



Preparation for IPO in Hong Kong - Corporate Reorganisation

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Listing in Hong Kong

Hong Kong is a strong equity fund raising platform as well as a strong secondary capital market. The Hong Kong Stock Exchange (“HKEx”) is one of the world’s top fund-raising markets. According to market statistics published by HKEx, for the period from 1 January 2018 to 14 December 2018, Hong Kong IPOs raised HK\$277,850 million in total.

Advantages of listing in Hong Kong include the following:

1. Raising the company's reputation and brand awareness in China and other Asian markets;
2. Strong and sound legal and regulatory framework: Hong Kong legal system is based on English common law, providing a solid foundation for companies to raise funds, as well as confidence in investors; and
3. World's freest economy: Hong Kong ranked top in the 2015 Index of Economic Freedom, having a free market policy with no capital flow restrictions and also freedom of information.



Accepted Jurisdictions

The listing rules of Main Board and GEM allow the listing of companies incorporated in Hong Kong, China, Bermuda and the Cayman Islands.

The Exchange has also accepted 24 jurisdictions as acceptable jurisdictions of incorporation – Australia, Brazil, the British Virgin Islands, Canada (Alberta, British Columbia and Ontario), Cyprus, France, Germany, Guernsey, the Isle of Man, Italy, Japan, Jersey, Luxembourg, Republic of Korea, Labuan, Singapore, the United Kingdom and the United States (State of California and State of Delaware).

Usually, a listing vehicle will come from one of the abovementioned jurisdictions.

Listing Requirements – The Main Board

The list below highlights the major listing requirements for the Main Board.

(1) Financial Requirements

A trading record of not less than three financial years fulfilling one of the three financial criteria, namely:

- the profit test – aggregate profit of at least HK\$50m in the past 3 years;
- the market cap / revenue test – market cap of HK\$4bn and revenue of at least HK\$500m in the past year; and
- the market cap / revenue / cashflow test – market cap of HK\$2bn, revenue of at least HK\$500m in the past year and positive operating cash flow of at least HK\$100m for the past 3 years

(2) Accounting Standards

- A new applicant's accounts must be prepared in accordance with Hong Kong Financial Reporting Standards, International Financial Reporting Standards or China Accounting Standards for Business Enterprises (PRC issuer only)
- Banking companies must also comply with the Guideline on the Application of the Banking (Disclosure) Rules issued by the Hong Kong Monetary Authority

(3) Suitability for Listing

- Both the issuer and its business must, in the opinion of the Exchange, be suitable for listing

(4) Operating History and Management

- Trading record period of at least three financial years with:
- management continuity for at least the three preceding financial years; and
- ownership continuity and control for at least the most recent audited financial year

(5) Minimum Market Capitalisation



- HK\$500 million
- (6) Public Float
 - HK\$125 million (25%)
- (7) Spread of Shareholders
 - There must be held among at least 300 holders
- (8) Post-IPO Lock-up period on controlling shareholders
 - Controlling shareholders cannot sell shares for the first year upon listing
 - For the next year, controlling shareholders may sell shares but should retain control
- (9) Offering Mechanism
 - A new applicant may not list by way of placing if there is likely to be significant public demand for its securities.
 - The Main Board Listing Rules set out certain procedures to be adopted in the allocation of shares in initial public offering – see Practice Note 18 of the Main Board Listing Rules
- (10) New Issue Price
 - New shares cannot be issued at a price below their nominal value

Companies from emerging and innovative sectors

To enable listing of companies from emerging and innovative sectors in Hong Kong, HKEx amended the Main Board Listing Rules in April 2018 in order to:

- permit the listing of biotech companies that do not meet the financial eligibility requirements (see the new Chapter 8A of the Listing Rules);
- permit the listing of companies with weighted voting right (WVR) structures (see the new Chapter 18A of the Listing Rules); and
- establish a new regime for the secondary listing of Greater China and international companies in Hong Kong (see the new Chapter 19C of the Listing Rules).

Listing Requirements – GEM

GEM (formerly called Growth Enterprise Market) has since the reform in February 2018 been a standalone board of HKEx for small and mid-sized companies. The list below highlights the major listing requirements for GEM.

- (1) Financial Requirements
 - A trading record of not less than two financial years comprising a positive cashflow generated from operating activities in the ordinary and usual course of business of at



least HK\$30m in aggregate for the two financial years immediately preceding the issue of the listing document

(2) Accounting Standards

- A new applicant's accounts must be prepared in accordance with Hong Kong Financial Reporting Standards, International Financial Reporting Standards or China Accounting Standards for Business Enterprises (PRC issuer only)
- Banking companies must also comply with the Guideline on the Application of the Banking (Disclosure) Rules issued by the Hong Kong Monetary Authority

(3) Suitability for Listing

- Both the issuer and its business must, in the opinion of the Exchange, be suitable for listing

(4) Operating History and Management

Trading record of at least two full financial years with:

- substantially the same management throughout the two financial years; and
- a continuity of ownership and control throughout the full financial year immediately preceding the issue of the listing document

(5) Minimum Market Capitalisation

- HK\$150 million

(6) Public Float

- HK\$45 million (25%)

(7) Spread of Shareholders

- Must be held among at least 100 persons

(8) Post-IPO Lock-up period on controlling shareholders

- Controlling shareholders cannot sell shares for the first year upon listing
- For the next year, controlling shareholders may sell shares but should retain control

(9) Offering Mechanism

- Mandatory public offering of at least 10% of the total offer size and the allocation of offer shares between the public and placing trances and the claw back mechanism to be consistent with those in Practice Note 18 to the Main Board Rules

(10) New Issue Price

- New shares cannot be issued at a price below their nominal value

Pre-IPO reorganization

An intended listing applicant will have to meet the relevant listing requirements, and the exercise often involves a certain degree of reorganization.

A. Pre-IPO spin-off

A re-organisation may be required in a situation where the shareholders of the



group conducting an IPO wish to attract public interest to a part of the business only and not the entire group. In this case, a pre-IPO spin-off may be required such that the entities and assets within the group which will be going public are legally separated from the rest of the group. Such a spin-off will involve not only a series of transfers of assets and shares within the group, but could also involve contractual arrangements being entered into between the parts of the group which will remain private and the parts which will be listed. This is the case where the businesses may be intertwined in the way they operate and dependent on each other. Should such a spin-off be required, several months should be allowed to successfully complete this process.

There will often be a period of uncertainty and unrest following such a major re-organisation, in which case the Company should not rush to go ahead with the IPO plan.

B. Jurisdiction

Commonly, minor re-organisations take place simply because the parent company is not domiciled in a jurisdiction which is conducive to listing on the HKex or the sponsors may perceive that the jurisdiction of domicile is not going to be very attractive for investors.

Where the jurisdiction of domicile of the parent company is determined to be not suitable for a listed vehicle, there are three principal options available:

1. The most common method of pre-IPO re-organisation is that a holding company may be established above the existing parent company in a more suitable jurisdiction. This involves the shares in the existing parent company becoming 100% owned by the new holding company and the shares in the new holding company being owned in the same proportion by the existing shareholders. Such a change in the shareholding structure is often achieved by way of a share-for-share exchange so that the existing shareholders give their existing shares as consideration for the shares they receive in the new holding company. This is in effect a "share swap". This avoids the need for additional subscription monies to be paid by those shareholders.



2. The existing parent company is wound up and the assets are transferred to a new holding company which is established in a more suitable jurisdiction. The existing shareholders take the shares in the new holding company in the same proportion as in the existing company. They may pay for these by way of funds paid to them during the winding-up process or a share-for-share exchange type transaction could take place in advance of the asset transfers, with the assets being moved after the event and the old parent company being wound-up once it no longer holds any assets.

This method is much more complex and is rarely adopted. It raises issues in respect of fund flow given shares and assets of value will be changing hands. In addition, it involves the assignment or novation of all key contracts the existing parent company has in place. Where counterparties must approve such amendments, there is a danger that one or more key contracts will be lost.

3. Redomiciliation: This involves the existing parent company moving its place of incorporation from one jurisdiction to another. The parent company stays in existence continuously and all contracts and assets it has in place remain with the entity as such a process does not trigger counterparty approval requirement. For a redomiciliation to be possible:

- (a) the law of the jurisdiction where the parent company is currently established must permit companies to redomicile and provide a process to do so; and
- (b) the law of the jurisdiction where the parent company will move must permit companies to move into that jurisdiction from elsewhere and provide a process to do so.

C. Adequate systems and controls

A company preparing for an IPO must ensure it has adequate systems and controls in place to meet the corporate governance requirements of the HKEx.

The HKEx has minimum standards with respect to the following:

- 1. Board compensation and appointment. For example, a minimum number of independent directors may be required and nomination and remuneration committees may need to be appointed.
- 2. Insider trading policies are put in place and communicated to all staff. There



will also be policies developed to address how related party transactions are reported and approved.

3. Corporate governance regulations prescribe certain important matters which shareholders must vote upon.
4. The regulator will often prescribe that listed companies must report semi-annually or (in some cases) quarterly. The financial statements must be fully audited annually, give a full and clear picture of the financial position of the company and, in many cases, be reported in compliance with certain standards such as IFRS.
5. An internal audit department is often appointed within the company to oversee and regularly monitor governance policies and procedures and to ensure staff at all levels of the company group are adequately trained and updated about the above.

TAC's corporate team serves client in initial offerings, pre-listing re-organisations and secondary fund-raising exercises.

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