

## HKEX GUIDANCE LETTER

HKEX-GL43-12 (October 2012) (Updated in July 2013 and March 2017)

<b>Subject</b>	<b>Guidance on Pre-IPO investments</b>
<b>Listing Rules</b>	<b>Main Board Rules 2.03(2) and (4)</b> <b>GEM Rules 2.06(2) and (4)</b>
<b>Related Publications</b>	<b>HKEX News Release (updated: 13/10/2010), Guidance Letters HKEX-GL29-12 (“Interim Guidance”) and HKEX-GL44-12 (Updated in March 2017)</b> <b>Listing Decisions superseded:</b> 1. HKEX-LD36-1 and 36-2 2. HKEX-LD55-1, 55-2 and 55-3 3. HKEX-LD59-1, 59-2, 59-3, 59-4, 59-5, 59-6 and 59-7
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**Important note:** This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Department on a confidential basis for an interpretation of the Listing Rules or this letter.

### 1. Purpose

- 1.1 This guidance is a consolidation of listing decisions on pre-IPO investments which the Exchange issued in the past, and only principles applicable after the introduction of the Interim Guidance on 13 October 2010 are included in this Guidance Letter. Past listing decisions have been superseded.
- 1.2 Listing decisions HKEX-LD12-2011 on whether the Interim Guidance applied to an applicant seeking a secondary listing on the Main Board of the Exchange in June 2011 and HKEX-LD15-2011 on whether the Interim Guidance was applicable to an issue of shares upon exercise of warrants in July 2011 remain effective.
- 1.3 This letter and the Interim Guidance apply to investments in shares of an unlisted company (“**pre-IPO investment**”)<sup>1</sup>. To clarify, an investment in shares refers to the acquisition of shares from an applicant or its shareholder by a new or existing shareholder prior to the applicant’s IPO, except as provided in paragraphs 6.2 and 6.3 herein. A potential applicant is encouraged to consult the Exchange in advance if it believes that special

<sup>1</sup> Guidance on pre-IPO investments of convertible or exchangeable securities in an unlisted company are covered in Guidance Letter HKEX-GL44-12.

rights granted to a shareholder should not be subject to this Guidance Letter.  
*(Updated in March 2017)*

## **2. Applicable rules, regulations and principles**

- 2.1 Main Board Listing Rules 2.03(2) and (4) (GEM Rules 2.06(2) and (4)) (the “**Rules**”) require the issue and marketing of securities to be conducted in a fair and orderly manner and that all holders of listed securities be treated fairly and equally.
- 2.2 Pre-IPO investors will often make their investments on more favourable terms than IPO investors (e.g. by being given special rights that do not extend to other shareholders and/or by investing at a lower price than the IPO price). This reflects the significantly different risks assumed by a pre-IPO investor.  
*(Updated in March 2017)*
- 2.3 However, where a pre-IPO investment is made close in time to an IPO, there is a concern that the pre-IPO investor is investing on more favourable terms than IPO investors but is not exposed to risks significantly different from those assumed by IPO investors, which would contravene the Rules. *(Updated in March 2017)*
- 2.4 Under the Interim Guidance, the Exchange will generally delay, except in very exceptional circumstances, the first day of trading of the applicant’s securities until 120 clear days after the later of the completion or divestment of the last pre-IPO investments (“**120 Day Delay**”) if (a) the applicant has a pre-IPO investment completed within 28 clear days before the date of the first submission of the first listing application form (the “**First Filing**”) and the relevant pre-IPO investor remains as a shareholder at the First Filing or (b) the pre-IPO investment is completed on or after the First Filing and before the date of the listing. *(Updated in March 2017)*
- 2.5 Pre-IPO investments are considered completed when the funds for the underlying shares are irrevocably settled and received by the applicant (in the case of an issue of shares by the applicant), or existing shareholders (in the case of a transfer or sale of shares by existing shareholders). *(Updated in March 2017)*

## **3. Special rights attached to pre-IPO investments** *(Updated in March 2017)*

- 3.1 Pre-IPO investors may be offered special rights by the applicant or its shareholders. The range of these special rights varies and generally, special rights which do not extend to all other shareholders are not permitted to survive after listing to comply with the general principle of even treatment of shareholders under the Rules. To clarify, such rights may exist and be exercised up to listing.
- 3.2 Except as otherwise provided in the Interim Guidance, this Guidance Letter and Guidance Letter HKEX-GL44-12 (collectively, the “**Pre-IPO Investment Guidance**”), rights granted by one shareholder to another or agreements among shareholders (including controlling shareholders) are private arrangements and generally not subject to the Pre-IPO Investment Guidance.

- 3.3 For the purposes of this paragraph 3, ‘applicant’ shall refer to the applicant, its subsidiaries or anyone acting on its behalf.<sup>2</sup>
- 3.4 Below are examples of common special rights and our guidance on whether they are permitted to survive. Our treatment of any specific special right will depend on the facts and circumstance of each listing application:
- 3.5 *Price adjustments*

May survive listing:

- Terms that provide a fixed rate of return to the pre-IPO investor (which effectively reduce the price per share) and settled by a shareholder provided that they are *not* based on (1) a discount to the IPO price; or (2) a discount to market capitalization of the shares at IPO.

Must terminate upon listing:

- Terms which adjust the purchase price based on a discount to the IPO price or discount to the market capitalization of the shares may not survive listing whether they are settled by the applicant or a shareholder because they are contrary to the principles of the Rules.

### 3.6 *Divestments*

#### (a) *Divestments prior to First Filing*

- Pre-IPO investors who divest prior to the First Filing do not disrupt the listing process nor affect the equal treatment of shareholders post listing. Therefore, there will be no penalty to the applicant for pre-IPO investors who divest prior to the First Filing regardless of when the pre-IPO investment was made or whether divestment is pursuant to a contractual right.
- the divestment must be a bona fide transaction.

#### (b) *Divestments on or after First Filing*

- Divestments on or after the First Filing is highly disruptive to the listing process and will be subject to a 120 Day Delay regardless of when the pre-IPO investment was made or whether divestment is pursuant to a contractual right.
- the divestment must be a bona fide transaction.

#### (c) *Divestment Rights*

- Any divestment right (e.g. put options, redemption or repurchase rights) granted by the applicant or the controlling shareholder to the pre-IPO investor or right (e.g. call options) permitting the applicant or the

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<sup>2</sup> To clarify, the controlling shareholder is not presumed to be acting on behalf of the applicant.

controlling shareholder to repurchase shares of the pre-IPO investor (together, the “**Divestment Rights**”) must be terminated before the First Filing. Except as provided in the following paragraph, if an applicant fails to comply with the above requirement in respect of the termination of its Divestment Rights, the applicant shall be subject to the 120 Day Delay from the date of exercise or termination of any Divestment Right existing on the date of First Filing<sup>3</sup>.

- A Divestment Right may exist on or after the First Filing if it is only exercisable if the listing does not take place<sup>4</sup> and will terminate upon listing.

### 3.7 *Director nomination/appointment rights*

May survive listing:

- Any agreement among the shareholders to nominate and/or vote for certain candidates as directors are generally not subject to this Guidance on Pre-IPO investments.
- Any rights available to all shareholders subject to certain qualifications stipulated in the applicant’s constitutive documents (e.g. holding a certain minimum interest) may survive after listing as such right is available to all shareholders that fulfil such criteria.

Must terminate upon listing:

- Any right granted by the applicant to nominate or appoint a director must terminate upon listing as such a right is not generally available to other shareholders. Any director nominated or appointed by a pre-IPO investor need not resign at listing unless required under the applicant’s articles of association.

### 3.8 *Other nomination rights*

May survive listing:

- Rights to nominate senior management and committee representatives (other than directors and board committee members) granted to pre-IPO investors by the applicant or the controlling shareholder are permitted to survive listing provided that all such appointments are subject to the decision of the board.
- In such circumstances, the board of directors must not be contractually obligated to approve pre-IPO investor’s nominations without further review as the directors are subject to fiduciary duties to act in the best interest of the applicant and its shareholders as a whole.

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<sup>3</sup> Unwinding a pre-IPO investment is no longer a remedy.

<sup>4</sup> Non-exhaustive examples of when listing does not take place include any event which occurs which would render the applicant unable to comply with the listing requirements or a listing application that has been withdrawn/rejected/returned/lapsed.

### 3.9 *Veto rights*

Must terminate upon listing:

- Any contractual right to veto the applicant's major corporate actions (e.g. a petition or resolution for winding-up, change in the business by the applicant group, or the amalgamation or merger by any member of the applicant group with any other company or legal entity, etc.).

### 3.10 *Anti-dilution rights*

- Under Main Board Rule 10.04 and Paragraph 5 of Appendix 6 to the Main Board Rules, no securities can be offered to existing shareholders of the issuer on a preferential basis and no preferential treatment can be given to them in the allocation of the securities.
- However, some pre-IPO investors are granted preferential rights to purchase additional shares to be issued by the applicant so as to maintain their percentages of shareholding in the applicant.

May exercise before and in connection with an IPO:

- Exercise of anti-dilution rights by the pre-IPO investors in connection with the IPO is permissible if:
  - (i) the allocation is necessary in order to give effect to the pre-existing contractual rights of the pre-IPO investors;
  - (ii) full disclosure of the pre-existing contractual entitlement of the pre-IPO investors contained in the relevant investor rights agreement and the number of shares to be subscribed by the pre-IPO investors will be made in the listing document and the allotment results announcement; and
  - (iii) the additional shares will be subscribed for at the offer price of the IPO offering.

Must terminate upon listing:

- Anti-dilution rights may not survive after listing to be in line with Main Board Rule 13.36 (GEM Rule 17.39) on pre-emptive rights.

### 3.11 *Financial compensation*

May survive listing:

- Any financial compensation<sup>5</sup> settled by a shareholder and is not linked to the market price or capitalisation of the shares;

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<sup>5</sup> Includes profit guarantees or compensation for failure to achieve a qualified IPO (i.e., an IPO which satisfies certain conditions agreed with a pre-IPO investor)

Must terminate upon listing:

- Any financial compensation that is settled by the applicant; or
- Any financial compensation linked to the market price or market capitalisation of the shares.

### 3.12 *Prior consent for certain corporate actions/ changes in articles*

Must terminate upon listing:

- Any right that requires the prior consent of the pre-IPO investor for certain corporate actions. Examples of these actions include:
  - (i) a declaration of dividend by any member of the applicant group;
  - (ii) the sale, lease or transfer of a substantial part of the applicant's business or assets;
  - (iii) any amendments to the applicant's constitutional documents; and
  - (iv) any change in executive directors.

### 3.13 *Exclusivity rights and no more favourable terms*

Must terminate upon listing unless the agreement is modified to include an explicit "fiduciary out" clause:

- Any restriction on the applicant to issue or offer any shares, options, warrants and rights to any direct competitor of the pre-IPO investor or to other investors on terms more favourable than the terms on which the shares are issued to the pre-IPO investor. These rights could potentially prevent the board of the applicant from considering bona fide alternative proposals that would be in the best interest of the applicant and its shareholders as a whole and thus must not survive listing except as provided below.
- The rights discussed above can survive after listing if the terms of the investment are modified to include an explicit "fiduciary out" clause so that directors are allowed to ignore the terms if complying with them would constitute a breach of their fiduciary duties. In such case, the directors would not be prevented from exercising their judgment in whether to undertake certain corporate actions in the best interest of the applicant and its shareholders as a whole.

### 3.14 *Information rights*

May survive listing if the information is made available to the general public at the same time:

- Information rights can only survive after listing if the pre-IPO investor is only entitled to receive published information or information which is at

the same time made available to the general public, with a view to avoiding unequal dissemination of information. If the issuer provides price sensitive information to the pre-IPO investor, the issuer needs to comply with the Inside Information Provisions (as defined in the Listing Rules).

### 3.15 *Right of first refusal and tag-along rights*

May survive listing:

- Any right of first refusal granted by the controlling shareholder such that the controlling shareholder must first offer to sell shares to the pre-IPO investor at the same price and on the same terms and conditions as proposed sales of shares to another investor.
- Any right granted by the controlling shareholder to include the shares of a pre-IPO investor for sale together (i.e. tag-along) with the shares of the controlling shareholder if the controlling shareholder sells any of its shares to another investor.
- These rights are agreements between shareholders and can survive after listing.

## 4. Lock-up and Public Float

- 4.1 Pre-IPO investors are usually requested by the applicant to lock-up their pre-IPO shares for a period of six months or more. These shares are counted as part of the public float so long as Main Board Rule 8.24 (note 3 to GEM Rule 11.23) (shares are not financed directly or indirectly by a connected person of the applicant) is fulfilled.

## 5. Disclosure requirements (*Updated in July 2013*)

- 5.1 The listing document must include the following information:

- (a) in table format, details of the pre-IPO investments, including the name of each pre-IPO investor, date of investment, amount of consideration paid, payment date of the consideration, cost per share paid by each pre-IPO investor and the respective discount to the IPO price, use of proceeds from the pre-IPO investments and whether they have been fully utilized, strategic benefits they will bring to the applicant, and shareholding in the applicant held by each pre-IPO investor upon listing;
- (b) the beneficial owner and background of each of the pre-IPO investors and their relationship with the applicant group and/ or any connected persons of the applicant;
- (c) basis of determining the consideration paid by each pre-IPO investor;
- (d) details of any material special rights granted to the pre-IPO investors that will survive after the applicant's listing and how they comply with Main Board Rule 2.03(4) (GEM Rule 2.06(4)) and the principles set out in

paragraph 3 of this Guidance Letter or a statement that no special rights shall survive listing; (*Updated in March 2017*)

- (e) whether the shares held by each pre-IPO investor will be subject to any lock-up after listing (as part of the terms of the pre-IPO investment) and, with basis, whether the shares held by the pre-IPO investors are considered as part of the public float for the purposes of Main Board Rule 8.08 (GEM Rule 11.23);
- (f) if the pre-IPO investment is in the form of share-based payments:
  - (i) the accounting treatment of the pre-IPO investments;
  - (ii) the basis of the reporting accountants' view on the accounting treatment;
  - (iii) a risk factor, if applicable, on the future impact on the applicant's profit and loss; and
- (g) the sponsor's confirmation, with basis, that the pre-IPO investments are in compliance with the Interim Guidance, this Guidance Letter and Guidance Letter HKEX-GL44-12.

**6. Application of the Pre-IPO Investment Guidance (*Updated in July 2013 and March 2017*)**

- 6.1 An applicant with a pre-IPO investment made within (1) 28 clear days of the First Filing or (2) after the First Filing and before its listing may not list until 120 days from the later of completion of such pre-IPO investment or subsequent divestment.
- 6.2 The Pre-IPO Investment Guidance do not apply to shares of the applicant acquired in an exchange of shares of a predecessor in interest company<sup>6</sup> or an operating subsidiary of the applicant or otherwise as part of a corporate restructuring of the applicant in connection with the listing.
- 6.3 Shares awarded to directors or employees of the applicant as part of a defined share award scheme are not subject to the Pre-IPO Investment Guidance.
- 6.4 All special rights, which do not comply with this Guidance Letter and/or Guidance Letter HKEX-GL44-12 must be amended or terminated prior to listing.

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<sup>6</sup> Refers to a company operating the applicant's business prior to the formation of the applicant.