

HKEX LISTING DECISION

HKEX-LD35-2012 (published in July 2012) (Updated in August 2018, October 2019 (Rule amendments))

Parties	Company A – a Main Board listed company Subsidiary B – a wholly owned subsidiary of Company A The Parent Shareholder – Company A’s controlling shareholder The Investor – a third party who proposed to acquire all the Parent Shareholder’s shareholding in Company A
Issue	Whether Company A would have sufficient operations or assets under Rule 13.24 after the Proposed Transactions
Listing Rules	Main Board Listing Rule 13.24
Decision	Company A would fail to meet Rule 13.24 upon completion of the Proposed Transactions

FACTS

1. Company A was principally engaged in a certain line of business.
2. Company A and the Parent Shareholder proposed to enter into the following transactions and arrangements (together the **Proposed Transactions**):
 - Company A would inject the bulk of its existing business into Subsidiary B and distribute all Subsidiary B’s shares in specie to Company A’s shareholders on a pro-rata basis (the **Distribution**).
 - Following the Distribution, the Parent Shareholder would make a voluntary cash offer to acquire all the remaining shares in Subsidiary B that were held by its other shareholders (the **Privateco Offer**).
 - The Parent Shareholder would also sell its controlling interest in Company A to the Investor who would then make an offer to acquire all the remaining shares in Company A that were held by its other shareholders (the **Listco Offer**).
3. The Distribution was conditional on approval by Company A’s shareholders (excluding the Parent Shareholder). The sale of the controlling interest in Company A by the Parent Shareholder was conditional on the shareholders’

approval of the Distribution. The Listco Offer and the Privateco Offer would be subject to the Takeovers Code.

4. After the Proposed Transactions, Company A would continue to engage in the **Remaining Business**. The Remaining Business recorded a loss and negative operating cash flow in the latest financial year. Its total assets and revenue represented about 6% of that of Company A before the Proposed Transactions.
5. The investor had no intention to inject capital into Company A or carry out fund raising activities. Company A would further expand the Remaining Business by broadening its customer base. While the Investor intended to explore new business opportunities and investments for Company A, no targets had been identified.
6. There was an issue whether Company A upon completion of the Proposed Transactions would have sufficient level of operations or assets of sufficient value to warrant its continued listing on the Exchange under Rule 13.24.

APPLICABLE LISTING RULES

7. Rule 13.24 states that

“An issuer shall carry out, directly or indirectly, a sufficient level of operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer’s securities.”

8. Rule 6.01 states that

“Listing is always granted subject to the condition that where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also do so where:—

...

- (3) the Exchange considers that the issuer does not have a sufficient level of operations or sufficient assets to warrant the continued listing of the issuer's securities (see rule 13.24)...”

(Rules 6.01(3) and 13.24 were amended on 1 October 2019. See Note 1 below.)

9. Rule 6.04 states that

“...The continuation of a suspension for a prolonged period without the issuer taking adequate action to obtain restoration of listing may lead to the Exchange cancelling the listing.”

ANALYSIS

10. Rule 13.24 imposes a continuing obligation for issuers to carry out a sufficient level of operations or have assets of sufficient value to warrant the continued listing of the issuers' securities.
11. Issuers that fail to meet the Rule are suspended and may be delisted. In these circumstances, trading can only be resumed if the issuer can demonstrate to the Exchange's satisfaction that it has a viable and sustainable business to support its continued listing. To enable the Exchange to make the assessment, the issuer must present its case in sufficient detail, including forecasts and clear and detailed plans for the future development of its businesses.
12. Rule 13.24 is intended to maintain overall market quality. Issuers that fail to meet this Rule are “blue sky companies” where public investors have no information about their business plans and prospects. This leaves much room for the market to speculate on their possible acquisitions in the future. To allow these issuers' shares to continue to trade and list may have an adverse impact on investor confidence.
13. In this case, Company A proposed to dispose of most of its existing businesses and assets. The Exchange noted that the Proposed Transactions were in effect privatizations of the company's existing business, but structured with the intention to allow the company to maintain its listing status. Company A would be left with minimal operations and this raised issues about market quality. Its submissions failed to demonstrate that it would have a viable and sustainable business upon completion of the Proposed Transactions. In making the assessment, the Exchange took into account the following:
 - The Remaining Business was immaterial compared to Company A's business operations and asset value before the Proposed Transactions.
 - The absolute size of the Remaining Business was also small. It only had asset value and annual turnover of HK\$20 million or less in recent financial years. It also recorded net losses and negative operating cash flow.
 - Company A's business plan lacked concrete details to show any substantial growth or improvement in the Remaining Business' scale of operations or financial position in the near future. The financial forecasts indicated that the

Remaining Business would continue to record a net loss and a negative operating cash flow in the next year.

14. It was Company A's view that it could meet Rule 13.24 after the Proposed Transactions as it would continue to have an operation. It also made reference to some other listed issuers which had a low level of activities and/or asset value, and whose shares were still trading on the Exchange.
15. The Exchange disagreed with Company A because:
 - When applying Rule 13.24 to issuers whose shares are trading on the Exchange, the Exchange generally allows their shares to continue to trade as long as they have an operation and meet the continuing disclosure obligations. If the Exchange were to suspend these issuers because of their low level of activities or asset values, public shareholders would have no access to the market for trading the issuers' shares. To balance the public shareholders' interests with the need to maintain market quality, the Exchange suspends trading only in extreme cases.
 - In the present case, the Rules and the Takeovers Code afforded shareholder protection:
 - The Proposed Transactions were subject to Company A's shareholders approving the Distribution and the Parent Shareholder could not vote because of its different interest in the proposal. The minority shareholders would have the opportunity to decide whether to allow the Proposed Transactions to proceed.
 - The Listco Offer and the Privateco Offer would be governed by the Takeovers Code. The minority shareholders could cash out of the listed vehicle and the distributed business, or alternatively continue to hold shares in Company A and Subsidiary B.
 - As noted in paragraph 13 above, Company A would be left with minimal operations as a result of the Proposed Transactions. This raised issues about market quality and should be discouraged.

CONCLUSION

16. The Exchange determined that Company A upon completion of the Proposed Transactions would not have a sufficient level of operations or assets of sufficient value to warrant its continued listing on the Exchange under Rule 13.24.
17. Should Company A proceed with the Proposed Transactions, it would fail to comply with Rule 13.24 and would be suspended and might be delisted upon completion of the transactions.

Notes:

(A) Amendments to Rules 6.01(3) and 13.24

1. *The amended Rule 6.01 states that:*

“Listing is always granted subject to the conditions where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also do so where:-

...;

- (3) the Exchange considers that the issuer does not carry on a business as required under rule 13.24; or*

...”

The amended Rule 13.24 states that:

- “(1) An issuer shall carry out, directly or indirectly, 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.*

Note: Rule 13.24(1) is a qualitative test. The Exchange may consider an issuer to have failed to comply with the rule in situations where, for example, the Exchange considers that the issuer does not have a business that has substance and/or that is viable and sustainable.

The Exchange will make an assessment based on specific facts and circumstances of individual issuers. For example, when assessing whether a money lending business of a particular issuer is a business of substance, the Exchange may consider, among other

factors, the business model, operating scale and history, source of funding, size and diversity of customer base and loan portfolio and internal control systems of the money lending business of that particular issuer, taking into account the norms and standards of the relevant industry.

Where the Exchange raises concerns with an issuer about its compliance with the rule, the onus is on the issuer to provide information to address the Exchange's concerns and demonstrate to the satisfaction of the Exchange its compliance with the rule.

(2) ...”

2. *Rule 13.24(1) makes it clear that an issuer must carry out a business with a sufficient level of operations to warrant its continued listing. The issuer must also have sufficient assets to support its operations.*

In this case, the Exchange's analysis and conclusion would remain unchanged, but an assessment of "sufficiency of assets to justify a listing" would not be required.

(B) Amendments to Rule 14.06E (disposal restrictions)

3. *With effect from 1 October 2019, an issuer must also comply with Rule 14.06E (which incorporates former Rules 14.92 and 14.93 with certain modifications) if it proposes a disposal of all or a material part of its existing business at the time of, or within 36 months from, a change in control.*

Under Rule 14.06E:

- “(1) A listed issuer may not carry out any disposal or distribution in specie (or a series of disposals and/or distributions in specie) of all or a material part of its existing business:*
- (a) where there is a proposed change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or*
 - (b) for a period of 36 months from a change in control (as defined in the Takeovers Code),*
- unless the remaining group, or the assets acquired from the person or group of persons gaining such control or his/their associates and any other assets acquired by the listed issuer after such change in control, can meet the requirements of Rule 8.05 (or Rule 8.05A or 8.05B).*

...”

4. *Rule 14.06E would apply in the circumstances described in this case.*