HKEX LISTING DECISION
HKEX-LD117-2017 (published in November 2017)

Parties	Company A – a Main Board issuer Company B – a Main Board issuer in which Company A had a significant investment Newco – Company A's subsidiary wishing to seek a separate listing on the Exchange
Issue	Whether Company A (excluding its interest in Newco) could meet the new listing requirements of Chapter 8 of the Main Board Rules
Listing Rules	Main Board Rule 8.04 and Paragraph 3(c) of Practice Note 15 to the Main Board Rules
Decision	The Exchange rejected the spin-off proposal as Company A could not demonstrate that its remaining businesses would be sustainable and suitable for listing after the proposed spin-off

FACTS

1. Company A proposed to inject its business in manufacturing and sale of certain electronic products into Newco and seek a separate listing of Newco on the Exchange.

2. After the proposed spin-off, Company A (excluding Newco) (**Remaining Group**) would continue to carry on the business in securities investment and trading (**Securities Business**) and a number of other businesses (**Other Businesses**) (together, the **Remaining Businesses**).

3. Company A submitted that during the immediately preceding 3 year (track record) period, the Remaining Group recorded an aggregated profit of about HK$150 million for the first two years of the track record period, and a profit of about HK$300 million for the latest financial year.

4. It was also noted that:

   (a) During the immediately preceding 3 year (track record) period, the Securities Business was the largest business segment of the Remaining Group in terms of revenue, profit and asset value. Its investment portfolio comprised primarily securities in Company B (which was a subsidiary of Company A until about three years ago).

It also held a few other investments but the investment amounts were small.

(b) The Remaining Group's revenues and profits during the track record period were mainly attributable to the gains derived from the investment in Company B in the last two financial years. The Other Businesses segments were small and were either loss-making or had only generated minimal profits.

(c) Company A had sold all its investment in Company B during the track record period. The value of its investment portfolio therefore decreased significantly from about HK$10 billion to less than HK$20 million.

(d) After the track record period, Company A had made further investments in two listed companies with an aggregated value of HK$10 million. It also set aside a budget of HK$300 million for future investments.

5. Company A was of the view that the Remaining Group could independently satisfy the new listing requirements of Chapter 8 of the Rules, including the profit requirement of Rule 8.05(1)(a), and other requirements under Practice Note 15. It sought the Exchange's approval for the spin-off proposal.

APPLICABLE LISTING RULES

6. Rule 8.04 states that:

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

7. Rule 2.06 states that:

"Suitability for listing depends on many factors. Applicants for listing should appreciate that compliance with the Exchange Listing Rules may not of itself ensure an applicant's suitability for listing. The Exchange retains a discretion to accept or reject applications and in reaching their decision will pay particular regard to the general principles outlined in rule 2.03. Prospective issuers (including listed issuers) are therefore encouraged to contact the Exchange to seek informal and confidential guidance as to the eligibility of a proposed application for listing at the earliest possible opportunity."

8. Paragraph 3(c) of Practice Note 15 to the Main Board Rules states that:

"The Listing Committee must be satisfied that, after the listing of Newco, the Parent would retain a sufficient level of operations and sufficient assets to support its separate listing status. In particular, it would not be acceptable to the Listing Committee that one business (Newco's) supported two listing statuses (the Parent's and Newco's). In other words, the Parent itself would be required to retain, in addition to its interest in Newco, sufficient assets and operations of its own, excluding its interest in Newco, to satisfy independently the requirements of Chapter 8 of the Exchange Listing Rules..."

ANALYSIS

9. Rule 8.04 provides that both the issuer and its business must, in the Exchange's opinion, be suitable for listing. Rule 2.06 further states that suitability for listing depends on many factors. Compliance with the Rules may not of itself ensure an issuer's suitability for listing / continued listing.

10. Suitability is a broad and flexible concept that applies in a wide range of circumstances. The Exchange has a broad discretion to interpret and apply this concept for maintaining market confidence with reference to the currently acceptable standards in the market place. This facilitates the Exchange to meet its regulatory objectives and its obligations to act in the best interest of the market as a whole and in the public interest.

11. For example, the Exchange may question an issuer's suitability for listing if, given its specific business model and the specific facts and circumstances, the issuer may not be operating a business of substance, giving rise to a concern that the issuer is carrying on its activities for the purpose of maintaining a listing status rather than genuinely developing its underlying business. In these circumstances, the issuer may be a "blue sky" company[1] susceptible of speculative activities and market manipulation. This raises a concern about the impact of such activities on the orderliness, quality and reputation of the market.

12. In the case of a spin-off, the Exchange retains its discretion to accept or reject the listed issuer's proposal having regard to, among other factors, the suitability of the remaining group and its business for listing under Rule 8.04[2].

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[1] "Blue sky companies" are those where public investors have no or little information about their business plans and prospects, leaving much room for the market to speculate on their possible acquisitions. These activities create opportunities for market manipulation. See LD35-2012.

[2] In any case, a listed issuer must ensure that it and its business are suitable for continued listing, failing which the Exchange may cancel its listing under Rule 6.01(4).

13. In this case, the Remaining Group would rely on its Securities Business to meet the new listing requirements under Paragraph 3(c) of Practice Note 15. The Exchange was not satisfied that the Remaining Group was suitable for listing because:

(a) The Securities Business primarily invested in one company (i.e. Company B) during the track record period. Its investment portfolio was highly concentrated. The revenues and profits of the Securities Business segment were almost entirely generated from the investment in Company B. This business model raised a concern that the Remaining Group was not carrying on a business of substance. This impacted on the Remaining Group’s suitability for listing.

(b) In addition, the whole investment in Company B was sold during the track record period. Company A’s subsequent investments in two listed companies amounted to HK$10 million only and there was no detail about its future investment plans. The Remaining Group’s track record was not representative of its business performance going forward. This called into question whether investors had adequate information to make an informed assessment of the Remaining Group’s business after the proposed spin-off.

(c) The scale of the Other Businesses was small and could not have met the profit requirement under Rule 8.05(1)(a). Company A had not demonstrated that there would be substantial improvement in these businesses after the proposed spin-off.

CONCLUSION

14. The Exchange rejected the spin-off proposal as Company A could not demonstrate that the Remaining Businesses would be suitable for listing after the proposed spin-off.