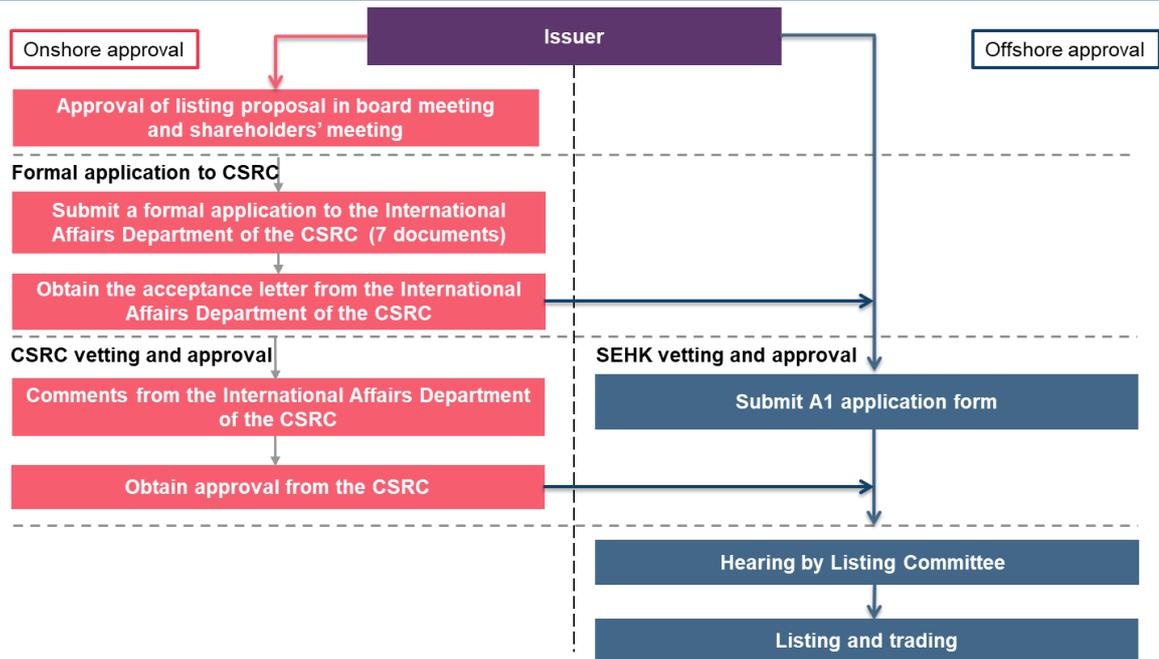
Note: For illustration only. There may be differences in practice.

1.2.5 H-share structure

H-shares are shares that are issued in Hong Kong to foreign investors and listed on the SEHK by joint-stock companies legally incorporated in Mainland China. Mainland laws such as the *PRC Securities Law* and the *Special Provisions of the State Council Concerning the Floatation and Listing Abroad of Stocks by Limited Stock Companies* also have provisions regarding the issuance of H-shares.

At present, companies applying for listing in Hong Kong under the H-share structure need to go through dual approval procedures, both domestic and overseas, with the China Securities Regulatory Commission (“CSRC”) and the SEHK.

Figure 3. Basic approval procedures for the listing of H-shares



Note: For illustration only. There may be differences in practice.

During its preliminary review, the International Affairs Department of the CSRC will raise matters of special concerns in the feedback meeting for discussion. After receiving the feedback, the applicant co-ordinates with the relevant intermediaries to prepare a reply as required, and submits the relevant documents to the processing department within the specified time frame. CSRC reviewers shall write a review report, perform the approval procedures involved in the administrative licensing for approving or rejecting an offshore IPO and listing or a follow-on offshore re-financing. The processing department will then issue approval documents to the applicant.

According to the *Highlights on the Review and Approval Process of Overseas Public Offerings and Listing (Follow-on Refinancing Included) by Joint-Stock Companies* issued by the CSRC on 23 July 2019, the key points to note for an H-share listing are set out in Table 1 below:

Table 1. Key points on the approval of H-share listings (as issued by the CSRC)	
Foreign entry and macro-economic control and industrial policy	1. Whether the business scope of the issuer and its subsidiaries involves areas where foreign investments are prohibited or restricted by China, and whether the relevant foreign investment access policy has been complied with both before and after the overseas shares issuance and listing.
	2. Whether the issuer's business scope falls within any of the following conditions: (1) the principal business is real estate business, or (2) the real estate business (consolidated) accounts for 50% or more of the operating income, or (3) the revenue and profit of the real estate business are the highest among all businesses, in average accounting for 30% or more of the company's total revenue and profit. And if positive for any of the above, whether there is any violation of the <i>Notice of the General Office of the State Council on Further Improving the Regulation of the Real Estate Market</i> ([2013] No. 17 of the General Office of the State Council) or <i>Notice of the State Council on Resolutely Curbing the Soaring of Housing Prices in Some Cities</i> ([2010] No. 10 of the State Council), and whether it had been named as a "real estate development enterprise and intermediary agent in breach of the laws or regulations" by the Ministry of Housing and Urban-Rural Development.
	3. Whether the issuer and its subsidiaries have violated the <i>Market Access Negative List</i> ; whether they are industries with overcapacity; whether there are violations of the rules, incompliance with legal procedures or key industry adjustment and revitalisation plans and related industrial policies, unauthorised approvals or approvals which are against the regulations or other cases of violation of [2013] No. 41 of the State Council, <i>Guiding Catalog for Adjustment in the Structure of Industries</i> , [2013] No. 67 of the General Office of the State Council, [2009] No. 386 of the People's Bank of China, [2016] No. 34 of the General Office of the State Council and the relevant documents issued by the State Council and the relevant departmental regulations.
Operational compliance	4. Whether the issuer and its subsidiaries have in the past year violated the <i>Notice of the State Council on Further Strengthening the Work Safety of Enterprises</i> ([2010] No. 23 of the State Council); whether they have violated national and local environmental protection requirements.
	5. Whether the issuer and its subsidiaries have in the past two years violated the <i>Securities Law</i> , the <i>Securities Investment Fund Law</i> , <i>Regulation on the Administration of Futures Trading</i> , <i>Special Provisions of the State Council Concerning the Floatation and Listing Abroad of Stocks by Limited Stock Companies</i> (Order of the State Council (No. 160)) and <i>Circular of the State Council Concerning Further Strengthening the Administration of Shares Issuance and Listing Overseas</i> ([1997] No. 21 of the State Council) and other securities and futures laws and regulations.
	6. Whether the issuer and its subsidiaries and the relevant securities service providers engaged by the issuer are subject to ongoing investigations by the administrative bodies for suspected violation of laws or regulations, or subject to ongoing investigations by the judicial authorities; whether they are currently subject to the CSRC's actions of imposing a restriction on their business activities or imposing an order of suspension for reorganisation, or of designated custody or takeover or other regulatory measures.
	7. Whether the shares subscribed by the issuer's promoters are fully paid, and whether the procedure of transferring the property rights has been completed regarding the capital contributions by the promoter. Whether the issuer is a "seriously dishonest entity" under the <i>Guiding Opinions</i> ([2016] No. 33 of the State Council).
Shareholding structure and corporate governance	8. Whether the issuer has stated in its articles of association what is required under the <i>Mandatory Provisions for the Articles of Association of the Companies to be Listed Overseas</i> . Whether there is any association or concerted action between the issuer's existing shareholders and the current issuance targets/target subscribers of the issue (if applicable). Please disclose the shareholding control relationship between the major shareholder(s) who, alone or together, hold(s) 5% or more of the shares of the issuer and the target of the current IPO/offer (if applicable) (including but not limited to the controlling shareholders and actual controllers).
	9. Whether the issuer and its subsidiaries have established and perfected complete and standardised rules and regulations for confidentiality and file management and whether they are in compliance with the <i>Provisions on Strengthening the Confidentiality and File Management related to Offshore Securities Issuance and Listing</i> .
The current issuance	10. In the current issuance, whether complete internal decision-making procedure has been implemented and whether the necessary internal approval and authorisation have been obtained; whether the necessary external approval such as the regulatory opinion (if applicable) issued by the industry regulatory authorities has been obtained; whether the issuance targets (if applicable) and issuance currencies comply with the relevant requirements of the <i>Special Regulations of the State Council on the Overseas Offering and Listing of Shares by Joint-Stock Limited Companies</i> (Order of the State Council (No. 160)).
	11. Whether the issuance and fund-raising project has obtained the necessary approval, permission or filing documents (if applicable) and whether it meets the relevant regulatory provisions of fixed asset investment administration; whether it meets the national and local environmental protection requirements. Whether the funds raised from this offshore issuance will be directed to the illegal land use projects stipulated in the <i>Notice on Promoting Land Saving and Intensive Use</i> ([2008] No. 3 of the State Council), or to the eliminated or restricted categories of industries stated in the <i>Guiding Catalog for Adjustment in the Structure of Industries</i> , or to the forbidden items provided in the <i>Market Access Negative List</i> ; if it involves overseas investment, whether it is in line with the overseas investment direction stated in [2017] No. 74 of the General Office of the State Council and whether the overseas investment approval or filing procedures have been followed in accordance with the law.

Table 1. Key points on the approval of H-share listings (as issued by the CSRC)	
Matters applicable to designated targets/applicants	1. Whether the current issuance complies with the <i>Guideline on the Review, Approval and Supervision of Domestic Enterprises in China Applying to List on the Hong Kong Growth Enterprise Market</i> issued by the CSRC ([1999] No. 126). (Applicable to domestic companies seeking to list on Hong Kong GEM board)
	2. Whether the current issuance is in breach of the <i>Circular on Issues in Relation to Regulating Overseas Listing of Subsidiaries of Domestic Listed Companies</i> issued by the CSRC ([2004] No. 67). (Applicable to subsidiaries of domestic listed companies seeking to list overseas)
	3. Whether the current issuance is in breach of the <i>Administrative Measures on the Pilot Scheme for Preference Shares</i> issued by the CSRC (Order of CSRC No. 97), the <i>Guidance Opinions on the Issuance of Preference Shares by Commercial Banks for Replenishing Tier 1 Capital</i> ([2014] No. 12 of the China Banking Regulatory Commission). (Applicable to domestic companies seeking to issue preference shares overseas)
	4. Shareholders already holding the issuer's shares before the current issuance and directors, supervisors and senior executives holding the issuer's shares (directly or indirectly) shall specifically undertake that they will not transfer their shareholdings within 1 year from the date the issuer's shares are listed and traded on the overseas exchange. Please supplement with the provision of such specific undertakings. (Applicable to domestic applicants not listed in Mainland China)
	5. Whether the number of shareholders of the issuer and its controlling shareholders, actual controllers, and significant majority-owned subsidiaries exceeds 200 according to <i>Guideline No. 4 for the Supervision of Unlisted Public Companies — Review Guidelines on Issues Concerning Administrative Licensing Applications of an Unlisted Joint-Stock Limited Company with Over 200 Shareholders</i> . If yes, please provide the relevant application documents and fulfill the relevant procedures. A "significant majority-owned subsidiary" refers to a majority-owned subsidiary whose operating income, net profit or total assets account for over 50% of the totals on the consolidated statement during the reporting period, and also one which has significant influence on the current and future operation and financial status of the group as a whole. (Applicable to domestic applicants not listed in Mainland China)
	6. Whether there is any direct or indirect shareholding or warehousing arrangement by the employees of the issuer. If yes, whether it is in breach of the <i>Notice on the Regulation of Internal Staff Shareholdings in Financial Enterprises</i> ([2010] No. 97 of the Ministry of Finance) and other relevant regulations. The issuer's relevant senior executives and other individuals holding more than 50,000 employee shares are required to give specific undertakings on the lock-up period and the sale limit of share transfers in accordance with relevant regulations. (Applicable to financial enterprises)
	7. Whether the non-overseas listed shares have been registered and in the custody of the China Securities Depository and Clearing Co., Limited pursuant to the <i>Notice of the CSRC on the Centralised Registration and Custody of Non-overseas Listed Shares of Overseas Listed Companies</i> ([2007] No. 10 of the CSRC). (Applicable to H-share listed companies seeking follow-on refinancing)

Source: Official website of the CSRC.

1.3 Listing of H-shares: An update

1.3.1 H-share companies have become an important part of the Hong Kong stock market

Starting from June 1993, companies incorporated in Mainland China are able to list in Hong Kong under the Exchange's Listing Rules. Tsingtao Brewery (stock code: 00168) became the first Mainland company to issue H-shares and list in Hong Kong in July 1993. After 2000, large Mainland enterprises, including the four major state-owned banks, China Unicom and CNPC (China National Petroleum Corporation), launched their H-share IPOs, unfolding a boom in Mainland enterprises' listing in Hong Kong.

As of 30 June 2019, a total of 1,197 Mainland enterprises were listed in Hong Kong (including 274 H-share companies), accounting for about 68% of Hong Kong's market total in terms of market capitalisation, and about 80% in terms of average daily turnover value (ADT) in 2019 up to June. The number of listed A+H share issuers reached 112, of which 90 and 22 were also listed on the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE) respectively.

Funds raised through all 274 H-share IPOs amounted to HK\$1.81 trillion, almost 80% of which came from IPOs in the major sectors of industrials (69 in number), financial (66) and consumer discretionary (25). Hong Kong's capital market is increasingly capable in serving Mainland enterprises.

Type of listed company	Number			Total market capitalisation (End-Jun 2019)		ADT (Jan-Jun 2019 ¹¹)	
	Total	Main Board	GEM	HK\$ million	% of total	HK\$ million	% of total
Mainland China	1,197	1,093	104	22,247,751.84	67.98	55,134.84	79.89
H-shares	274	250	24	6,376,083.15	19.48	24,257.63	35.15
Red-chips ¹²	176	171	5	5,595,665.82	17.10	7,908.10	11.46
MPEs ¹³	747	672	75	10,276,002.88	31.40	22,969.11	33.28
Hong Kong	1,006	765	241	7,921,907.18	24.21	9,484.60	13.74
Overseas	179	138	41	2,556,988.79	7.81	4,393.95	6.37
Total	2,382	1,996	386	32,726,647.81	100.00	69,013.39	100.00

Source: HKEX.

In addition, since the launch of the Shanghai-Hong Kong Stock Connect (Shanghai Connect) in 2014 and the Shenzhen-Hong Kong Stock Connect (Shenzhen Connect) in 2016, the mutual market access between the stock markets in Hong Kong, Shanghai and Shenzhen has been promoting the two-way healthy development of the capital markets across the border. As of the end of June 2019, 118 of the 326 Hong Kong stocks included in the Shanghai Connect, and 144 of the 481 Hong Kong stocks in Shenzhen Connect were H-shares.

1.3.2 Successful implementation of the H-share full circulation pilot programme

The share capital structure of H-share issuers includes “foreign shares” which are tradable in the Hong Kong stock market, as well as “domestic shares” such as the original legal person shares and state-owned shares before listing. “Domestic shares” are non-tradable before they are listed and traded in the domestic market. Full circulation of H-shares will turn these non-tradable “domestic shares” into “foreign shares” available for public trading on the Hong Kong stock market.

According to the *CSRC Pilot Programme for the Deepening Reforms on the Overseas Listing Regime with the “Full Circulation” of H Shares* issued on 29 December 2017, the pilot programme for the full circulation of H-shares will be implemented in an orderly manner, “enterprise by enterprise”, in accordance with the principle of active, steady and gradual progress.

Given that Legend Holdings (03396), AVIC (02357) and Weigao (01066) have successfully completed their pilot programmes of H-share full circulation in 2018, CSRC Vice Chairman Fang Xinghai publicly stated that the programme shall be launched in full swing as soon as possible so as to allow qualified H-share companies to apply for full circulation, and facilitate overseas listing of domestic innovative enterprises.

In June 2019, the CSRC Chairman, Yi Huiman, said at the Lujiazui Forum in Shanghai that “the capital market will be further opened up, with impetus given to the comprehensive promotion of H-share circulation reform”. With good progress of the pilot programme, H-share companies listed on the SEHK can expect a wider and stronger capital market support in the future.

¹¹ Turnover value included listed ordinary shares and preference shares.

¹² Red-chips here refer only to those listed in Hong Kong with a “state-owned red-chip” structure.

¹³ MPEs refer to Mainland private enterprises that have no H-shares.

1.3.3 Pilot programme for NEEQ companies to list in Hong Kong under the “NEEQ + H shares” model

In April 2018, HKEX signed a Memorandum of Cooperation with NEEQ Co., Ltd. which operates the NEEQ system (“New Third Board”) in the Mainland to allow companies qualified for listing in Hong Kong to list in both places simultaneously in the form of “NEEQ + H shares”. In other words, NEEQ companies can apply for listing on the SEHK without prior delisting from NEEQ.

According to statistics, as of 30 June 2019, more than 25 NEEQ companies (or their spin-off subsidiaries) have submitted listing applications to the SEHK. Seven have completed listing in Hong Kong, among which Junshi Pharma-B (01877) has successfully landed on Hong Kong's capital market in the form of “NEEQ + H shares”. The success of this “NEEQ + H shares” programme provides insights and valuable experience in mobilising both domestic and overseas capital markets to serve H-share issuers.

1.3.4 Closer connection between B and H shares

B-shares generally refer to the RMB-denominated foreign-funded shares listed and traded on the SSE or the SZSE that are subscribed and traded in foreign currencies. As of 30 June 2019, there were 50 B shares listed on the SSE and 47 on the SZSE.

In recent years, some B-share listed companies have chosen to delist from the B-share market and convert their shares into H shares to be listed on the SEHK. CIMC (02039) was the first to have successfully entered the Hong Kong capital market in this way in August 2012 by converting its B shares to H shares. After that, Vanke (02202) and Livzon Pharma (01513) also delisted from the B-share market and changed respectively from an “A+B” share company to an “A+H” share company in 2014. Apart from these, a number of B-share companies have chosen to be listed on the SEHK in other ways, such as Chenming Paper (01812) listed in the form of a “A+B+H” share company, and Yitai Coal (03948) listed in the form of a “B+H” share company.

As these “B to H” and “B+H” models go popular, the connection between Hong Kong and the Mainland capital markets will be further deepened, providing more channels for the multi-currency and international equity financing of Mainland enterprises.

1.4 Listing in Hong Kong: Professional parties involved

1.4.1 Sponsors and Compliance Advisers

An applicant who seeks to list on the Main Board of the SEHK must appoint at least one independent sponsor licensed by the Securities and Futures Commission (SFC) to assist with its listing application¹⁴. A sponsor, once appointed or dismissed, the listing applicant must notify the SEHK in writing as soon as possible, regardless of whether a listing application has been submitted. A listing application must not be submitted to the SEHK by a new applicant in less than two months upon the formal appointment of a sponsor. Duties of a sponsor usually include:

- Conduct overall planning and coordination of listing;
- Assist in preparation of a financing plan for the applicant;
- Conduct reasonable due diligence;
- Review the profit forecast and cash flow forecast prepared by the applicant;

¹⁴ See Listing Rule 3A.02 for details.

- Be deeply and closely involved in the preparation of application materials for listing for the applicant;
- Liaise with regulators on behalf of the applicant and accompany it to meetings.

In addition, an applicant must appoint a Compliance Adviser for a term commencing on the date of listing and ending on the date of announcement of its financial results for the first full financial year after listing.

1.4.2 Underwriters

An underwriter of an IPO mainly involves in the issue and sale of shares. The appointment of underwriters of different types may help absorb, to a certain extent, the sales pressure and lower offer risks, especially for large offers or in a downbeat market. Duties of an underwriter usually include:

- Assist in the preparation of roadshow materials for the applicant;
- Arrange analysts to compile research reports;
- Identify potential investors for the applicant;
- Organise roadshows and promotion activities;
- Conduct public offering and international placing;
- Fully underwrite the IPO subscription of the securities;
- Assist in determining IPO price;
- Provide post-listing share price support.

1.4.3 Solicitors

Due to the different legal systems of the Mainland and Hong Kong, application for listing in Hong Kong normally involves four teams of solicitors, which are solicitors representing the issuer (both local¹⁵ and overseas solicitors¹⁶) and solicitors representing sponsors and underwriters (both local and overseas solicitors). Duties of a solicitor team usually include:

- Draft prospectus;
- Assist in restructuring the company;
- Assist in due diligence work;
- Advise on legal matters of the applicant in the course of due diligence work, in accordance with listing requirements;
- Provide legal advice to sponsors and underwriters on compliance matters of the applicant;
- Assist the applicant and its sponsors in responding to regulators' enquiries.

1.4.4 Accountants

An applicant shall engage professional accountants to audit its financial reports and assist with its IPO. Duties of an accountant usually include:

- Prepare audit reports;

¹⁵ Local solicitors refer in general to those who have background in Mainland laws.

¹⁶ Overseas solicitors refer in general to those practicing in Hong Kong, Cayman Islands and the United States (if securities laws in the US is involved) and other jurisdictions popular for overseas operations (if applicable).

- Assist the applicant in taxation matters (if the applicant do not have an independent tax consultant);
- Review the profit forecast and cash flow forecast prepared by the applicant;
- Assist the sponsors in responding to regulators' enquiries.

In addition, a Hong Kong IPO may involve professional services provided by other external parties as follows:

- Industry consultants: mainly responsible for industry research and industry analysis reports etc.;
- Property valuers: responsible for issuing valuation reports on the applicant's property interests or other assets, etc.;
- Special asset valuation: valuation of special assets, such as mine valuation;
- Printers: mainly responsible for the proofreading, translation and printing of prospectuses, etc.;
- Public relations firms: arrange roadshows, media activities and listing ceremonies, etc.

1.5 Conditions for a GEM listing

GEM has been positioned as a market for small and medium-sized companies. It is a market with lower listing eligibility criteria but similar continuing obligations compared to the Main Board. On 15 December 2017, the Exchange published its GEM consultation conclusions with amendments to the GEM Listing Rules that removed the streamlined process where GEM issuers could be transferred to the Main Board, and repositioned GEM as a stand-alone market for small and medium-sized companies¹⁷. Upon such amendments, applicants seeking a GEM listing shall meet the following basic requirements:

- Aggregate operating cash flow over the two preceding years \geq HK\$30 million¹⁸;
- Market capitalisation \geq HK\$150 million;
- A minimum public float (normally 25%; may reduce to 15% at discretion if market capitalisation at the time of listing $>$ HK\$10 billion);
- At least 100 shareholders after listing¹⁹;
- Largely the same management in the latest two financial years;
- Same ownership and control in the latest financial year;
- At least three independent directors, which shall account for at least one-third of the Board;
- At least one independent non-executive director who shall be ordinarily resided in Hong Kong in case of H-share applicant;
- Publication of quarterly financial reports.

Eligible GEM issuers may apply for a transfer of listing to the Main Board²⁰. There were ten successful transfers of listing of issuers from GEM to the Main Board in 2018, and eight in the first half of 2019.

¹⁷ The Consultation Conclusion took effect on 15 February 2018.

¹⁸ See GEM Listing Rule 11.12A for details.

¹⁹ See GEM Listing Rule 11.23(2)(b) for details.

²⁰ See Chapter 9A for details.

1.6 Backdoor listing in Hong Kong

In recent years, the Exchange has noted an increase in market activities related to the trading, and creation, of shell companies on the back of demands for backdoor listing through listed shells. To maintain market quality, the Exchange has adopted a more stringent approach in applying the Listing Rules to crack down on ever changing shell activities, including backdoor listing, corporate actions involving disposals of businesses of listed issuers, and not having a sufficient level of operations. On 29 June 2018, the Exchange published the *Consultation Paper on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments*, and consulted the market on proposed Listing Rules amendments to address market concerns on backdoor listing and shell activities.

On 26 July 2019, the Exchange published its consultation conclusions on backdoor listing and other shell activities. Consultation proposals are to be implemented with modifications reflecting comments received, and with related Listing Rules amendments to take effect on 1 October 2019²¹. In this connection, the Exchange also issued three new guidance letters on the application of the amended Listing Rules²².

Major Rules amendments relating to backdoor listings include those in sub-sections below.

1.6.1 Definition of reverse takeover (RTO) transactions

Principle-based test

The six assessment factors under the principle-based test in the relevant Guidance Letter²³ are codified into the Listing Rules with modifications made to the last two factors:

- Size of transaction;
- Quality of business/assets to be acquired;
- Nature and scale of the issuer's business;
- Fundamental change in principal business;
- Change in control or de facto control;
- Series of transactions and/or arrangements, including acquisitions, disposals and/or change in control or de facto control that take place in reasonable proximity of time (normally within 36 months) or are otherwise related.

Bright-line tests

The bright-line tests are modified to cover very substantial acquisitions from an issuer's controlling shareholder within 36 months after a change in control of the issuer; and to restrict disposals (or distributions in specie) of all or a material part of the issuer's business proposed at the time of or within 36 months after a change in control of the issuer. The Exchange may also apply the restriction to disposals (or distributions in specie) at the time of or within 36 months after a change in de facto control (as set out in the principle-based test) of the issuer.

²¹ The Consultation Conclusions also applied to GEM Listing Rules. See Amendments to the GEM Listing Rules (Update No. 62) for details.

²² See HKEX Guidance Letter HKEX-GL104/105/106-19 for details.

²³ See HKEX Guidance Letter HKEX-GL78-14 for details.

Backdoor listing through large-scale issue of securities

The relevant Guidance Letter²⁴ is codified into the Listing Rules to disallow backdoor listing through large-scale issuance of securities for cash, where there is, or will result in, a change in control or de facto control of the issuer, and the proceeds will be applied to acquire and/or develop new business that is expected to be substantially larger than the issuer's existing principal business.

1.6.2 Tightening the compliance requirements for RTOs and extreme transactions

Extreme transactions

The "extreme very substantial acquisitions" requirements in the relevant Guidance Letter²⁵ are codified into the Listing Rules and this category of transactions is renamed "extreme transactions". Additional eligibility criteria are also imposed on issuers who may use this transaction category: (1) the issuer must operate a principal business of a substantial size; (2) the issuer must have been under the control or de facto control of the same person(s) for a long period of time (normally not less than 36 months) and the transaction will not result in a change in control or de facto control of the issuer.

Requirements for RTOs and extreme transactions

The Listing Rules are modified to require the acquisition targets in a RTO or extreme transaction to meet the requirements of Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B), and the enlarged group to meet all the new listing requirements in Chapter 8 of the Listing Rules other than Rule 8.05. Where the RTO is proposed by a Rule 13.24 issuer, the acquisition targets must also meet the requirement of Rule 8.07.

During the consultation period, the Exchange received a total of 121 responses from a broad range of respondents, which were supportive of the initiatives to address backdoor listing and shell activities. The consultation and related amendments to the Listing Rules will also help the Exchange enhance the quality and sustainability of the Hong Kong market.

2. APPLICATION AND VETTING PROCESS FOR ENTERPRISE LISTING IN HONG KONG

2.1 Roles and duties of the SEHK and the SFC

The SEHK adheres to the disclosure-based approach with transparent processes and predictable timetables on listing approvals. It has a statutory obligation under the Securities and Futures Ordinance to ensure, so far as reasonably practicable, that Hong Kong markets are fair, orderly and informed.

The SFC plays a leading role in market regulation and certain areas of listing regulation and a complementary role in cases involving corporate misconduct through the exercise of its statutory powers of investigation and enforcement.

The SFC has a statutory duty to supervise and monitor the SEHK's performance of its listing-related functions and responsibilities. The staff of the SEHK and the SFC meet regularly to discuss listing-related matters. Under the dual filing regime, the SEHK passes copies of materials submitted by listing applicants to the SFC. The SFC may object to a listing if the disclosure in the listing materials appears to contain false or misleading information. The SFC

²⁴ See HKEX Guidance Letter HKEX-GL84-15 for details.

²⁵ See HKEX Guidance Letter HKEX-GL78-14 for details.

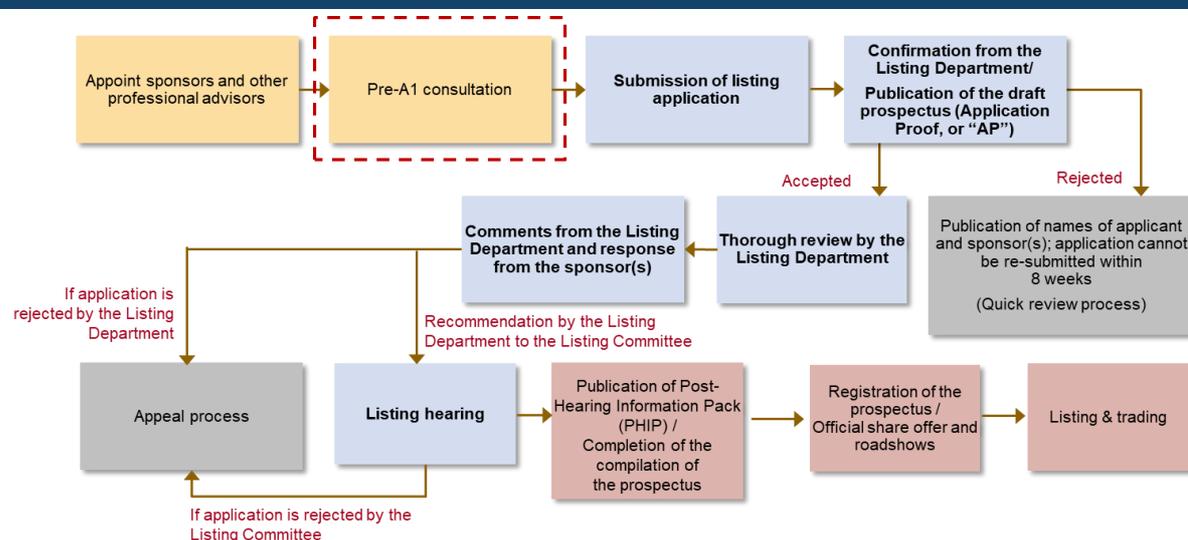
also conducts a periodic audit of the performance of the SEHK in its regulation of listing-related matters.

The SEHK's listing-related functions are discharged by the Listing Department and the Listing Committee, including the formulation, announcement and enforcement of the Listing Rules. All changes to the Listing Rules and policy decisions that have mandatory effect or general application are to be approved by the SFC.

2.2 Overview of the IPO vetting process

When a company comes to a certain stage of development and intends to be listed in Hong Kong, it shall go through procedures at different stages from pre-listing preparation to listing application (A-1 filing), vetting and hearing, and finally listing and trading of shares in the market, as indicated in Figure 4 below.

Figure 4. Overview of the review process for listing on the SEHK



Note: For illustration only. There may be differences in practice.

(1) Step 1: Appointment of sponsors and other professional advisors

Appointing an experienced team of professional advisors is crucial for the success of an IPO. Professional advisors normally include sponsor(s) and underwriter(s), domestic and overseas lawyers, accountants, etc. It is required to appoint a sponsor at least 2 months before submission of an IPO application and notify the SEHK in writing within five business days of its appointment. The applicant should discuss with professional advisors whether a listing is right for it, the listing structure, the time and cost, division of labour in the listing team, and the potential issues, challenges and obligations the applicant may face once listed.

(2) Step 2: Listing preparation process

Sponsors conduct due diligence on the applicant and assist in the drafting of the prospectus (aka Application Proof, or "AP", in this stage). The prospectus must contain all the significant information that an investor reasonably requires to make an informed investment decision. During the preparation process, sponsors would assist the applicant in formulating or enhancing medium- to long-term strategies and making business and financial forecasts for underwriter(s) to create valuation models, determine the use of proceeds and sort out highlights to pitch investors.

(3) Step 3: Submission of listing application to listing department

The listing application (A1), which includes the AP, is submitted to the Listing Department. Assuming the A1 is substantially complete, the Listing Department will confirm receipt and publish both Chinese and English versions of the AP online.

Applicants are encouraged to seek informal and confidential guidance from the Exchange regarding novel and specific issues prior to the formal submission of a listing application. This is usually referred to as “Pre-A1 Submission”. It can help issuers, based on their actual circumstances, understand whether the proposed listing is in line with the requirements in a timely manner and also their key considerations for listing in Hong Kong.

(4) Step 4: Vetting by the Listing Department

The Listing Department will subsequently conduct detailed vetting of the A1 based on eligibility, suitability for listing, business sustainability, compliance of rules and regulations and sufficiency of disclosures.

First round of comments will be provided as soon as possible, normally within 15 business days, from receipt of application. Time needed for subsequent review will depend on the applicant’s response time and quality of response.

(5) Step 5: Hearing by the Listing Committee

The Listing Committee will review the application and determine if it is suitable for the applicant to proceed with its IPO. As required under the Listing Rules, the Listing Committee shall comprise 28 members, among which at least 8 members shall represent investors’ interests; 19 members shall appropriately represent the listed issuers and market participants including lawyers, accountants, corporate finance consultants and other senior personnel, nominated in appropriate proportions; and the remaining member shall be the Chief Executive of HKEX. Major duties of the Listing Committee include²⁶:

- Listing review;
- Vetting of listing applications and oversight of the Listing Department;
- Approval of IPO listing and rule waiver applications;
- Passing, amendment or modification of decisions made by the Listing Department and the Listing Committee;
- Provision of policy advice and comments for important policies and amendments to the Listing Rules.

(6) Step 6: Marketing and sales of new shares

At this stage, the applicant would be required to meet the minimum standard for public shareholding and the number of shareholders, but the SEHK will not interfere in the pricing process of the applicant.

The underwriter(s) or underwriting group are generally responsible for assisting the applicant in listing preparation and marketing, including investor education, communication with potential cornerstone investors, analyst roadshows and IPO roadshows by management. Allocation of IPO shares in Hong Kong falls into two tranches “international placing” and “Hong Kong public offering”, subject to adjustment as

²⁶ See the official website of the SEHK for details.

appropriate according to the clawback mechanism and share reallocation mechanism. International placing and public offering usually account for 90% and 10% respectively of the total number of newly issued shares.

Many companies have chosen to introduce cornerstone investors when they have IPOs in Hong Kong. IPO shares under the placing tranche are preferentially placed to certain investors, usually referred to as “cornerstone investors”. Principles for placing to cornerstone investors generally include²⁷:

- Placing must be carried out at the IPO price;
- Shares placed during the IPO are subject to a lock-up period for at least 6 months in general from the listing date;
- Each investor has no representative in the board of directors of the listing applicant and is independent of the listing applicant, and its connected persons as well as their respective associates;
- Details of the placing (including identities and background of the investors) must be disclosed in the listing documents;
- If an investor will be regarded as a member of the public according to Rule 8.24 of the Listing Rules (Notes 2 and 3 to Rule 11.23 of the GEM Listing Rules), the shares placed to such investor will still be part of the public float as referred to in Rule 8.08 of the Listing Rules (Rule 11.23 of the GEM Listing Rules) regardless of the lock-up for a period of at least 6 months as mentioned above;
- Save for the guaranteed preferential share placement, cornerstone investors should not be given any direct or indirect interests.

(7) Step 7: Listing and post-listing trading

Upon completion of pricing and share allocation to institutional and retail investors, shares of the applicant would be listed for trading on the SEHK.

Upon listing, the share price of an issuer would be subject to fluctuation due to different reasons. The underwriting group would usually designate one or more underwriter(s) as the Stabilisation Agent responsible for buying shares of the newly listed company when the share price becomes lower than the IPO price in order to stabilise the post-listing share price performance for a defined period of time.

For Hong Kong IPOs, the listing applicant may grant an “over-allotment option” to its underwriter(s) which usually equals to 15% of the total number of shares originally issued in the IPO and is to be exercised within 30 days after the Hong Kong public offering is closed; such process is called “Green Shoe” mechanism. The Stabilisation Agent may assess secondary market investors’ demand for shares of the issuer based on the post-listing share price movement, and decide at its own discretion whether to exercise the over-allotment option in order to mitigate volatility in the market, bringing mutual benefits to all parties concerned including the listed company, investors and underwriters.

²⁷ See HKEX Guidance Letter HKEX-GL51-13 for details.

3. HONG KONG LISTED COMPANY REGULATION AND EQUITY REFINANCING

3.1 Listed company regulation

The SEHK adheres to the basic principle for listed issuer regulation to ensure issuers' ongoing compliance with the Listing Rules in order to maintain a fair, orderly and efficient market. The regulatory functions of the SEHK are mainly reflected in three aspects, namely supervision, vetting and guidance. For example, the SEHK is responsible for monitoring media reports and share prices of listed issuers, handling complaints, vetting waiver applications, suspending and resuming the trading of shares, handling enquiries from listed companies regarding the Listing Rules, providing guidance to listed companies, and market education, etc.

The regulation of listed companies in Hong Kong is effected through enforcement of continuous disclosure obligations on the part of issuers, including the following three types of disclosure: (1) disclosing inside information as required by the relevant laws and regulations in a timely manner²⁸; (2) disclosing necessary information to avoid false market²⁹; (3) responding to enquiries from the Exchange regarding unusual fluctuations (price/turnover) of securities transactions of listed companies³⁰.

Other general matters that need to be disclosed include, but are not limited to:

- Financial result announcement/report (interim/annual);
- Amendments to the memorandum or articles of association;
- Change of directors or supervisors;
- Change of auditors and financial reporting year;
- Change of company secretary, share registrar and registered address;
- Change in share capital;
- Notice of shareholders' meeting.

3.2 Equity refinancing of listed companies

Upon listing on the Exchange, an issuer will have access to diversified and efficient channels for refinancing and increasing/reducing percentage interest of shareholders. In fact, post-listing equity refinancing channels for Hong Kong listed companies and their shareholders include, among others, post-listing issuance of new shares, rights issues, convertible/exchangeable bonds, equity warrants/options and block trades.

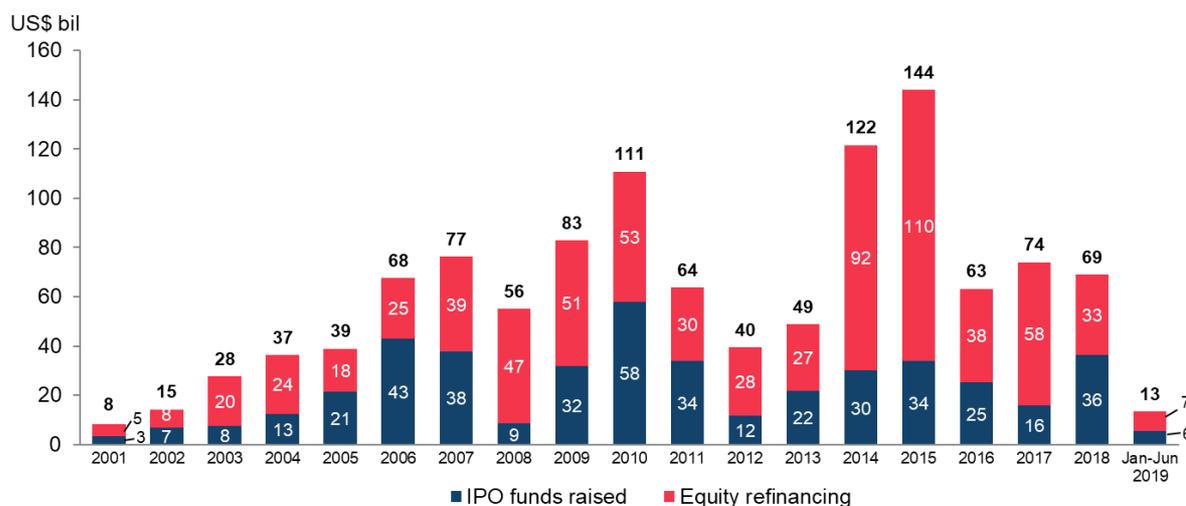
For many years, the amount of equity refinancing in the Hong Kong stock market has exceeded the amount of IPO funds raised, providing strong capital support for the sustainable development of companies listed in Hong Kong.

²⁸ See Part XIVA "Disclosure of Inside Information" of the *Securities and Futures Ordinance* (Cap. 571) for details. As defined by the Ordinance, inside information "is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities".

²⁹ "False market" generally refers to a situation where there is material misinformation or materially incomplete information in the market which is compromising proper price discovery.

³⁰ See Listing Rule 13.10 for details.

Figure 5. IPO funds raised and equity refinancing of listed companies at the SEHK (2001 – Jun 2019)



Source: HKEX.

3.2.1 Further equity issuance after listing

- It is the issuance of new shares by listed companies for financing purposes (not allowed only within the first six months after initial offer³¹);
- The basic principle is to protect the pre-emptive rights of existing shareholders; the issuance of new shares is subject to prior approval by shareholders to prevent passive dilution of their interests;
- General mandates granted at annual general meetings allow listed companies in Hong Kong to freely and flexibly issue additional new shares or equity securities (usually not more than 20% of total share capital), which can be done speedily (normally completed overnight)³²;
- For additional issues for cash, the issue price under a general mandate must not be more than 20% below the market price.

3.2.2 Rights issues

- This is an offer by way of granting rights to existing shareholders, enabling them to subscribe securities in proportion to their existing holdings;
- The company should ensure that all shareholders are treated fair and equal, and should provide shareholders with sufficient information for making informed investment/voting decisions;
- It is subject to approvals by the board of directors and shareholders at general meetings (if applicable);
- An announcement or listing document (if applicable) is required for listing by way of rights issue.

3.2.3 Convertible/exchangeable bonds

- Listed issuer and its shareholders may issue convertible/exchangeable bonds;

³¹ See Listing Rule 10.08 for details.

³² See Listing Rule 13.36(2) for details.

- The initial conversion price must not be lower than the benchmark price of the issuer's shares at the time of issue;
- Convertible bonds are issued by listed companies for financing;
- Exchangeable bonds are issued by shareholders with the tradable shares they hold in the listed company for capital replenishment (either the listed company they control or the listed company in which they hold a minority interest).

3.2.4 Equity warrants/options

- Equity warrants may only be issued (under general mandates) with a conversion price higher than the market price.

3.2.5 Block trades

- Shareholders may obtain financing by selling the stakes they hold in the listed company by way of block trades;
- Controlling shareholders are not allowed to reduce their percentage interest in the issuer within the first six months after the IPO; and from the 7th month to the 12th months after the IPO, the reduction of percentage interest is allowed only if it does not affect their controlling status.

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