BDO NEWS

February 2018

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EXPANDING THE LISTING REGIME TO ATTRACT LISTING OF INNOVATIVE COMPANIES IN HONG KONG

CONTENTS

Introduction

Listing of companies from emerging and innovative sectors, including companies with weighted voting rights (WVR), was controversial and has been under debate in Hong Kong in recent years. In December 2017, The Stock Exchange of Hong Kong Limited (the Exchange) announced the conclusion to the New Board Concept Paper published in June 2017. Based on the feedback from market stakeholders, the Exchange decided to expand Hong Kong's listing regime to facilitate the listing of companies from emerging and innovative sectors. After the consultations, the Exchange published their decision to expand the Main Board regime by setting up two new chapters to the Main Board Listing Rules (rather than creating a new board) to allow the listing of:

- Biotech companies which are pre-profit / pre-revenue; and
- Companies from emerging and innovative sectors that have WVR structures, subject to additional disclosures and safeguards.

The Exchange also proposes to modify the existing Listing Rules in relation to overseas companies to create a new concessionary for secondary listing of innovative companies already primary listed on the New York Stock Exchange, NASDAQ or the "premium listing" segment of the London Stock Exchange's Main Market (the Qualifying Exchange) with a "centre of gravity" in Greater China.

Biotech sector

The Exchange intends to facilitate the listing of New Economy companies of pre-revenue or pre-profit nature through a new chapter in the Main Board Listing Rules. The Exchange has chosen the Biotech Industry as the initial focus in widening market access for early stage companies as the activities undertaken by biotech companies tend to be strictly regulated under a regime that sets external milestones on development progress. This will provide investors with a frame of reference to judge the value of companies that do not have revenue and profit, being the traditional indicators of performance. Biotech companies also make up a majority of companies in the pre-revenue stage of development seeking a listing. Those Biotech Issuers would also be subject to the same regulatory standards as other issuers in the Main Board, save for the financial track record requirements.

The listing requirements for Biotech Issuers as proposed by the Exchange in the consultation conclusion are as follows:

a. minimum expected market capitalisation of not less than HK$1.5 billion at the time of listing

b. meet the enhanced working capital requirements (125% of the Biotech Issuer's current requirements over the next 12 months), and has been in operation in its current line of business (for example, research and development in Biotech) for at least two years prior to listing

c. provide enhanced risk disclosures, disclosures on the phases of development for its products and the potential market of its products, disclosures of details of spending on research and development, patents granted and applied for as well as the research and development experience of management

At present, the Exchange considers a Biotech Issuer for the purpose of the Main Board Listing Rules would normally be expected to possess the following features:

a. has been primarily engaged in research and development for the purposes of developing new or innovative products/processes/technologies

b. has unique features of innovation or intellectual property that could be reasonably expected to give rise to commercialisable patents, copyrights and/or trade secrets

c. has as its primary reason for listing the raising of finance for research and development to bring identified products/processes/technologies to commercialisation

d. has at least one product/process/technology which has proceeded beyond the concept stage

e. has a portfolio of durable patents, registered patents and/or patent applications that demonstrates its rights to the new technologies or innovations that form the basis of its listing application

f. has previously received investment from at least one sophisticated investor (including financial institutions)

Innovative sectors with WVR structures

The Exchange also proposes to facilitate the listing of innovative companies with WVR structures through another new chapter in the Main Board Listing Rules.

Companies with WVR structures would be required to have a minimum expected market capitalisation of $10 billion and, if below $40 billion of market capitalisation, would need to meet a higher revenue test of HK$1 billion in the full financial year before listing.

At present, the Exchange considers an innovative company for the purpose of the Main Board Listing Rules would normally be expected to possess more than one of the following characteristics **(Innovative Company Characteristics)**:

a. its success is demonstrated to be attributable to the application of new (1) technologies; (2) innovations; and/or (3) business model to the company's core business, which also serves to differentiate the company from existing players;

b. research and development is a significant contributor of expected value and constitutes a major activity and expense;

c. its success is demonstrated to be attributable to unique features or intellectual property; and

d. it has an outsized market capitalisation / intangible asset value relative to its tangible asset value.

Applicants of innovative company will also be required to establish that they are both eligible and suitable for listing with a WVR structure. In this connection, the Exchange would normally consider a company suitable for listing in Hong Kong with WVR structures if they are able to demonstrate the following characteristics:

a. Nature of the company: the applicant must be an innovative company (by reference to the **Innovative Company Characteristics** set out above).

b. Success of the company: the applicant demonstrates a track record of high business growth, as can be objectively measured by operational metrics such as business operations, users, customers, unit sales, revenue, profits and/or market value (as appropriate) and that its high growth trajectory is expected to continue.

c. Contribution of WVR holders: Each WVR holder has been materially responsible for the growth of the business, by way of their skills, knowledge and/or strategic direction where the value of the company is largely attributable or attached to intangible human capital.

d. Responsibility of WVR holders:

   (i) Each WVR holder has an active executive role within the business, and contributes to a material extent to the ongoing growth of the business.

   (ii) Each WVR holder is or would assume the role of director of the issuer at the time of listing.

e. External validation: the applicant has received meaningful (being more than just a token investment) third party funding from sophisticated investors (including financial institutions). Such investors will be required to retain an aggregate 50 percent of their investment at the time of listing for a period of at least 6 months post-IPO (subject to exceptions for de minimis investments by specific investors). This characteristic does not apply if the applicant is a spin-off from a parent company and in other exceptional circumstances.

The Exchange proposes to require the following safeguards in respect of WVR issuers:

a. Ring-fencing provisions;

b. Restrictions of WVR to eligible persons only;

c. Limits on WVR powers to share based structure with capped voting power, and for certain fundamental matters to be determined on a one share one vote basis;

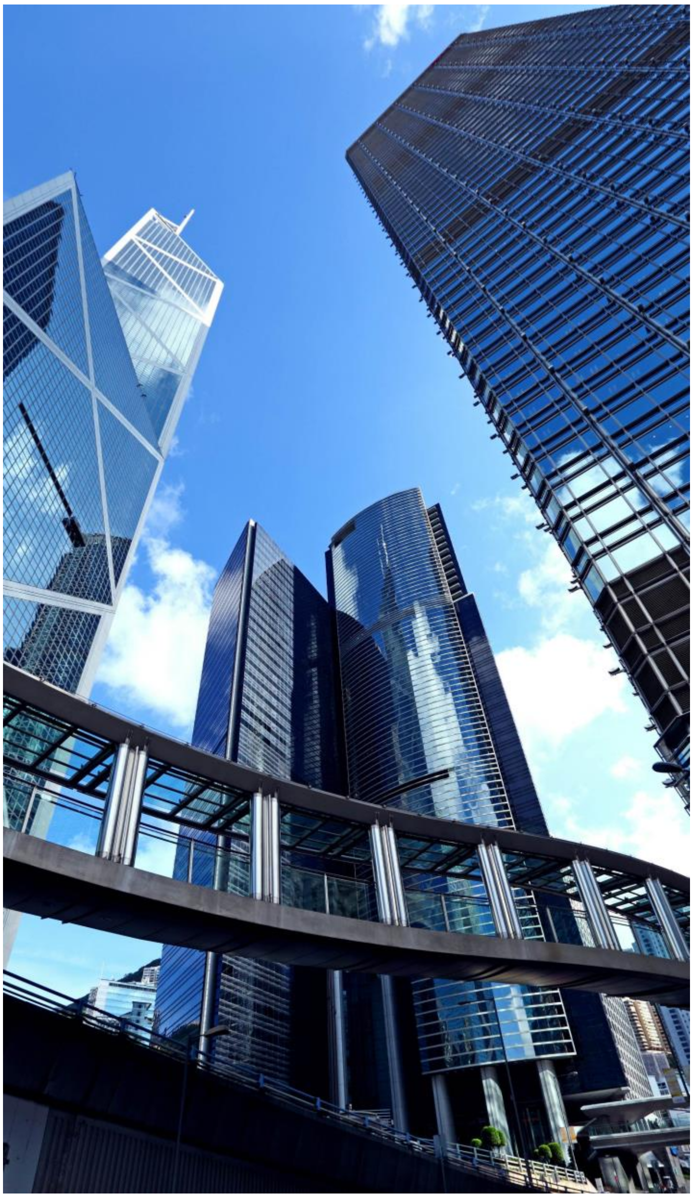
d. Enhanced disclosure and prominent warning language;

e. Enhanced corporate governance measures; and

f. Constitutional backing for the WVR safeguards to allow private legal action by shareholders.

The new concessionary secondary listing regime

The Exchange proposes to modify the existing Listing Rules in relation to overseas companies to create a new concessionary secondary listing route to attract issuers from emerging and innovative sectors that are primary listed on a Qualifying Exchange (including New York Stock Exchange, NASDAQ or the "premium listing" segment of the London Stock Exchange's Main Market).



The Exchange proposes the new secondary listing route to be set out in the amended Main Board Listing Rules will only be available to companies with all of the following characteristics. The company must:

a. be an innovative company by reference to the **Innovative Company Characteristics** set out above;

b. be primary listed on a Qualifying Exchange;

c. have a good record of compliance for at least two years on a Qualifying Exchange; and

d. have an expected market capitalisation at the time of secondary listing in Hong Kong of at least HK$10 billion. A secondary listing applicant (i) with a WVR structure; and/or (ii) with a "centre of gravity" in the Greater China region will also be required to meet the revenue test applicable to WVR applicants if it has an expected market capitalisation at the time of secondary listing in Hong Kong of less than HK$40 billion.

Expected time table for expanding the listing regime to facilitate the listing of innovative companies

As mentioned in the announcement in December 2017, the Exchange is in the process of finalising the proposals and has commenced the drafting of the proposed amendments to the Listing Rules to put the proposals into effect. The Exchange intends to further refine the proposals through discussions with stakeholders, following which a formal consultation on the detailed proposals and proposed amendments to the Listing Rules will be conducted. The Exchange expects to begin the discussions shortly after the publication of these consultation conclusions with a view to proceeding with the formal consultation on the proposed Rule amendments in the first quarter of 2018.

We will promptly update this newsletter as and when the Exchange announces further detailed rules concerning this new initiative.

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