HKEX LISTING DECISION
HKEX-LD88-2015 (published in May 2015) (Updated in August 2018)

Parties	Company A – a Main Board issuer
Issue	Whether Company A would have sufficient operations or assets under Rule 13.24 after a very substantial disposal
Listing Rules	Main Board Rule 13.24
Decision	Company A would not meet Rule 13.24 upon completion of the disposal

FACTS

1. Company A and its subsidiaries (the **Group**) were principally engaged in the manufacturing and sale of certain machinery and equipment (the **Original Business**) since its listing on the Exchange. The Group also carried out the production and sale of certain pharmaceutical products (the **Remaining Business**) through a subsidiary which Company A acquired a few months before the proposed transaction described in paragraph 2 below.

2. Company A proposed to sell the Original Business to a third party purchaser for cash (the **Disposal**), leaving the Remaining Business as its principal business. The Disposal constituted a very substantial disposal and was subject to shareholders' approval.

3. The Disposal would reduce Company A's revenue and net profits by over 80% and 95% respectively. Company A would record a significant loss of about HK$100 million from the Disposal, reducing its net assets by about 50%.

4. The issue was whether Company A would have sufficient operations or assets under Rule 13.24 after the Disposal.

5. Company A was of the view that it could meet Rule 13.24 after the Disposal based on the Remaining Business and the assets retained by the Group. It submitted, among other things, that:

   - The Remaining Business had been operating for more than 10 years before it was acquired by Company A. It had its own production facilities and employed over 100 staff.

   - It owned a number of trademarks and licenses for its products, and had recently obtained the good manufacturing practice (GMP) accreditation. It was also developing new products and taking steps to expand its sale network.

- For the latest financial year, the Remaining Business recorded revenue of over HK$50 million and net profits of about HK$0.4 million. Its net assets amounted to about HK$50 million.

- The Group would have pro forma tangible assets of about HK$400 million upon completion of the Disposal, of which about 40% were related to the Remaining Business. The other assets were mainly cash balances, including the proceeds from the Disposal.

6. Company A also argued that the remaining Group would be able to meet Rule 13.24, compared to a number of issuers with lesser revenue, profit and/or assets whose shares were allowed to continue to trade on the Exchange.

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*)…"* (Updated in August 2018)

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"

10. Listing Decision (LD35-2012) describes the purpose behind Rule 13.24 and provides guidance on the application of Rule 13.24:

- 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.

- Where an issuer's shares are trading on the Exchange, the Exchange generally allows those shares to continue to trade as long as the issuer has an operation and meets the continuing disclosure obligations. This is to allow shareholders to have access to the market for share trading as far as possible. The Exchange would exercise its suspension power only in an extreme case.

- However, if an issuer takes a corporate action, the Exchange is more likely to suspend the issuer's trading where the issuer fails to satisfy the Exchange that it would have a viable and sustainable business to justify its continued listing after completion of the corporate action. In this case, shareholders would have the opportunity to decide whether to allow the corporate action to proceed, knowing that the Exchange would exercise the suspension power should the corporate action proceed. In that way shareholders' interests are safeguarded through the shareholders' approval process.

ANALYSIS

11. 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 is a qualitative test and is assessed case by case.

12. Here, Company A proposed a corporate action that would substantially reduce its scale of operations, net profits and net assets.

13. The Exchange considered that Company A would not have sufficient operations or assets to meet Rule 13.24 upon completion of the Disposal because:

(a) *Scale of operation of the Remaining Business*

- The Remaining Business would be the principal business of the Group upon completion of the Disposal.

- The Exchange noted Company A's submission about the history and scale of operations of the Remaining Business, including its production facilities, the number of employees and the product licenses and trademarks. Despite all these, the revenue and profits of the Remaining Business were minimal. It only recorded revenue of HK$50 million with a net profit of less than a million in the latest financial year. This result had not yet taken into account Company A's corporate expenses.

- Company A said it was developing new products and sales network for the Remaining Business. However, it had not provided any credible financial forecasts or budgets to substantiate its future plan. It had not demonstrated a proven ability to expand the Remaining Business.

- Given the above, the Exchange considered that the scale of the Remaining Business was insufficient to justify a listing.

(b) *Assets of the Remaining Business*

- The Remaining Business had a net asset value of about HK$50 million only. While Company A also mentioned its ownership of a number of trademarks and licenses and the GMP accreditation relating to the Remaining Business, it had not provided sufficient information to demonstrate their value.

- The Exchange also noted that the Remaining Business was acquired from a third party a few months before the proposed disposal at less than the fair value of its net assets. The arm's length market price transaction might indicate that the business did not command much or any intrinsic value.

- In any event, the Exchange considered that the assets (tangible and intangible) of the Remaining Business were insufficient to meet Rule 13.24 because, as mentioned in (a) above, the operations of these assets could not generate sufficient revenue and profits to justify a listing.

(c) *Other assets retained by the Group*

- Other assets retained by the Group would mainly be cash, including the proceeds from the Disposal.

- Company A said that the proceeds would be used to reduce the Group's liabilities, and it was seeking new business opportunities to diversify its business scope and might use the cash to acquire other businesses. However, there were no concrete details to demonstrate that the cash retained by the Group would enable it to substantially improve its operations and financial performance after the Disposal.

14. Company A also sought to prove its compliance with Rule 13.24 by comparing its revenue, profits and assets with those of other issuers. The Exchange disagreed with Company A because Rule 13.24 is a qualitative test and it is not meaningful to simply compare the revenue, profits and/or assets of different issuers. Each case must be considered on its own merits and with reference to the particular circumstances of the issuer concerned.

CONCLUSION

15. The Exchange considered that Company A would not comply with Rule 13.24 should it proceed with the Disposal.