

## HKEX LISTING DECISION

HKEX-LD115-2017 (published in November 2017) (Updated in August 2018, October 2019 (Rule amendments))

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

### FACTS

1. Company A and its subsidiaries (**Group**) were engaged in coal mining and coal trading.
  - The coal mining business had not generated any revenue since the Group acquired the mining rights of its coal mines about nine years ago. The Group's mining exploration activities had been restricted due to regulatory prohibitions and it had fully impaired the values of the mining right licenses.
  - The coal trading business commenced about three years ago and the Group had a few customers only. Its revenue decreased from HK\$30 million in the first year to about HK\$11 million in each of the last two financial years. It recorded a segment loss over the last three years.
  - The Group had discontinued its other business in the provision of some consumer products and related services for more than two years. In the preceding three financial years, it recorded annual revenue in the range of HK\$9 million to HK\$12 million from such business with a segment loss.
2. The Group recorded substantial losses (in the range of HK\$25 million to HK\$140 million) and negative operating cash flows over the last five financial years. Its loss amounted to HK\$50 million in the latest financial year.
3. As at the latest year end date the Group had total assets of HK\$20 million comprising mainly cash and bank balances and trade and other receivables. Its net liabilities amounted to HK\$60 million.

4. The Exchange queried whether Company A was maintaining sufficient operations or assets as required under Main Board Rule 13.24. Before a regulatory decision was made on this issue, trading in Company A's shares on the Exchange was continuing.
5. Company A submitted that it had plans to improve its business operations and financial position.
  - a. Company A intended to increase the number of customers to up to seven within two years to expand its coal trading business. It also planned to cut the administrative costs and expenses of the Group and raise funds through placing of new shares to repay outstanding indebtedness and reduce finance costs.

Based on the above, Company A expected that the Group would record a significant increase in revenue from the coal trading business to more than HK\$120 million and HK\$140 million in the current and next financial year. It would start making net profits of about HK\$6 million in the next financial year.

- b. Company A had also identified some potential acquisition targets for business expansion and diversification, and expected to complete one within 12 months.

However, the Company did not provide details or basis to support its business plans or forecasts for the acquisition targets.

## **APPLICABLE LISTING RULES AND GUIDANCE MATERIALS**

6. 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 ... .”*

7. 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.”*

8. 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.)

9. 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*

*...”*

10. 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**

11. 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.
12. 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 9 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.
13. 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.

- 14. 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.
- 15. 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. In the latest financial year, the Group recorded revenue of HK\$11 million only, which was solely generated from the coal trading business, with a minimal gross profit of HK\$0.5 million. This was insufficient to cover the corporate expenses, resulted in a net loss of about HK\$50 million.
  - b. The level of the Group's business operations had remained low over the past five years. Its coal exploration activities had been restricted for more than eight years and had never generated any revenue. Whilst the Group commenced the coal trading business three years ago, it had a few customers only and the revenue decreased from HK\$30 million in the first year to HK\$11 million only in each of the last two financial years with a segment loss. Revenues from the business in the provision of consumer products and related services were also low before the business was discontinued two years ago (in the range of HK\$9 million to HK\$12 million during the preceding three years). The continuing net losses and operating cash outflows recorded in each of the last few years had suggested that this situation was not a temporary decline or downturn.
  - c. Based on the latest financial report, the Group had total assets of HK\$20 million only, which comprised mainly cash and receivables, with net liabilities amounted to HK\$60 million. As mentioned above, the

Group's assets had not generated sufficient revenue and profits to ensure Company A to operate a viable and sustainable business. Company A had not demonstrated that it had assets of sufficient value to warrant the continued listing of its shares.

- d. The Group's plans to improve its business operations and financial positions (paragraph 5 above) were preliminary and not substantiated. Company A had not provided any detailed information about the business plans or acquisition targets to support a substantial improvement of the Group's scale of operations and financial results as projected. Company A had failed to demonstrate that it had a viable and sustainable business to support its listing status.

## CONCLUSION

- 16. 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 a share trading suspension under Rule 6.01(3) and the commencement of delisting procedures under Rule 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.*