

HKEX LISTING DECISION

HKEX-LD116-2017 (published in November 2017) (Updated in August 2018, October 2019 (Rule amendments) **and withdrawn in January 2024**)

[Streamlined and incorporated into the guidance letter GL106-19 (Guidance on sufficiency of operations).]

Party	Company A – a Main Board issuer
Issue	Whether Company A had a sufficient level of operations or sufficient assets to meet Main Board Rule 13.24
Listing Rules	Main Board Rules 6.01(3), 6.10 and 13.24
Decision	Company A had failed to maintain a sufficient level of operations or sufficient assets to meet Main Board Rule 13.24, resulting in commencement of delisting procedures under Rule 6.10

FACTS

1. Company A and its subsidiaries (**Group**) were principally engaged in the manufacturing and sale of fashion accessories (**Fashion Accessories Business**) and the development and sale of software related applications (**Software Business**).
2. Over the past few years, the Group had gradually scaled down the Fashion Accessories Business by disposing of its manufacturing arms, outsourcing such function to other subcontractors, and closing its retail shops. Revenues from this business segment decreased from about HK\$200 million to HK\$9 million during the last five financial years. Company A had decided to discontinue this business, and the revenue of HK\$9 million in the latest financial year was mostly generated from the sale of obsolete inventories.
3. The Group started the Software Business through its acquisition of a company (**Acquisition**) engaging in such business at a consideration of HK\$160 million about a year ago. It was noted that:
 - (a) In the latest financial year, the Group recorded revenue of around HK\$6 million from this business and an impairment loss of HK\$9 million on goodwill arising from the Acquisition. As at the year end date, the goodwill amounted to HK\$140 million.
 - (b) The Group's auditor had issued a disclaimer opinion on the Group's financial statements due to, among others, issues concerning the revenue recorded from the Software Business and the carrying value of the goodwill. In particular, the auditor had raised concern about the carrying value and recoverability of the goodwill having considered the

short history of the Software Business, the difficulties faced by the management in executing the business plan and the lack of supporting information relating to the revenue from this business.

- (c) Towards the end of the latest financial year, all the staff for the development team of the Software Business left their employment, resulting in suspension of its operation. The operation resumed only after new staff were recruited three months later.
4. As at the latest year end date, the Group had total assets of HK\$280 million.
- (a) Its major assets included (i) goodwill of HK\$140 million in relation to the Software Business (see paragraph 3 above); and (ii) a deposit of HK\$31 million paid for the acquisition of certain trademarks relating to the Fashion Accessories Business under an agreement signed two years ago. The title of the trademarks had not been transferred to the Group and there was insufficient evidence to satisfy the auditors as to the recoverability of such deposit.
 - (b) Other assets mainly included cash, trade and other receivables and prepayments.
5. The Group had recorded net losses and negative operating cashflows for each of the last five financial years.
6. The Exchange queried whether Company A was maintaining sufficient operations as required under Main Board Rule 13.24(1).
7. Company A submitted that it had plans to improve its business operations.
- (a) The Group had entered into sales contracts of about HK\$16 million for the Software Business and was in discussion with potential customers on new contracts of HK\$6 million. Company A expected a significant increase in revenues from this business to HK\$23 million and HK\$35 million in the current and the next financial year respectively, but did not provide details or basis for its business plans or forecasts.
 - (b) The Group also planned to commence certain regulated activities under the Securities and Futures Ordinance (the **Securities Business**). It expected to obtain the relevant licenses within 3 months and record revenue of about HK\$2.5 million from this business in the next financial year.
 - (c) Based on the above, Company A expected that the Group would record net profits of about HK\$2 million and HK\$16 million in the current and next financial year respectively.

APPLICABLE LISTING RULES AND GUIDANCE MATERIALS

8. Main Board Rule 2.03 states that-

“The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and”

9. Main Board 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.”

10. Main Board 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.)

11. Main Board Rule 6.10 states that-

“There may be cases where a listing is cancelled without a suspension intervening. Where the Exchange considers that any circumstances set out in rule 6.01 arise, it may:

(1) publish an announcement naming the issuer and specifying the period within which the issuer must have remedied those matters which have given rise to such circumstances. Where appropriate

the Exchange will suspend dealings in the issuer's securities. If the issuer fails to remedy those matters within the specified period, the Exchange will cancel the listing. The Exchange may treat any proposals to remedy those matters as if they were an application for listing from a new applicant for all purposes, in which case, the issuer must comply with the requirements for new listing applications as set out in the Listing Rules; or

...”

12. Listing Decisions (LD35-2012 and LD88-2015) describe the purpose behind Main Board Rule 13.24 and provide guidance on the application of the Rule:

“ ... 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.

...

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 assets 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.

...”

ANALYSIS

13. Main Board Rule 13.24 requires issuers to maintain a sufficient level of operations or assets of sufficient value to warrant the continued listing of their securities. Without quantitative criteria for sufficiency, this Rule calls for a qualitative test and is assessed based on the specific facts and circumstances of individual cases.
14. An issuer that fails to meet Rule 13.24 is a “blue sky company” that would attract speculation on its possible acquisitions in the future and lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market which are not in the interest of the investing public.

As set out in paragraph 11 above, to balance public shareholders' ability to access the market to trade in the security with the need to maintain market quality, the Exchange would suspend trading only in an extreme case. When making the assessment, the Exchange takes into account the current regulatory concerns and the acceptable standards in the market.

15. In recent period, the Exchange has tightened its approach in applying Rule 13.24 by treating cases with the following characteristics as extreme cases:
- (a) a very low level of operating activities and revenue; for example the issuer's business does not generate sufficient revenue to cover its corporate expenses, resulting in net losses and negative operating cashflows;
 - (b) the current operation does not represent a temporary downturn, the issuer had been operating at a very small scale and incurring losses for years; and
 - (c) the assets do not generate sufficient revenue and profits to support a continued listing.

In these cases, the issuers are not operating substantive businesses, and the value of the businesses (excluding the listing status) is minimal, if any. There is a question whether the Rule requirement to carry on a sufficient level of operations or have assets of sufficient value is met. The Exchange considers it necessary to apply Rule 13.24 in these cases with a view to maintaining investors' confidence and overall market quality.

16. Once suspended, the issuer would be given a remedial period to submit a resumption proposal to demonstrate that it has a viable and sustainable business to re-comply with Rule 13.24. If the issuer fails to do so, it would be delisted according to the delisting procedures under Rules 6.01(3) and 6.10.
17. In this case, the Exchange considered that Company A had failed to comply with Rule 13.24 and this was an extreme case:
- (a) The Group had a very low level of operations. Its original business (the Fashion Accessories Business) had diminished substantially, causing the Group to record losses and negative operating cashflows in each of the last five years. This business generated revenue of HK\$9 million only in the latest financial year, which was mostly generated from a one-off sale of obsolete inventories. Company A had decided to discontinue this business.

- (b) The Group sought to rely on new businesses (the Software Business and the Securities Business) to support its listing. However,
- The Software Business had a short operating history. It generated minimal revenue of HK\$6 million in the latest financial year, which was insufficient to cover the corporate expenses of the Group.
 - Company A expected to record total revenue of HK\$58 million from the Software Business in the current and next financial years, of which the Group had entered into sale contracts of HK\$16 million only. Company A had not provided any details of its business plans to support a substantial increase in the scale of operations of the Software Business as projected.
 - The Securities Business was still in at the planning stage and had not commenced operations. Based on Company A's projection, even if the business would proceed to operate as planned, it would generate revenue of HK\$2.5 million only in the next financial year.
- (c) In light of the above, Company A had failed to demonstrate that it had a viable and sustainable business to support its listing status.
- (d) Company A had also failed to demonstrate that it had assets of sufficient value to support its listing status. The Group's auditors had raised concerns about the recoverability of the goodwill relating to the Software Business and the deposit paid for acquisition of trademarks, which accounted for a majority of the Group's assets. Also, the operations of the Group's assets had not generated sufficient revenue and profits to ensure Company A to operate a viable and sustainable business.

CONCLUSION

18. The Exchange decided that Company A had failed to maintain a sufficient level of operations or assets of sufficient value to meet Rule 13.24. This resulted in commencement of delisting procedures under Rules 6.01(3) and 6.10.

Notes:

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.*

The Rule amendments would not change the analysis and conclusion in this case.