

HKEX LISTING DECISION

HKEX-LD105-2017 (published in April 2017) (updated in October 2019 (Rule amendments))

Party	Company A – a GEM issuer
Issue	Whether Company A has a sufficient level of operations or assets to meet GEM Rule 17.26
Listing Rules	GEM Rules 9.04 and 17.26
Decision	Company A had failed to maintain a sufficient level of operations or assets of sufficient value to meet Rule 17.26, resulting in a share trading suspension and commencement of the Exchange's delisting procedures

FACTS

1. Until recent months, Company A and its subsidiaries (**Group**) were principally engaged in trading of metals and trading of beverage products. It also held exploration rights of iron mines. The Group had been loss making for many years.
2. About six months ago, the Group:
 - a. failed to renew the exploration rights of iron mines and fully impaired its mining assets of about \$150 million;
 - b. discontinued its metal trading business after surrendering its related warehouse property. This business was the Group's main business and generated 90% of the Group's revenue (about \$12 million) in the last financial year; and
 - c. started a number of new businesses including trading of cosmetics and skincare products, stainless steel wire, nephrite, listed securities and chartering of vessel (**New Businesses**). The New Businesses had no correlation with each other. They were mostly trading businesses relying on one to two customers and each operated by a small number of employees.
3. The remaining beverage trading business and the New Businesses together generated revenue of \$30 million in the last six months. The Group recorded a gross profit of only \$6 million, which was insufficient to cover its expenses, resulting in a net loss of \$60 million. The Group had total assets of about \$130 million, but its net liabilities amounted to \$400 million.

4. Given this, the Exchange questioned whether Company A was maintaining sufficient operations or assets as required under GEM Rule 17.26. Trading in Company A's shares on the Exchange was continuing.
5. Company A took the view that it was able to meet GEM Rule 17.26 because the New Businesses would enable the expansion of its business portfolio, diversify its income sources and enhance its financial performance. It submitted that:
 - a. the Group's revenue had increased to \$50 million for the first nine months of the current financial year. The performance of the New Businesses was in line with the management's projection; and
 - b. based on its financial forecast, the Group would continue to maintain growth in revenue from the New Businesses and exercise effective control over its corporate expenses. It expected to record revenue of about \$100 million and a substantial loss in the coming 12 months.

APPLICABLE LISTING RULES, LISTING DECISIONS AND GUIDANCE

6. GEM Rule 17.26 imposes a continuing obligation on issuers:

"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."

7. GEM Rule 9.04 states that:

"...the Exchange may direct a trading halt or suspend dealings in an issuer's securities regardless of whether or not the issuer has requested the same and may do so in any circumstances, including:-

...

(3) Where 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 17.26); or

(4) where the Exchange considers that the issuer or its business is no longer suitable for listing..."

(GEM Rules 9.04(3) and 17.26 were amended on 1 October 2019. See Note

1 below.)

8. Listing Decisions (LD35-2012 and LD88-2015) describe the purpose behind Main Board Rule 13.24 (equivalent to GEM Rule 17.26) 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 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.

...”

ANALYSIS

9. GEM Rule 17.26 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.
10. Under GEM Rule 9.04, the Exchange may suspend trading in shares of an issuer which fails to meet GEM Rule 17.26. As set out in paragraph 8 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 case¹. This would likely involve

¹ Separately, where an issuer undertakes a corporate action that would substantially reduce its operations, the Exchange will evaluate whether the remaining business would meet GEM Rule 17.26/MB Rule 13.24. See Listing Decisions (LD35-2012 and LD88-2015), “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

circumstances where the actions of the issuer call into question issues about market quality or the creation of blue sky companies.

11. Once suspended, an issuer would be subject to the delisting procedures under the GEM Rules. To avoid delisting and resume trading, it must, before the expiry of the delisting procedures, prepare a resumption proposal to demonstrate that it has a viable and sustainable business to re-comply with GEM Rule 17.26.
12. The Exchange considered the circumstances of Company A to be an extreme case which warranted a trading suspension of Company A's shares under GEM Rule 9.04. In particular, the Exchange noted that Company A had substantially ceased its principal business activities, and immediately sought to commence a number of new businesses that have no relation with Company A's original principal activities. The new businesses are asset-light businesses with a low entry barrier. These events brought into question whether the resulting businesses warranted the continued listing of Company A's securities.
13. The Exchange considered Company A failed to meet GEM Rule 17.26:

Scale of operations

- a. The Group had substantially ceased all its principal businesses after discontinuing the metal trading business. The remaining beverage trading business generated revenue of \$0.65 million only in the last six months, with a segment loss of \$19 million.
- b. The Group sought to rely on a number of New Businesses. However,
 - The New Businesses had no correlation with each other and involved a low level of activities. They were mostly trading businesses relying on a few customers and suppliers and operated by a few employees. In the last six months, the Group generated minimal revenue which was insufficient to cover its expenses. Despite projection of an increase in revenue, the Group would still record a loss during the forecast period.
 - Company A had not provided any concrete business plan for the New Businesses or otherwise demonstrated the prospects of substantially improving the scale of its business operations. There

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..."

was also a concern about the lack of management experience in the New Businesses.

- The Group had failed to demonstrate the viability and sustainability of these businesses.

The Group's assets

- c. The Group did not have any significant non-cash assets after impairing its mining assets. Its remaining assets were insufficient to cover its liabilities. It had a significant net liabilities position. As noted above, the Group's assets could not generate sufficient revenue and profits to justify a listing.

CONCLUSION

14. The Exchange decided that Company A had failed to comply with GEM Rule 17.26. This resulted in a trading suspension of Company A's shares under GEM Rule 9.04 and a commencement of the Exchange's delisting procedures.

Notes:

1. *The amended GEM Rule 9.04 states that:*

"...the Exchange may direct a trading halt or suspend dealings in an issuer's securities regardless of whether or not the issuer has requested the same and may do so in any circumstances, including:-

...

- (3) *Where the Exchange considers that the issuer does not carry on a business as required under rule 17.26; or*

..."

The amended GEM Rule 17.26 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 17.26(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. *GEM Rule 17.26(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.