HKEx GUIDANCE LETTER
HKEx-GL84-15 (December 2015)

Subject	**Guidance on Cash Company Rules**
Listing Rules	**Main Board Rules 14.82, 14.83 and 14.84** **GEM Rules 19.82, 19.83 and 19.84**

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.*

I. Purpose

1. Recently there has been an increase in listed companies proposing large scale fundraisings that involved investors injecting substantial amounts of cash into the companies. This letter provides guidance on the Exchange's approach to applying the cash company Rules in these cases.

II. Relevant Rules

2. Rules 14.82 to 14.84 state that:

> *"**Where for any reason** (including immediately after completion of a notifiable transaction or connected transaction) **the assets of a listed issuer** (other than an "investment company" as defined in Chapter 21 of the Exchange Listing Rules) **consist wholly or substantially of cash or short-dated securities, it will not be regarded as suitable for listing** and trading in its securities will be suspended. "Short dated securities" means securities such as bonds, bills or notes which have less than 1 year to maturity.*
>
> *A listed issuer which is solely or mainly engaged in the securities brokerage business will not be subject to rule 14.82.*
>
> *The listed issuer may apply to the Exchange to lift the suspension once it has a business suitable for listing. **The Exchange will treat its application for lifting of the suspension as if it were an application for listing from a new applicant**. ... The Exchange reserves the right to cancel the listing if such suspension continues for more than 12 months or in any other case where it considers it necessary. ..."*

III. Guidance

3. Under Rule 14.82, a cash company is a company whose assets consist wholly or substantially of cash or short-dated securities. Once a company is found to be a cash company for any reason, it will not be regarded as suitable for listing and trading in its securities will be suspended. The company must apply to the Exchange to lift the suspension as if it were an application for listing from a new applicant (Rule 14.84). As a result, the company would be required to comply with all new listing requirements and issue a full listing document.

4. The object and purpose of these Rules is to enable the Exchange to maintain market quality and avoid speculative trading in the securities of cash companies.

5. Listed companies should note that there is no prescribed quantitative threshold in the cash company Rules for assessing whether a company's assets consist *substantially* of cash. The assessment required is not simply an analysis of a company's cash to assets ratio. Consideration is to be given also to the background facts and circumstances of the company's business, operation and financial position.

Application of cash company Rules to large scale fundraisings

6. Recently a number of listed companies have proposed large scale fundraisings where investors would inject substantial amounts of cash into the companies, for example, through share subscriptions. The Exchange has assessed the application of the cash company Rules to individual cases based on their specific facts and circumstances (see examples in Part IV below). These cases share all or some of the following features:

   (a) The size of the fundraising would be very significant to the company and would bear little or no correlation with the needs of the company's existing principal business.

   (b) Funds raised would be used in largely greenfield operations of new businesses with little or no relation to the company's existing principal business. In some cases, these new businesses were the same as or similar to the businesses of the investor(s). There were also cases where the company claimed to have started the new businesses shortly before the proposed fundraisings (e.g. obtained a money lending license or acquired a small size money lending company).

   (c) The investor(s) would obtain control (or de facto control) of the company and would intend to manage the new businesses. In most cases, a significant proportion of the directors of the company would resign and new directors would be nominated by the investor(s).

   (d) Employing the cash obtained from the fundraising, the company would proceed to operate new businesses which are expected to be substantially larger than the original business.

7. In these cases, the Exchange considers that the proposed fundraisings would result in the companies' assets consisting substantially of cash upon completion. The facts of individual cases also suggested that the investors were in effect listing, through the listed company, new businesses which would not have otherwise met the new listing requirements as the lack of a track record would render these businesses unsuitable for listing.

8. The Exchange has also noted in some cases that the companies have tried to address the cash company concerns by providing further details about their business plans and/or signing agreements to commit the use of the cash proceeds. They took the view that these actions would allow them to exclude those cash proceeds to be utilized pursuant to such agreement from their cash position upon completion of the fundraisings. The Exchange does not agree. This is because, under the cash company Rules, the cash company assessment is made based on a company's cash balance as a result of the fundraisings and the situation as pertaining at the date of completion of the fundraising. The company cannot rely on the future intended use of proceeds, whether by way of legally binding agreement or otherwise, as a means of reducing the cash level at completion for the purpose of the rules. Once the company is considered to have its assets consisting substantially of cash, the Exchange is required to evaluate the business plans (including the intended use of proceeds) as if it were a new listing application.

9. The Exchange believes that its current approach in applying the cash company Rules would not prohibit equity fundraisings by companies for legitimate business expansions. The expression of *wholly or substantially* in Rule 14.82 is understood as meaning *in the main* or *as of the greater part*. A company with less than half (50%) of its assets being cash as a result of a fundraising would not normally be regarded to have assets consisting wholly or substantially of cash under the rule. Nevertheless, if the Exchange considers that any fundraising, acquisition or other corporate action of the company in the future together with the current fundraising are a means to list new businesses that are not suitable for listing or otherwise circumvent the new listing requirements, the Exchange would impose additional requirements or conditions on such future arrangement(s).

Consultation with the Exchange

10. Rule 13.52(2)(c) requires announcements relating to cash companies to be pre-vetted by the Exchange. Listed companies who intend to undertake large scale fundraisings are encouraged to contact the Exchange at the earliest possible opportunity to seek guidance on the application of the cash company Rules in individual cases.

III. Examples

11. In each of the following two examples, the Exchange considers that should the listed company (Companies A or B, as the case may be) proceed to complete its proposed subscription, it would become a cash company and its business plans would be evaluated against the new listing requirements under Rule 14.84.

<u>Example 1</u>

12. Company A is principally engaged in the garment business. It recorded revenue of about HK$60 million and a net loss of about HK$20 million in the latest financial year, and its total assets value was about HK$100 million.

13. *The proposed subscription:* Company A signed subscription agreements to raise a total of HK$400 million by issuing restricted convertible bonds[1] to subscribers:

    - Upon completion, over 85% of the company's assets would consist of cash. The proceeds from the subscriptions would be mostly used to develop a new mobile game business.

    - Assuming full conversion of the bonds, the conversion shares would represent about 4 times of the company's existing issued shares, and the major subscriber would hold more than 60% of the company's shares as enlarged by the conversion shares.

    The major subscriber is an entrepreneur.

14. After signing the subscription agreements, Company A acquired a newly set up company engaged in distributing and marketing mobile games. Taking this into account, Company A's cash would represent 65% of its total assets upon completion of the subscriptions.

15. *The Exchange's analysis:* The Exchange considers that the proposed subscriptions would render the company a cash company under the Rules:

    (a) Under the proposal, the subscription amount is significant to the company and the cash level would be 65% of the company's total assets upon completion. The company's assets would comprise substantially of cash.

[1] Convertible bonds with a restriction from conversion to avoid triggering a change in control under the Code on Takeovers and Mergers

(b) The subscriptions would be a means to list a new business which is unsuitable for listing:

- The company has been engaging in the garment business since listing. It acquired a company engaged in the mobile game business only after it signed the subscription agreements.

- The subscription amount is significant to the company. It has no correlation, and is completely disproportionate, to the company's existing garment business. The proceeds would be used to develop and operate a new mobile game business that would be significant relative to the existing business after the subscription.

- The company would in effect be a listed vehicle for the subscriber (who would acquire a de facto control of the company using the restricted convertible bonds) to develop and operate a new mobile game business which has no track record and does not meet the new listing requirements.

<u>Example 2</u>

16. Company B is principally engaged in the business of manufacturing toys. It recorded revenue of about HK$200 million and a loss of HK$38 million in the latest financial year, and its total assets value was about HK$500 million.

17. Two months ago, Company B obtained a money lender licence in Hong Kong and commenced a money lending business.

18. *The proposed subscription:* Company B signed subscription agreements to raise HK$1 billion by issuing shares to subscribers:

- Upon completion, about 75% of its total assets would consist of cash. The proceeds from the subscriptions would be mostly used to develop the money lending business. In particular, Company B signed loan agreements to provide financial assistance of a total amount of HK$900 million to several independent third parties. These agreements were subject to completion of the subscriptions.

- The subscribers would hold about 55% of Company B's shares as enlarged by the new shares.

The major subscriber is a money lending company.

19. *The Exchange's analysis:* The Exchange considers that the proposed subscriptions would render the company a cash company under the Rules:

(a) The subscription amount is significant to the company and the cash level would be 75% of the company's total assets upon completion. Company B's assets would comprise substantially of cash.

(b) The subscriptions would be a means to list a new business which is unsuitable for listing:

- Company B has been engaging in manufacturing toys. The money lending business commenced shortly before the subscriptions were agreed and is a new business of Company B.

- The subscription amount is significant to Company B. It has no correlation, and is completely disproportionate, to Company B's original toy business. The proceeds would be used to develop and operate the money lending business that would be significant relative to the existing business after the subscription.

- Company B would in effect be a listed vehicle for the subscribers (who would become controlling shareholders of Company B) to develop and operate the new money lending business that has no track record and does not meet the new listing requirements.

20. Whilst Company B has signed legally binding agreements (i.e. the loan agreements) to ensure that a substantial part of the subscription proceeds would be used shortly after completion of the subscriptions, this does not address the cash company concern. Once a company is considered to have assets consisting substantially of cash, the Exchange will evaluate the business plans (i.e. with the proposed use of proceeds) as if it were an application for listing from a new applicant.