

Hong Kong IPO Guide 2014

from LexisNexis
The 3rd Annual Guide to Listing in Hong Kong

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Foreword

LexisNexis is pleased to be the publisher of the Hong Kong IPO Guide 2014, the third edition in this series. The previous editions were met with very positive responses and we appreciate all the feedback we received from the readers, which we have sought to incorporate into this volume.

This handbook takes a comprehensive view of the Hong Kong IPO process, from consideration of a listing here, conducting pre-IPO restructuring, selection of bankers, legal and auditing advisers, D&O insurance, business valuation and communications experts, to proceeding with the IPO and preparing for continuing obligations after listing.

By publishing this Guide, we aim to help companies interested in listing in Hong Kong understand what needs to be done at each stage and to gain control of the process - all in a single source and laid out in a clear and sequential manner. The information contained in the Guide is contributed by leading professionals in the IPO field who have provided up-to-date and relevant information about listing.

This year, we have been supported by an extraordinary number of organizations who are distributing this edition of the IPO Guide to their members. We heartily thank each of these organizations, and each of the contributing authors and their firms, for helping to bring this edition of the IPO Guide to life.

Yours sincerely,

Claris Tam
Project Manager, Hong Kong IPO Guide 2014

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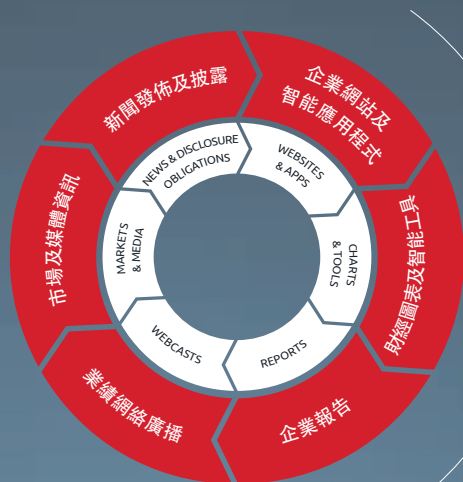
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Chapter 1 – Why List in Hong Kong

When your business has grown to a certain scale, listing will become an available option for you to take your business to the next level. A successful listing by way of an initial public offering (IPO) is more than a capital-raising activity. It also enhances the public profile of the business and affords it a sense of prestige. However, a hasty move to list a business with poor planning and execution may end up in spending more effort and getting less reward. As listing is an important milestone in a company's history, it should not be decided lightly. In this chapter, we will guide you through some fundamental questions you should ask before proceeding with your listing plan:

1. Why list?
2. Why list in Hong Kong?
3. Can you list your business in Hong Kong?
4. How to plan a listing?
5. How long does it take?

1. Why List?

Listing or not is a critical decision to make. In deciding whether you should list your business, the following pros and cons should be weighed:

Pros	Cons
<p>Raising capital – An IPO is a relatively cost-effective way of raising capital when compared to financing available to private companies, such as debt financing.</p>	<p>Listing expenses – An IPO involves substantial capital outlay during the process. Careful budgeting and precise execution are required to ensure its cost-effectiveness. Please refer to Appendix 1 for a list of common categories of listing expenses.</p>
<p>Easier future financing – A listed company can raise further finance easily and cheaply by issuing more shares. Moreover, a listed company generally enjoys better terms for bank financing. Banks may release the personal guarantees given by the major shareholders for the company's bank facilities upon listing.</p>	<p>Maintenance and Compliance Costs – Maintenance of a listing status involves additional costs, e.g. annual listing fees, share registrar's fees, wages and service fees for additional personnel such as independent non-executive directors, professional company secretary, etc. In addition, to ensure compliance with different laws and regulations, listed companies generally seek professional advice more frequently and engage larger audit firms.</p>

Pros	Cons
<p>Liquidity – A shareholder of a private company may not easily increase or decrease his or her stake in the company, as it may involve complicated business valuations and heighten the tension among the shareholders. By providing liquidity to the shares and affording the founders an exit option to realise their investments in the company, listing a business may mitigate the risk of shareholders' disputes.</p>	<p>Unwanted Shareholders – A listed company cannot avoid unwanted shareholders. Shareholdings in a listed company should be closely monitored so as to avoid takeover bids from competitors or other investors.</p>
<p>Publicity – Listing a business is a means to raise its public profile and visibility, which will in turn increase the market's awareness of the company's products or services.</p>	<p>Market Scrutiny – The company will face a larger group of shareholders, regulators as well as other stakeholders; each with their own requirements and expectations. Under significant disclosure and reporting obligations, listed companies are expected to demonstrate a high degree of transparency towards the regulators and the public.</p>
<p>Prestige – A listing status is a badge of quality. It generally shows that the company is adhering to higher standards of compliance and corporate governance.</p>	<p>Compliance burden – A listed company will be subject to a more onerous compliance burden as compared with a private company. Only those enterprises with capable and committed management which are prepared to demonstrate high standards of corporate governance should take up the challenge of listing.</p>

2. Why List in Hong Kong?

Once you have decided to pursue a listing for your business, the next step is to choose the most suitable market for listing. The Hong Kong Stock Exchange (HKEx) is an attractive listing venue for many local and international businesses. It is the sixth largest stock exchange in the world in terms of the total market capitalisation of all securities listed thereon, outperforming its Shanghai counterparts.¹ It has also been the busiest stock exchange in the past few years in terms of its numbers of IPOs. Its popularity can be explained by a number of Hong Kong's advantages as the listing venue:

¹ Statistics for 2012 are available on www.world-exchanges.org



a. Gateway between Mainland China and the Rest of the World

Strategically located in a high-growth region, Hong Kong is well-positioned to capture the opportunities offered by the booming economy of Mainland China. HKEx allows PRC businesses to access capital from investors from all over the world. Meanwhile, it also allows international investors to invest in PRC businesses. Moreover, it has now become a trend for international brands to list on the HKEx to gain access to capital from the Mainland China and to raise their profile and visibility in the Mainland China.

To capture the opportunities arising from the internationalisation of the Renminbi (RMB), HKEx is also working on new products, platforms and infrastructure, aiming at becoming the exchange of choice for international investors to access RMB-denominated products.

b. Bilingual legal documents and communication

One of the unique features of HKEx is the requirements of bilingual prospectus in English and Chinese. Market players in Hong Kong regularly handle dual-language documentation and bilingual communication with international and PRC enterprises as well as the regulatory authorities. These enable the listing applicants to be closely involved and fully informed throughout the listing process, whilst attracting investors from the East and the West.

c. Liquid Market with Free Flow of Capital

Having access to both local and international funds, HKEx is a vibrant and liquid stock market. With numerous tax advantages, currency convertibility and free transferability of securities but no capital flow restrictions, HKEx is an attractive market for both companies and investors alike.

With its unique role as a gateway to Mainland China, coupled with a more liquid market, HKEx is expected to continue its position as the pre-eminent exchange in the region.

d. Strong Legal System and Sound Regulatory Framework

A well-established and respected legal system is the cornerstone of Hong Kong's success. HKEx is regulated by a clear and sound regulatory framework, which is on par with international standards. These provide a strong foundation for companies to raise funds in Hong Kong and afford investors confidence in Hong Kong's stock market.

e. Objective Listing Criteria and Streamlined Vetting Process

Despite the fact that A-share listings in Shanghai and Shenzhen generally enjoy higher profit-to-earnings (P/E) ratios², many Mainland businesses choose to list in Hong Kong because the HKEx adopts a clear set of objective listing criteria and a more guaranteed listing timetable. Effective from 1 October 2013, HKEx has implemented a streamlined vetting and approval process. These would further facilitate the listing preparation and provide more certainty to a listing application.

f. Innovation to Attract More Listing Applicants

HKEx has continued to innovate with an aim to attract more listing applicants from different parts of the world and cater for different business models. Here are some examples of innovation in recent years:

Depository receipts (DRs) – Some overseas companies may not be able to list their shares in Hong Kong due to the regulatory requirements of their places of incorporation. In addition, direct investment in shares in some countries entails onerous registration procedures, withholding tax reclaim and foreign currency conversion. By allowing DRs to list on the Main Board, HKEx provides a convenient means for Hong Kong investors to invest in these companies indirectly. Brazilian mining giant Vale, New York luxury goods design house Coach and Japanese financial services group SBI are listed in Hong Kong by way of DRs.

Business Trusts – Business trusts are now allowed to list in Hong Kong. Generally speaking, business trusts are managed by trustee managers, and these trusts operate the business and hold legal title to assets for the beneficiaries. The beneficiaries do not have day-to-day control over the management of those assets, but they will be able to receive returns from the business trusts. HKEx Guidance Letters GL40-12 sets out the applicable principles and key issues that a business trust should address when preparing a listing in Hong Kong. There are two successful listings of business trusts so far and more are expected to come.

² Statistics of the average P/E ratios for companies listed on the Hong Kong Stock Exchange, the Shanghai Stock Exchange and the Shenzhen Stock Exchange are available at: www.hkex.com.hk/eng/csm/highlight.asp

Moving Forward – Will HKEx Allow Dual Class Shares?

The recent proposed HK\$100 billion IPO of the mainland internet giant Alibaba sparks debate on whether Hong Kong should allow non-standard shareholding structures such as dual class shares. The debate stems from Alibaba's advocacy for HKEx's acceptance of a "partnership structure", which in essence entrenches control of the founders notwithstanding that their shareholding will be diluted when they tap the market for funds. The unusual structure is said to be created as a way to protect the long-term strategic interests of the founders. Arguably, this is inconsistent with the "one-share-one-vote principle" which underpins the existing regulatory regime in Hong Kong and hence the Hong Kong regulators have preliminarily refused to yield to Alibaba's request. However, HKEx CEO Charles Li has campaigned for further debate on alternative governance structures for innovative companies. As he rightly said, "losing one or two listing candidates is not a big deal for Hong Kong; but losing a generation of companies from China's new economy is."⁷ Whether the Hong Kong market can grasp the opportunity to embrace the new round of technology boom is to be seen.

3. Can You List Your Business in Hong Kong?

The HKEx runs two platforms for listing – the Main Board and the Growth Enterprise Market (GEM). The Main Board mainly serves those large and mature enterprises which satisfy the financial tests under Rule 8.05 of the Rules Governing the Listing of Securities on the HKEx (the Listing Rules), while GEM is positioned as a stepping-stone to the Main Board and mainly serves emerging enterprises which do not satisfy the Main Board listing requirements. A GEM listed company may apply for a transfer of its listing to the Main Board at a later stage, provided that the Main Board listing criteria is met.⁸

The key listing requirements for the Main Board and GEM are set out below:

a. Financial Requirements

Main Board

For a Main Board listing applicant, one of the following financial tests, namely: (i) profit test; (ii) market capitalisation/revenue/cash flow test; or (iii) market capitalisation/revenue test, must be satisfied:

⁷ Charles Li Direct, "Taking the debate forward: Should Hong Kong act on non-standard shareholding structures?"; available at: <http://www.hkex.com.hk/eng/newsconsul/blog/131024blog.htm>

⁸ Chapter 9A of the Listing Rules

	Profit Test⁹	Market Capitalisation/ Revenue/ Cash Flow Test¹⁰	Market Capitalisation/ Revenue Test¹¹
Trading record	A trading record of not less than three financial years (unless a shorter period is accepted by the HKEx)		
Minimum profit attributable to shareholders	HK\$50 million in the last three financial years (At least HK\$20 million recorded in the most recent financial year, and aggregate profits of at least HK\$30 million recorded in the two preceding financial years)	-	-
Minimum market capitalisation at the time of listing	HK\$200 million	HK\$2 billion	HK\$4 billion
Minimum revenue	-	HK\$500 million for the most recent audited financial year	HK\$500 million for the most recent audited financial year
Minimum cashflow	-	Aggregate positive cash flow from operating activities of HK\$100 million for the three preceding financial years	-

GEM

There are no minimum profit/revenue requirements for GEM listing applicants. Instead, GEM listing applicants have to satisfy the following requirements:

⁹ Rule 8.05(1) of the Listing Rules

¹⁰ Rule 8.05(2) of the Listing Rules

¹¹ Rule 8.05(3) of the Listing Rules

Trading record	A trading record of at least two financial years ¹²
Cashflow	A positive cashflow generated from operating activities in its ordinary and usual course of business of at least HK\$20 million for the two preceding financial years ¹³
Minimum market capitalization at the time of listing	HK\$100 million ¹⁴

b. Acceptable Jurisdiction

To list in Hong Kong, the listing vehicle must be incorporated in an acceptable jurisdiction. Currently, Hong Kong, the PRC, Bermuda and the Cayman Islands are the four jurisdictions prescribed by the Listing Rules with eligibility for listing. However, the Listing Rules do not prohibit the listing of companies incorporated in jurisdictions other than these recognised jurisdictions, provided that these companies can demonstrate that they are subject to appropriate standards of shareholder protection which are at least equivalent to those required under Hong Kong law.¹⁵

The HKEx will assess the jurisdiction of incorporation on a case-by-case basis. The HKEx has so far formally ruled the following jurisdictions to be acceptable as an issuer's place of incorporation:

List of acceptable jurisdictions (other than Hong Kong, the PRC, Bermuda and the Cayman Islands)¹⁶	
1. Australia	12. Italy
2. Brazil	13. Japan
3. British Virgin Islands	14. Jersey
4. Canada – Alberta	15. Republic of Korea
5. Canada - British Columbia	16. Labuan
6. Canada – Ontario	17. Luxembourg
7. Cyprus	18. Singapore
8. France	19. United Kingdom
9. Germany	20. United States of America - California
10. Guernsey	21. United States of America – Delaware
11. Isle of Man	

¹² Rule 11.10 of the Rules Governing the Listing of Securities on GEM (GEM Listing Rules)

¹³ Rule 11.12A(1) of the GEM Listing Rules

¹⁴ Rule 11.23(6) of the GEM Listing Rules

¹⁵ Joint policy statement regarding the listing of overseas companies published by the HKEx and the Securities and Futures Commission dated 27 September 2013

¹⁶ List of Acceptable Overseas Jurisdictions (last update: 27 September 2013, which is available at www.hkex.com.hk/eng/rulesreg/listrules/liststoptopic/list_of_aoj.htm)

c. Suitability for Listing

Both the listing applicant and its business must, in the opinion of HKEx, be suitable for listing. There is no definitive “suitability” test, although the HKEx may raise concerns in situations where:

Issue
<ul style="list-style-type: none"> • The company does not have control over its business and is unable to carry on an independent business as its main activity, e.g. <ul style="list-style-type: none"> (i) The company is heavily dependent on one customer/supplier.¹⁷ (ii) The company relies heavily on the support of a closely related party.¹⁸ (iii) The company relies heavily on the support of the parent company or a controlling shareholder.¹⁹ • The company has serious regulatory non-compliance records.²⁰ • The company has deteriorating financial performance and uncertain business prospects.²¹

Regulatory Non-Compliance and Illegal Acts

Listing applicants need to disclose incidents of regulatory non-compliance or illegal acts committed by the companies in their prospectuses. Common incidents of regulatory non-compliance include:

Hong Kong	<ol style="list-style-type: none"> 1. Failure to hold annual general meetings and lay accounts in accordance with the requirements of the Companies Ordinance (Cap 32) 2. Failure to file specified forms with the Companies Registry in accordance with the requirements of the Companies Ordinance 3. Default in filing tax returns 4. Failure to hold the relevant licences by the relevant operating subsidiary 5. Failure to comply with building orders
PRC	<ol style="list-style-type: none"> 1. Non-payment or under-payment of social insurance and housing fund contributions for the employees in the Mainland China 2. Failure to register lease agreements with the relevant government authorities 3. Commencement of construction work before obtaining the relevant construction work commencement permit 4. Bank financing without genuine underlying transactions 5. Inter-company loans with interest which fall within the category of unauthorised loans under the General Rules for Loans (貸款通則) 6. Issuance of pre-paid cards in the PRC without prior approval of the relevant authorities

Regulatory non-compliance or illegal acts of an applicant may not necessarily render the applicant unsuitable for listing. HKEx will consider the nature and seriousness of the breach, whether it was intentional or involved dishonesty, the impact on ongoing operations, the rectification measures adopted and the measures

¹⁷ HKEx Listing Decision LD107-1

¹⁸ HKEx Listing Decision LD92-1

¹⁹ HKEx Listing Decision LD46-1, LD46-2, LD51-1, LD51-3, LD30-2012

²⁰ HKEx Listing Decision LD97-1, LD19-2011, LD73-2013

²¹ HKEx Listing Decision LD37-2012, LD73-2013

put in place to prevent further breaches.²² In most of the cases, the HKEx will allow listing provided that the non-compliance or illegal acts are fully disclosed in the listing documents. For serious breaches, the HKEx may require the listing to be delayed to ascertain the full effects of the breaches and the effectiveness of the preventive measures put in place.

d. Ownership and Management Continuity

Each listing applicant has to satisfy the following requirements of ownership and management continuity:

	Main Board ²³	GEM ²⁴
Ownership continuity and control	At least the most recent audited financial year	At least the most recent audited financial year
Management continuity	At least three preceding financial years ^{Note}	At least two preceding financial years

Note: Except under the market capitalisation/revenue test, the HKEx may accept a shorter trading record period under substantially the same management if the listing applicant can demonstrate that:

- i. its directors and management have sufficient and satisfactory experience of at least three years in the line of business and industry of the listing applicant; and
- ii. management continuity existed for the most recent audited financial year.²⁵

What is meant by “ownership continuity and control”?

The HKEx defines “ownership continuity and control” as the continuous ownership and control of the voting rights attached to their shares by:

- i. a controlling shareholder; or
- ii. where there is no controlling shareholder, the single largest shareholder; or
- iii. a group of individual shareholders aggregating their shareholding interests and control where they can, on the facts, be regarded as a controlling group for the purposes of the Listing Rules.

What is meant by “management continuity”?

The HKEx ordinarily considers management continuity to be a question of fact. It concentrates on the substance of the management, particularly considering whether:

- i. an identifiable group of individuals most relevant and responsible for the track record results of a listing applicant remained in positions of responsibility with the enterprise under review throughout the relevant track record period; and
- ii. such group of individuals would form the core management of the applicant at the time of listing and thereafter.²⁷

²² HKEx Listing Decision LD97-1

²³ Rule 8.05 of the Listing Rules

²⁴ Rule 11.12A of the GEM Listing Rules

²⁵ Rule 8.05A of the Listing Rules

In this respect, the Exchange will ordinarily attribute proportionately greater responsibility to officers with more senior positions than those with more junior positions.²⁸

e. Minimum Public Float

	Main Board ²⁹	GEM ³⁰
Minimum public float	At least 25 per cent of the total issued share capital of an issuer has to be held by the public at all times upon listing. The HKEx has the discretion to accept a lower percentage of between 15 per cent and 25 per cent if the issuer has an expected market capitalisation at the time of listing of over HK\$10 billion.	
Shareholder spread	At least 300 public shareholders	At least 100 public shareholders
	Not more than 50 per cent of the securities held by the public can be beneficially owned by three largest public shareholders	

What is meant by “Public”?

The following persons will not be recognised as members of the “public” for the purpose of calculating the public float:

- i. any connected person of the issuer;
- ii. any person whose acquisition of securities has been financed by a connected person; and
- iii. any person who is accustomed to taking instructions from a connected person relating to the acquisition, disposition and voting of securities of the issuer held by him.³¹

f. Special Listing Qualifications for Mineral Companies or Newly-Formed “Project” Companies

Due to their unique characteristics, the listings of mineral companies or newly formed “project” companies in Hong Kong are subject to specific listing qualifications and requirements. For details, please refer to Chapter 7 (Preparing for an IPO – Specific Listing Issues).

²⁵ Rule 8.05A of the Listing Rules

²⁶ HKEx Listing Decision LD44-4

²⁷ HKEx Listing Decision LD45-1

²⁸ HKEx Listing Decision LD45-1

²⁹ Rule 8.08 of the Listing Rules

³⁰ Rule 11.23(7) to Rule 11.23(11) of the GEM Listing Rules

³¹ Rule 8.24 of the Listing Rules.

4. How to Plan a Listing?

a. Pre-IPO Diagnosis

In formulating a listing plan, you should consult with professional parties at an early stage for a clear understanding of the listing requirements, as well as the HKEx's current vetting attitude towards the business of the potential issuer. Legal advisers, together with accountants and/or sponsor firms, could provide pre-IPO diagnosis against the business to be listed to identify material issues in advance and propose solutions for the potential issuer. With the advice of the professional parties, you may devise an action plan for listing, which would facilitate project management and the control of cost outlay.

b. Pre-IPO Re-organisation

An IPO process usually involves group re-organisation, which aims at organising the group into a suitable listing structure. Such re-organisation usually commences shortly before the submission of listing application. However, in some cases, potential issuers may have to commence the group re-organisation at an earlier stage. Otherwise, the listing process may be delayed.

For example, some business partners may run a business using different entities. If they cannot prove that the entities are operated under their common control, they will not be regarded as a legal group and the reporting accountants may not be able to prepare consolidated accounts for these entities. As a result, the results, assets and liabilities of the entities may only be consolidated into the group account after the restructuring. In such case, the disregarded results may render the listing group failing to meet the listing qualifications, and the business partners may need to wait for a longer time to list their business.

In addition, sometimes the existing group structure may not entail all material operating subsidiaries, assets and businesses, or may contain businesses which need to be excluded. In such cases, pre-IPO re-organisation should be commenced earlier to allow the effect of the inclusion or exclusion of businesses or assets to be reflected in the track record period results.

Pre-IPO re-organisation requires careful consideration of various aspects, including legal, tax and accounting implications, as well as the requirements under the Listing Rules. Legal advisers and accountants should be consulted to ensure all aspects would have been considered.

c. Pre-IPO Financing

Companies may have funding needs before listing. Potential issuers may consider introducing strategic investors to the company so as to obtain funding and to access the business experience of strategic investors. Many private equity, hedge funds and investment banks would invest in unlisted companies, with the aim of cashing out on eventual IPOs. In return, these investors may take the form of a straightforward investment in ordinary shares or convertible instruments. As different investment structures may have different impact on the company's financial position, pre-IPO financing should be carefully structured.

Pre-IPO investors are usually given large discounts because of the risk that the IPO might not be successful. Also, they may ask for some special rights to protect their exposure. These preferential treatments may not be allowed by HKEx. For details, please refer to Chapter 7 (Specific Listing Issues).

5. How Long Does it Take?

For illustrative purpose, an indicative IPO timetable is set out below. The actual duration of the entire IPO will depend on the complexity of the offering structure and issues, as well as the parties' response time.

Actions required	Approximate days before listing
1. Pre-IPO Diagnosis <ul style="list-style-type: none"> ● Identify issues which need to be resolved/ remedied before IPO ● Determine if the business will meet the listing qualifications ● Seek professional advice if necessary 	365
2. Pre-IPO Reorganisation <ul style="list-style-type: none"> ● Organise the group of companies into a suitable listing structure ● Ensure the listing group will hold all assets, IPs and contractual rights to carry on its business ● Inclusion/ exclusion of businesses 	As early as possible as it takes time to complete and be approved
3. Pre-IPO Investment <ul style="list-style-type: none"> ● Introduce private equity investors/ strategic investors ● Negotiate terms of investment 	180+
4. Kick-off <ul style="list-style-type: none"> ● Confirm engagement of all professional parties ● Circulate memorandum on publicity restrictions to all parties ● Sponsor to prepare a tentative listing timetable ● Notification of sponsor's engagement to the Stock Exchange (at least two months before A1 submission) 	180+

Actions required	Approximate days before listing
<p>5. Sponsor's Due Diligence</p> <ul style="list-style-type: none"> ● Sponsor, together with other professional parties, to conduct reasonable inquiries on the listing group, which typically entail: <ul style="list-style-type: none"> ■ review corporate documents, accounts, contracts and other internal documents ■ review public records ■ attend site visit to material properties and operations ■ interview the management ■ interview major customers, suppliers, subcontractors, distributors, bankers and the professional parties involved in the listing ■ conduct background search against the controlling shareholder(s) and the proposed directors ■ obtain back-to-back confirmations from the controlling shareholders, directors, senior management and the listing applicant ● The sponsor is duty-bound to conduct due diligence with professional skepticism and raise follow-up inquiries until it is satisfied that the listing group is good for listing. 	180+
<p>6. Prospectus Preparation</p> <ul style="list-style-type: none"> ● All parties to attend drafting meetings and printer sessions to draft the prospectus ● Sponsor's lawyers to conduct verification on the prospectus 	180+
<p>7. A1 Submission</p> <ul style="list-style-type: none"> ● Sponsor to submit a listing application including a substantially completed draft of the prospectus to the Stock Exchange on behalf of the listing applicant ● For listing applications submitted after 1 April 2014, the application proof of the prospectus will be published on the Stock Exchange's website ● The Listing Division will conduct a three-day check to determine if a listing application should be rejected on the ground that the information in the listing application is not substantially complete 	80+

Actions required	Approximate days before listing
8. Vetting Process <ul style="list-style-type: none"> ● Two rounds of comments from the HKEx are expected: ● 1st round of comments to be issued within 10 business days from receipt of listing application ● 2nd round of comments to be issued within 10 business days from receipt of replies to the 1st round of comments 	66+
9. Listing Hearing <ul style="list-style-type: none"> ● The listing applicant and the sponsor may need to attend the hearing in order to answer any questions which the Listing Committee may have 	20+
10. Post Hearing <ul style="list-style-type: none"> ● All parties continue to address any queries from the Listing Committee ● Convene long board meeting to approve the listing and the relevant documents ● Publish Post-Hearing Information Pack (PHIP) on the HKEx's website ● Issue pre-deal research and distribute "red-herring" prospectus during roadshow 	14+
11. Bulk-Print of Prospectus <ul style="list-style-type: none"> ● Sponsor to conduct pre-bulkprint follow-up due diligence ● All parties to finalise the prospectus at the printer's office 	10+
12. Prospectus Registration <ul style="list-style-type: none"> ● Sign Hong Kong underwriting agreement ● Register the prospectus with the Companies Registry of Hong Kong together with other relevant documents 	8+
13. Before Dealing Commence <ul style="list-style-type: none"> ● Issue and post the prospectus on the HKEx's website ● Public offer opens and closes ● Sign international underwriting agreement and fix the IPO price ● Sponsor to conduct pre-listing follow-up due diligence 	7+
14. Listing <ul style="list-style-type: none"> ● Dealings in shares commence on the HKEx ● Listing Ceremony 	0
15. Post Listing <ul style="list-style-type: none"> ● Exercise of over-allotment option ● Price stabilisation ● Initial disclosure of interest ● On-going compliance 	Ongoing

Disclaimer

The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.



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Appendix 1 - List of Common Categories of IPO Expenses

IPO expenses generally account for 5% to 30% of the IPO proceeds, depending on the size and complexity of the offering, as well as the experience and reputation of the professionals engaged.

Here is a list of common categories of IPO expenses:

1. HKEx's initial listing fee
2. sponsorship fee
3. underwriting commission
4. company's legal advisers (as to Hong Kong laws and other jurisdiction)
5. sponsor's legal advisers (as to Hong Kong laws and other relevant jurisdiction)
6. reporting accountants
7. internal control consultant
8. industry expert, in any
9. property valuer, if any
10. financial printer
11. public relations firm
12. roadshow expenses, including travel and accommodation
13. receiving banks
14. share registrars and transfer agent
15. miscellaneous charges such as directors & officers liability insurance (D&O insurance), incorporation fees for the listing vehicle, background search fees, etc.

To control its cost exposure, a potential issuer may consult with professional parties involved in the IPO to agree on payment of fees by instalments. If necessary, potential issuers may consider introducing pre-IPO investors to the company for fund flow.

Chapter 2 – Preparing for an IPO: The Role of Reporting Accountants in an IPO

Introduction

The objective of this chapter is to describe the role played by reporting accountants in an IPO application process. New listing applicants will need to know what reporting accountants do in relation to a company prospectus, which must comply with Hong Kong's rules and regulations. They may also want to understand how professional accountants can otherwise assist them in achieving the objective of having their shares traded on the trading platform of the Hong Kong Stock Exchange (HKEx). Accordingly, the following topics will be covered in this chapter:

- Why there is a need to involve reporting accountants in the listing application
- Reporting accountants' involvement in the preparation of the prospectus
- Group reorganisation
- Qualifications of reporting accountants

The regulatory and financial reporting environment in Hong Kong is always evolving. For the materials in this chapter to be referred to appropriately, it is necessary to specify that the HKEx Listing Rules and professional standards covered in this chapter are those that are effective as at 30 November 2013. Because this IPO Guide 2014 is published for general reference purposes, the matters dealt with in this chapter can only be written at a high level. Following this principle the rules and regulations applicable to specialised industries, financial conglomerates and mineral companies, are excluded intentionally. Under certain restricted conditions, the HKEx may, at its discretion, give listing applicants exemptions from full compliance with the Listing Rules. These exemptions would be granted on a case-by-case basis and therefore are outside the scope of this chapter.

Why There is a Need to Involve Reporting Accountants in the Listing Application

The HKEx requires new listing applicants to include an accountants' report in their prospectus. Among other matters, the accountants' report must provide the listing applicant's historical financial information during the trading record period (which we will call "Financial Information"). Where the listing applicant includes pro forma financial information and/or a profit forecasts in its prospectus, they must engage an independent accountant (usually the reporting accountants) to report on the information, and their reports are included in the prospectus.

As a general practice, listing applicants also engage reporting accountants to review and report on other matters to be included in the prospectus, such as the indebtedness of the listing group.

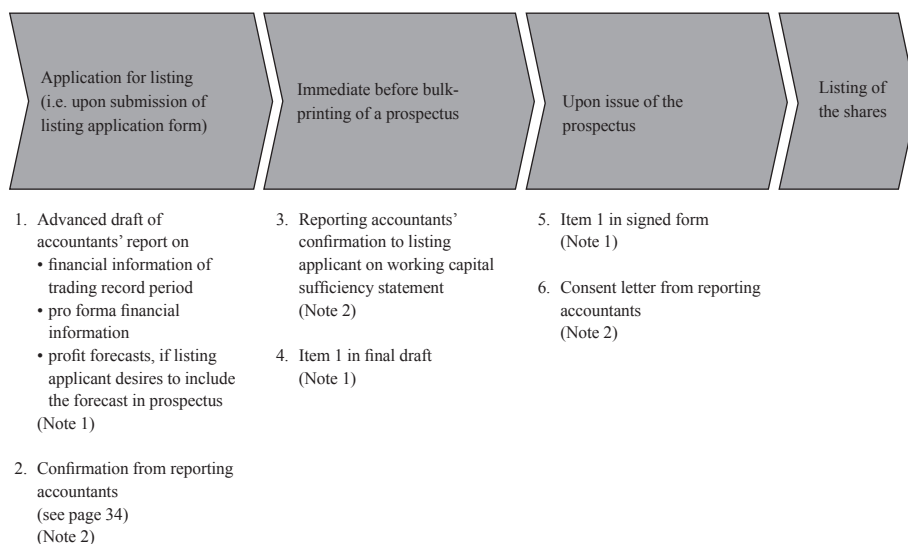
The general public may have the impression that new listing applicants involve reporting accountants in their IPO working team simply because of regulatory requirements. In fact, reporting accountants can contribute significant value to the success of an IPO application. Well before an entity confirms its IPO plan, it would need an independent accountant to advise on financial reporting-related issues. For instance, the involvement of reporting accountants in the design of a group structure can help avoid unpleasant surprises.

Most People's Republic of China (PRC) enterprises tend not to maintain their books and records according to the Hong Kong Financial Reporting Standards (HKFRS), International Financial Reporting Standards (IFRS) or the China Accounting Standards for Business Enterprises (CASBE). A transition from their local accounting standards to these standards may be too demanding for these enterprises if they do not have assistance from their reporting accountants. Reporting accountants with a sufficient track record of successful IPOs can generally help listing applicants work out a viable timetable and provide valuable advice on regulatory requirements in their areas of expertise.

Reporting Accountants' Involvement in the Preparation of a Prospectus

The primary responsibility of reporting accountants in a new listing application is to report on the financial or non-financial information, either historical or forecast, to be included in a prospectus. Some of these reports are set out in the prospectus whereas others are not.

The following table summarises the various information/disclosures that the Listing Rules requires the involvement of reporting accountants as the listing application progresses:



Note 1 – included in the prospectus

Note 2 – not included in the prospectus

The HKEx requires the information in the draft prospectus submitted together with a listing application (the Application Proof) to be substantially complete except in relation to information that by its nature can only be finalised and incorporated at a later date.

Details of the Listing Rules requirements on the information that reporting accountants will report on and the responsibilities of reporting accountants are set out below. There are also circumstances in which reporting accountants would be engaged as a matter of general practices.

Financial information of the trading record period

The role of reporting accountants is to give an opinion on the Financial Information as to whether or not it gives a true and fair view of the results and cash flows for each of the periods reported on, and the financial position as at the end of each of the periods reported on.

There are primarily three sources of requirements governing the form and contents of an accountants' report. They are:

- The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the Main Board Listing Rules), or The Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the GEM Listing Rules),
- The Third Schedule to the Hong Kong Companies Ordinance (Cap. 32)¹ - "Matters to be Specified in Prospectus and Reports to be Set Out therein" (the Third Schedule), and
- Auditing Guideline 3.340 – "Prospectuses and The Reporting Accountant" (AG 3.340) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA).

Any prospectus offering for subscription or purchase shares in a company should follow the relevant provisions in the Hong Kong Companies Ordinance. Particular requirements for the accountants' report are dealt with in the Third Schedule. These provisions are applicable to all companies whether incorporated in Hong Kong or not. Requirements in the Third Schedule are generally covered by the Listing Rules. Where the Third Schedule and the Listing Rules have similar requirements on a matter included in a prospectus, this chapter would mention the Listing Rules only on that requirement.

In respect of an application for new listing on the Main Board of the HKEx, the Financial Information should cover each of the three financial years immediately preceding the issue of the prospectus. Under GEM Listing Rule 11.10, the Financial Information covers at least the two preceding financial years. The HKEx, in some circumstances, may consider accepting a shorter period. In any case, the latest financial period reported on by the reporting accountants must not have ended more than six months before the date of the prospectus. Due to this requirement, in some cases, an interim period is added to the Financial Information. Generally this additional interim period is referred to as a "stub period". The reporting accountants' true and fair opinion covers also the Financial Information of the stub period. In respect of comparatives in the stub period, the reporting accountants are required to perform a review on them. A review opinion is of lower assurance level than a "true and fair view" opinion.

¹ Hong Kong Companies Ordinance (Cap. 622) comes into operation on 3 March 2014. The Third Schedule remains in Cap.32 which will be re-titled to "Companies (Winding up and Miscellaneous Provisions) Ordinance" upon the commencement of Cap. 622.

Subject to certain conditions, HKEx accepts early filing of listing applications in which case the financial information would cover a shorter trading record period. For example, an applicant for new listing on the Main Board of the HKEx may present financial information covering two years and nine months in the Application Proof. Financial information of the nine-month stub period, including the comparatives, has to be at least reviewed by reporting accountants according to Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity”. For the HKEx to accept a early filing, the HKEx requires a sponsor’s confirmation that it is beyond reasonable doubt that the applicant will satisfy the Main Board Listing Rule 8.05/GEM Listing Rule 11.12A (e.g., profit test) and other financial standard requirements.

The early filing application has to be filed after the trading record period of the listing applicant and the listing applicant has to file the updated financial information covering the full trading record period as soon as practicable. The reporting accountants would have to perform work on the updated financial information to support their opinion on the historical financial information of the trading record period as a whole.

The Main Board Listing Rules and the GEM Listing Rules generally have similar requirements on the form and contents of the Financial Information in an accountants’ report. The Financial Information must normally be prepared in conformity with HKFRS, IFRS and CASBE in the case of a PRC issuer that has adopted CASBE for the preparation of its annual financial statements. In brief, the Listing Rules require, as the minimum, the following elements:

- Statements of financial position as at the end of each of the periods reported on
- Statements of comprehensive income, statements of cash flows and statements of changes in equity in respect of each of the periods reported on
- Specific details concerning the Financial Information as set out in Main Board Listing Rule 4.04 & 4.05 and Appendix 16, or GEM Listing Rule 7.03 & 7.04.

The Financial Information must be prepared according to best practice, which is at least that required in the accounts of a company under the Hong Kong Companies Ordinance and the adopted financial reporting framework.

The HKEx also reserves the right to require a new applicant to provide more information, or vary the requirements for information to be disclosed according to what the HKEx considers necessary.

Directors of the listing applicant are responsible for ensuring the Financial Information is prepared in conformity with the above requirements. The reporting accountants are responsible to obtain sufficient relevant and reliable evidence to enable them to form an opinion on the Financial Information.

For many of PRC enterprises, entities in their listing group may not have been reporting under HKFRS, IFRS or CASBE before the listing application. Making the transition to these financial reporting frameworks may be a hurdle to these listing applicants.

Set out below are two more common issues relating to financial reporting encountered by listing applicants, in particular PRC enterprises.

Related party transactions

Under HKAS/IAS 24, if the reporting entity has related party transactions during the reporting period, it is required to disclose the nature of this related party relationship, information about those transactions, and outstanding balances. In PRC enterprises, the controlling shareholders are frequently individuals who also own other businesses not included in the listing groups. They should note that transactions between entities controlled by the same shareholders that are included in and outside of the listing group during the trading record period (which is three years before listing on the Main Board, and two years for the GEM) will be caught by HKAS/IAS 24.

The definition of a related party includes close family members of the owners. Since transactions between the listing group and the entities controlled by close family members of the owners of the listing group are caught by HKAS/IAS 24 as related party transactions, the volume of related party transactions in PRC entities is anticipated to be higher than the average reported by other entities. A systematic approach to identifying related parties would bring some relief to this burden. Until the time when the entities and businesses that will comprise the listing group is finalised, the identity of the related parties and their transactions with the listing group are subject to change.

Recognition of impairment on financial instruments (including trade receivables) and other assets

Generally when the future economic benefits associated with an asset falls below its carrying amount, the asset is impaired. The assessment of any impairment and the estimation of the amount of impairment should be determined based on the facts and circumstances existing at the end of each period reported on. Listing applicants reporting under their local financial reporting frameworks may not have been required to recognise impairment losses. When they adopt HKFRS/IFRS, they must be cautious not to perform the assessment with hindsight. Sometimes their existing books and records do not have the necessary information to support this assessment. It is advisable for listing applicants to begin the assessment early and seek advice from their reporting accountants.

Among their procedures, the reporting accountants must review the accounting policies the listing applicant has adopted and ensure these accounting policies are appropriately and consistently applied, and the Financial Information is presented on a consistent and comparable basis. To achieve this, the reporting accountants may need to adjust figures previously reported in the financial statements on which the preparation of Financial Information is based:

- to the extent practicable, the Financial Information is stated on the basis of accounting policies adopted in the last financial period reported on;
- if there has been a change in the group structure in the period reported on (for example, the acquisition or disposal of a subsidiary or business, or a reorganisation of the group) it may sometimes be appropriate to make adjustments so that the effects of the change on the results of the group and its state of affairs do not distort the Financial Information; and
- adjustments to make the Financial Information in all other respects properly comparable. An example is correction of material accounting errors in the financial statements of the period reported on.

Where adjustments are made, under the Main Board Listing Rule 4.15 and GEM Listing Rule 7.19, the reporting accountants are required to prepare a statement showing each adjustment made, the reasons for them, and include sufficient details so the figures in the audited financial statements can be reconciled with those in the accountants' report. This statement is commonly referred to as the statement of adjustment, and is available for public inspection. In the accountants' report, the reporting accountants should state all the adjustments that were considered necessary have been made, or that no adjustments were necessary.

Where the auditor's opinion on the underlying financial statements of the listing applicant and/or its subsidiaries was qualified and the reporting accountants conclude that, for the purpose of the accountants' report, the previous qualified audit opinion need not be repeated, the reporting accountant should indicate in the accountants' report how the matter was resolved.

To ensure the Financial Information in the accountants' report included in the Application Proof is substantially completed, the HKEx required a signed copy of the accountants' reports when the Application Proof is submitted. Where the accountants' report is not yet signed, the reporting accountants have to provide a confirmation (the Confirmation) to the listing applicant that no significant adjustment is expected to be made to the draft accountants' reports subject to completion of certain outstanding procedures as specified in HKEx Guidance Letter - HKEx-GL58-13. A copy of the Confirmation is made to the sponsor, the HKEx and the Securities and Futures Commission (SFC).

Pro forma financial information

Where a listing applicant includes pro forma financial information in the prospectus, whether the pro forma financial information is required by the Listing Rules or not, its preparation and presentation should comply with Main Board Listing Rule 4.29 or GEM Listing Rule 7.31. The listing applicant must engage its auditors or reporting accountants to report on the pro forma financial information according to the Main Board Listing Rule 4.29(7) or GEM Listing Rule 7.31(7). The report on pro forma financial information is set out in the prospectus.

With all new listings, the applicants should include in their prospectus a statement about the net tangible asset backing for each class of security for which a listing is being sought. This statement should be prepared taking the new shares to be issued into account as detailed in the prospectus, and is regarded as pro forma financial information.

The statement of net tangible assets is included in a prospectus to provide users with information about the listing of the applicant's shares on the HKEx (and the new shares to be issued, if applicable) by showing how it might have affected the financial information of the listing applicant if the transaction had been undertaken at the end of the trading record period (or the stub period, if applicable).

Compilation of pro forma financial information is the responsibility of the directors of listing applicants. The HKICPA has published Accounting Guideline 7 (AG 7), "Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars", to provide guidance on preparing and presenting pro forma financial information under the Listing Rules. AG 7 also contains guidance on judging whether pro forma financial information is misleading.

Notwithstanding the guidance in AG 7, Note 6 to the Main Board Listing Rules Appendix 1 Part A and Note 11 to the GEM Listing Rules Appendix 1 Part A provides a practical solution as to how to pro forma the financial statements effect arising from the valuation of property assets or other tangible assets under Main Board Listing Rule 5.01 or GEM Listing Rule 8.01. Listing applicants should state, in a note in the adjusted net tangible asset statement, the additional depreciation (if any) that would be charged against the income statement had such assets been stated at valuation.

The role of reporting accountants is to plan and perform their work in accordance with Hong Kong Standard on Assurance Engagements (HKSAE) 3420, “Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus” issued by HKICPA, so as to obtain sufficient evidence to provide reasonable assurance² that:

- the pro forma financial information has been properly compiled by the directors of the listing applicant;
- such basis is consistent with the accounting policies of the listing applicant; and
- the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to the Listing Rules.

The work of reporting accountants primarily consists of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments made by the directors and making enquiries of the directors regarding the process by which they have prepared the pro forma financial information.

When the Application Proof is submitted, the reporting accountants also have to state in the Confirmation (see page 34) that no significant adjustment is expected to be made to the accountants’ report on pro forma financial information.

Profit forecasts

The Listing Rules require the profit and cash flow forecasts memorandum to be submitted together with the listing application. However, the Listing Rules and the Third Schedule do not have requirements for a profit forecast to be included in a prospectus. Listing applicants may wish to do so voluntarily. In this regard, listing applicants should be cautious about the meaning of profit forecast under the Listing Rules. In cases where information in a prospectus is considered as a profit forecast, the listing applicant should engage reporting accountants to review and report on this forecast.

When preparing a listing document, a “profit forecast” means any forecast of profits or losses, however it is expressed, and includes any statement which explicitly or implicitly quantifies the anticipated level of future profits or losses, whether expressly or by referring to previous profits or losses or any other benchmark or point of reference. It also includes any estimate of profits or losses for an expired financial period that has not yet been audited or published. Any valuation of assets (other than land and buildings) or businesses acquired by an issuer based on discounted cash flows or projections of profits, earnings or cash flows will also be regarded as a profit forecast.

² The work to be performed by the reporting accountants or auditors does not constitute an audit or review.

Where a profit forecast appears in any listing document (other than one supporting a capitalisation issue), it must be clear, unambiguous and presented in an explicit manner and the principal assumptions, including commercial assumptions, upon which it is based must be stated. A profit forecast must also be prepared in a way that is consistent with the accounting policies normally adopted by the listing applicant. Main Board Listing Rule 11.19 and GEM Listing Rule 14.31 contain further rules on making the assumptions.

Directors of listing applicants are wholly responsible for the assumptions used in profit forecasts and the preparation and presentation of profit forecasts. Reporting accountants are engaged to review and report on the accounting policies and calculations for the forecast. Their report on the profit forecast must be set out. Although it is not the responsibility of reporting accountants to report on the assumptions used in a profit forecast, reporting accountants following Auditing Guideline 3.341, “Accountants’ Report on Profit Forecasts” issued by the HKICPA, are required to include an appropriate comment in their report should the assumptions adopted by the listing applicant appear to them to be unrealistic, or if there are any assumptions omitted but appear to the reporting accountants to be important.

The HKEx also requires reporting accountants to state in the Confirmation (see page 34) that no significant adjustment is expected to be made to the accountants’ report on profit forecasts included in the Application Proof.

Statement of indebtedness and other liquidity disclosure

In the prospectus, there must be a statement disclosing the details of the listing group’s loan capital, borrowings, mortgages or charges, indebtedness and contingent liabilities or guarantees (Statement of Indebtedness), as at the most recent practicable date or an appropriate negative statement (Paragraph 32 of Part A Appendix 1 to the Main Board Listing Rules/GEM Listing Rules). The Listing Rules also require a prospectus to include a commentary on the listing applicant’s liquidity and financial resources and capital structure (Other Liquidity Disclosure) as at the most recent practicable date (Paragraph 32 (5) of Part A Appendix 1 to the Main Board Listing Rules/GEM Listing Rules). As specified in the HKEx Guidance Letter HKEx38-12, the most recent practicable date for Statement of Indebtedness and Other Liquidity Disclosure in the Application Proof is a date no more than two calendar months before the date of the Application Proof. The information in the Statement of Indebtedness and Other Liquidity Disclosure have to be updated to a date no more than two calendar months before the date of the final prospectus.

It is the responsibility of the directors of the listing applicants to prepare this Statement of Indebtedness and Other Liquidity Disclosure. Though not required by the Listing Rules, the reporting accountants are usually engaged to report on the statement and disclosures. Note that this engagement is not an audit and the procedures taken by the reporting accountants cannot necessarily reveal all significant matters concerning these disclosures. Given that the date at which the borrowings and indebtedness are stated and Other Liquidity Disclosure is made is usually not the end of an accounting period, the reporting accountants unavoidably would need to place reliance on representations from the directors of the listing applicants as to the completeness of the amounts shown in the statement.

Where the reporting accountants are engaged, the report from the reporting accountants to the directors of the listing applicants (and the sponsors) is a private letter and usually is issued at the time when the final proof of the prospectus is ready. Depends on the practice of the sponsors, reporting accountants may be requested

to provide an additional report on the Statement of Indebtedness and Other Liquidity Disclosure included in the Application Proof.

Working capital sufficiency statement

The Listing Rules require the directors of listing applicants to state in the prospectus that, in their opinion, the listing applicant's working capital is sufficient for the group's requirements for at least 12 months from the date of publication of the prospectus or, if not, how it is proposed to provide the additional working capital considered by the directors as necessary (the Directors' Statement). To fulfil this requirement, the directors would prepare a cash flow forecast with the underlying assumptions recorded in the board minutes.

Before a prospectus is bulk-printed, the sponsors are required by Main Board Listing Rule 8.21A or GEM Listing Rule 12.23A (1) to confirm to the HKEx in writing that they are satisfied that (i) the directors' opinion on the adequacy of working capital is given after due and careful enquiry by the listing applicant; and (ii) that the persons or institutions providing finance have stated in writing that the relevant financing facilities exist.

As required by the HKEx, the sponsors' confirmation should be based on the sponsors' own due diligence work, the listing applicant's confirmation on the Directors' Statement and the reporting accountants' confirmation to the listing applicant. The Listing Rules are not specific as to the matters that the reporting accountants have to cover in their confirmation. To provide comfort in respect of sponsors' confirmation, the reporting accountants are engaged to review the assumptions adopted by the directors, compare the cash flows in the forecast with the facilities and resources available to the listing group and check arithmetical accuracy of the forecast. The confirmation from the reporting accountants is addressed to the listing applicant and copied to the sponsors, the HKEx and the SFC.

Comfort letter on other matters

In addition to the comfort letters on Statement of Indebtedness and Other Liquidity Disclosure and working capital sufficiency statement, reporting accountants may also be requested by sponsors to assist them to perform due diligence investigation or perform procedures to provide comfort in respect of the integrity of certain information included in the prospectus, such as other financial information and subsequent changes in historical financial information. This represents a separate engagement by the sponsors and is outside the scope of Listing Rules requirements.

The sponsors determine which information requires a level of comfort, the procedures that will provide the required degree of comfort on that information and when the comfort letter have to be ready. The reporting accountants would accept such engagements provided that they possess adequate knowledge of the subject matter. In respect of financial information, the nature of work is performing procedures as agreed with the sponsors and reporting the factual findings to the sponsors in accordance with Hong Kong Standard on Related Services 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information" issued by the HKICPA without giving any assurance on the matters reported on. In respect of subsequent changes in historical financial information, it is customary for reporting accountants to provide limited assurance in accordance with HKSAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information". It is the responsibility of the sponsors to determine what kind of procedures are appropriate, and the work performed by the reporting accountants do not release the sponsors from their

responsibilities under the Listing Rules. The reporting accountants will report to the sponsors in a private letter not available to the public.

Consent letter

The reporting accountants must have given and not withdrawn their consent to the issue of the prospectus with their reports in the form and context in which they are included. A statement to this effect must be made in the prospectus.

Paragraph 60 of AG 3.340 provides a comprehensive summary of the matters that the reporting accountants should pay attention to before they sign off their consent letters. The paragraph is reproduced below:

“Financial and other information is contained throughout a prospectus and not only in the accountant’s report. Whilst the reporting responsibility of the reporting accountant does not extend beyond his own report, he should consider the document as a whole. He should be satisfied that nothing contained within the prospectus as a whole is inconsistent with the information in his report, and that all relevant matters which have come to his attention have been properly reflected. In particular he should take steps to make himself aware of all the principal issues arising during the drafting of the prospectus. He should give consent to the publication of the prospectus containing his report only if he is satisfied with the form and context in which his report appears in the published document.”

Group Reorganisation

Group reorganisation is a common exercise for entities seeking listing in Hong Kong. Streamlining the group entities to carry out the core businesses of the listing group is one possible reason. In many PRC enterprises, the owners run their businesses using different entities, but according to law these entities are not connected. (In other words, these entities are under the common control of an individual or a group of individuals.) For the purpose of an IPO, these entities will be structured into a legal group. Group reorganisation in these situations is unavoidable for the PRC enterprises, which otherwise may not meet the qualifications for listing. For example, they may not have sufficient profits nor a long enough trading record period. Sometimes new listing applicants will redefine the principal activities of the entities in the listing group when they prepare for their listing application. As a result, businesses, identified assets and liabilities are transferred between the group entities.

A group structure is such a critical decision that the listing applicant’s management, sponsors, legal advisors and reporting accountants must work together to ensure all aspects would have been considered. For example, the ownership and management continuity requirement is satisfied under the Listing Rules and the desired reorganisation steps are legally practical. Determining the appropriate accounting for group reorganisation can be a complex accounting issue. It would be advisable to involve the reporting accountants early once the core business of the listing group is determined.

Here is an example highlighting how different accounting treatments would affect the views given by the Financial Information: where a group reorganisation is determined to be a business combination under common control, the entities combined would be regarded as in the same group since the date when common control is established. The results and assets and liabilities of the entities now combined would be included in the Financial Information as if the current group structure were always in existence. On the other hand, if no

common control can be proven and the group reorganisation is a business combination as defined in HKFRS 3, “Business Combinations”, the results and assets and liabilities of the entities legally become group entities will be consolidated into the Financial Information since the parent and subsidiary relationship is established. Often the date when the legal group structure is formed is not long before the IPO application, and therefore results of the entities legally joining the listing group would only be included in the trading record period results for a short period of time before the listing application.

Appendix 3 of AG 3.340 illustrates some of the types of adjustments which may be made to previously reported figures for the purpose of the Financial Information arising as a result of changes in the group structure.

From experience, listing applicants are recommended to take into account the following matters when they design their group structure:

- would the excluded businesses constitute competitive businesses and as a result adversely affect the chance of being considered as suitable for listing?
- have there been or would there be transactions regarded as related parties under HKFRS/IFRS or connected persons under the Listing Rules?
- if the group restructuring involves any carve-ins or carve-outs, whether or not the generally accepted conditions necessary for the split are present.

Qualification of Reporting Accountants

Reporting accountants should be qualified under the Professional Accountants Ordinance for appointment as auditors of a company and who are independent both of the listing applicant and of any other company concerned to the same extent as that required of an auditor under the Hong Kong Companies Ordinance and in accordance with the requirements on independence issued by the HKICPA.

The Third Schedule uses the terminologies “the auditors” and “accountants” in respect of different reports to be issued by professional accountants. There has been confusion as to the meaning of these terminologies. Paragraph 3 of AG 3.340 interprets that the report by the “reporting accountants” under Chapter 4 of Main Board Listing Rules and Chapter 7 of GEM Listing Rules will normally be made by the statutory auditors of the listing applicant.

Though the HKEx does not have vetting procedures or requirements on professional accountants acting as reporting accountants, the HKEx has stringent quality control measures on the competency and quality of reporting accountants so as to protect the interests of the public when they refer to the information reported on by the reporting accountants to make their investment decisions. One of the factors the HKEx will consider is the accountants’ prior experience with IPOs.

Regulations aside, reporting accountants can be a key ingredient for making a successful IPO application as they can assist applicants to resolve practical problems throughout the whole application process.



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Chapter 3: Financial Information Requirements and Transforming the Business

The information in this chapter focuses on the requirements for a listing applicant seeking a primary listing. It expands in more detail certain financial information requirements discussed in Chapter 2 and is published for general reference purposes. It then covers the important issue of the transformation of the business that is likely to be required before being suitable for listing in Hong Kong.

Financial information requirements

Key questions:

- Do we have an attractive story for potential investors?
- What financial information should be presented and on what basis?
- What periods should be covered?
- What additional disclosures are required for a public company?
- Is existing financial information of sufficient detail to communicate our historical performance?
- What forecast information will need to be prepared during the due diligence process?

Historical financial information and management's discussion and analysis

A company seeking to become public needs to include financial information in its prospectus to enable potential investors to assess the financial performance and position of the Group. This financial information must cover the three years immediately preceding the date of the prospectus for a Main Board listing applicant, and at least the two preceding years for the GEM Board. The latest period presented must not be older than six months at the date of publication of the prospectus.

A company will want to ensure that it discusses the historical financial information to be included in the Accountant's Report early on with their Reporting Accountant as the information will have to conform to positions and practices prescribed by the Hong Kong Listing Rules and the Hong Kong Companies Ordinance which may be different than the financial statements a company previously prepared, for example, they may be stated in local GAAP rather than accounting standards acceptable to the HKEx. If so, the Reporting Accountant will assist the company in drawing up the required additional financial information. This can often be a significant and time-consuming exercise.

The HKEx currently accepts financial information presented in accordance with Hong Kong Financial Reporting Standards (HKFRS), International Financial Reporting Standards (IFRS), and China Accounting Standards (for People's Republic of China issuers). However, a company should discuss the likely target

market for their potential shareholders with their investment bank as certain investors may have a preference for the use of certain accounting standards.

As a company gains financial sophistication, it should also begin preparing interim financial statements. Preparing these statements in a timely manner can add to an investment bank's positive evaluation of a company. In addition, starting to prepare interim financial statements can help expedite the IPO process, as they may be required to be included in the Accountant's Report, depending on when the prospectus will be issued or if the listing timetable is delayed.

A stumbling block that many companies face is their inability to describe the effect of underlying factors on the company's performance. A prospectus and all future financial statements will require the inclusion of a Management's Discussion and Analysis (MD&A) related to a company's financial statements. This is a quantitative and qualitative discussion of a company's performance. The company will need to describe in-depth such items as changes in sales volumes and cost structures, liquidity and capital resources, sources and uses of cash flows, vendor relationships, employee compensation, unusual nonrecurring charges, significant environmental exposures, and other risks and uncertainties.

A robust and detailed MD&A with the ability to clearly explain performance greatly assists the HKEx in assessing whether an applicant is suitable for listing and also assists the company in communicating with potential investors. The practice of writing quality, comprehensive MD&As will therefore expedite a company's IPO process and be a major step toward operating like a public company.

Forecast financial information

Profit forecasts

There is no requirement under the Listing Rules or Companies Ordinance to include a profit forecast in the prospectus. Listing applicants may wish to include a profit forecast voluntarily after discussion with their investment banks if they believe it would be significantly beneficial to the offering process and marketability of the shares. Where a profit forecast appears in a prospectus, the Listing Rules require it to be clear, unambiguous and presented in an explicit manner and the principal assumptions, including commercial assumptions, upon which it is based must be stated. If a profit forecast is included within a prospectus, it must be accompanied by a report from the Reporting Accountant stating that it has been prepared on the basis stated in the prospectus and whether they consider any of the assumptions are unreasonable.

Subsequent to its listing, the period that was the subject of the forecast must be audited, so profit forecasts are generally only presented for the period up to the end of the issuer's next financial year in order to avoid additional audit costs. If an issuer's actual results are significantly different from the information that was forecast in the prospectus, that issuer must explain the differences in their annual or interim report.

The inclusion of a profit forecast carries with it an increased level of risk to the directors of the issuer and a company should consider carefully whether the cost and benefit of inclusion of such information is significantly beneficial to the offering.

As part of the HKEx vetting process, an issuer must submit a profit forecast memorandum to the HKEx covering the period to the issuer's next year-end. This information is private and not included in the

prospectus and is not required to be reported on by the Reporting Accountant. However, the directors should ensure this information has been prepared on an appropriate basis similar to that required for inclusion in the prospectus to enable the HKEx to assess the company's prospects and disclosures about its future. The profit forecast memorandum is usually combined with the working capital memorandum (see below).

The listing rules require the directors of listing applicants to state in the prospectus that, in their opinion, the applicant's working capital is sufficient for the Group's requirements for at least 12 months from the date of publication of the prospectus or, if not, how it is proposed to provide the additional working capital considered by the directors as necessary.

In order to make this statement, and to demonstrate to the sponsor that the company has been through due process, the directors usually prepare a detailed working capital forecast memorandum which includes the group's forecast cash flows for that period, usually on a monthly basis, together with the key assumptions and sensitivities.

As part of the vetting process, the sponsor is also required by the Listing Rules to confirm to the HKEx in writing that they are satisfied that the directors' opinion on the adequacy of working capital is given after due and careful enquiry. Therefore the sponsor will also need to be closely involved in understanding the basis of preparation of the cash flow forecasts and the directors' internal assurance process.

The HKEx will review and comment on the profit forecast and working capital forecast memoranda which are an important part of the vetting process.

Other financial information to be submitted to the HKEx

As part of the listing application process, the HKEx requires the listing applicant to submit additional schedules to the HKEx to assist in their vetting of the application. This additional information is not included in the prospectus and some items that need to be submitted may not be information that the applicant prepares or reviews on a regular basis.

The information to be submitted as part of the first filing to the HKEx includes details of top five customers and suppliers, ageing analysis of accounts receivable and payable including details of subsequent settlement, ageing and usage of inventory. These areas are often problematic and time consuming for issuers to prepare.

Transforming the Business

The IPO process is not the end of the story; it is only the beginning. Once listed, a company will be under far greater public scrutiny and will have a range of continuing obligations with which to comply. Any weakness in systems or failure to comply with regulations could cause management significant public embarrassment, reputational damage, and the potential for company and personal fines.

The most significant change for many companies is the need to close and report publicly on their financial results on an accelerated timeline and to comply with corporate governance requirements and market expectations. Inability to meet these requirements will shake investor confidence or subject the company to a delisting.

This preparation process can often be lengthy, depending on the current maturity of a company's existing processes. It is vital that the company understand and address any gaps before going public.

Key questions:

- What are the expectations of our potential investors?
- What corporate governance issues need to be addressed?
- How many directors need to be recruited?
- Do we have the right resources to operate as a public company?
- Is the finance function ready?

Recruiting a Strategic Board

In any public offering, the quality of the leadership team is a key factor. It is vital to ensure that the board of directors as well as management has the right blend of experience and skills to establish the optimal corporate governance structure and ensure that the board committees are operating effectively. To gain credibility with the investing public, the organisation must have experienced leadership that functions well as a team. For a successful IPO, management must be committed to the time and effort involved in meeting filing requirements, conducting analyst and other investor-facing meetings, and providing financial information required by both the Hong Kong Listing Rules and shareholders on a timely basis. It must also be prepared to upgrade the company's system of management controls and financial reporting well in advance of the offering to ensure compliance with full disclosure requirements and shorter financial reporting deadlines, both of which are necessary to maintain credibility and investor confidence after the IPO.

The investment community wants to be sure that the management running a company is not a "one-man band." This may require adding individuals with public company experience in marketing, operations, development, and finance. Many companies also want to put a Chief Financial Officer in place who has previously been through the IPO process. The team needs to be cohesive and share a long-term vision for the company to obtain maximum financial return and valuation.

One of the best sources of objective advice can come from an independent or outside director. The Hong Kong Corporate Governance Code requires a listed company to have at least three independence non-executives who must also comprise at least one third of the board.

A company should not wait until the last minute to begin its search for qualified outside board members. A potential board member who is unfamiliar with a company may be reluctant to join the board immediately prior to an IPO, since a director has responsibility for information contained in or omitted from the prospectus.

Assessment of internal controls

As part of the listing application process, the sponsor is required to confirm, as part of its declaration to the HKEx that it reasonably believes the applicant has established procedures, systems and controls (including accounting and management systems) which adequately address the obligations of the company and its directors to comply with the Listing Rules and other relevant legal and regulatory requirements.

Such procedures, systems and controls should enable the Company's directors to make a proper assessment of the financial position and prospects of the company and the related group of companies, both before and after listing. The sponsor must also confirm that the designated company directors should collectively have the experience, qualifications and competence to manage the company's business and to comply with the Listing Rules.

Individually, the directors should also possess the experience, qualifications and competence to perform their individual roles, including an understanding of what is expected of them and their obligations to the company as an issuer under the Listing Rules and other legal or regulatory requirements relevant to their role.

The HKEx has issued Practice Note 21 (PN21) to clarify to Sponsors the expected due diligence procedures to be performed as part of the listing application. Market practice is for the sponsor to engage third party professionals to assist with the due diligence process, in particular the assessment of corporate governance and internal control systems. Therefore as part of the listing process, the listing applicant will likely require an internal control consultant to perform a review of the group's corporate governance and internal controls over financial reporting which usually cover the following:

- Corporate governance/Control Environment
- Risk Assessment
- Information and Communication
- Monitoring
- Control Activities (e.g. business controls related to sales, purchases, financial reporting processes, and so on.)

This process usually identifies a number of areas that will need to be remediated prior to completion of the IPO therefore it is recommended that listing applicants engage with their sponsor early in the process to ensure there is sufficient time to address any issues.

Meeting reporting requirements

Internal monitoring of performance

Throughout the IPO process, sponsors will ask for financial projections and will compare a company's historical performance to its past budgets and also for the purposes of reviewing the applicants profit and working capital forecast memoranda. Accordingly, a company should establish a financial planning and analysis team, which should put a budget and forecasting process in place. The company should get into the habit of preparing realistic budgets, updated forecasts, and be able to articulate why variances have occurred. For the early-stage company, projections and market share are the most important measures of performance.

After a company goes public, budgets and projections will become an important tool for research analysts. This information and a public company's ability to meet its own earnings estimates and market commentators' earnings estimates can have a significant impact on its stock performance. Accurate budgeting and forecasting is critical for a successful IPO, as the market gives very little margin of error in that area and punishes the stock for any significant underachievement.

Periodic external reporting of performance

Public companies are required to file certain periodic information to keep the investing public informed. Preparing to meet these requirements should be a focus for a company as goes through the IPO process. Companies should discuss their obligations under the various regulations with their lawyers and accountants at the beginning to lay out the obligations and ensure they can be met. A financial public relations firm can assist companies with furnishing annual reports to shareholders. The table below presents an overview of the basic reporting requirements for Main Board listed public companies:

Reporting	Requirements	Timing
Annual Results Announcement	<ul style="list-style-type: none"> Based on financial statements and agreed with auditors Primary financial statements and significant notes Business review 	Within three months from year end date
Annual Financial Report	<ul style="list-style-type: none"> Audited financial statements prepared in accordance with HKFRS/IFRS A management report An appropriate statement of assurance from the directors An audit report A corporate governance report 	Within four months from year end date
Half-Yearly Report	<ul style="list-style-type: none"> A condensed set of financial statements prepared in accordance with HKFRS/IFRS A business review An appropriate statement of assurance from the directors An interim review by the auditors (optional) 	Results announcement within two months, report within three months from half-year end date

Timely disclosure of inside information

A public company should disclose all inside information both favorable and unfavorable, as promptly as possible. Information that is generally considered material includes: significant financial transactions, new products or services, acquisitions or dispositions of assets, dividend changes, and top management or control changes. The disclosure of such information should be made as soon as it is reasonably accurate and full details are available to the company.

Key elements of effective corporate governance and internal control

Given the level of interest by institutional investors and the investing public in corporate governance matters, it is important for companies to take a close look at their corporate governance principles and practices when planning the public offering process. The framework for corporate governance for listed companies in Hong Kong is set out in the Corporate Governance Code and Corporate Governance Report (the Code) included as Appendix 14 to the Main Board Listing Rules. Appendix 14 also sets out the required contents of annual reporting of corporate governance to shareholders.

Chapter 3 of the Main Board Listing Rules also requires the board to be comprised of at least one third of independent directors, and to have audit and remuneration committees. The Code sets out a number of “principles” followed by code provisions and recommended best practices. It is important to recognise that the code provisions and recommended best practices are not mandatory rules. The Exchange does not envisage a “one size fits all” approach. Deviations from code provisions are acceptable if the issuer considers there are more suitable ways for it to comply with the principles.

Section C.2 of the Code sets out the HKEx’s views on internal control. Directors are expected to conduct a review of the effectiveness of the systems of internal control of the issuer and its subsidiaries at least annually and report to shareholders that they have done so in their Corporate Governance Report (CGR). The review should cover all material controls, including financial, operational and compliance controls and risk management functions. In order to comply with the Code in relation to internal control, the boards of listed companies should:

- 1) Assess how the company has applied this Code principle;
- 2) Implement the requirements of the Code provisions; and
- 3) Report on these matters to shareholders in the CGR.

IPO readiness assessment

Undertaking a structured exercise to analyse a company’s state of preparedness for going public can give management a full understanding of key IPO issues as they apply to the company. The assessment process allows a company to identify and resolve issues at an early stage, thereby saving time and money. Advance planning helps you minimise the impact of potentially unpleasant surprises and be prepared to benefit from any positive market movements. In our experience, businesses that have undertaken a full pre-IPO readiness exercise are those that are best prepared to handle the complexities of the IPO transaction. The right amount of preparation also helps companies establish a timetable based on the offering’s strategic objectives, specific business issues and the actual work that needs to be performed. Such an assessment provides a reasonable basis for discussions with stakeholders about timing. The diagram below sets out a preliminary framework for assessing IPO readiness:

Framework for assessing IPO readiness	Private	Mid-stage	IPO ready
Eligibility for listing	Unknown	Assessed	Compliant
Equity story	Proprietor focus	Developed	Coherent and robust
Financial history	Separate accounts	IFRS/HKFRS consolidated accounts	IFRS/HKFRS 3-year record
Corporate structure	Legacy businesses	Rationalised	Efficient tax and legal structure
Forecasting	High level plan	Accrual based forecasting	Reliable working capital forecasts
Taxation	Unassessed risks	Assessed risks	Mitigation and disclosure strategy

Framework for assessing IPO readiness	Private	Mid-stage	IPO ready
Corporate governance, financial control and risk management	Proprietor discipline	Professional management	Governance procedures
Financial reporting	Statutory filings only	IFRS/HKFRS reporting	Annual and interim reporting
Due diligence readiness	Not assessed	Some information	Full information available

A typical IPO readiness assessment would address the following questions:

- What does being a public company really mean?
- How long will it take to complete an IPO?
- Do we have the right resources?
- Are my people ready?
- Do we have an attractive story for potential investors?
- What is the best way to articulate our strategy?
- What are the corporate governance issues we need to address?
- How many non-executive directors should we have on the board?
- What are the implications of a concurrent offering of shares to sophisticated investors in the United States (via Rule 144A of the US Securities Act of 1933)?
- How do our accounting policies compare with other companies in the sector?
- Is my finance function ready?
- Are my operations run and managed effectively?
- What additional disclosures will we need to provide as a public company?
- Will it be a problem if one of our subsidiaries has a modified audit opinion?
- Do we need to restate our track record for recent acquisitions and disposals?
- How will an IPO affect our existing incentive arrangements?



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Appendix – The Need for Valuation

A1. Pre-IPO Valuation Need

Company Restructuring and Financing

It is not unusual that companies undergo series of restructuring activities prior to their IPOs so that they, together with their subsidiaries and associates, would be reorganized into structures more favorable to listing. In the course of restructuring, sales and purchase of assets, liabilities and equity interests are often involved. The International Financial Reporting Standards (IFRS) determines that fair valuations be measured in these transactions.

Besides, companies typically issue convertible preferred shares to investors, such as private equity funds and investment banks, before their planned IPOs. Again, the IFRS determines how these financial instruments are to be recognised. Depending on the terms of these instruments, their impacts on the financial statements, both on their issue and year-end dates, could be very different.

Business Combinations

Company restructuring may lead to a business combination transaction in which the acquirer obtains control of one or more acquirees. Pursuant to the Hong Kong Financial Reporting Standard 3 Business Combinations (HKFRS3), the purchase method must be applied to all business combinations. Assets given and liabilities incurred or assumed by the acquirer in exchange for control of the acquiree are required to be measured at their fair values at the acquisition date. The acquirer has to allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised shall be recognised as goodwill. Application of the HKFRS3 involves the following steps:

- 1) Identify the acquirer and acquiree(s);
- 2) Determine the acquisition date;
- 3) Identify and measure the intangible assets and, if available, contingent liabilities at fair value;
- 4) Recognize and measure goodwill.

■ Intangible Assets

Intangible assets are identifiable non-monetary assets without physical substance. Brand names, patents, licenses, customer relationships, and distribution rights are some common intangible assets. They are generally valued by the following approaches:

Cost Approach – The approach considers the cost to reproduce or replace in new condition the assets appraised, taking into consideration past and present maintenance policy and rebuilding history.

Market Approach – In this approach, an asset is valued by looking at how the market prices similar assets.

Income Approach – In the income approach, the value of an asset is the present worth of the expected future economic benefits of ownership.

The remaining life of the intangible assets must also be determined properly as it may have profound impacts to the earnings of the acquirer in subsequent years. The different treatments and accounting effects are as follows:

Lifetime	Subsequent Treatment	Accounting Effect
Fixed	Amortization	<ul style="list-style-type: none"> • Annual amortization cost; • No impairment loss
Indefinite	Impairment test (annually or more frequent)	<ul style="list-style-type: none"> • No annual amortization cost; • Possible impairment loss

■ **Contingent Liabilities**

Contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. For example, financial guarantee contract and customer contract with penalty clause. The contingent liability has the following characteristics:

- ◆ a present obligation has arisen as a result of a past event;
- ◆ the payment is probable; and
- ◆ the payment amount can be estimated reliably.

The table below summarizes the accounting treatments for the various account items during business combination.

Account Item	Accounting Treatment	
	Fair Valuation?	Consideration & Treatment Description
<u>Current Asset</u>		
Cash	✗	No adjustment
Short Term Receivables	✗	No adjustment
Long Term Receivables	✓	Present value of the amounts to be received, less allowances for uncollectibility and collection costs.
Inventories	✓	
Finished Goods	✓	Selling price less the sum of (1) cost of disposal and (2) a reasonable profit allowance for the selling effort
Work in Progress	✓	Selling prices less the sum of (1) cost to complete, (2) cost of disposal and (3) a reasonable profit allowance.
Raw Material	✓	Current Replacement costs
<u>Non-Current Asset</u>		
Financial Instruments	✓	Market Value (Mark-to-Market/Mark-to-Model)
Fixed Assets		
Land & Building	✓	Market Value (Determined by appraisal)
Plant & Machinery	✓	Market Value (Determined by appraisal)
Intangible Assets	✓	Market Value (Mark-to-Market/Mark-to-Model)
Goodwill	✓	Different between Acquisition Cost and Fair value of the business
<u>Current Liabilities</u>		
Short Term Loan	✗	No adjustment
<u>Long-Term Liabilities</u>		
Long Term Loan	✓	Present value of amounts to be disbursed in settling the liabilities
Financial Instruments	✓	Market Value (Mark-to-Market/Mark-to-Model)

Financial Instrument Treatment

A company may issue financial instruments, often in the form of convertible debts, to raise capital for funding needs. On the other hand, a company may also hold financial instruments issued by other companies for investment purposes.

Depending on the terms of the convertible instrument, the accounting treatment and hence the financial statement impacts could be very different. In general, from the perspective of the issuer, a convertible note consists of the following components:

- Debt;
- Derivative; and
- Equity

The debt component is the liability part of the instrument, owed by the issuer. Its fair value is the sum of the present values of all expected future cash flows from the instrument, each discounted by their prevailing market rates of interest for a similar instrument with a similar credit rating respectively. The prevailing market interest rates could be estimated by combining the corresponding risk-free rates, which are the rates implied by the related government sovereign securities, an appropriate credit risk premium commensurate with the credit status of the issuer, and some other risk premiums compensating the risks specific to the instrument.

The derivative component is more complicated. Common examples are the early redemption options inherent to the financial instrument. These options could be call (at the discretion of the issuer) or put (at the discretion of the holder) in nature. The binomial model and Monte Carlo simulation are some of the commonly adopted methodologies to value these options.

The equity component is the right entitling the holder to receive a fixed number of the issuer's own equity instruments for a fixed principal amount of the instrument. According to the International Accounting Standard 32 (IAS32), the residual amount after any asset and liability components are separated first from the instrument is the amount of the equity component.

A2. IPO Valuation Need

Property valuation for Hong Kong IPO

When an applicant decides to float its company's shares and undergoing the listing procedure, one of the concerns will be whether or not, a valuation of properties amongst its assets portfolio is needed. This section provides a brief introduction to the requirements, content, methodology, workflow and other important issues with respect to property valuation for IPO purposes.

Property valuation requirements

Under Chapter 5 and Practice Note 12 (Main Board) or Chapter 8 (GEM Board) of the Rules Governing the Listing of Securities (known as Rules and Guidance) issued by the HKEx, the basic criteria in determining whether property valuation is required will be primary regulated by an applicant's property activities. Along with the Rules and Guidance, it is defined as *"holding (directly or indirectly) and/or development of properties for letting or retention as investments, or the purchase or development of properties for subsequent sale, or for subsequent letting or retention as investments. It does not include holding of properties for own use."* In turn, property means *"land and/or buildings (completed or construction in progress). Building includes*

fittings and fixtures”, whereas “equipment and machinery used for production should be excluded”. Property interests means “an interest in the property”.

The following summary defines whether a property valuation for an applicant’s property interests is required in an IPO exercise.

Applicant’s property interests forms part of property activities	☑/☒
Property interests forms part of property activities <1% carrying amount of its total assets	☒
The total carrying amount of property interests not valued >10% of its total assets	☑

or,

Applicant’s non-property activities property interests	☑/☒
Carrying amount of a property interest \geq 15% carrying amount of its total assets	☑
Single property interests has a carrying amount \geq 15% carrying amount of its total assets	☑

Notes: ☑ Valuation required | ☒ Valuation not required

In accordance to the HKEx Rules and Guidance, carrying amount means “*an asset is recognized in the most recent audited consolidated balance sheet of the group as disclosed in the listing document after deducting any accumulated depreciation (amortization) and accumulated impairment losses*”. Whereas total assets means “*the total fixed assets, including intangible assets, plus the total current and non-current assets, as shown in the latest audited consolidated financial statements in the accountant’s report in the listing document*”.

Valuation Methodology

The aim of valuation for IPO is to appraise the market value for those properties whereas assessment is required corresponding to the Rules and Guidance. It is broadly accepted that the comparison method or the market approach is the best method given the valuation figures is largely substantiated by market transactions evidence.

Having said that, when comparables are unavailable or insufficient to sustain the market approach, there are alternative notional techniques, namely the investment method / income approach, profits method, discounted cash flow approach (DCF) or the residual method to assess the market value of properties. Another means is the contractor’s method or cost approach when buildings and structures have to be valued while market transactions for these kinds of properties are virtually not exist.

Yet, particular due care has to be addressed in valuing properties based on either income or profit or residual method. HKEx requires valuers to further reveal the rationales in the valuation reports when either approach were adopted in particular for developing property markets where properties have been valued on open market basis, but indeed is not referencing to market transactions evidence. As far as the residual method is concerned, valuers have to disclose the rationale and assumptions with titles evidences or even accepted legal opinion in supporting the permitted or hypothetical development scale, the gross development value with comparables to demonstrate the calculation as well as market evidence for the cost and outgoings, interest, developer’s

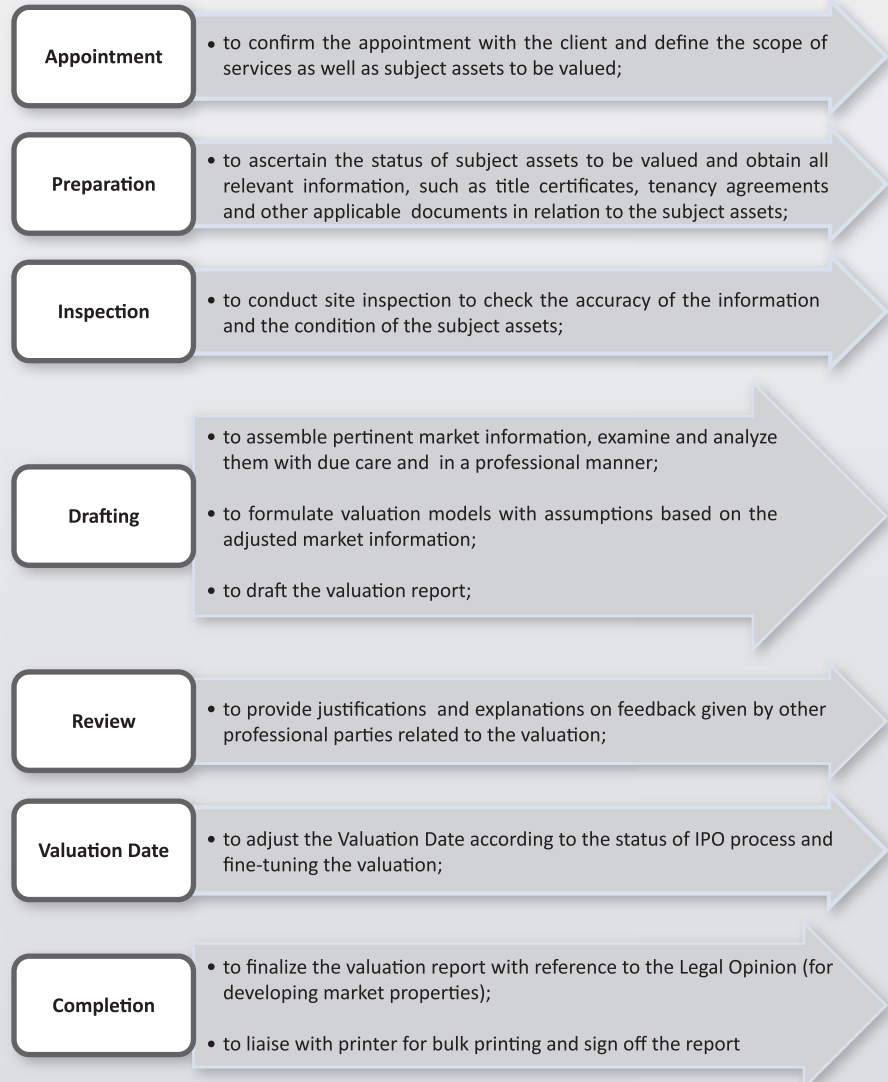
profit, etc. As for the investment or profits method as well as DCF approach, valuers should also state the assumptions for the adoption of the method and if any other indirect market evidence were adopted in the valuation.

Summary of Valuation Methods	
Comparative Method / Market Approach	<ul style="list-style-type: none"> ▶ compare the subject property with sale or rental transactions of similar properties on a like-with-like basis (comparables) ▶ apply the comparable market transactions as indicator ▶ formulate realistic adjustments regarding time, location, building age, size, design, quality, plot ratio and other relevant factors
Investment Method / Income Approach	<ul style="list-style-type: none"> ▶ determine the future actual rents the property will produce ▶ capitalize the future rent at the current discount rate over the remaining tenure of the property ▶ construct appropriate adjustments or deductions for factors like rent-free period, vacancy voids, non-recoverable expense
Profits Method	<ul style="list-style-type: none"> ▶ ascertain subject property's historical operating profits and performance ▶ make allowance for outgoings in arriving the net operating profit and any unusual revenues or expense ▶ capitalize the realized profit with a realistic rate ▶ analyze the historical operating data and make assumptions about future market condition ▶ anticipate the future income stream receivable and outgoings for a term ▶ capitalize the net income flow into present value at an appropriate discount rate
Discounted Cash Flow Approach	<ul style="list-style-type: none"> ▶ analyze the historical operating data and make assumptions about future market condition ▶ anticipate the future income stream receivable and outgoings for a term ▶ capitalize the net income flow into present value at an appropriate discount rate
Residual Method	<ul style="list-style-type: none"> ▶ ascertain the development proposal, work out the gross development value of a property upon completion ▶ deduct the cost of development including construction cost, professional fee, interest payment, developer's profit and other factors ▶ take into account the time for completion and reflect it on the residual value of the property by adopting an adjusted market interest rate to replicate the risk as discount factor
Contractor's Method / Cost Approach	<ul style="list-style-type: none"> ▶ consider the cost to reproduce or replace in new condition of the subject property ▶ make reference to the current construction costs for similar buildings and structures in the locality ▶ deduct the allowance for accrued depreciation or obsolescence from physical, functional or economic causes

A3. Valuation Practice

Property valuation work flow

In carrying out a property valuation, this will normally comprise the following procedure:



Independence of valuer

In order to maintain the impartiality and independence of valuers, HKEx requires that property valuation has to be prepared by an independent qualified valuer, who is summarized as:

Definition of independent and qualified valuer			
A valuer is not independent if:	Valuer	Role	Employed by
	Individual	Officer/ Servant/ Proposed Director	Issuer/ Issuer's subsidiary or holding company/ subsidiary of the issuer's holding company or any associated company
	Firm or Company	Issuer's subsidiary or holding company/ subsidiary of the issuer's holding company/ partners, directors or officers of the Firm is an officer or servant or proposed director	
A valuer is a qualified valuer only if they are authorized to value:	Properties	Qualification	
	Inside Hong Kong	Fellow or associate member of The Royal Institution of Chartered Surveyors (Hong Kong Branch) or The Hong Kong Institution of Surveyors	
	Outside Hong Kong	With an appropriate professional qualification and experience in valuing properties in the same location and category	

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Chapter 4 – Pre-IPO Preparation: Regulatory Requirements and Preparation of the Prospectus

Preparing for an IPO on the Hong Kong Stock Exchange (HKEx) is a painstaking process that can often take up to two years, and most advisers suggest at least a year from decision to execution. This ensures that appropriate internal financial and management controls are put in place and that any necessary restructuring can be completed.

Preparing a company for an IPO will usually necessitate the consideration of the following issues:

- is the company ready to go public, in particular, can it meet the HKEx's listing requirements?
- is the company's existing group structure suitable for a listed company?
- should the company engage strategic investors for support?
- who should the company work with to ensure a successful listing?
- what information needs to be included in the prospectus?

These issues are considered below.

Is the company ready to go public?

Once a decision is made to list in Hong Kong, a company must then consider if it can satisfy the HKEx's listing criteria. First and foremost, the company and its business must, in HKEx's opinion, be suitable for listing. There is no definitive "suitability" test although the HKEx may raise concerns in situations where:

- the company does not have control over its business and is unable to carry on an independent business as its main activity¹;
- the company's directors or controlling shareholders have an interest in a competing business²; or
- the company's assets consist solely or substantially of cash or short-dated securities³.

¹ A company may be considered to be not independent if, for instance, it is heavily dependent on one customer/supplier or relies heavily on the support of a related party or a controlling shareholder.

² In such cases, full disclosure of the competing interests must be made at the time of listing and on an ongoing basis in order for the company to pass the "suitability" test.

³ An exception to this is where the company is engaged in the securities brokerage business (in which case, the company may still be regarded as suitable for listing).

It must also satisfy one of the following three financial "tests" set out under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Listing Rules):

	Profit Test	Market Capitalisation/ Revenue Test	Market Capitalisation/ Revenue/Cash Flow Test
Minimum profit attributable to shareholders	HK\$50 million in the last three financial years (with profits of at least HK\$20 million recorded in the most recent year, and aggregate profits of at least HK\$30 million recorded in the two years before that)	-	-
Minimum market capitalisation at the time of listing	HK\$200 million	HK\$4 billion	HK\$2 billion
Minimum revenue	-	HK\$500 million for the most recent audited financial year	HK\$500 million for the most recent audited financial year
Minimum cash flow	-	-	Aggregate positive cash flow from operating activities of HK\$100 million for the three preceding financial years

Regardless of which test the company chooses to satisfy, it must still demonstrate:

- a trading record of at least three financial years with management continuity for at least the three preceding financial years and ownership continuity and control for at least the most recent audited financial year⁴;
- that it has enough working capital for its current needs and for at least 12 months after listing;
- that at least 25% of its total issued share capital will at all times be held by the public⁵, which means that the market capitalisation of the public float must be at least HK\$50 million; and
- that it will have at least 300 shareholders post-listing.

⁴ The HKEx may accept a shorter trading record period under substantially the same management if the company qualifies under the Market Capitalisation/Revenue test and can demonstrate (i) that its directors and management have sufficient and satisfactory experience of at least three years in that line of business/industry; and (ii) management continuity for the most recent audited financial year.

⁵ The HKEx may accept a lower public float percentage of between 15% and 25% in cases where a company has an expected market capitalisation of over HK\$10 billion at the time of listing.

A company that cannot meet the above requirements will generally not be eligible for a listing on the HKEx Main Board (unless the HKEx agrees to relax those requirements in a particular case). Nevertheless, such company may still be able to list on the Growth Enterprise Market (GEM), which is an alternative stock market operated by the HKEx and is aimed at enterprises that have growth potential but are not necessarily able to meet the financial tests for the Main Board.

To be eligible for a GEM listing, an applicant company must have:

- a positive cashflow of at least HK\$20 million for the two preceding financial years generated from operating activities in its ordinary and usual course of business;
- a market capitalisation of at least HK\$100 million at the time of listing. As with the Main Board requirements, at least 25% of the company's total issued share capital must at all times be held by the public, and for GEM companies the minimum market capitalisation of the public float is HK\$30 million;
- a trading record of at least two financial years with management continuity for at least the two preceding financial years and ownership continuity and control for at least the most recent audited financial year; and
- at least 100 shareholders post-listing.

A GEM listed company may apply for a transfer of its listing to the Main Board at a later stage, provided that the Main Board listing criteria are met.

Please note that some relaxation to the above financial requirements (for the Main Board and GEM) may be accepted by the HKEx for mineral companies or newly formed project companies.

Is the company's group structure suitable for listing?

Organisational restructuring

A company considering going public must have an organisational structure suitable for public investment and one which ensures compliance with the Listing Rules. As mentioned before, to be suitable for listing, its listed business must be capable of operating independently from its controlling shareholders. Therefore, the business of the company seeking a listing should be reorganised so that it is conducted through a listing group that is separate from the controlling shareholders' other businesses. The listing group may consist of a listing vehicle and its subsidiaries, with each subsidiary holding a different business line and/or asset.

The steps that must be taken to reorganise the group structure will vary from one company to another, although in many cases the restructuring will involve:

- incorporating a new entity or converting an existing legal entity into another form for listing purposes (see below);
- winding up redundant/dormant entities;
- ring-fencing high-risk businesses; or

- transferring assets/businesses from one legal entity to another to make sure the business divisions align and that all the relevant assets and contractual rights are owned by the company group that is being listed.

In this connection, the company must bear in mind that:

- transfers of assets will likely take time to complete, especially where government approval is required or there are "change of control" provisions in the relevant contracts which require third party consent. It is therefore essential to start preparation and communicate/negotiate with the relevant government authorities or third parties early;
- its tax advisers should be consulted on the tax implications of the pre-IPO reorganisation (for instance, the amount of capital gains tax payable for share or asset transfers) and to ensure that the resulting structure is tax efficient; and
- the management continuity and the ownership continuity of the business are not affected.

Incorporation of the listing entity

A PRC business can be listed on the HKEx via an "H share" listing, whereby a PRC-incorporated entity is converted into a joint stock company to become the listing vehicle. Alternatively, subject to compliance with relevant PRC laws and regulations, a PRC business can be listed via a "red chip" listing, which involves the incorporation of a listing vehicle outside the PRC.

A question that sometimes arises in a "red chip" listing is where to incorporate the listing entity. In this regard, applicants incorporated outside Hong Kong and other recognised jurisdictions (Bermuda, the Cayman Islands and the PRC) are assessed on a case-by-case basis and must demonstrate that they are subject to appropriate standards of shareholder protection, which are at least equivalent to those required under Hong Kong law. The HKEx has also set out a list of jurisdictions which it considers to be acceptable as an issuer's place of incorporation, and it may follow a simpler vetting process for these jurisdictions which have already been accepted. The number of these jurisdictions is growing as the HKEx, in an attempt to attract more listings from overseas companies, is continually expanding its list of jurisdictions acceptable as an issuer's place of incorporation.⁶ Companies should seek local legal advice on the regulatory requirements which they must satisfy in their jurisdiction of incorporation, as these requirements may be onerous and impact on the listing timetable.

⁶ The list of jurisdictions acceptable as an issuer's place of incorporation can be found on the HKEx's website. At the time of writing, the list includes the following jurisdictions (other than the PRC): Australia, Brazil, Bermuda, British Virgin Islands, Canada (Alberta, British Columbia and Ontario), the Cayman Islands, Cyprus, France, Germany, Guernsey, Isle of Man, Italy, Japan, Jersey, the Republic of Korea, Labuan, Luxembourg, Singapore, the United Kingdom and the United States Of America (California and Delaware).

Other pre-IPO related organisational arrangements

Apart from structuring and incorporation issues, there are other aspects within the organisation which a company must address when transforming itself into a listed company:

- **shareholder arrangements:** generally speaking, special rights and obligations of shareholders and arrangements with shareholders not concluded on an arm's length basis tend to be unwound upon listing. Existing shareholders may be required to enter into lock-up arrangements which restrict their rights to sell shares for a certain period of time post-listing;
- **constitutional documents:** these must be reviewed to ensure that they are suitable for a listed company (for instance, provisions in the existing articles of association which restrict the transfers of shares must be deleted). Amongst other things, the articles of association of PRC-incorporated issuers must contain provisions to reflect the different nature of domestic shares and overseas listed foreign shares (including H shares) and the different rights of their respective holders;
- **accounts and audits:** after the listing group structure has been decided, annual audits should be performed on the companies in the group. If significant operations have not been properly audited in the past, then it is necessary for this to be performed at the pre-listing stage. For a primary listing, a new applicant's accounts are generally required to be prepared in accordance with either the Hong Kong Financial Reporting Standards or International Financial Reporting Standards⁷;
- **banking facilities:** these will need to be reviewed to ensure that they are sufficient to satisfy the working capital requirements in the Listing Rules and the company's capital needs going forward;
- **property issues:** intellectual property rights should be reviewed to verify ownership and to ensure that they are properly protected. PRC businesses should also endeavour to obtain all the relevant land use rights certificates and building ownership certificates to evidence title and ownership rights for their PRC properties;
- **employee arrangements:** if the company has a share scheme then such scheme should be reviewed. A company that does not already have a share scheme may consider establishing one to attract and provide incentives to employees. The availability of such schemes may be an important factor in valuing the company's shares and its future success. Pension schemes should also be reviewed to ensure the adequacy of funding levels;
- **insurance:** the company's insurance policies (including directors and officers liability insurance) should be reviewed to ensure they provide adequate cover. Directors may also consider obtaining insurance against their liabilities under the prospectus, and if they do, then it is essential that insurers are involved in the listing process at an early stage; and

⁷ The Generally Accepted Accounting Principles in the United States of America (US GAAP) may be acceptable under certain circumstances. For instance, for a GEM listing US GAAP are acceptable if the applicant is listed, or will simultaneously be listed, on either the New York Stock Exchange or the NASDAQ National Market.

- litigation: legal advice should be sought in respect of any risks, potential damages and costs which may flow from pending or threatened litigation, and take all necessary precautions to ensure that the listing exercise can proceed smoothly.

Involve strategic investors?

Quite often, a company that is considering an IPO will invite strategic or institutional investors to invest in its business at the pre-IPO stage through the subscription of its shares or convertible securities. Participation from high-profile investors can often enhance the public interest in the company's listing.

Companies seeking pre-IPO investments should however note the overriding principle in the Listing Rules, namely, the issue and marketing of securities must be conducted in an orderly manner and all holders of listed securities must be treated fairly and equally. This can be an issue for pre-IPO investments if the company offers better terms to pre-IPO investors than IPO investors, thereby potentially breaching the requirement to treat both categories of investors fairly and equally.

There are no hard and fast rules as to what constitutes fair and equal treatment, although in general the HKEx will consider matters such as:

- the justification for the investment (i.e. whether the pre-IPO investor is providing any strategic value to the business);
- the investment risks assumed by the pre-IPO investors⁸; and
- whether the pre-IPO investors are offered any rights which are not available to the IPO investors.

Based on these considerations, the HKEx may consider that the "fair and equal treatment" principle is breached if, for example, the pre-IPO investor is given guaranteed discounts to the IPO price (or where the discount size is dependent on the final IPO price), the right to appoint a certain number of directors to the listing applicant's board, or the right to veto certain corporate actions of the applicant (such as mergers or amendments to constitutional documents) if such rights are not available to the IPO investors.

The HKEx has published guidance on the issue of pre-IPO investments. Essentially, the guidance states that the HKEx will generally require pre-IPO investments to be completed at least either (i) 28 clear days before the date of the first submission of the first listing application form, or (ii) 180 clear days before the first day of trading of the listing applicant's securities. If a pre-IPO investment is not in accordance with these requirements after submission of an applicant's listing application, the applicant is expected to defer its listing date or unwind the pre-IPO investment.

The HKEx may reject a listing application if it considers a pre-IPO investment to be contrary to the principles in the Listing Rules. Even where the HKEx permits a pre-IPO investment to go ahead, it may nevertheless impose a lock-up on the shares placed to a particular pre-IPO investor. Where that is the case, the locked-up shares would not count for the purposes of calculating the public float. Potential listing applicants should therefore consult the HKEx with regards to pre-IPO investments before submitting their listing applications.

⁸ Usually, the greater the risks assumed by the pre-IPO investors, the more likely that such investments will be considered acceptable by the HKEx.

Who will assist the company with IPO preparations?

The preparation for an IPO requires the co-operation of both the external and internal teams.

External team

The external team comprises of the key professional advisers to the IPO⁹, whose roles in the listing process are summarised below:

- sponsor¹⁰ is responsible for dealing with the regulators and overseeing the entire listing exercise. The HKEx relies on the sponsor to confirm that the company is suitable for listing and has satisfied all eligibility criteria and other regulatory requirements. The sponsor must also satisfy the regulatory bodies that the company's directors are fit to manage a listed company and will advise on the structure and composition of the board. In conjunction with brokers, the sponsor will also advise as to the pricing and underwriting of the shares (i.e. acting as the underwriter). A sponsor may sometimes serve as the company's compliance adviser post-listing to assist with the company's compliance with the Listing Rules;
- lawyers advise on the legal aspects of the listing process and assist with the HKEx listing application. The company's lawyers carry out legal due diligence on the company, and deal with any pre-IPO reorganisation and amendments to its constitutional documents. They will also advise the directors in relation to their responsibilities and prepare the directors' service contracts, share incentive schemes and where necessary, assist in the drafting of the prospectus. The sponsor's lawyers advise the sponsor on any agreements between it and the company (in particular any underwriting agreement), prepare verification notes in relation to the prospectus and assist with the preparation of the prospectus. Local PRC counsel will need to be engaged for IPOs involving PRC businesses, and where the IPO includes offerings in other jurisdictions (such as the United States of America), local counsel in those jurisdictions must also be engaged;
- reporting accountants review the company's financial records for the benefit of potential investors;
- independent property valuers provide independent valuations of the properties of the company group which are included in the prospectus;
- public relations consultants generate positive press interest in order to gain maximum coverage of the company and the IPO. They also monitor the wording and format of any public statements or press releases made during the listing process; and
- internal control consultants review the company's internal control systems and make recommendations for their improvement.

⁹ There are other parties involved in an IPO besides the key professional advisers listed here, for instance, the registrar (to maintain the register of shareholders), the receiving banks (to receive and process share applications), and printers (for the bulk printing of prospectuses).

¹⁰ Sometimes, this may combine the roles of bookrunner, global coordinator and lead manager.

Internal team

The internal team, consisting of the company's management and employees, is equally important for a successful IPO. Investors prefer a potential HKEx listed company with a strong, experienced and stable management team. The company should therefore review the strengths and weaknesses of its current management team and consider whether additional members need to be recruited to bring additional expertise.

In doing so, the company should ensure a balanced recruitment of executive and non-executive directors, and that such directors (and supervisors too, for PRC companies) have the character, experience, integrity and competence commensurate with their role. The Listing Rules currently require an issuer to have at least three independent non-executive directors (INEDs), and they should represent at least one-third of the board. At least one of the INEDs must have an accountancy or financial management background. The search for suitable INEDs can be time-consuming, but is nonetheless an important process because they play a crucial role in the various committees¹¹ which a listed company should establish under the Listing Rules.

In addition to INEDs, Main Board companies with a primary listing must have a sufficient management presence, which normally means that at least two of the company's executive directors must be ordinarily resident in Hong Kong. The HKEx may waive this requirement in certain circumstances, provided that the company has satisfactory arrangements for maintaining regular communications with the HKEx (for instance, having its authorised representatives¹² as the principle channel of communication with the HKEx, and ensuring that such representatives have the means for contacting all directors promptly).

To help prepare for their upcoming role as directors of a listed company, the board must typically attend training sessions to understand and familiarise themselves with their legal responsibilities and the company's post-listing continuing obligations under the Listing Rules.

Preparing the prospectus

A prospectus is the principal marketing document in a Hong Kong IPO. It must contain all information necessary to enable investors to make an informed assessment of the company's assets and liabilities, financial position, profits and losses, business prospects, and rights attached to the shares. The prospectus is ordinarily prepared by the listing applicant and its sponsor, with the assistance of their legal counsel. Other parties and experts will also contribute to the content of the prospectus - for instance, the reporting accountants will include details of the company's financial information and group accounts, whereas property valuers will provide independent valuation reports with regards to the company's properties.

Prior to its publication, the HKEx must vet and approve the prospectus to ensure compliance with all disclosure requirements. To do this, the HKEx will set out their comments and queries on the draft prospectus; and with each round of HKEx comments a new/revised draft of the prospectus will be produced and submitted again

¹¹ The typical examples of committees that a listed company would set up include the remuneration committee (which reviews the remuneration issues of directors and senior management), the audit committee (which deals with internal control issues) and the nomination committee (which is concerned with board appointments).

¹² Every listed company on the HKEx must appoint two authorised representatives to act at all times as the company's principal channel of communication with the HKEx. Such representatives must generally be either two directors, or a director and the company secretary.

for the HKEx's consideration. The vetting process can take weeks or even months to complete, and will focus on major issues such as disclosure deficiencies and compliance with the applicable laws and regulations, as well as the applicant's suitability for listing. A prospectus will often need to go through numerous rounds of redrafts and updating before it can be signed off and ready for bulk print.

Prospectus content

A prospectus must contain a number of disclosures specified in the Companies Ordinance¹³, the Listing Rules and guidance materials issued by the HKEx. These disclosures include, for example:

- the general nature of the company's business;
- the names, addresses and descriptions of the company's directors;
- particulars relating to the company's shares, such as the company's authorised share capital and the nominal value of shares;
- information to enable a reasonable person to form an opinion of the company's shares and the financial condition and profitability of the company;
- financial information relating to the listed company group, such as its gross trading income or sales turnover during each of the three financial years immediately preceding the issue of the prospectus;
- information regarding persons holding a substantial part of the company's share capital; and
- a report by the auditors of the company with respect to the group's profits, losses, assets and liabilities.

However, parties preparing the prospectus should not treat these specified disclosure items as an exhaustive list as to content requirements - there is an overriding requirement to disclose all the information in the prospectus which is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities, financial position, management, prospects and profits/losses of the company. Other more specific prospectus requirements also apply to certain listing applicants, such as mineral companies and investment companies.

A prospectus for a Hong Kong IPO is available in both Chinese and English versions. Companies which intend to launch an IPO in Hong Kong typically issue their prospectuses to prospective investors in printed form, although they have the option to take the "mixed media offer" approach. This approach allows companies to issue paper application forms to investors along with an electronic form of the prospectus, provided that certain conditions are met¹⁴. This approach allows companies to reduce the number of paper prospectuses which they will need to print, which can potentially help save costs.

¹³ At the time of writing, the statutory requirements regarding disclosures in a prospectus are contained in the existing Companies Ordinance (Cap 32 of the Laws of Hong Kong). However, when the new Companies Ordinance (Cap 622 of the Laws of Hong Kong) comes into operation in March 2014, these requirements will remain in the existing Companies Ordinance, which will be renamed the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32 of the Laws of Hong Kong)

¹⁴ The relevant conditions are set out in the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice. Essentially, these conditions require companies to provide at least three printed copies of the prospectus for inspection, as well as free printed copies for collection, at specified locations throughout the offer period. Companies must issue an announcement to provide particulars of these locations, and the address of the website where the electronic form prospectus can be accessed.

In all cases, the information in a prospectus must be presented clearly and in plain language format. It must also be accurate, complete in all material respects and not misleading or deceptive. This also means that the prospectus must not omit unfavourable facts which are material, present favourable possibilities as certain (or more probable than it actually is) or present projections without sufficient justification.

Appendix I lists out in full the common sections in a typical Hong Kong IPO prospectus for a Main Board listing. The table below sets out some of the more important sections in a Hong Kong IPO prospectus for a Main Board listing and the matters that are often covered and, where applicable, some important matters to note when preparing these specific sections:

Section in the prospectus ¹⁵	Content description
Expected Timetable	This section sets out the important dates in the IPO process from the perspective of potential investors. These dates include, for example, the latest time for lodging application forms for the IPO shares, the date on which the price of the IPO shares are determined, and the listing date (i.e. when trading of the shares commences on the HKEx).
Summary and Highlights	This section sets out an overview of the listing applicant, its selling points/competitive strengths and highlights of significant matters disclosed elsewhere in the prospectus. This is an important section because it helps investors decide at an early stage whether they might be interested in the IPO and read the rest of the prospectus. According to guidance from the HKEx this section should be as concise as possible and generally be no more than 10 pages, although this will depend on the nature and complexity of the company's business.
Definitions / Glossary	This section sets out the meaning of certain terms in the prospectus. Companies involved in specialised industries (such as mining) may also consider using a separate Glossary section to set out the meaning of the technical terms in the prospectus.

¹⁵ The exact names of the sections may vary from one prospectus to another.

Section in the prospectus ¹⁵	Content description
Risk Factors	<p>This section sets out the risks that may affect the listed company's business, financial condition or results or operations. Examples of risk factors include the level of competition in the company's industry, and the company's reliance on certain key personnel and debt facilities for its operations.</p> <p>In order to draft this section, it is important to get an in-depth understanding of the business and the environment in which it operates. External factors which may affect the company's business (for example, economic conditions or even potential natural disasters in the jurisdictions in which the company operates) should also be included as risk factors and this section should explain why these risks are, from an investor's perspective, material in the context of the company's business. HKEx guidance also states that only risks that the company are unable to mitigate should be included as risk factors.</p>
Waivers from Compliance with the Listing Rules and Exemptions from the Hong Kong Companies Ordinance	<p>This section sets out the waivers that the company has sought from the HKEx in relation to the strict compliance with certain provisions in the Listing Rules. Typical examples include waivers from compliance with the following Listing Rule/Hong Kong Companies Ordinance requirements:</p> <ul style="list-style-type: none"> • requirements regarding transactions between the company and its connected persons/related parties; • requirements regarding disclosures of the company's pre-IPO share option scheme details; and • requirements regarding the company's management presence in Hong Kong.

¹⁵ The exact names of the sections may vary from one prospectus to another.

Section in the prospectus ¹⁵	Content description
Industry Overview	<p>This section sets out information relating to the jurisdictions, industries and markets in which the company group operates.</p> <p>Government and industry analyst publications/reports are frequently used to prepare the content of this section. However, caution must be exercised when using such information - in particular, prior consent should be sought from the relevant parties if parts of an industry report are reproduced in the prospectus. Where multiple research reports have been used to compile this section, one needs to make sure that the contents of such publications do not contradict with each other and are up-to-date. Appropriate wording should also be included in this section to alert investors to the fact that the relevant information from these reports has not been independently verified by the parties involved in the IPO.</p>
History and Development	<p>This section sets out the milestone events in the company's history (such as its establishment), development (such as any major acquisitions or mergers), its corporate structure and shareholding. Care needs to be exercised to make sure that the statements included in this section can be verified.</p>
Business	<p>This section sets out general information about the company's business model, suppliers, customers, production, products and services etc. Other details such as the company's risk management policies and procedures should also be identified.</p>

¹⁵ The exact names of the sections may vary from one prospectus to another.

Section in the prospectus ¹⁵	Content description
Directors, Senior Management and Staff	<p>This section sets out brief biographical details (such as educational and professional qualifications) of the directors and senior managers and staff of the company.</p> <p>The qualifications included should be verifiable and supported by evidence. With regards to academic qualifications, the sponsor should verify the accreditation of universities concerned (i.e. check whether the academic accreditation bodies are indeed authorised by competent bodies to grant such accreditations).</p>
Financial Information	<p>This section sets out an analysis of the company group's historical performance, important accounting policies and current financial conditions (such as its liquidity). This also includes a discussion of the factors that will affect the company's operations.</p> <p>Please note that the inclusion of financial statements alone will generally not suffice as they do not provide all the information that investors need. Companies are expected to explain the significance of the information and the implications for their future. The financial controller or chief financial officer of the company should review the draft of this section. Financial data in this section should also be checked with the accountants' report to ensure accuracy and consistency.</p>
Controlling Shareholders	<p>This section sets out the background of the company's controlling shareholders. It is a Listing Rule requirement for listing applicants to demonstrate that they are able to conduct its business independently, therefore, this section of the prospectus will usually set out the factors which demonstrate the company's independence from its controlling shareholders.</p>

¹⁵ The exact names of the sections may vary from one prospectus to another.

Section in the prospectus ¹⁵	Content description
Connected Transactions	This section sets out the details of the company's connected persons (i.e. related parties) under the Listing Rules, and its relationship with them. Details of transactions which are exempt from certain Listing Rule requirements (e.g. announcement or independent shareholders' approval requirements) will also be included in this section.
Future Plans and Use of Proceeds	<p>This section describes the future plans of the company and a meaningful breakdown on how the proceeds raised from the IPO are to be used (for example, for the company's proposed acquisitions). If the company does not have any current or specific plan for the proceeds, this section must include a statement to that effect and explain the principal reasons for the IPO.</p> <p>This section should be drafted consistently with the corporate strategies outlined in the Business section, and must be fair and reasonable by reference to the company's existing production capacity and future growth.</p>
Underwriting	This section sets out the material terms of the underwriting agreement between the company and its underwriter(s) and the commissions that they receive for their work on the IPO.
How to Apply for Hong Kong Offer Shares	As its name suggests, this section sets out the application procedures for the Hong Kong IPO shares. The information contained in this section should be more detailed than what is in the application forms. This section should also be drafted in plain language so that the procedures are easy for investors to understand.

¹⁵ The exact names of the sections may vary from one prospectus to another.

Section in the prospectus ¹⁵	Content description
Accountants' Report	<p>This section sets out a report on the consolidated profits and losses, assets and other relevant financial information of the company group for the three years immediately before the issue of the prospectus (i.e. the track record period).</p> <p>The company's reporting accountants should sign off on this section as well as any variations to its content.</p>
Unaudited Pro Forma Financial Information	<p>This section contains (i) a statement of unaudited pro forma adjusted net tangible assets of the company group and (ii) a report on unaudited pro forma financial information (and whether, in the accountants' opinion, such information has been properly compiled by the company's directors and is consistent with the group's accounting policies).</p> <p>As with the accountants' report, the reporting accountants should sign off on this section as well as any variations to its content.</p>
Property Valuation	<p>This section is likely to be prepared by the independent property valuer, and contains valuations of all the company's interests in land or buildings and the material details of the basis of such valuations.</p>
Summary of the Constitution of the Company	<p>This section sets out a summary of the constitutional documents of the company (such as its memorandum and articles of association). The company law of the place of incorporation of the company, in particular provisions dealing with share capital, will also be summarised in this section.</p> <p>This section is usually drafted by local counsel (i.e. from the jurisdiction where the company is incorporated).</p>

¹⁵ The exact names of the sections may vary from one prospectus to another.

Section in the prospectus ¹⁵	Content description
Statutory and General Information	This section sets out further information about miscellaneous aspects of the company, including its subsidiaries, summaries of material contracts and intellectual property rights and its share option schemes.
Documents Delivered to the Registrar of Companies and Available for Inspection	This section lists out the documents which have been delivered to the Registrar of Companies in Hong Kong for registration (such as the IPO application forms) and the documents which are available for public inspection (such as the company's memorandum and articles of association).

Please note that additional content requirements may apply if the company's shares will be offered to investors in overseas jurisdictions. For instance, if the IPO includes an offer to investors in the United States of America then an additional "US wrap" will need to be prepared to set out information (such as additional risk factors, disclaimers and notices, etc. and so on.) to satisfy the relevant securities law requirements there.

General tips for the preparation of a prospectus

Set out below are some practical tips which should assist the IPO working group when drafting a prospectus:

- allocate drafting responsibilities between the different working group members early on in the process. The various parties should also agree on resources (i.e., the staffing of working group members) and timeline for production of the drafts of the prospectus;
- set deadlines for turning each draft of the prospectus. These deadlines should be monitored and followed up with the responsible parties. Any possible delays should always be communicated to the working group to ensure that the listing timetable can be met;
- consider using recent "precedent" Hong Kong IPO prospectuses for companies that come from the same industry and/or jurisdiction as a starting point in the drafting process. Discuss and agree with the working group which precedents should be used before drafting begins. Note however that every company is unique and the structure of the offering may vary, so the content of the prospectus must tailor to the company's individual circumstances. The content of any "precedent" prospectuses should therefore not simply be adopted as a boilerplate;
- produce lists of outstanding information required for drafting the content in the prospectus. This should help to ensure that the drafting process is organised and that the gaps of information in the prospectus are filled. Ideally, one person at the company should be identified as the point of contact and take responsibility to provide the outstanding information requested by the working group;
- use appropriate headings and sub-headings, as well as charts, tables and diagrams in the document so that information can be presented more clearly;

¹⁵ The exact names of the sections may vary from one prospectus to another.

- pay attention to grammar, spelling errors and cross-references, ensure all defined terms are included in the "Definitions" section and a consistent format is used for charts and tables in the prospectus; and
- check and review the work done by the printer, for example, by making sure that all the requested amendments have been incorporated in the revised draft of the prospectus. The final product of the prospectus should always be proofread by members of the team.

Prospectus liabilities

Care must be exercised when preparing the content of the prospectus, otherwise those involved in its preparation (especially the listing applicant and its directors) can be exposed to both civil and criminal liabilities. The Listing Rules require every director of the company named in the prospectus to accept responsibility for the prospectus, and the document must include a statement to that effect. The purpose of this statement is to reinforce the legal liabilities of the listed company's directors in connection with the prospectus.

As mentioned above, every prospectus must contain certain disclosures as specified in the Companies Ordinance. Therefore, a failure to include these specified disclosure items is a breach of statutory duty and make the company (and every person who is knowingly a party to the issue of the prospectus) liable to fines and civil proceedings.

Apart from the need to include all the requisite disclosure items in the prospectus, it is equally important to ensure the accuracy and completeness of what is being drafted or incorporated into the prospectus (for example, reports from experts), otherwise directors of the company and persons who have authorised the issue of the prospectus can be subject to liability to pay compensation for any untrue statements in the document. An "untrue statement" has a broad meaning in this context, and may include any statement which is not completely true, misleading or in which material facts are omitted. The inclusion of false information constitutes market misconduct under the Securities and Futures Ordinance (SFO). Under the SFO market misconduct can take place if a person discloses or circulates information (such as a prospectus) which is false or misleading, with the purpose of inducing the market to subscribe for the company's shares.

Inaccurate statements in the prospectus can also give rise to civil liabilities for misrepresentation under tort law and the SFO, if such misrepresentation induces investors to acquire shares in the company. Liabilities can arise regardless of whether the company or its directors have a fraudulent intent when making such misrepresentations, since liabilities can still arise if the misrepresentations are made negligently or recklessly.

Furthermore, from a legal perspective the prospectus content forms part of the terms and conditions of the subscription contract between the IPO share investors and the listed company. If the prospectus contains misrepresentations then investors who have been so induced to enter into the contract and subscribe the IPO shares will have the right to rescind the contract after discovering the misrepresentation or bring a civil action for compensation.

Aside from these civil liabilities, the potential criminal liabilities associated with the content of the prospectus should not be ignored. In particular, the Companies Ordinance states that a person who authorises the issue

of a prospectus which contains untrue statements will be liable to imprisonment and a fine, unless he proves either the statement was immaterial or that he had reasonable grounds to believe that the statement was true. Similar provisions also exist in the SFO with regards to statements and forecasts in a prospectus. By the same token, the Theft Ordinance also imposes criminal liabilities on officers of a listed company (including its directors) if they publish written statements or records (such as prospectuses) which to their knowledge are deceptive, false or misleading with the intent to deceive the company's shareholders or creditors. These potential criminal liabilities can be serious - for instance, with regards to the Theft Ordinance described before, a company officer who has been convicted of the offence can be imprisoned for a maximum of 10 years.

Apart from the above civil and criminal liabilities, the failure to make proper disclosures in a prospectus can have other dire consequences for those involved in the IPO. A recent example which illustrates the seriousness of these consequences is Hontex International Holdings Company Limited (Hontex), a company in the apparel retail business. Hontex was originally listed on the HKEx in 2009, but there were allegations that the amounts stated in its IPO prospectus in respect of its turnover for the years 2006, 2007 and 2008 were materially false and misleading. The Securities and Futures Commission (SFC) initiated High Court proceedings as a result of these allegations. During the trial, Hontex agreed that these amounts were indeed materially false and misleading. Trading in Hontex's shares was suspended from March 2010 under the directions of the SFC, and the company's Hong Kong listing was subsequently cancelled by the HKEx Listing Committee in September 2013. Simultaneously, the SFC investigated into the practices and procedures of Hontex's IPO sponsor, Mega Capital (Asia) Company Limited (Mega Capital). The SFC found that Mega Capital failed to act independently and impartially in its due diligence work and as a result revoked its licence to advise on corporate finance and levied a fine of HK\$42 million.

Other related tasks to be performed

The drafting of a prospectus will form a major part of the IPO process. There are, however, numerous other tasks which need to be performed by the team in connection with the drafting process, as described below:

- **due diligence:** due diligence must be carried out at an early stage to gather information required for inclusion in the prospectus. From the company's perspective, this process will commonly involve answering questions in due diligence request lists and providing relevant documents for review by legal counsel. The professional advisers may hold meetings with the company's management team to conduct financial and business due diligence as well. Where relevant, the information gathered during due diligence will then be used to draft the content of the prospectus;
- **verification:** a thorough verification exercise must be carried out in tandem with the due diligence exercise and drafting process. This exercise requires all statements in the prospectus to be verified (with documentary support, where appropriate) to help ensure that the content in the prospectus is true, accurate and not misleading. Further, the verification process should assist in ensuring that all material facts have been disclosed in the prospectus. Verification can be a long process, but it is vital and the production of verification notes will assist the company's directors to focus on the issues that should be considered and help protect them from potential liabilities arising from the content of the prospectus;

- application for listing: in order to have its prospectus vetted/approved and also have its securities listed on the HKEx, a company must make an application for listing to the HKEx. For the application to be successful, the company must comply with the HKEx's admission and disclosure standards. The company and its team of advisers should liaise with the HKEx from a relatively early stage to ensure the listing process runs as smoothly as possible. An advanced draft of the prospectus must be submitted alongside the application for listing. This draft must be substantially complete except in relation to information that by its nature can only be finalised and incorporated at a later date (otherwise the HKEx can decide to return the listing application);
- marketing: the success of a listing depends to a large extent on the marketing of the offer to potential investors. The scale and nature of such marketing depends on the structure of the offer. The leading role in pre-IPO marketing is generally taken by the underwriters, since they are in direct contact with the market and can best monitor the market's response to the listing. Typically, the company's senior management will meet with analysts at investment banks before the IPO (in order for such banks to then publish pre-deal research), and participate in a series of road shows to potential investors in the weeks leading up to listing. Copies of the draft prospectus will be provided to these potential investors during road shows to assist them to make an informed assessment about buying shares in the company. The IPO shares will then be priced based on the level of interest shown at these road shows; and
- preparation of an underwriting agreement: an underwriting agreement will be entered amongst the underwriters, the company, the company's directors and any selling shareholders, pursuant to which the underwriters agree to underwrite the new and existing shares being issued or sold. Details of the underwriting arrangements will be included in the prospectus in the "Underwriting" section.



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Directors' and Officers' Liability Insurance: What Is It and Why Is It Important to the Listed Companies in Hong Kong

Potential risk exposures arising out of an IPO

Raising capital through a stock exchange listing provides a company and its shareholders with significant opportunities. However, the liabilities imposed on the listed company's directors and shareholders in such a transaction can be onerous. The heightened exposure to risks from various sources during the IPO process amplifies the need for adequate directors' and officers' (D&O) insurance protection when a company is considering an IPO.

Recent legal and regulatory reform in Hong Kong has significantly increased the risks and liabilities faced by company directors in this jurisdiction. Corporate governance reform has resulted in greater scrutiny on board performance, board practices and accountability of directors and officers.

Directors and officers may be personally liable to any party who has an interest in the company, and they can be sued in their individual names.

A breach of duty exposes the individual director's personal assets (and even assets in their spouse's names) to claims that, when combined with the doctrine of joint and several liability amongst the board members, could mean paying out these assets for the liability of the entire board.

What is directors' and officers' liability insurance?

D&O Liability Insurance is coverage designed to address the personal liability that company directors, officers and other members of a corporate board can incur for their acts and/or decisions arising from their duties, which may or may not be indemnifiable by the corporation.

Who does the directors' & officers' liability insurance protect?

The policy protects the directors and officers of the parent company and its subsidiaries.

A directors' and officers' insurance policy will usually protect:

- All past and present directors and officers and those appointed during the currency of the policy.
- The company when it reimburses its directors and officers

Why buy directors and officers liability insurance?

Claims from employees, clients and stockholders may be made against any company and against the directors and officers of a company. Since a director or officer can sometimes be held responsible for acts of the company, most directors and officers will want to be covered rather than risk their personal assets. A major benefit of having a D&O policy is to protect directors and officers from litigation and provide a legal defence should such litigation that may arise in the conduct of their duties. Protection of directors and officers by purchasing appropriate insurance coverage is also in compliance with the Hong Kong Stock Exchange's Listing Rules. What is appropriate insurance cover depends heavily upon the nature of the issuer's business.

Board directors should not risk their personal assets to serve as a corporate director or officer without D&O insurance coverage.

What does directors' and officers' liability insurance cover?

Criminal, administrative, civil, and regulatory proceedings based on actual or alleged acts, errors, omissions, misstatements, neglect, or breaches of duty committed or allegedly committed by a director or officer are covered with directors' and officers' liability insurance.

Key Protection provided by a D&O policy includes the following key extensions:

- i) Advancement of Defence Costs - extends to provide coverage for defence costs prior to the final settlement of the claim. Allegations of wrongful acts, or threats of litigation may lack merit or reasonable grounds for success. Whether or not the director or officer is ultimately held liable for allegations of wrongdoing, such actions require legal defence. By virtue of this extension, the policy advances defence costs subject to the policy terms and conditions. If ultimately defence costs are advanced for a matter not covered by the insurance, then such a need is to be repaid to the insurer.
- ii) Investigation Costs - can be incurred by an individual insured arising from a need to prepare for, attending or providing documents, with respect to an investigation by a regulatory body. An investigation generally is defined to mean an official investigation, examination or inquiry in relation to the affairs of the company at which the attendance of the director is required.

A D&O policy is also designed to provide automatic coverage to directors for liabilities which may arise out of the following:

- a) Acquisition of a New Subsidiary – a D&O policy can automatically cover new subsidiaries subject to certain parameters. Coverage is provided to the directors of the new subsidiary.
- b) Secondary Offering of Securities – provides coverage to an issuer and its directors with respect to D&O claims arising out of a secondary offering of its securities.
- c) Merger or Acquisition – specific policy features provide discovery period or run-off coverage for directors up to six years or the relevant statute of limitations, should the company be majority sold to, or merged with another entity.

What are the Roles of Brokers?

Because D&O is a sophisticated and somewhat complex insurance product, only certain insurance brokers have an expertise and comfort level in providing advice to clients and placing the business.

How do you select an insurer?

There are several factors to consider such as:

- Evaluate the policy form, including the declarations, all endorsements, and the proposal form;
- Evaluate the financial strength and integrity of the insurer. Your insurance broker should have objective data on these;
- Evaluate the insurer's underwriting and claims-handling abilities in the D&O area. You can get this information from your insurance broker;
- Evaluate the premium level in relation to the limits of liability offered and applicable deductions or retentions. Price should not be a key factor in the purchasing decision in the D&O area when one considers the potential exposures to the management of a corporation.

Some additional tips on purchasing D&O insurance:

- Allow sufficient time before the IPO for an underwriting review by insurers. There are requirements under the Listing Rules to have D&O insurance cover;
- Select an insurance broker / advisor with this specialised knowledge and experience working with IPO risk and cover;
- Be aware of claim scenarios involving an IPO or listed companies. An experienced insurance broker can advise you on these areas;
- Work with your insurance broker to determine an appropriate level of cover (policy limit). An experienced broker can provide benchmarking data and advice on this;
- Coverage and pricing terms are negotiable. Work with your insurance broker to arrange a suitable policy for your company;
- Respond to the underwriter's questions (through your insurance broker) promptly;
- Complete insurer proposal form and provide all requested information. Do not view the application process as a burdensome paperwork requirement, but as an important process for this protection. Be accurate and truthful in answering questions on the application (including any prior claim or circumstance). Misstatements may cause the policy to be void;
- Make certain that any prior incidents that might potentially give rise to a claim are reported on your application to a new carrier as well as to your existing carrier. Claims stemming from known incidents will be excluded under your new policy.

Conclusion – Why the Directors & Officers Liability Insurance Is Important?

- Directors and officers can incur personal liability for breach of duty and personal (as opposed to corporate) liability is unlimited. Hence, their personal assets are at risk;
- Defence costs can be very significant;
- Breach of duty may have civil and criminal consequences;
- Lack of knowledge of the law is no defence;
- There are an increasing number of claims and regulatory actions in Hong Kong and Asia.

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Chapter 5 – Listing Application I: IPO Process

Hong Kong has been one of the major initial public offering destinations worldwide. It is expected to have more international companies with an Asian nexus to consider listing in Hong Kong so as to gain access to investors and funds in Asia. This chapter aims to give an overview of IPO process in the Stock Exchange of Hong Kong Limited (“HKEx” or “Exchange”).

Methods of Listing

Typical IPOs with capital raising on the main board of the HKEx (“Main Board”) comprise of offer for subscriptions, offer for sale and placing. A listing by way of introduction, is an application for listing of securities already, where no marketing arrangements are required because the securities for which the listing is sought are already of such an amount and so widely held that their adequate marketability when listed can be assumed. Introduction is typically used when the securities for which listing is sought are already listed on another reputable stock exchange, also known as secondary listing.

Primary and Secondary Listings

Issuers, from an acceptable jurisdiction, may apply for primary listing on the HKEx and must fully comply with the Listing Rules unless waivers are obtained. In recent years, the majority of the listing issuers apply for primary listings, of whom the main operations are based in the People’s Republic of China (PRC). Secondary listed issuers are primarily listed on another stock exchange where the majority of their equity securities are usually not frequently traded. Secondary listings are available to overseas issuers, excluding PRC issuers, seeking a Main Board listing and having sufficient connections with a foreign market. The Exchange will generally consider a number of factors of the issuer including its place of incorporation, the number of Hong Kong shareholders, the likely extent of equity securities trading on the Exchange, the location of the head office and place of central management, the existing and expected future of the location of business and assets, with reference to its corporate and tax registration and the protection available to Hong Kong investors under any foreign laws or regulations to determine its centre of gravity.

IPO Process

Listing Timetable and Document Submission

An IPO typically requires a few months of intensive preparatory work before the A1 submission. The new sponsor regime, which came into effect in October 2013, requires sponsors to be formally appointed for a minimum period of two months prior to the submission of the listing application. In general, the duration of IPOs will last from six to 12 months and can be generally divided into three main stages, preliminary planning and preparation, documentation preparation and listing application, as well as marketing and deal launching. The following graph summarizes some key milestones for the IPO process.



- Engage professional parties
- Kick-off meeting
- Re-organisation
- Preparation of accountants' report and legal opinions
- PN21 due diligence
- Prospectus drafting
- A1 pack documents
- A1 submission
- Vetting by SFC and HKEx
- Listing hearing
- Pre-deal research reports
- Investor Education
- Roadshow presentation
- Bookbuilding and Pricing
- Commencement of trading

Preliminary Planning and Preparation

Prior to project kick-off, planning before execution is a challenging task for sponsors. Issuers are advised to engage professional parties such as sponsor's underwriters, legal advisers, reporting accountants once the IPO plan is confirmed, with an aim to identify issues to resolve at early stages of the execution and ensure that the tight timetable can be met.

IPO projects typically commence with an all parties kick-off meeting, at which multiple appointed professional parties are introduced and the preliminary background of the potential issuer is presented, as well as the overall timetable is set out. This shall be followed by a series of due diligence meetings to cover all areas including but not limited to business, financial and legal aspects with reference to the Practice Note 21 ("PN21") of the Listing Rules. For details, please refer to the sub-section later of this chapter, "Due Diligence – PN21 and Rule 10b-5".

Documentation Preparation and Listing Application

The A1 Submission comprises of a bundle of documents, including a draft prospectus with various appendices of the accountants' report and property valuation report. The other submission documents mainly comprise of legal opinions, a profit and working capital forecast memorandum and checklists of other corporate and financial information.

The A1 submission is often regarded as a major milestone in IPO process. According to the new sponsor regime, sponsors are expected to have their due diligence substantially completed before making a listing application. The Exchange will conduct an initial check ("3-Day Check") with limited qualitative assessment. A successful application will undergo a dual-filing regime during which each case is reviewed by the Securities and Futures Commission ("SFC") and HKEx. The new regime also aims to enhance the quality of the application and streamline the vetting process to a target period of 40 business days. There will be other supplementary documents to be submitted in four business days prior to the listing hearing, which is called 4-Day Submission. Towards the end of the vetting process, the case will be tabled for the listing committee hearing, which is a process of obtaining regulatory approval. A green light will be given for those successful cases to proceed with marketing activities.

Marketing and Deal Launching

There are typically two tranches offered in Hong Kong IPO deals, of which 90% are of international placing tranche and 10% are of the public subscription tranche. Listing Rules prescribe an initial allocation of a minimum of 10% to the public retail investors, with an aim to ensure a sufficient supply of shares to satisfy the demand of Hong Kong retail investors, while otherwise allowing issuers and underwriters a sufficient degree of flexibility to determine their offer structures.

As a common practice, prior to the listing hearing, research analysts of syndicate underwriters will attend an analyst presentation initiated by the issuer's management to understand the detail background of the issuer for the purpose of drafting a detailed pre-deal research report, which is to be distributed to institutional investors globally.

It usually takes four weeks between a listing hearing and commencement of trading. It begins with an investor education period of around one week when research analysts of syndicate underwriters travel to meet the institutional investors and receive feedback thereafter. It will then come to a bookbuilding period of one to two weeks, during which the issuer's management will typically travel around the world to conduct roadshow presentations to institutional investors. This includes a four-day Hong Kong public offer to local retail investors typically at the end of the bookbuilding period. At the end of the bookbuilding period, depending on the overall market sentiment, demand of the offered shares and price sensitivity of potential institutional investors, and the joint global coordinators and joint bookrunners will consider the above factors and give their recommendation to the issuer and agree on the final offer price. Finally, the joint global coordinators and joint bookrunners will distribute allocations of shares to sales and subsequently investors from international placing tranche and settlements of funds, which is then followed by the commencement of trading on the Exchange.

Due Diligence – PN21 and Rule 10b-5

Practice Note 21 ("PN21")

Requirement to Conduct Due Diligence

When an issuer applies to list on the HKEx, sponsors are required to conduct due diligence, with reference to PN21, on the listing applicant. Sponsors are required by the HKEx to make declarations that the listing applicant has established adequate procedures, systems and controls (including accounting and management systems) which are the obligations of the listing applicant and its directors to comply with the Listing Rules and other relevant legal and regulatory requirements. Practice Note 21 is not a set of prescribed minimum procedures that are applicable to all issuers as each new applicant is unique, so the step of due diligence is necessary for the purpose of its listing application. The sponsors must exercise its judgment as to what investigations or steps are appropriate for a particular new applicant and the extent of each step. The following major due diligence actions, among others, are commonly performed by sponsors:

- i) interviewing senior management to explore all aspects of the issuer's business;
- ii) interviewing major customers, suppliers, distributors, licensees, bankers and other major third parties to verify the business operations of issuers;
- iii) inspecting the headquarters, major production bases and material assets;

- iv) reviewing the financial information and inquiring the issuer's management about historical and upcoming financial results;
- v) reviewing industry-related publications to ascertain industry trends, market trends and competitive information; and
- vi) reviewing material contracts, board minutes, legal proceedings and other corporate documents.

Professional Skepticism

Sponsors must examine with professional skepticism on the accuracy and completeness of the statements and representations made, or other information given to it, by the listing applicant or its directors, rather than simply relying on management representations. Failure to exercise professional skepticism or any attempt to avoid full disclosure of material information until requisitions or inquiries by the regulators create inefficiencies and unnecessary delays in the listing process. Another severe consequence is that the credibility of the listing applicant and the sponsors might also be questioned.

Planning and Significant Deviations

Proper record retention is critical to provide evidence of the trail of due diligence. The Exchange expects sponsors to document their due diligence planning and significant deviations from their plans. The regulators hold the view that in a situation where the matter bears some significance, even if a conclusion has been reached that the matter is not sufficiently material to warrant disclosure, sponsors are expected to document how such a conclusion has been reached. It is important for sponsors to provide satisfactory documentary proof to the regulators, otherwise they may not be convinced that sponsors, with proper supervision by its management, have actually considered the relevant issue and conducted reasonable due diligence on that aspect.

Third-party Professionals (including legal counsels, reporting accountants and property valuers)

Sponsors must make their own independent judgment that it is reasonable to rely on information or advice provided by the third-party professionals, and should not place uncritical reliance on experts' work, including accountants' and valuers' reports.

Rule 10b-5

Rule 10b-5 under the United States Exchange Act prohibits any person, in connection with the purchase or sale of a security (whether public or private), from making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

In addition to satisfying requirements under the Listing Rules, sponsors, with the role as global coordinators, may also use due diligence to address potential liabilities under US securities laws, particularly when the listing involves an international offering. It is very common for underwriters to obtain a legal opinion issued by legal counsels to cover the risk of this aspect.

Approval and Registration of Prospectus

Prospectuses are one the most important documents to be submitted to the Exchange for a listing application. It is prepared in accordance with the requirements of the Listing Rules, the Company Ordinance and The

Securities and Futures Ordinance. Besides, it also plays a principal role in the communication between the issuer and the public and potential investors. Basically, it enables the reader to have a thorough understanding of the issuer's business prospective, financial performance and position, future development and right attached to the shares offered.

Prospectus Review

Prior to the registration and publication of the prospectus, each application case is required to undergo the review and vetting process by the regulatory authorities. Under the dual filing arrangement, the listing applicant is required to file applications and disclosure materials with the SFC and the Exchange. Once the issuer submits their listing application with the draft prospectus, a vetting team of the IPO Department of the Listing Division will be assigned to review the case. The vetting process normally takes three months or even longer, depending on the complexity of the case. It is important to know that one of the aims for the Exchange and SFC is protecting the interest of the public and potential investors. They give comments on the draft prospectus and make sure all the disclosures are adequate and fully reflect the picture of the issuer in various aspects. After several rounds of comments, if the vetting team is satisfied with all the responses from the working team and the disclosure in the prospectus, a hearing invitation letter will be issued by the vetting team, which forwards the reviewing process to next level.

Hearing

The Listing Committee of the Exchange normally consists of 28 members. Members are appointed to the Listing Committee by the Board of the Exchange based on nominations that have been made by the Listing Nominating Committee. During the listing hearing, the Listing Division presents the application cases to the Listing Committee for approval.

Registration of Prospectus

It is the responsibility of the issuer to deliver the prospectus and any ancillary documents to the Companies Registry for registration after the authorisation granted by the Exchange

- Core documents to be submitted to the Exchange and Registrar of Companies in registration process
- Prospectus in both English and Chinese versions, signed by two members of the governing body of the issuer
 - Share application forms signed by two members of the governing body of the issuer
 - Power of attorney (if the Prospectus and Share application forms are signed by the agent)
 - The consent letters signed by each of the experts named in the prospectus
 - Certificate in the approved format as to the accuracy of the Chinese translation of the Prospectus and Share Application Forms
 - Certificate in the approved format as to the competency of the Chinese translator to be given by the sponsor
 - Certificate of authorisation for registration issued by the Exchange
 - Details of any selling shareholders
 - Statement of adjustment (if any)

Underwriting and Other Contractual Arrangements

In the case of IPO for subscription, all the subscription of shares must be fully underwritten, which normally includes both a placing tranche and a public subscription tranche. A minimum of 10% of the shares offered in the IPO should be allocated to a public tranche initially. The allocation will be adjusted in accordance with the clawback mechanism as required by the Exchange. Shares can also be transferred between the public subscription tranche to the placing tranche where there is insufficient demand in either tranche. In relation to these arrangements, the issuer will usually enter into two agreements, namely (1) the Hong Kong Underwriting Agreement and (2) the International Underwriting Agreement with underwriters.

Hong Kong Underwriting Agreement

The Hong Kong Underwriting Agreement governs the underwriting arrangement of public subscription tranche. Normally, it is executed before the issuance of prospectus and public offer period. Under the agreement, the Hong Kong underwriters have agreed severally to subscribe or procure subscribers for their respective applicable proportions of the shares offered in public subscription tranche. Apart from this core term, the agreement also includes the descriptions of the arrangement of clawback, reallocation and stabilisation, commission fee and expense, representations and warranties, indemnity and termination, and so on.

International Underwriting Agreement

In the terms of the international placement, the international underwriters enter into the international underwriting agreement with the issuer and agree to subscribe for, or procure subscribers for, their respective applicable proportion in the placing tranche. The international underwriting agreement is usually concluded after the publication of the prospectus and together with the price determination agreement. Before that, the management of the issuer and the underwriters had undergone the roadshow presentation and bookbuilding process.

Hard Underwriting

For Hong Kong IPOs, it is common for the issuers to enter soft underwriting agreement with the underwriters who do not have a commitment for the portion of shares to be underwritten at the launch of the roadshow/bookbuilding. Therefore, if the market condition and the demand on the shares offered are not satisfactory after the investor education process, the issuer may consider entering into a hard underwriting arrangement to secure a portion of shares which are committed to be underwritten. For such arrangement, the issuer agrees to pay an extra commission fee on the committed portion to the hard underwriters, given that the final offer price is fixed at the low-end in the price range. All these terms are required to be disclosed in the prospectus as well.

Other Contractual Agreements

Agreement among Hong Kong/International Underwriters

The agreement sets out all the terms and obligations among the Hong Kong / International underwriters. The lead Hong Kong / International underwriters will coordinate with the issuer for the underwriting arrangement on behalf of the other underwriters.

Price Determination Agreement

The price determination agreement is usually executed together with the international underwriting agreement after the close of both public and international offer, in which the lead underwriters and the issuer determine and agree on the final offer price.

Receiving Bank Agreement

For IPOs with a public offer subscription, the issuer and the lead underwriters may sign the receiving bank agreement with one or more commercial banks in Hong Kong. The agreement mainly sets forth the overall arrangement of the public offer application, prospectus distribution, payment and refund process.

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Chapter 6 – Listing Application II: Marketing the Deals, Sales and Stabilisation

One of the most important, if not the most important, part of the IPO process is to sell the shares. Starting from marketing preparation, pre-deal research and investor education till investor roadshow, pricing and allocation, and finally listing, the whole process will usually takes around 10 weeks. It is vital to communicate marketing and sales plan with the issuer before it actual happens to have everyone well prepared. This Chapter explains what is involved in the marketing and sales process during an IPO.

Publicity Restrictions

So we start with what information that can, and perhaps more importantly, cannot be released to the public. Before the transaction is formally announced on the Stock Exchange, there should not be any public news regarding this particular IPO plan. In addition, after the transaction is announced, all communication and information sourced from the issuer and the syndicate investment banks should be restricted to what is already disclosed in the IPO prospectus.

Pre-deal analysts' research is a good source of information.

Investor education starts with the research analysts' pre-deal research reports. A comprehensive pre-deal research report usually covers the issuer's equity story, i.e. how the issuer is now and how it will grow, key investment highlights for the next two year financial forecasts and valuation range formulation. It is to promote the issuer as well as to share respective analysts' views with potential investors, providing an independent view of the issuer.

The pre-deal research will be vetted for the factual data. However, this does not affect the analysts' views on the issuer. After being finalized, the pre-deal research reports will be sent to institutional investors around the globe within the selling restrictions. The number of investors could be in the thousands.

Analysts will then go to different regions to meet with their key investors typically for a week on an analysts' roadshow. During the roadshow, the analysts will explain and share in more details their view and findings with potential investors. More importantly, this will start warming up and building up investor momentum before formal deal launch. At the same time, investors can express their preliminary opinions about the issuer. During the exercise, analysts can estimate the demand, identify anchor investors, collect investor feedback, which will help the issuer to determine price better, and address any concerns in the management roadshow stage.

How long is management roadshow?

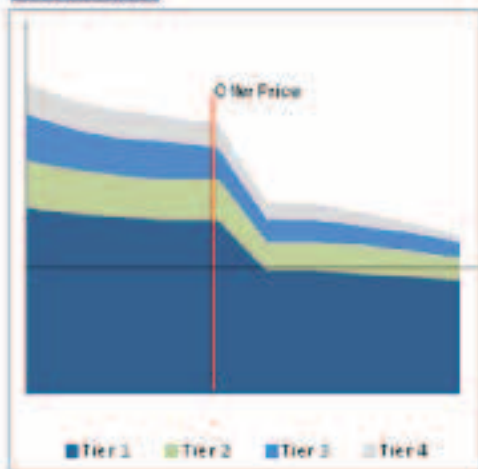
In short, one and a half to two weeks. The IPO roadshow usually lasts around nine days for the management to meet investors which are most interested in the IPO as revealed by the syndicate's sales and investor education feedback. The roadshow is intended to present the investment story of the issuer, in order to confirm the understanding and interest of the potential investors to place their orders. At the end of each roadshow day, the joint global coordinators and joint book-runners will meet with the management of the issuer to summarise and highlight the performance of the management in the roadshow, including feedback and Q&A from investors that were met. This would allow the issuer to incorporate appropriate adjustments to facilitate better communications with investors for the rest of the roadshow.

Preparatory Stage	Investor Education	Management Roadshow	Pricing and Allocation
ASAP	T-6 weeks	T-3 weeks	T-1 weeks
<ul style="list-style-type: none"> • Syndicate structure • Draft marketing plan • Identify potential large orders • Fully understand investors' interest • Draft introduction to selective audience on a confidential basis; prepare them on communicating with investors and understand concerns 	<ul style="list-style-type: none"> • Backout • Syndicate analysts engage in investor education • Critical phase in which analysts narrate equity story to investors • Equity sales and analysts collect and analyse investors' feedback • Determine price range • Establish an H-PO list 	<ul style="list-style-type: none"> • Focused roadshow (heavy based on investor education feedback) • Management address investors concerns on the road • Salesforce convert investors orders • Group meetings plus 1-on-1s • Price conference for retail/institutional investors • H-PO commences 	<ul style="list-style-type: none"> • Demand / book review • Develop a placing plan • Price determined • Allocation
-1-10 weeks			
<ul style="list-style-type: none"> • Management presentation to syndicate analysts and other banks • Analysts produce comprehensive research report <ul style="list-style-type: none"> - Review of equity story - Key investment highlights - Valuation range formulation 			

Structuring and Pricing of the Offer

After the deal announcement, institutional investors will indicate their interest to syndicate banks by stating their indicative order size at a specific price. The syndicate banks will collect the investor interests and feedback, and usually will synchronise these orders at each day's end. This will allow the syndicate group to assess investor demand and account for quality, and hence learn the price sensitivity of the orderbook. Generally speaking, large long-only funds, sector specialist funds, one-on-one meetings attendees and some selected large hedge funds are considered high quality investors, and syndicate banks should ensure to maximize allocations to these investors. In contrast, smaller hedge funds, private banking and proprietary trading desks are usually considered lower quality accounts, to which the syndicate group would normally limit the allocations in order to ensure after-market performance.

Syndicates should maximize the demand from tier-1 investors



Investor Tiering

Tier 1

- Large long only funds
- Sector specialist funds
- 1-on-1 meetings attendees
- Selected large hedge funds

Tier 2

- Other long only funds
- Asian/PRC investors

Tier 3

- Smaller hedge funds
- Selected tycoons and corporate investment arms

Tier 4

- Private banking
- Proprietary trading desks

Other than the institutional investor tranche, there is also the public offering tranche which will be sold to individual investors in Hong Kong. As set out by the listing rules, the initial minimum allocation to the public offering tranche (“PO”) is 10% of the total shares offered. However, when the Hong Kong PO tranche is over 15 times oversubscribed, there will be clawback arrangements that transfer allocations from the institutional offering tranche to the PO tranche. The arrangements are, if the PO tranche is 1) over 15 times oversubscribed, PO allocation will be increased to 30% of the total offering as versus the original 10%; 2) over 50 times oversubscribed, the PO allocation will be increased to 40% of the total offering; 3) over 100 times oversubscribed, the PO allocation will be increased to 50% of the total offering, and this is the maximum portion a PO tranche can be.

Based on investor demand, size of orders, investor indications/feedback and order quality, the syndicate group will recommend an offering price to the issuer for consideration and discussion. The final pricing is therefore determined by a number of factors—size of demand, price sensitivity and quality of investors. The issuer will approve the final pricing before it is released to the public.



Places and Placing Guidelines

There is a Placing Guidance in Appendix 6 of the Listing Rules designed to ensure the placing of shares are placed to independent investors instead of related parties or connected investors to the distributors.

The lead manager must provide the Exchange with a list of each placee, the amount of shares taken up and detailed information of the places, including the ultimate beneficiary of each placee company. The Exchange will then vet and approve the list before the placement could be actually made. In some events, the Exchange may request for further evidence to prove the independence of the placees. The lead manager and the issuer must keep a record of all placees for at least three years after the placing.

Under the Placing Guidelines, there are two major requirements, namely, the “General Public” requirement and “Restricted Placees” requirement. The General Public requirement requires that not more than 75% of the total shares must be made available to the general public.

The Restricted Placees requirement requires that no allocations are permitted unless there is a written consent from the Exchange; that is, allocations to “connected clients” of the lead manager or any book-runner; directors or existing shareholders of the issuer to be listed or their associates or nominee companies, unless the ultimate beneficiary is being disclosed.

Closing and Listing the Deal

All placing/underwriting agreements will be entered into amongst the sponsor, the underwriter and the issuer. Simultaneously, the public offering starts with the indicative price range of offer price offered to the public investors, and the public offer period will be a minimum of 3.5 days. After the final price and allocation of shares in both international offering and the public offering tranches are set, the shares will be listed on the Stock Exchange typically within one week.

Stabilisation and Over-allotment

Normally, there will be price stabilisation activities for each IPO in Hong Kong and appointed stabilisation manager will be responsible for it. The primary purpose of stabilisation is to facilitate capital raising activities by addressing short-term fluctuations. Stabilisation activities are governed by the Securities and Futures (Price Stabilisation) Rules (hereby referred to as the “Stabilisation Rules”). Under the Stabilisation Rules, the stabilising manager may purchase or agree to purchase the shares for the sole purpose of preventing or minimizing any reduction in the market price of that share. However, this action will only be allowed during the stabilisation period, which usually lasts 30 days after the initial listing date.

In order to facilitate the stabilisation with an IPO, the company of the controlling shareholder may grant the underwriter an over-allotment option, also known as “Green shoe” options, to buy additional shares at the offer price. The over-allotment option is not expected by the Exchange to exceed in aggregate 15% of the total number of shares available under the offering. Further, there will be a disclosure obligation for any over-allotment option exercised during the stabilisation period under the Listing Rules.

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Selecting and Working with Your Underwriter

Investment Banks Parade

To succeed an IPO deal, it is necessary for the prospective issuer to cooperate with various professional parties, among which bookrunners play a main role in navigating the underwriting process. In the pitching stage, investment bankers may highlight their credentials to the senior management of the prospective issuer, which includes the recent completed IPO cases, firm ranking and league table as well as sales network. They may also have a brief study in the industry of the prospective issuer and present their idea of the “investment story” to impress the senior management. For a medium- to large-sized IPO, it is common for the prospective issuer to select more than one bookrunner for underwriting.

Selection Consideration

A sound combination of underwriters is able to assist the issuer and complete the IPO effectively. Thus, it is crucial to have a robust consideration in the selection process:

Credentials and Experience

Underwriters who have a sound track record and ranking on the league table are certainly a good start. Besides, the issuer still has to know more about the recent deals the underwriters have completed, the size and industry in particular. If they are experienced in deals of a similar size and industry to the issuer, it is more likely that they can assist the issuer in selecting potential investors.

Research Analyst Coverage

Research analyst reports serve as communication tools between the underwriters and potential investors before the publication of prospectus. The issuer usually initiates the analyst presentation to demonstrate the information in regards to the financial, business and future development of the issuer. Therefore, underwriters with a reputable research arm may be of value to the issuer and potential investors.

Sales and Distribution

Underwriters may have their strengths in particular markets, such as distribution channels and networks, connections with foreign or local brokers and size of target investors. The issuer can select suitable underwriters that cater to their business strengths and development strategies. To a certain extent, the mixture of investors may also have an influence on the future transactions in secondary market.

Post-IPO Support

Some issuers may take a long-term partnership view when selecting underwriters. The capability of the security houses in the equity and debt markets can also be a factor worth considering.

Working with Underwriters

The engaged sponsors are often also appointed as underwriters to the IPO deal. At the outset, it is the issuer's responsibility to present its key strengths and future strategies for the benefit of the sponsors and legal advisers in order to draft the prospectus and position the issuer in relevance to its valuation to the investors. The process of due diligence as mentioned under "Practice Note 21 ("PN21")" also serves this purpose.

Negotiating Terms

The terms between underwriters are often negotiated at the outset. The terms are determined by the size of the offering and the number of senior underwriters in the deal, calculated by way of percentage of the offering size and typically range from 3% to 4%, depending on the market conditions. Sometimes it will be based on some additional incentive terms in relation to performance. The finalized economics will be stipulated in the underwriting agreements which are entered amongst syndicated underwriters and the issuer.

In addition to being responsible for the organisation and marketing of the IPO, underwriters should ensure the market can digest the total number of shares offered at the required valuation to raise the amount of money that they intend to raise. Such an undertaking can either be an undertaking of best efforts based on market appetite (referred to as a "soft underwriting") or a firm undertaking to underwrite the securities offered regardless of the market conditions and investor appetite (for details, please refer to "Hard underwriting" in Chapter 6).

The underwriting agreement is typically conditional upon the satisfaction of certain conditions, i.e. the outcome of the offering and the payment of the securities. In addition, the underwriting agreement would contain representations, warranties and indemnities to be given to the underwriters by the issuer that relate to the issuer's business and the contents of the prospectus. Additionally, the underwriters typically also hold an option to invoke a termination clause in case there are certain factors beyond the control that can affect the underwriter's ability to place the shares with the investors.

Syndicate Structure

A syndicate structure refers to the practice that two or more investment banks jointly manage a security issuance, which includes joint global coordinators and joint bookrunners in the underwriting process.

Once the syndicate structure is settled, the joint global coordinators/bookrunners will lead and assist the issuer, allocate duties and collaborate on designing the offering scheme, organising public marketing activities, arranging roadshows and equity sales. Before these, the structure has clearly set forth the rights and obligations of different houses in respect of the whole process. Nevertheless, from the issuer's point of view, the syndicate structure will not generate material additional cost, instead of saving travelling and other administrative costs.

The Advantages of Syndicate Structures in Hong Kong

Mitigates the Risks in the Process of Listing

Underwriters' previous experience and distribution channel resources can be fully exploited to mitigate the risks during the listing process and ascertain a complete success of the listing. In the case when the market demand is weak, the introduction of a hard underwriter may also be a choice for the issuer.

Incurs Minimal Additional Costs

The syndicate structure incurs minimal extra costs to the issuer since the underwriting commissions are fixed in advance and the issuer has the right to determine whether and how to distribute bonuses after the transaction.

Maximizes the Interests

The structure allows the underwriters to monitor each other progress, which ensures the maximization of issuer's interests, particularly in the tracking of the listing progress and valuation.

More Diversified and Comprehensive Investor Base and Sales Network

Joint underwriters outpace a sole underwriter in the way that they have an all-embracing access to market information and demand. Such diverse investor bases of different underwriters supplement one another so that the issuer can benefit from a large sales network and subscription demand.

Broader Research Coverage

Quality research reports provide thorough analysis that allows the investors to understand the potential value of the issuer. The bookrunner's analysts usually initiate coverage before the marketing campaign and the issuer can enjoy a broader research coverage under the syndicated structure.

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Chapter 7 – Preparing for an IPO – Specific Listing Issues

Planning, executing, and managing an initial public offering (IPO) can be a challenging task. The better prepared a company is, the more efficient and less costly the process would be. It is therefore of paramount importance for potential issuers to identify issues in advance and resolve them at an early stage of the IPO.

There are many issues and challenges that may arise according to the specific circumstances of the listing, the nature of the company and its industry. This chapter discusses some of the specific listing issues that may be encountered by potential issuers. In particular, as mainland enterprises form a substantial portion of Hong Kong's stock market, this chapter highlights some common issues those businesses experience when listing in Hong Kong.

1. Listing Applicants from Overseas Jurisdictions – A General Introduction

a. Acceptable Jurisdictions

As discussed in Chapter 1, in addition to the four recognised jurisdictions under the Rules (the Listing Rules) Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (HKEx) (i.e., Hong Kong, the People's Republic of China (the PRC), Bermuda and the Cayman Islands), the HKEx has so far accepted 21 jurisdictions as suitable for listing in Hong Kong.

b. General Framework

The general framework for determining the suitability for listing of an overseas listing applicant is set out in Chapter 19 of the Listing Rules. In particular, Rule 19.05(1) provides that the HKEx may refuse a listing of securities of an overseas issuer if:

- the HKEx believes that it is not in the public interest to list it; or
- the HKEx is not satisfied that the overseas issuer is incorporated or otherwise established in a jurisdiction in which the standards of shareholder protection are at least equivalent to those provided in Hong Kong.

c. Joint Policy Statement regarding the Listing of Overseas Companies

The HKEx and the Securities and Futures Commission (the SFC) issued a Joint Policy Statement regarding the Listing of Overseas Companies (the Joint Policy Statement) in 2007 to facilitate the listing of overseas issuers by clarifying the requirements under the Listing Rules and setting out the principal shareholder protection requirements to be satisfied by an overseas incorporated issuer. If a company cannot demonstrate that these standards exist in its home jurisdiction, it may alter its constitutional documents to achieve the same standards. In September 2013, the HKEx and the SFC updated the Joint Policy Statement. The principal changes include:

Shareholder protection standards¹	<p>The shareholder protection standards have been refined by removing those already provided for by the Listing Rules. Noting that companies incorporated in jurisdictions whose companies law is based on the UK Companies Act find it easier to comply with the 2007 Joint Statement than those incorporated in jurisdictions with completely different company law regimes (such as Brazil, France, Germany, Italy and Japan), some standards have been revised to accommodate practices in other jurisdictions. For example, the revised Joint Policy Statement allows an overseas company to approve certain matters by a “super-majority” vote rather than meet Hong Kong’s specific threshold requirements.</p>
Regulatory cooperation arrangements²	<p>Regulatory cooperation arrangements have been extended to require the statutory securities regulator in both an overseas company’s jurisdiction of incorporation and place of central management and control (if different) to either: (i) be a full signatory of the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMOU); or (ii) to have entered an appropriate bi-lateral agreement with the SFC for mutual assistance and exchange of information. Previously, this was required only in respect of the jurisdiction of incorporation.</p>
Accounting and auditing related and other disclosure requirements³	<p>The revised Joint Policy Statement gives guidance on acceptable overseas accounting and auditing standards. Guidance is also given on the additional disclosure requirements for overseas companies’ prospectuses and Company Information Sheets.</p>
Practical and operational matters⁴	<p>The revised Joint Policy Statement highlights some of the practical difficulties overseas companies face when listing in Hong Kong (e.g. those with scripless securities).</p>

¹ Section 1 of the revised Joint Policy Statement

² Section 2 of the revised Joint Policy Statement

³ Section 3 of the revised Joint Policy Statement

⁴ Section 4 of the revised Joint Policy Statement

Suitability for secondary listing⁵	The revised Joint Statement clarifies the regulators’ approach to the suitability of companies seeking a secondary listing on the HKEx. Since these companies are listed and primarily regulated outside Hong Kong, they apply for extensive waivers from the Listing Rules. To be suitable for these waivers, a company seeking a secondary listing must: (i) normally have a large market capitalisation and a long track record of regulatory compliance on its primary market; (ii) be primarily listed on an exchange recognised by the Hong Kong regulators as having a strong reputation for requiring high standards of shareholder protection and corporate governance; and (iii) have a “centre of gravity” outside Greater China.
Waivers⁶	The revised Joint Policy Statement sets out the common waivers the HKEx is prepared to grant an overseas company on application and the automatic waivers granted (i.e. without application) to companies seeking a secondary listing if they meet the criteria set out in the revised Joint Policy Statement.

2. Listing of a PRC Business – Red Chip or H-Share?

a. What is Meant by “Red Chip” and “H-share”?

PRC businesses listed on the HKEx include “H-share companies” and “red chip companies”. H-share companies are joint stock companies incorporated in the PRC which have received approval from the China Securities Regulatory Commission (CSRC) to list in Hong Kong; whereas red chip companies refer to the companies which are incorporated outside the PRC (usually in Hong Kong, the Cayman Islands or Bermuda) but with most of its business in the PRC and are usually controlled by PRC entities. Listing a PRC business is generally more complicated than other listings in Hong Kong as relevant PRC approvals may be required for the reorganisation and listing process.

b. Breakthrough in the Innovation of Red Chip Structure

Historically, the PRC regulatory process for the reorganisation and listing of red chip companies was simpler than that for H-share issuers. Nevertheless, following the introduction of the “Regulations Concerning the Merger and Acquisition of Domestic Enterprises by Foreign Investors” (commonly known as “Circular No. 10” or the “M&A Rules”) in August 2006, the listing process for red chip companies has become increasingly complicated.

Circular No. 10 was promulgated by the Ministry of Commerce (MOFCOM), the State-owned Assets Supervision and Administration Commission, the State Administration of Taxation, the State Administration for Industry and Commerce (SAIC), CSRC and the State Administration of Foreign Exchange (SAFE) on 8 August 2006. It came into effect on 8 September 2006 and was amended by MOFCOM on 22 June 2009. By

⁵ Section 5 of the revised Joint Policy Statement

⁶ Appendix to the revised Joint Policy Statement

virtue of Circular No. 10, MOFCOM's approval is required at various stages of a red chip listing, including:

- the establishment of a special purpose vehicle (SPV) outside the PRC by a PRC domestic enterprise for the purpose of an overseas listing of the interest in a PRC domestic enterprise⁷; and
- the acquisition of the businesses or assets of a PRC domestic enterprise by the⁸SPV.

In addition, Circular No. 10 reinstated the requirement to obtain CSRC approval for a proposed red chip listing⁹, which was previously removed when CSRC's practice of issuing a no-objection letter was phased out in 2003. Moreover, under the framework of Circular No. 10, companies that successfully list overseas must repatriate proceeds within a pre-determined time frame to the PRC. Even if an enterprise obtains listing approval, failure to complete the overseas listing within 12 months of such approval would result in the enterprise reverting to its original shareholding structure¹⁰.

It was originally perceived that the stringent requirements and restrictions under Circular No. 10 would curb the overseas listing of those PRC enterprises whose red chip structures were not consummated before the implementation date of Circular No. 10 (i.e. 8 September 2006). However, in past years, we have witnessed various ingenious reorganisation plans adopted by different PRC enterprises to oust the application of Circular No. 10 on their listings in Hong Kong, for example, the so-called "slow walk" or "option" arrangement and the variable interest entity (VIE) structure. While these options are not free from regulatory risk, it is expected that the transactional structures for red chip listings will continue to be developed and refined.

In 2012, a breakthrough was achieved with the innovation of red chip listings. A PRC domestic enterprise, by transforming itself into a Sino-foreign enterprise and then a wholly foreign-owned enterprise (WFOE), successfully listed in Hong Kong in 2012.¹¹ As this enterprise only commenced the building of its red chip structure in 2010, i.e. after the implementation date of Circular No. 10, its successful listing is said to have turned Circular No. 10 into a paper tiger.¹² As a result, PRC enterprises can be listed more freely in Hong Kong.

⁷ Article 42 of Circular No. 10

⁸ Article 11 of Circular No. 10

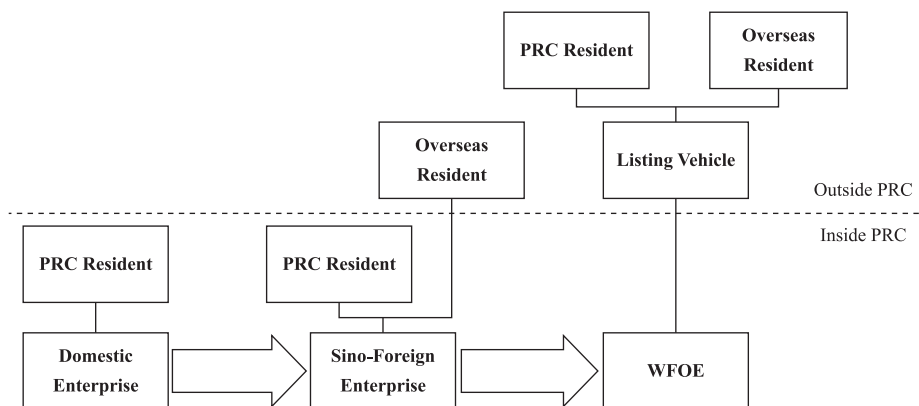
⁹ Article 40 of Circular No. 10

¹⁰ Article 49 of Circular No. 10

¹¹ China Zhongsheng Resources Holdings Limited (Stock Code: 2623). A similar approach was adopted in the listing of China Tianrui Group Cement Company Limited (Stock Code: 1252)

¹² Zhongsheng Resources Holdings – New Route for Red Chip Listing" (中盛資訊控股"紅籌"新路徑) published in the September 2012 issue of Capital Finance

A diagram summarising the key reorganisation steps involved in the innovative red chip model¹³:



Since 2005, China’s State Administration of Foreign Exchange (SAFE) has issued a series of circulars concerning round-trip investments by SPVs, directing that certain types of round-trip investments are required to be registered with SAFE. As these circulars would affect the feasibility and timetable of red chip restructurings, potential issuers should not overlook these circulars and should seek professional advice in planning their red chip listings.

c. Relaxation of the “4-5-6 Requirements” – A New Era for H-Share Listing

Pursuant to the CSRC’s rule issued in July 1999, enterprises must have RMB400 million of net assets, raise US\$50 million of funds, and have an after-tax profit of not less than RMB60 million before they can apply for listing on overseas main boards, including Hong Kong’s.¹⁴ These are commonly referred to as the “4-5-6 requirements”. During the IPO boom year of 2007, it was widely reported that CSRC had adopted an unofficial policy of approving an H-share listing only if the amount to be raised exceeded US\$1 billion or if the company was willing to do a dual-listing in the mainland.¹⁵ As a result, the trend over the past few years has been for mega-PRC enterprises to conduct “A + H dual listings” on the Shanghai and Hong Kong stock exchanges. For less sizable PRC businesses, they are more commonly listed in Hong Kong by way of red chip listings.

Further to Supplement IX to the Closer Economic Partnership Arrangement (CEPA) which was signed on 29 June 2012, the CSRC promulgated the Guidelines for Supervising the Application Documents and Examination Procedures for the Overseas Stock Issuance and Listing of Joint Stock Companies (No. 45 [2012] of the CSRC) to lift the “4-5-6 requirements” and simplify the approval procedures for overseas listings. The relaxation took effect on 1 January 2013. As CSRC loosens its grip on overseas IPO applications, it is expected that H-share listings will be open up to smaller issuers.

¹³ This diagram is simplified for illustrative purpose. In practice, investment holding companies may be added to each layer.

¹⁴ The Notice on Relevant Issues Concerning Enterprises’ Application for Overseas Listing” (No. 83 [1999] of the CSRC) issued on 14 July 1999

¹⁵ “China ups the ante against HK listing”, Financial Times, 16 April 2007

d. Red chip or H-share?

With the abolition of the “4-5-6 requirements”, the distinction between H-share and red chip listing is diminishing. Here is a summary of the comparison between red chip and H-share listing on the HKEx:

	Red chip	H-share
Listing vehicle	No specific requirements. Any recognised/ acceptable jurisdiction can serve as the listing vehicle.	Must be a PRC joint stock company.
Key legal obstacle	The listing group needs to undergo restructuring to inject domestic assets/ business into an offshore structure, which may be restricted by Circular No. 10.	Approval from the CSRC is required.
Financial tests	Same. Previous 4-5-6 requirements applicable to H-share listing have been abolished.	
Restriction on circulation	Subject to lock-up requirements, all securities can be freely circulated.	Domestic shares held by founders cannot be circulated outside PRC without CSRC approval. Full circulation of H-shares has yet to be formalised. ¹⁶
Lock-up period	Pursuant to the Listing Rules, controlling shareholders cannot sell any of their shares 6 months from the date of listing; and within the 6 months thereafter, controlling shareholders cannot sell their shares to the extent of losing the controlling status.	Apart from the requirements under the Listing Rules, according to PRC Company Law, shares issued before listing cannot be transferred within one year from the date of listing.
Issue after listing	Pursuant to the Listing Rules, a listed company cannot issue new shares within six months after listing. Generally speaking, approval from PRC authorities is not required for issue of shares after listing. Future financing is more flexible.	Apart from the requirements under the Listing Rules, an H-share listed company requires approval from the CSRC every time when it issues new shares.

3. Feasibility of VIE Structures under Close Examination

a. What is a VIE structure?

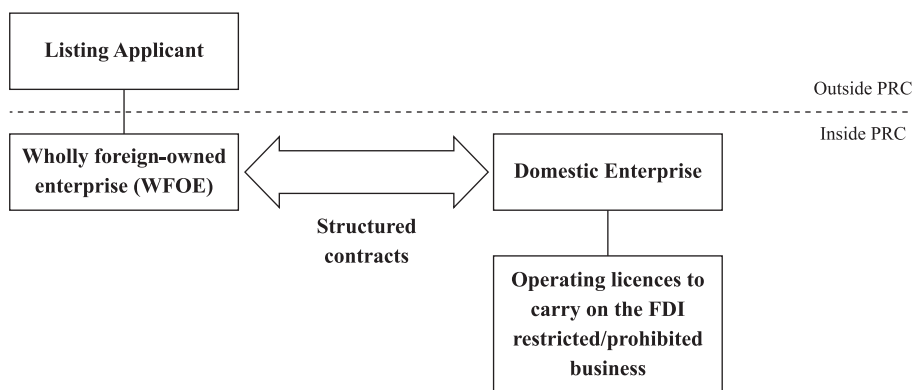
VIE structures have long been used by foreign parties to indirectly invest in sectors in the PRC in which foreign direct investment (FDI) is restricted or prohibited. In addition, VIE structures have been adopted to enable PRC businesses in those FDI restricted or prohibited sectors to list offshore. Coined as a “Sina structure”

¹⁶ “Fuguiniao gave up H share full circulation listing, CSRC not yet approved, striving for listing in Hong Kong by year end” (富貴鳥棄H股全流通上市 中證監未放行 爭取年底前港掛牌), Hong Kong Economic Times, 5 November 2013

after Sina.com successfully listed its value-added telecom business on NASDAQ in 2000 by adopting a VIE structure, VIE structures have been replicated in other sectors such as publications, broadcasting, media, mining and internet-based businesses.

In essence, a VIE structure refers to a structure whereby a fully or partially foreign-owned entity established in the PRC has control over a PRC domestic enterprise which holds the necessary licence(s) to operate in a FDI restricted/prohibited sector. By virtue of various contractual arrangements, the de facto control over the operation and management as well as the economic benefits of the PRC domestic enterprise are shifted to the foreign-owned entity. In past red chip listings adopting VIE structures, Circular No. 10 was interpreted by the relevant issuers to be inapplicable as no acquisition of the relevant PRC domestic enterprises was involved.

b. Typical VIE / Structured Contract Arrangement



c. Can a VIE Structure be Listed in Hong Kong?

Since there is no express endorsement of VIE structures by the PRC authorities, the legality of VIE structures is questionable. In 2010 and 2011, the Shanghai Sub-commission of the China International Economic and Trade Arbitration Commission (CIETAC) granted two arbitral awards, in which the CIETAC invalidated some VIE agreements on the grounds that they violated express provisions of PRC laws that prohibit foreign investors from controlling and participating in the FDI restricted business and constituted “concealing illegal intentions with a lawful form”.¹⁷ Further, in June 2013, the Supreme People’s Court ruled in a dispute involving Chinachem Financial Services Limited that the relevant entrustment agreements were void on similar grounds.¹⁸ In light of these arbitral awards and judgment, there was an uncertainty as to whether VIE structures can be listed in Hong Kong.

¹⁷ “Shanghai CIETAC’s findings on VIE case raises plenty of questions”, China Business Law Journal, December 2012/January 2013 issue

¹⁸ “Supreme court judgment again touches sensitive VIE nerve”, China Business Law Journal, July/August 2013 issue

The uncertainty has now been lifted as different enterprises adopting VIE structures successfully listed in Hong Kong in 2012 and 2013.¹⁹ HKEx also published two listing decisions to clarify that the listing of VIE structures would continue to be allowed on a case-by-case basis, subject to disclosure of the relevant details of the VIE structures and the risks involved in the prospectus.²⁰ Potential issuers with VIE structures who decide to press on with their listing plans ahead of the potential legislative change in the PRC should keep track of the regulatory development and seek competent legal advice.

4. Mineral Companies and Infrastructure Projects – Special Listing Qualifications and Requirements

As the businesses of exploration and extraction of natural resources and infrastructure projects are essentially capital intensive in nature, more and more mineral companies and infrastructure companies are going public. Due to their unique characteristics, their listings in Hong Kong are subject to specific listing qualifications and requirements.

a. Mineral Companies

What is meant by a “mineral company”?

“Mineral companies” include those whose principal activities (representing 25% or more of their total assets, revenue or operating expenses) involve the exploration for, and/or extraction of, minerals or petroleum (which includes hydrocarbons in any form)²¹. If a mineral company is unable to satisfy any of the financial tests under Rule 8.05 of the Listing Rules, it may still apply to be listed if its directors and senior managers have at least five years’ experience relevant to the exploration and/or extraction activity that the listing applicant is pursuing.

¹⁹ Branding China Group Limited (Stock Code: 8219), Flying Financial Service Holdings Limited (Stock Code: 8030), IGG Inc (Stock Code: 8002), Wisdom Holdings Group (Stock Code: 1661), Forgame Holdings Limited (Stock Code: 484) and China Huirong Financial Holdings Limited (Stock Code: 1290)

²⁰ HKEx Listing Decision LD33-2012 and HKEx Listing Decision LD43-3

²¹ Rule 18.01(3) of the Listing Rules

²² Rule 18.04 of the Listing Rules

Additional Listing Qualifications

In addition, a listing applicant which is a mineral company has to demonstrate that:

Right to participate	It has the right to participate actively in the exploration for and/or extraction of minerals or petroleum, either through <ul style="list-style-type: none"> (i) control over 50% (by value) of the assets in which it has invested together with adequate rights over the exploration for and/or extraction of the relevant resources; or (ii) adequate rights arising under arrangements which give the applicant sufficient influence in decisions over the exploration for and/or extraction of those resources²³.
Portfolio	It has at least a portfolio of <ul style="list-style-type: none"> (i) “Indicated Resources”²⁴ (in the case of minerals), or (ii) “Contingent Resources”²⁵ (in the case of petroleum), identifiable under a recognised reporting standard and substantiated in a competent person’s report; and the portfolio must be meaningful and of sufficient substance to justify a listing ²⁶ .
Available working capital	It has available working capital for 125% of its present requirements for at least the next 12 months ²⁷ .

Additional Disclosure

A mineral company is also subject to additional prospectus disclosure requirements. In particular, if it has not yet begun production, it must disclose its plans to proceed to production with indicative dates and costs, which is supported by at least a scoping study, substantiated by the opinion of a competent person. If exploration rights or rights to extract resources and/or reserves have not yet been obtained, relevant risks to obtaining these rights must be prominently disclosed²⁸.

²³ Rule 18.03(1) of the Listing Rules

²⁴ “Indicated Resources” refer to the mineral resources for which tonnage, densities, shape, physical characteristics, grade and mineral content can be estimated with a reasonable level of confidence (Rule 18.01(3) of the Listing Rules).

²⁵ “Contingent Resources” refer to those quantities of petroleum estimated, at a given date, to be potentially recoverable from known accumulations by application of development projects, but which are not currently considered to be commercially recoverable due to one or more contingencies (Rule 18.01(3) of the Listing Rules).

²⁶ Rule 18.03(2) of the Listing Rules

²⁷ Rule 18.03(4) of the Listing Rules

²⁸ Rule 18.03(4) of the Listing Rules

Competent Person's Reports and Valuation Reports

Competent person's reports and valuation reports must comply with a recognised reporting standard²⁹, including:

- the JORC Code, NI 43-101 and the SAMREC Code for mineral resources and reserves;
- PRMS for petroleum resources and reserves; and
- CIMVAL, the SAMVAL Code and the VALMIN Code for valuations.

Where information is presented in accordance with other reporting standards acceptable to the HKEx, reconciliation to the required reporting standards must be provided.³⁰

b. Newly Formed "Project" Companies*What is meant by a newly formed "project" company?*

Newly formed "project" companies include those companies formed to construct major infrastructure projects, which create the basic physical structures or foundations for the delivery of essential public goods and services that are necessary for the economic development of a territory or country. Examples of infrastructure projects include the construction of roads, bridges, tunnels, railways, mass transit systems, water and sewage systems, power plants, telecommunication systems, seaports and airports³¹.

Specific Listing Qualifications

For a listing application by a newly formed "project" company, the HKEx may accept a shorter trading record period or may vary or waive the financial tests under Rule 8.05 of the Listing Rules if it satisfies certain specific requirements³², which include:

- The company's only business, either directly or through subsidiaries or joint venture companies, is to build and operate specific infrastructure project(s) as stipulated in the infrastructure project mandates or contracts;
- The infrastructure project(s) must be carried out under a long term concession or mandate awarded by the government;
- The remaining term of concession must normally be at least 15 years at the time of listing;
- The company's share of the total capital cost of the project(s) should normally be at least HK\$1 billion;
- The majority of the company's project(s) should be in the pre-construction or construction stage;
- The bulk of the proceeds of the offering should be used to finance the construction of the project(s) and not principally to repay indebtedness or to acquire other non-infrastructure assets; and

²⁹ Rule 18.24 of the Listing Rules

³⁰ Note to Rule 18.29 of the Listing Rules

³¹ Rule 8.05B(2) of the Listing Rules

³² Rule 8.05B(2) of the Listing Rules

- Its substantial shareholders and management have the necessary experience, technical expertise, track record and financial strength to carry out the project(s) to completion and to operate it/ them thereafter. In particular, its directors and management must have sufficient and satisfactory experience of at least three years in the line of business and industry of the new applicant.

5. Pre-IPO Investment – Principles and Guidance to be Observed

a. General Principle

It is common for private equity and hedge funds to invest in unlisted companies with the aim of cashing out on an eventual IPO. Investors are usually given large discounts because of the risk that the IPO might not be successful. However, potential issuers should observe the principles under Rule 2.03(2) and (4) of the Listing Rules, which provide that the issue and marketing of securities should be conducted in a fair and orderly manner and all holders of listed securities should be treated fairly and equally.

b. Timing of Pre-IPO Investment – 28 Day/180 Day Requirement

In addition, potential issuers should also take note of the Interim Guidance on Pre-IPO Investments (Interim Guidance) announced by the HKEx on 13 October 2010, which was re-issued by way of a guidance letter by the HKEx in January 2012. The Interim Guidance requires that pre-IPO investments should normally be completed either (i) at least 28 clear days before the date of the first submission of the first listing application form; or (ii) 180 clear days before the first day of trading of the applicant's securities. Pre-IPO investments are considered completed when the funds are irrevocably settled and received by the applicant.

c. Consequences for Non-Compliance

HKEx has in the past disapproved certain pre-IPO investments on the ground that they have contravened the principles under Rule 2.03(2) and (4) of the Listing Rules. In particular, in two cases where the pre-IPO investment agreements were signed on the date of submission of the listing application forms with settlement taking place later and the prices were at a deep discount to the IPO price, HKEx found that the pre-IPO investors would have received much more favourable terms than investors at the IPO stage. Hence, it considered that either the investments should be retracted or the listing timetable should be extended so that the pre-IPO investors would be exposed to risks significantly different from those assumed by investors investing at the IPO stage.³³

³³ HKEx News Release published on 13 October 2010, which was re-issued by way of a guidance letter (GL29-12) in January 2012

d. Special Rights which Cannot Survive Upon Listing

HKEx published a guidance letter (GL43-12) in October 2012 which sets out a list of common special rights attached to pre-IPO investments and HKEx's guidance on whether these special rights would be allowed to survive upon listing. Here is a summary of the special rights which will not be allowed to survive upon listing:

Price adjustment	Any price adjustment provisions (e.g. a guaranteed discount to the IPO price or an adjustment linked to the market capitalization of the shares) effectively create two different prices for the same securities for pre-IPO investors and other shareholders at the time of listing, potentially creating a disruptive effect at that time.
Put or exit options	All put or exit options granted to pre-IPO investors to put back the investments to the listing applicant or its controlling shareholder, are against the Interim Guidance, which requires pre-IPO investments to be irrevocably settled. The put or exit option can only be exercised when listing does not take place.
Director nomination rights	Any contractual right of a pre-IPO investor to nominate a director should not survive after listing. However, pre-IPO investors may nominate or appoint a director to the board before the applicant's listing. That director would be subject to the retirement and re-appointment requirements under the applicant's articles of association after listing.
Veto rights	Any contractual rights to exercise veto power over the listing applicant's major corporate actions (e.g., winding-up, carrying on a new business, or effecting an amalgamation or merger) should be terminated upon listing.
Anti-dilution rights	Anti-dilution rights should be extinguished upon listing to be in line with Rule 13.36 of the Listing Rules on pre-emptive rights. However, exercise of anti-dilution rights by the pre-IPO investors is permissible at the time of the listing where: <ul style="list-style-type: none"> • the allocation is necessary to give effect to the pre-existing contractual rights of the pre-IPO investors under the relevant investor rights agreement; • full disclosure of the pre-existing contractual entitlement of the pre-IPO investors, and the number of shares to be subscribed by them, will be made in the prospectus and the allotment results announcement; and • the proposed subscription will be conducted at the IPO price.
Profit guarantee	Disallowed if it is settled by the listing applicant or if the compensation is linked to the market price or market capitalization of the shares.

Negative pledges	<p>Disallowed unless:</p> <ol style="list-style-type: none"> i. they are widely accepted provisions in loan agreements; ii. they are not egregious; and iii. they do not contravene the fairness principle in the Listing Rules. <p>Widely accepted provisions include:</p> <ul style="list-style-type: none"> • not to create or effect any mortgage, charge, pledge, lien or other security interest on an applicant’s assets and revenues; and • not to dispose of any interest in the economic rights or entitlements of a share the controlling shareholder owns or controls to any person. <p>HKEx may require confirmation from the sponsor that the relevant pledges which remain after listing are in line with normal terms of debt issues.</p>
Prior consent for corporate actions	<p>Disallowed unless:</p> <ol style="list-style-type: none"> i. the terms are not egregious; and ii. the terms do not contravene fundamental principles to the disadvantage of other shareholders
Exclusivity rights and no more favourable terms	<p>These rights prevent an applicant from issuing or offering securities or rights to any direct competitor of the pre-IPO investor or to other investors on more favorable terms than those granted to the pre-IPO investor. Such rights cannot survive after listing unless the investment agreement is modified to include an explicit “fiduciary out” clause, which allows directors to ignore the terms if complying with the terms would constitute a breach of their fiduciary duties.</p>
Information rights	<p>Information rights can survive after listing only if the pre-IPO investor is entitled to receive only published information or information that is at the same time made available to the general public, so as to avoid unequal dissemination of information.</p>
Representation/attendance rights	<p>Contractual rights granted to a pre-IPO investor to nominate senior management and committee representatives would be allowed, but any such appointment is subject to the decision of the board. The board of directors is not contractually obligated to approve a pre-IPO investor’s nominations without further review, as they owe fiduciary duties to all the shareholders.</p>
Right of first refusal and tag-along rights	<p>HKEx considers that these rights, which intend to protect the pre-IPO investor’s interest in the applicant by limiting the controlling shareholder’s freedom to sell its shares to other parties, are purely contractual rights between two shareholders and should be allowed to survive after listing.</p>

e. Pre-IPO Investments in Convertible Instruments

It is not uncommon for pre-IPO investments to invest in convertible instruments (e.g. convertible or exchangeable bonds, notes or loans and convertible preference shares (collectively, CBs)), which are convertible or exchangeable into securities of the listing applicant or its holding company. HKEx has published a guidance letter (GL44-12) to set out its current practice in dealing with convertible instruments issued to pre-IPO investors. Here is a summary of HKEx's practice:

Conversion price linked to IPO price or market capitalisation	The conversion price for the CBs should be at a fixed dollar amount or at the IPO price. Where the CBs will be converted into shares at a price based on a guaranteed discount to the applicant's IPO price or the conversion is linked to market capitalisation, this essentially creates two different prices for the same securities at listing, which is inconsistent with the principles of the Listing Rules. The discount to the applicant's IPO price or any linkage to the market capitalization of shares may also give rise to concerns that the pre-IPO investor does not bear the same investment risk as public investors.
Conversion price reset	Any conversion price reset mechanism of the CBs should be removed as they are considered to be contrary to the principle of the Listing Rules.
Mandatory or partial conversions	Partial conversion of CBs is only allowed if all atypical special rights are terminated after listing. This prevents the situation where a pre-IPO investor enjoys the special rights it held as bondholder by converting a significant portion of their CBs into shares and yet still be entitled to special rights by holding a small portion of the CBs.
Redemptions and early redemptions	Certain CBs provide bondholders the option to redeem early the outstanding CBs at a price which would enable the bondholders to receive a fixed internal rate of return (IRR) on the principal amount of the CBs being redeemed. Such early redemption is allowed and should be distinguished from other cases where the bondholders do not undertake any risk and the investment money is not paid yet.

6. Competing Interests of Controlling Shareholders and Directors

Generally speaking, the Listing Rules allow the presence of a competing business of a listing applicant's directors and controlling shareholders, provided that full disclosure is made in the prospectus (and for directors, also in its annual reports after listing) of the following³⁵:

Disclosure for competing business
<ul style="list-style-type: none"> • Reasons for the exclusion of the competing business from the business about to be listed; • A description of the excluded business and its management, including the nature, scope and size of the business, with an explanation as to how such a business may compete with the business to be listed;

³⁵ Rule 8.10 of the Listing Rules

Disclosure for competing business (cont'd)

- Facts demonstrating that the listing applicant is capable of carrying on its business independently of, and at arm's length from, the excluded business; and
- Any intention of the controlling shareholder to inject the excluded business into the company to be listed and the timeframe of the intended injection.

However, in assessing the suitability of listing, HKEx will review if there are adequate arrangements to manage conflicts of interest and delineation of businesses between the company and other businesses under common control. In addition, HKEx will also consider factors relating to the conduct of the listing applicant's business independently from its controlling shareholders in areas including financial independence, operational independence and management independence.³⁶

In this regard, the controlling shareholders of a listing applicant would normally be expected to enter into a non-competition agreement with the listing applicant to delineate their businesses following listing and to eliminate future competition. The controlling shareholders may be required to give undertakings as to referral of future business opportunities to the listing applicant, approval procedures prior to the controlling shareholder entering into future competing businesses and grant of options, pre-emptive rights or rights of first refusal over their existing or future competing businesses.

In some cases, the HKEx may consider the giving of non-competition undertakings by the controlling shareholders inadequate or ineffective to manage conflicts of interest and delineation of businesses, and may require additional arrangements to be made by the listing applicants. For instance, the independent non-executive directors may be required to review the options, pre-emptive rights or rights of first refusal granted by the controlling shareholders over their existing or future competing businesses and to decide whether to exercise these rights. They may also be required to disclose the matters relating to the exercise or non-exercise of these rights to the public.³⁷

7. Share Option Scheme

To recognize the contribution of employees and directors to the company and to share the success of the company with them, many listed companies in Hong Kong adopt share option schemes. Potential issuers may consider adopting either or both of pre-IPO schemes and post-IPO schemes.

a. Post-IPO Share Option Scheme

For post-IPO schemes, a number of rules under Chapter 17 of the Listing Rules have to be observed. Here is a summary of the key terms of the scheme which are required under Chapter 17 of the Listing Rules:

Eligible participants	No specific restriction under the Listing Rules. Directors and employees of the group and other persons who have or will contribute to the group are generally eligible grantees.
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³⁶ HKEx Listing Decision LD51-3

³⁷ The Listing Committee Annual Report 2006, pp5-6

Number of shares to be issued	The total number of shares which may be issued upon exercise of all options to be granted under all share option schemes must not in aggregate exceed 10% of the issued shares as at the date of approval of the scheme. ³⁸
The 10% limit	The listed issuer may seek approval by its shareholders in general meeting for “refreshing” the 10% limit under the scheme. Options previously granted under the scheme will not be counted for the purpose of calculating the limit as “refreshed”. ³⁹
Number of shares under outstanding options	The total number of shares that may be issued upon exercise of all outstanding options granted and yet to be exercised under all schemes must not exceed 30% of the issued shares from time to time. No options may be granted if this would result in the limit being exceeded. ⁴⁰
Entitlement per participant	Unless approved by shareholders, the total number of shares issued and to be issued upon exercise of the options granted to any participant in any 12-month period must not exceed 1% of the issued shares. ⁴¹
Exercise price	The exercise price must be at least the higher of (i) the closing price of the shares on the date of grant and (ii) the average closing price of the shares for the five business days preceding the date of grant (or the IPO price for new issuer). ⁴²
Exercise period	The period within which the shares must be taken up under the option must not be more than 10 years from the date of the grant. ⁴³
Life of scheme	The life of the scheme must not be more than 10 years from the date of its adoption. ⁴⁴
Transferability of options	Options granted under the scheme must be personal to the grantee and may not be transferred or assigned. ⁴⁵

³⁸ Note 1 to Rule 17.03(3) of the Listing Rules

³⁹ Note 1 to Rule 17.03(3) of the Listing Rules

⁴⁰ Note 2 to Rule 17.03(3) of the Listing Rules

⁴¹ Rule 17.03(4) of the Listing Rules

⁴² Note 1 to Rule 17.03(9) of the Listing Rules

⁴³ Rule 17.03(5) of the Listing Rules

⁴⁴ Rule 17.03(11) of the Listing Rules

⁴⁵ Rule 17.03(17) of the Listing Rules

Approvals for grants of options	<p>Where an option is to be granted to a director, chief executive or substantial shareholder of a listed issuer (or their respective associates), the grant must be approved by the independent non-executive directors (INEDs) (excluding any INED who is the grantee).</p> <p>Where an option is to be granted to a substantial shareholder or INED of a listed issuer (or their respective associates), the grant must be approved by the shareholders if it would result in the shares issued or to be issued upon exercise of all options already granted or to be granted to such person in the 12-month period up to and including the date of grant:</p> <ul style="list-style-type: none"> • representing in aggregate over 0.1% of the issued shares; or • the aggregate value of the options granted is greater than HK\$5 million (based on closing price at date of grant).⁴⁶
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b. Pre-IPO Share Option Scheme

Pre-IPO schemes do not need to comply with all aspects of Chapter 17 of the Listing Rules. Where a company issues options to employees prior to an IPO, options granted before listing remain valid after listing but no further options may be granted following listing. Pre-IPO schemes may provide that the exercise price of options will represent a limited discount to the IPO price. The company is required to disclose in the prospectus full details of outstanding options, the grantees and their dilution effect and impact on earnings per share upon exercise.⁴⁷ The HKEx may grant a waiver from the requirement to include details of the grantees if such a disclosure would be unduly burdensome or irrelevant.⁴⁸

Disclaimer

The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

This article also covers some specific issues that are governed by the laws of the PRC. We have not investigated, and do not express or imply any opinion on the laws of the PRC. If you have any question(s) on PRC issues, please consult PRC lawyers.

⁴⁶ Rule 17.04(1) of the Listing Rules

⁴⁷ Rule 17.02(1) of the Listing Rules

⁴⁸ HKEx Guidance Letter GL11-09



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Choosing a Registrar

Choosing your Registrar

For companies listing on the Hong Kong Stock Exchange, the requirement to have an approved Registrar is enshrined in the Listing Rules.

Timescale

You should aim to choose and appoint your Registrar at least three months before your listing is scheduled, or longer for large and complex IPOs.

First Considerations

There are some key questions to ask when picking a Registrar starting with your immediate listing requirements. If you are anticipating a significant response from investors, make sure to pick a Registrar who is equipped to cope with the volume of subscribers. If it has already been decided that a cross-border listing is required, then select a provider with the ability to cope with this, and can provide hands-on experience in all the countries the IPO will impact.

Also, give thought to future-proofing your needs. Ask yourself: what do I want my company to look like in five or ten years' time? Do I want to have only a few shareholders or am I looking for a large retail investor base? Will I want to hold an annual general meeting (AGM) that all my shareholders could attend, no matter where they are? Do I just want access to capital in my local market or would the company benefit from overseas investment? Will I be looking to get to a stage where I could buy a competitor? Will I want to reward my employees with a stake in the company by rolling out an employee share plan? What kind of service do I want from a Registrar? Do I want a basic low-cost provider, or do I want a long-term strategic partner who will help maintain a strong investor relationship, making sure the company's decisions are well supported in a shareholder vote? The answers to all of these questions will help you decide on the best Registrar for your company.

What Can a Registrar Do for You?

Single, Dual and Multiple Exchange Listings

You may have decided to list on Hong Kong's stock exchange only, in which case, your choice of Registrars will be regulated by Hong Kong's listing requirements and you will have a larger pool of options. However, if you have opted for a dual or multiple listing, you can look at Registrars who have a presence in each country you list in, which allows you to rely on them to manage the communication and interaction in-house and under one roof with less oversight from you.

You also need to consider the type of instruments you are looking to offer and to ascertain what experience each Registrar has in offering those to the markets you are intending to list in. If you're issuing H shares or

opting for a renminbi listing, then picking a Registrar with experience in handling these is essential, as the listing rules and regulations are complex.

Paper and Online IPOs

In Hong Kong, all IPOs are available both physically and online. Try out the various enrolment methods available, particularly with regard to the online platforms. If you are especially keen to encourage retail shareholders to take up the offer, then making it as convenient as possible for them to enrol will be of great importance. If you are looking to turn your customers into shareholders, then you will want to make sure that the service experience they get from your company carries through to their experience when they apply for shares. Different registrars will have different options for application, so take this into account when making your choice.

Post IPO: Communicating with Your Shareholders

Once the listing has taken place, you have a set of shareholders that you need to keep happy: good communication is one of the keys to this and will help you achieve your desired results at your AGM. You should check the communications your shareholders will receive from your Registrar – from the share certificate itself to the welcome letter, and the experience retail shareholders will get when contacting a call centre for service. The Hong Kong Stock Exchange's Listing Rules stipulate that an issuer must do e-filing and online disclosure, as well as electronic shareholder communication, so your Registrar needs to have the capability to meet these requirements. To help keep costs down and maximise corporate social responsibility opportunities, you should look for a first class e-communications service and an associated online self-service platform for shareholders.

Of increasing importance is the ability to deal with requests received via social media – whether it is Weibo or Twitter – the younger generation of investors are moving to public platforms to get the service they expect and your Registrar should have a strategy for managing this.

The Annual General Meeting

The AGM is the best opportunity for investors to hear what the company has been up to, to ask questions, and meet the Board responsible for delivering the returns on their investment. Your AGM will set the tone of your corporate appearance in the eyes of the investors, the industry and the media.

Typically, companies start preparing about three months in advance, deciding on a venue and working with their Registrar to plan for the registration of the shareholders, voting and general administration of the meeting. The more attendees you are expecting, the more complex this exercise is. If, at the IPO stage, you can gauge how much interest you will have from shareholders in attending your AGM, you can take this into account when picking a Registrar; assessing their manpower and infrastructure capabilities, particularly voting service options – which can range from the traditional paper vote right through to voting via electronic devices for instantaneous results.

You should have confidence in your Registrar's ability to cope with whatever circumstances your AGM demands and be able to represent your brand in the way you require. Meeting options and regulatory requirements are different in every country, so having a registrar with experience of different jurisdictions will help if you are looking to hold a meeting encompassing different locations.

Mergers, Acquisitions and Other Corporate Actions

When selecting a Registrar, you should consider the company's future need for corporate actions. If you would like to acquire a competitor, merge with a complementary business or raise capital overseas – then taking the necessary skillset into account ahead of deciding on a Registrar is crucial.

Rewarding and Retaining Your Employees

You may have decided to award stock to employees at the point of listing, or after a period of time. Make sure you pick a Registrar with experience in implementing and administering a variety of share plans for your top executives as well as your broader employee base. You should look for experience in making the most of local tax breaks, making accurate payments to deadline, delivering excellent customer service, managing a well-planned roll-out and communications, supporting the company with financial reporting requirements and coping with any international elements you may have.

Shareholder Challenges

Many companies find that they have some contentious issues they need to communicate with shareholders about, and to get a "yes" vote for. A common mistake is for companies not to understand who their underlying shareholders are – typically because accounts are held via a nominee rather than via a name on register. Knowing who makes up your shareholder base can help to prevent and manage potential issues which may result in a "no" vote at an AGM. Choosing a Registrar with a shareholder analytics service and the ability to undertake a proxy solicitation campaign to help you identify your shareholders and to communicate directly with them whether they are with a nominee or on the register would help to avoid this situation.

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Chapter 8

The Company Secretary and His Role in Corporate Governance

Every company incorporated in Hong Kong must have a secretary (s 154 of the Cos. Ord.).

Historically, the secretary was regarded as a “mere servant”,¹ doing what he was told, with no authority to represent anything, and a “limited . . . humble character”.² However, his position has changed a great deal in the last century. First recognised in 1971 as the chief administrative officer with extensive authority to bind the company concerning contracts connected with the administrative side of the company’s affairs,³ the secretary is now regarded as a member of senior management who has a duty to, amongst other tasks, advise the Board, through the chairman and/or the CE, on corporate governance matters.

The secretary is an officer of the company (s 2 of the Cos. Ord. and s 2(1) of the S&F Ord.) and is liable to fines and, in certain cases, imprisonment if he fails or omits to carry out his duties as imposed by the applicable ordinances, rules and regulations. As part of the senior management team and at the centre of the Board’s decision-making process, the secretary having good communication skills and knowledge of the company’s business, operations and specific circumstances is influential to promote good corporate governance. Indeed, he can assist the directors in their legitimate pursuit of growth and profit with integrity, independence, dedication and professionalism and use his reasonable endeavours to seek to protect the interests of the company and its stakeholders (including shareholders, employees, suppliers, customers, independent auditors, regulators, government and the investing public).

General Roles and Routine Duties

Depending on the size and nature of the company and the contractual arrangements made with him, the secretary may perform a variety of duties (e.g. company secretarial, administration, management, etc.). No doubt, the role of the company secretary will be dictated by his initiatives, experience, knowledge and capability as well as the culture, tradition and practice of the company in which he is working.

As regards the company secretarial duties, the secretary will be present at all meetings of the members, directors and Board committees of the company and prepare proper minutes of the proceedings. Under the direction of the Board, he will issue all notices to members and other persons who are entitled to receive them. The secretary may countersign every document to which the common seal of the company is affixed, and the company secretarial department headed by him will deal with share and debenture transfers,

¹ *Barnett, Hoares & Co. v South London Tramway Co. (1887)*.

² *George Whitechurch Ltd. v Cavanagh (1902)*.

³ *Panorama Developments (Guildford) Ltd. v Fidelis Furnishing Fabrics Ltd. (1971)*.

keep the statutory books and records of the company, including the registers of directors, secretaries, members and charges, and prepare and file resolutions and other documents including the prescribed forms usually signed by him (e.g. the annual return, return of allotments, notices regarding directors, company secretaries, registered office and particulars of mortgages and charges for registration as well as monthly return on movements in securities) to the regulators such as the Hong Kong Companies Registry and the Exchange.

Essential Corporate Governance Responsibilities

Section F of the Code provides that the secretary of a listed company is responsible for advising the Board through the chairman and/or the CE on governance matters and should also facilitate induction and professional developments of directors. It also provides that he should be an employee of the company and where an external service provider is engaged as the secretary, the identity of a person with sufficient authority (e.g. chief legal counsel or chief financial officer) of the company whom the external provider can contact must be disclosed by it. Further, the secretary should report to the chairman of the Board and/or the CE (it appears that the above provision seeks to preserve the independence of the secretary and help the secretary earn the credibility and trust from the Board and management); and all directors should have access to the advice and services of the secretary to ensure that Board procedures as well as all applicable laws, rules and regulations are followed.

In addition, every listed company must appoint two authorised representatives who: (a) will act at all times as the principal channel of communication between the Exchange and the listed company; and (b) must be either two directors or a director or the secretary (r 3.05 of the Listing Rules and r 5.24 of the GEM Rules). As such, the secretary is usually appointed as one of such representatives.

To actively promote good corporate governance, secretaries can, as suggested by The Hong Kong Institute of Chartered Secretaries (HKICS) to its members in the guide entitled *The Essential Company Secretary* published by it on 30th October, 2013, which has been substantially modified, elaborated and supplemented by me, consider the following responsibilities:

- 1) Supporting the chairman positively and establishing an effective working relationship with the chairman and the CE, with accountability to the Board (through the chairman) for all matters relating to directors' duties as an officer of the company;
- 2) Ensuring the smooth running of the activities of the Board and Board committees (such as the audit, remuneration, nomination and corporate governance committees) by helping the Board chairman and by helping on each of the Board committee chairmen set agendas and preparing and presenting papers to the Board and Board committees, advising on Board and Board committee procedures and ensuring that they are followed and regularly reviewed;
- 3) Keeping under close review all legislative, regulatory and corporate governance developments as well as compliance issues that may affect the company's business and operations, and ensuring that the Board is timely and fully briefed on these and takes them into account when making decisions;
- 4) Ensuring that the concept of stakeholders is in the Board's mind when important matters are being considered and decisions are being made;

- 5) Advising the Board on the need to comply with or explain any deviation from the code provisions of the Code, including provisions relating to the adoption of various governance policies and periodic reporting of measurable objectives for implementing such policies, and updating progress thereon in the corporate governance report to be contained in the annual report;
- 6) Advising the Board on potentially enhancing existing governance practices which suit the company's needs and adopting some or all of the recommended best practices under the Code;
- 7) Keeping abreast of sustainability issues as well as environmental, social and governance (ESG) policies and practices and reporting thereon;
- 8) Acting as a confidential sounding board to the chairman, executive directors and non-executive directors on matters that may concern them, and taking a lead role in managing any difficult inter-personal issues on the Board;
- 9) Acting as a primary point of contact and source of advice and guidance for directors, and in particular non-executive directors, as regards the company and its principal activities in order to support the decision-making process;
- 10) Acting as an additional enquiring voice in relation to Board decisions which particularly affect the company, drawing on his experience and knowledge of the practical aspects of management including law, accounting, tax and business finance to act as the "conscience of the company";
- 11) Ensuring, where applicable, that the standards and/or disclosures required by the relevant laws, rules and regulations (e.g. the Listing Rules, the Cos. Ord. and the S&F Ord.) and the applicable financial reporting standards are observed and, where required, reflected in the quarterly, interim and annual reports. He usually takes the lead oversight role in the preparation of such reports (and in the case of the annual report, in particular the directors' report (which will include information on environmental and employee matters in the business review section thereof after the coming into effect of the new Companies Ordinance on 3rd March, 2014), the corporate governance report and, as from March 2015 if the listed company elects to make, the ESG report), and obtaining consensus on these from the Board and the Board committees;
- 12) Complying strictly with the company's constitution and codes of practice and the continuing obligations of the relevant laws, rules and regulations, including publication and distribution of the following documents within the periods specified by the Listing Rules:
 - a) Annual reports which contain, amongst others, the audited financial statements;
 - b) Interim and quarterly reports which contain, amongst others, unaudited condensed financial statements; and
 - c) Circulars which contain, amongst others, particulars of the transactions or corporate actions and disseminating announcements to the market timely and ensuring proper disclosure of inside information;
- 13) Managing relations with investors with regard to corporate governance issues and the Board's practices in relation to corporate governance;
- 14) Induction of new directors and CEs into the business, explaining their roles and responsibilities (including notification of their and their respective associates' interests and dealings in securities) and facilitating their continuing professional development and maintaining the relevant record of directors' training;
- 15) Ensuring that the Board is fully aware of its responsibility to avoid engaging in any market misconduct practices, including not disseminating or allowing the release of inaccurate or misleading information, or engaging in a course of conduct which could amount to market misconduct;

- 16) Ensuring compliance with all statutory document preparation, record maintenance and filing requirements and regulatory disclosure;
- 17) Arranging and managing AGMs and any other general meetings and putting forward, with the Board's agreement, the items to be considered at such meetings, including resolutions dealing with governance matters;
- 18) Providing an interface between the Board and senior management and acting as the key liaison between non-executive directors and senior management, thereby ensuring good information flow;
- 19) Ensuring that the directors' dissenting views or concerns about the running of the company or a proposed action which cannot be resolved, if any, are contained in the minutes of the relevant Board or Board committee meetings; and
- 20) Where possible, in the case of larger companies, separating the roles of the secretary and the finance director (and the like) and in the case of smaller companies with limited resources, recognising the potential for conflicts of interest and building "firewalls" between such roles by ensuring that information received in one capacity is not used for other purposes.

Qualifications

The secretary of a company may be one of its directors pursuant to the Cos. Ord. (s154(1)), and there may be joint secretaries. However, the sole director of a private company cannot be appointed also as the secretary of the company. Further, a private company having only one director may not appoint as secretary a body corporate whose sole director is the only director of the private company. The secretary must be a Hong Kong resident or a body corporate having its registered office or place of business in Hong Kong (s 154(2)). On the other hand, the secretary of a listed company must be an individual (r 3.28 of the Listing Rules and r 5.14 of the GEM Rules).

As in the case of directors, the Cos. Ord. does not specify any qualifications needed for holding the office of secretary. Nonetheless, the secretary of a listed company must, by virtue of his academic or professional qualifications or relevant experience, be, in the opinion of the Exchange, capable of discharging the functions of a secretary (r 3.28 of the Listing Rules and r 5.14 of the GEM Rules).

Therefore, the secretary:

- 1) may be a member of The Hong Kong Institute of Chartered Secretaries, a lawyer (i.e. solicitor or barrister) or a certified public accountant;
- 2) may have served the listed company or other listed companies in a certain role before;
- 3) must be familiar with the Listing Rules and other relevant laws and regulations (including the S&F Ordinance, the Cos. Ord. and the Code on Takeovers and Mergers administered by the Securities and Futures Commission of Hong Kong); and
- 4) should have gone through the relevant training and have at least 15 hours of relevant professional training in each financial year of the listed company commencing on or after 1st January, 2012 if he commenced his role on or after 1st January, 2005 in the same and other listed companies. For secretaries who commenced their role at an earlier date (e.g. the writer was appointed secretary of a Hang Seng

Index Constituent stock company in 1991), later commencement dates apply (r 3.29 of the Listing Rules and r 5.15 of the GEM Rules).

Dual Capacity

It is common for the secretary to act in a dual capacity (e.g. secretary-cum-financial controller, legal counsel or human resource manager). However, where a provision of the Cos. Ord. requires or authorises anything to be done by (or to) a director and the secretary, the same person cannot act in a dual capacity as both director and secretary (s154B). For example, if the company's Articles provide that a share certificate must be signed by a director and the secretary jointly, any individual or body corporate who/which has been appointed both a director and the secretary of the company cannot sign the certificate in both capacities.

If the office of the secretary is vacant, the directors may authorise an assistant, a deputy or an officer to act, specifically or generally, as secretary (s154(3)). This should apply in the event of the secretary's incapacity.

Appointment and Vacation of Office

The appointment of a secretary must be made in accordance with the company's Articles. Table A provides that the secretary will be appointed by the directors for such term, at such remuneration and upon such conditions as they think fit (art 112). The secretary may vacate his office by resignation, death, expiration of the length of employment specified in the subject contract or as otherwise provided in the company's Articles. Though the Cos. Ord. does not expressly confer on the directors a power to remove a secretary, the secretary who is appointed by the directors may be removed by them (art 112 of Table A). In addition, the Articles of a company may contain a provision that the secretary may be removed by the directors on justifiable grounds. Pursuant to the Cos. Ord., a secretary may resign subject to the same restrictions as directors (s157D).

However, if there are no directors by reason of the company's failure to hold AGMs pursuant to s 111 of the Cos. Ord., the alleged appointment of a secretary is void and of no effect.⁴

As regards listed companies, the selection, appointment or dismissal of the secretary should be approved by the Board which must deal with such matters at a physical meeting rather than by a written resolution (section F of the Code).

Exclusion from Liability

When acting on behalf of the company, the secretary is the company's agent. Irrespective thereof, he owes the company the following, which are similar to those owed by the directors:

- 1) Statutory duties;
- 2) Contract duty of performance;
- 3) Common law duty of care and skill; and
- 4) Equitable duty as a fiduciary, e.g. the duty to act in good faith for the benefit of the company as a whole.

⁴ *Ong Kim Yim v Sheecon Trading Co. Ltd. (1996)*.

Certainly, the secretary (being an officer of the company) is bound to perform all the duties imposed on all officers of a company. He, as provided in the Cos. Ord., cannot by virtue of any provision, whether contained in the Articles or in any contract with the company or otherwise, be exempt from, or indemnified with respect to, any liability for negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company, and any such provision is void (s 165). However, a company may purchase and maintain for any officer of the company insurance against any liability incurred by him (s 165(2)).

Conclusion

The secretary occupies an unusual position in the corporate structure. He sits on the Board but is not, unless being a director of course, a Board member. He may work with senior management but is not part of the line management structure. The breadth and importance of the secretary have increased noticeably over the last decade and the company secretarial role will, certainly, continue to broaden in scope and evolve towards a greater responsibility for corporate governance. However, not until the recent years following the amendments to certain regulations, and in particular the Listing Rules, has the company secretary been required to perform such a crucial role as an independent in-house “gatekeeper”. To me, it may be apt to add “chief governance officer” or “corporate governance advisor” to the secretary’s job title. Whilst endeavouring to enable the company to abide by all relevant legal principles in form and in substance, the secretary is tasked with assisting the company to satisfy the reasonable ethical expectations of its stakeholders in respect of transparency and accountability and ensuring that all plans and activities of the company meet good corporate governance standards. Above all, he must be bold enough to speak out and not compromise his professional integrity, being loyal to his employer when his professional obligations conflict with the decisions taken by the Board or management. It is important for the individual secretary to bear in mind that he is an employee of the company and not the chairman or the Board as a whole and plays a pivotal role in looking after the long-term interests of the company.

Glossary

In this article, unless the context requires otherwise, words importing one gender include any other genders and the following abbreviations and terms will have the following respective meanings:

“AGM”	annual general meeting;
“Articles”	articles of association, bye-laws or other equivalent constitutional document of a company;
“associate”	has the same meaning ascribed to it by the Listing Rules;
“Board”	board of directors;
“CE”	chief executive;
“Code”	Corporate Governance Code contained in both Appendix 14 to the Listing Rules and Appendix 15 to the GEM Rules;
“Cos. Ord.”	Companies Ordinance, Chapter 32 of the laws of Hong Kong (Please see remarks below);
“e.g.”	for example;
“Exchange”	The Stock Exchange of Hong Kong Limited;
“GEM Rules”	Rules Governing the Listing of Securities on the Growth Enterprise Market of the Exchange;
“Listing Rules”	Rules Governing the Listing of Securities on the Exchange;
“S&F Ord.”	Securities and Futures Ordinance, Chapter 571 of the laws of Hong Kong; and
“secretary”	company secretary.

Remarks:

- 1) *The Cos. Ord. will be renamed as “Companies (Winding Up and Miscellaneous Provisions) Ordinance as the core provisions affecting the operation of companies will be repealed and only the provisions relating to winding-up and insolvency of companies and prospectuses will be retained.*
- 2) *A new Companies Ordinance, Chapter 622 of the laws of Hong Kong will come into operation on 3rd March, 2014.*
- 3) *Therefore, the section numbers of the Cos. Ord. referred to in this article will have to be replaced by the relevant section numbers of the new Companies Ordinance, where applicable.*



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Chapter 9 – Managing the IPO Marketing Process

Phase 1: Pre-marketing – Building an Equity Story, Research Reports, and Education Plans Prior to Road Show

Pre-marketing can be conducted on a sliding scale, depending on how prepared your company is, how far it extends geographically and the extent of its business interests. This phase typically lasts from six to 18 months, and its purpose is to maximise positive public interest for your company. We can divide the process into four stages:

Stage 1: Strategic Planning

This is an important stage which will form the backbone of listing and post-listing communications and activities, and since several important factors should be considered before submitting the listing form, companies will do well to give themselves sufficient lead time to ensure a successful listing process. In fact, this is a critical stage in which companies need to hire an investor relations (IR) advisor to provide professional guidance and help them navigate through the pre-and post-IPO processes.

Before any IPO campaign or plan is determined, companies need to conduct an analysis of their current business strategies, their corporate positions and the readiness of their communications system. Here are some important things that should be included in the pre-marketing phase:

- Conduct a communication audit
- Develop the Equity Story/Investment Case
 - Corporate positioning
 - Commission industry reports
 - Determine local and global peers
 - Key messages for investors
 - Key messages for media
- Determine pre-IPO program for publicity/IR to tie in with company events and listing timetable

The communication audit should include the following:

- Corporate messages (vision, strategy, business model, CSR)
- Corporate identity guidelines
- Collaterals – fact book, brochures, video, photos, media kit
- Media or external communication policy
- Media or external spokesperson system or enquiry channel
- Media monitoring of company and industry
- Prepare your company or facilities for site visits
- Crisis management plan

After the audit is completed, the company will be able to work out a list of essential action items to address in preparation for the impending IPO. Sometimes companies have already covered the majority of items listed above, but even so, they should be evaluated and developed further in anticipation for the intense media and external scrutiny that will inevitably follow during and after listing publicly.

Stage II: Coaching and Preparing Senior Management

As companies will be reaching out to media and investors leading up to IPO, it is essential that media spokespersons and senior management (those who will be highly visible at the roadshow) are prepared to communicate to media and investors.

- Presentation skills for external audiences, particularly analysts and investors
 - Large groups
 - One-to-one
- Media training
 - Knowledge of different kinds of media and their cultures
 - Delivery of key messages and interview techniques for spokespersons
 - Rehearsals and mock interviews

Stage III: Initial Media Exposure & Investor Pre-Marketing

Given sufficient planning and preparation, strategic media exposure greatly enhances a company's reputation and popularity. Before the company hands in the listing application form (A1), this is a wonderful “conditioning” time for target media to get to know the company and its management, and for the company to build up stronger relations with specialist media for they become important influencers of their investment story from now on.

Companies can best leverage any corporate or marketing event which is part of their company activities to connect with media. Whenever appropriate, companies can use paid media (e.g. advertisements) to promote their products and services or corporate image.

- Background briefings with senior financial news editors/columnists
- Interviews with specialist or trade media

- One-on-one interviews
- Paid media (advertisements, sponsorships)
- Management speaking opportunities at appropriate forums/events

It is important to remember, however, that companies should not disclose prospective listing information to the media or in advertisements at this stage. At all times, refer closely to the Listing Rules of the Hong Kong Exchanges and Clearing Limited (HKEx), and seek advice from sponsors or legal counsel.

Investor Pre-marketing

For most companies, it will be necessary to organise a familiarisation tour around the workplace for syndication analysts to get a feel for how the business operates.

This is also a good time to have the IR advisor to conduct an investor targeting study to determine who and where your potential investors are, which are dependent on several factors, including size, sector and geographic reach of your company. Ultimately, this will help companies plan for their IPO roadshow more optimally (discussed later in Phase 2) and achieve maximum benefits for the IPO and the company post-listing.

Stage IV: Design & Production of Offering and Marketing Materials

A strong visual design that complements the professional content and layout of printed material and websites not only improves and distinguishes your corporate image and capital market brand, but also enhances communication with potential investors, media and stakeholders.

This stage should be started as early as possible in conjunction with Stage III or earlier, as it will typically need to be revised several times, reviewed internally and by the IPO project team and approved before production begins. Companies will do well to use the quiet period after submitting the listing application to finalise most of the materials listed here.

It is also wise to factor in sufficient time for any contingencies, since production entails third party vendors.

Offering materials to prepare include:

- Prospectus content
- Marketing material:
 - Photographs (assets, plant, products, services, people)
 - IPO design theme (this will be used in the rest of your IPO and roadshow materials)
 - Prospectus cover
 - IPO roadshow video
 - Investor presentation
 - Roadshow displays/booth
 - Roadshow collaterals (brochures, souvenirs)

Corporate and Investor Relations Marketing include:

- Rebranded or revamped website to incorporate IPO visual theme
- Reinforcing content in website and build IR website

Phase 2: Road Show – Drafting a Formal Marketing Strategy, Targeting Prospective Investors and Research Analysts

Momentum quickly builds in this phase as this period marks the start of the “noisy period” in the pre-IPO process, characterised by intensified publicity and a frenzy of logistics activity.

Stage I: Final Leg Preparation

Companies will need to finalise their offering and marketing materials at this stage.

A timetable then needs to be organised to oversee multiple logistics requirements, including press conferences, investor lunches in Hong Kong and overseas roadshows. Alongside this, you will need to prepare the following for the public launch, including notices and advertisements, e-IPO advertisements, and website uploads.

Stage IIA: International Road Show Planning

Although sponsors and banks will be the major drivers for the IPO roadshow, it is worthwhile for companies to determine their potential targets and desirable shareholder constitution base and start to envision a long-term view, as earlier explained. For this purpose, you should refer closely to the results from your investor targeting conducted in Phase 1 Stage III and work with your IR advisor as you plan for the roadshow direction.

Checklist for planning a roadshow:

- Where to go
- Who to see
- Road show teams
- Who will be travelling (keep in mind which advisors or supporting vendors you will require)
- What to bring along
- Schedule of the roadshow/routing (to ensure optimal investor communication while ensuring the peak performance and availability of the management team)

Stage IIB: Extensive Media Exposure

This period is also a prime time to gain maximum media exposure and stoke investors’ interest (through newspapers, magazines, radio, TV and the internet), though companies must be mindful of the strict rules

limiting communication (including no comments on pricing and valuation, or direct references to competitors) at this phase. Activities can include the following:

- Press conference/media luncheons on IPO launch
- Press release on IPO (HK Public Offer)
- Exclusive interviews
- Media visits to company's plant or facilities
- Luncheon or dinner with HK stock commentators

Ongoing public and press announcements include:

- Offer prices
- Allotment results

One very important thing to remember during this period is to keep up with ongoing media coverage and be ready to manage issues in a timely manner when they arise, thereby avoiding an escalation of any issues that may otherwise serve as hindrances or distractions to the IPO.

Stage III: Listing Day

After the public offer closes in Hong Kong, Listing Day is on the horizon. This is typically a very event-driven occasion and companies work with their IR advisors to make this occasion the talk of the town. Several events to consider include:

- Listing ceremony
- Media interviews for Listing Day
- Celebratory dinner
- Celebration/congratulatory advertisements
- Listing Day press release

Phase 3: Aftermarket Strategy – Dealing with Media, Attracting the Right Investors and Analysts

With a successful listing and the first trading of shares, the company has embarked on a new life as a publicly listed company. In fact, within the first 18-24 months after listing, it is critical for companies to build up the necessary IR infrastructure and process to ensure that momentum continues in order to achieve a fair valuation in the capital market and attract high quality investors.

Here is a checklist for IR best practice:

- IR materials development and update
- IR website enhancement and update

- IR policy and disclosure rules and regulations
- IR and media database
- Monitoring your share price performance versus your peers'
- Monitoring media and analysts/investor commentary
- Establishing the communication platform for the shareholders and investors
- Building relations and maintaining consistent channels of communication
- Interim and annual results reporting (includes Annual Report)
- Annual General Meeting of shareholders
- Corporate governance
- Corporate social responsibility

Going further, your IR advisor will be also able to assist your company in the following to help you strategise and strengthen your IR capabilities and program:

- Identifying investors and analyst audiences
- Shareholder composition analyses
- Investor targeting – the “perfect fit” between the company’s direction and its shareholder base
- Investor perception survey
- Peer-group perception survey
- Peer group shareholder and performance analysis

While there are a number of organisations that are designed to work closely with companies to help optimise your publicity during the entire IPO process, companies are recommended to seek an IR advisor who has the necessary capabilities to guide them from pre to post-listing and ensure that the good start is a foundation for even better prospects to facilitate future growth and expansion in the capital market. FleishmanHillard’s GCM team (GCM) offers a full range of services to users of capital markets, including international investor relations and analytical research services, financial media relations, corporate reputation management, and crisis and transaction communications.

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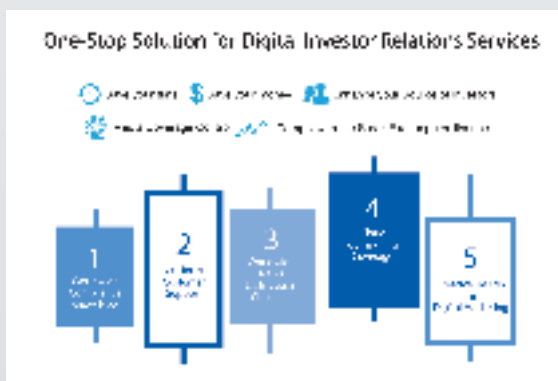
Best Use of an Effective Online Investor Relations Plan for IPO

An initial public offering (IPO) is the starting point for a listed company to develop investor relations. Good investor relations management can help improve corporate transparency, establish strong corporate images and lay a solid foundation in the capital market for the company. Statistics show that between 2009 and 2011 Hong Kong ranked No.1 globally in terms of capital raised through IPO. However due to market fluctuations, it fell to the fourth position in 2012. With improving macro-economic performance and conditions of the financial markets, the equity market of Hong Kong is stabilising and likely to become one of the top three IPO markets in the Asian Pacific region again in 2013.

No. of Hong Kong Listed Company (2011-2013)

	2011	2012	2013
Listed Companies	100	103	116
IPO	45	64	101

Thanks to technological advancements, it is becoming easier to capture global information as investors around the world can access market information through the Internet. Digital investor relations service has become the prevalent trend in the market, especially when such service makes it easier for more global financial institutions and individual investors to access first-hand corporate information in IPO processes.

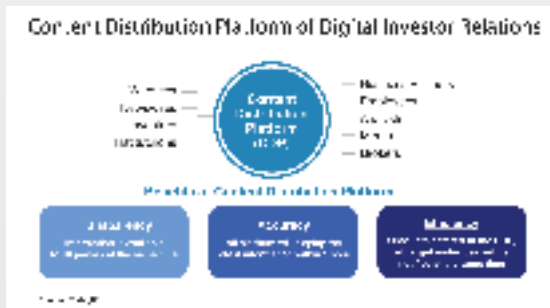


To develop a targeted investor database more effectively, here is a range of solutions which can help increase opportunities to access various types of investors, help the public understand the core business of the company and enhance the company’s competitive advantages in the capital market.

Five effective ways to build an investor database

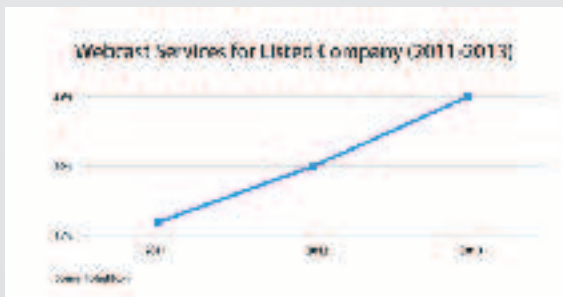
1. Make good use of digital investor relations service, and extend the reach to global investors

- Reduce risks by complying with rules of local exchanges;
- Gain market exposure and enhance company's visibility and transparency by uploading latest announcements and news to the investor relations page of the company website; and
- Enhance the corporate image and investors' confidence by publishing key messages about the company in an accurate and timely manner on well-known global media networks.



2. Use exclusive webcasts to increase visibility

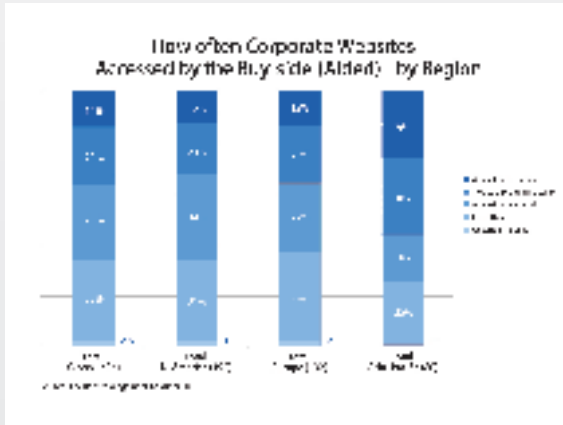
- Increase media penetration and visibility through integrated webcast solutions (e.g. IPO promoting events, news conferences, visits to the company, shareholders meeting, results announcements);
- Provide investors with quicker access to first-hand information via real-time webcasts; and
- Support program replay and sharing to release key messages to the public, enhance investor confidence and polish the corporate image effectively.



3. Create a customised and professional website for IPO

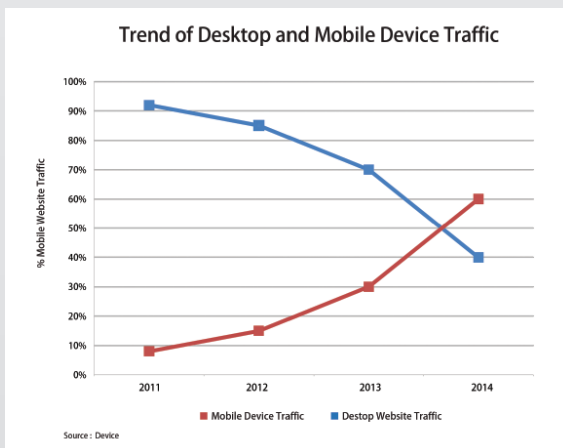
- Help investors get all the information they need easily through comprehensive digital IR solutions (e.g. webpage designing, brand image promotion, content management systems, webpage hosting, online stores, corporate and brand logo designing, banner designing for web-based advertisements, e-mail promotion systems);

- Apply the brand new cloud computing technology to store and retrieve data quickly and reliably;
- Present the corporate image and convey the company's core business and value for investment by applying innovative design concepts; and
- Communicate highlights of the company through a clear and concise layout.



4. Develop mobile apps to gain access to investors across geographic boundaries

- Launch mobile apps and the mobile version of corporate website to develop business and attract repeated investor visits;
- Make a compact and tidy mobile website, so visitors can identify useful data at a glance and access boundless information from a small screen at any time and any place; and
- Update both mobile and desktop versions of the website simultaneously to stay close to investors and market trends.





5. Use social networks to gain market exposure swiftly

- Establish stable and positive investor relations on diverse social networking platforms, such as Facebook, Weibo, Twitter, Youtube and LinkedIn;
- Improve visibility and online exposure to access more prospective investors with the support of images, texts, videos and other interactive means;
- Leverage on this major source of online traffic today, offering low costs and potential high returns;
- Benefit from the wide coverage and continuous high-frequency browsing, without regional barriers, which enables corporate information to reach investors instantly; and
- Strengthen the marketing effects by combining with community promotion, two-way communication channels with instant interaction and responses.



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Chapter 10 – Post-Listing Compliance Obligations

Once a company is listed on the Hong Kong Stock Exchange, it will need to meet the continuing obligations set out under the Listing Rules, these continuing obligations are primarily designed to ensure the maintenance of a fair and orderly securities market and that users of the market have simultaneous access to the same information. Failure to do so may result in the Exchange taking disciplinary actions, to suspend or cancel a listing.

Three major post-listing compliance obligations relating to (i) inside information; (ii) notifiable transactions; and (iii) connected transactions will be discussed in this chapter. A listed company should note that there are other compliance obligations set out in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the Listing Rules), the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (SFO) and other securities laws and regulations in Hong Kong.

Disclosure of inside information

Timely disclosure by listed companies of its significant information has long been the focus of Hong Kong regulators for enhancing market transparency and investor protection.

Statutory requirements

As such, the SFO has been amended to regulate the disclosure of “inside information” by listed corporations. Part XIVA was introduced to the SFO from 1 January 2013 so that the disclosure requirements became part of the law.

The Securities and Futures Commission (SFC) has issued “Guidelines on Disclosure of Inside Information” (Guidelines) to provide examples and discuss issues on particular situations. The Guidelines do not have the force of law and do not remove the requirement for listed corporations to make their own judgment on the identification of inside information. However, the principles and elaborations contained in the Guidelines do illustrate the SFC’s views on the operation of the new disclosure regime.

► *What is “inside information”*

Under Part XIVA of SFO (which came into effect on 1 January 2013), inside information, in relation to a listed corporation, means specific information that is about:

- (i) the corporation;
- (ii) a shareholder or officer of the corporation; or
- (iii) the listed securities of the corporation or their derivatives,

and is not generally known to the persons who are accustomed or would be likely to deal in the listed securities but would, if generally known to them, be likely to materially affect the price of such listed securities.

This definition is the same as that of “relevant information” for the purpose of insider dealing in the SFO.

The Guidelines identified three key elements comprised in the concept of “inside information”:

- (a) the information about the particular corporation must be specific;
- (b) the information must not be generally known to that segment of the market which deals or which would likely deal in the corporation’s securities; and
- (c) the information would, if so known be likely to have a material effect on the price of the corporation’s securities.

Even with the Guidelines in place, a listed corporation must assess the impact of significant or unexpected events to decide whether they constitute inside information to such corporation. It also has to consider the prevailing market conditions and surrounding circumstances. For instance, in periods of market volatility and turmoil, the market is more sensitive to information, both positive and negative, concerning the financial performance and condition of a listed company.

► *Examples of possible “inside information”*

The Guidelines set out some common examples of events and circumstances where a listed corporation should consider whether a disclosure obligation arises:

- changes in performance, or the expectation of the performance, of the business;
- changes in financial condition, e.g. cash flow crisis, credit crunch;
- changes in control and control agreements;
- changes in directors, supervisors or auditors;
- changes in the share capital, e.g. new share placing, bonus issue, rights issue, share split, share consolidation and capital reduction;
- issue of debt securities, convertible instruments, options or warrants to acquire or subscribe for securities;
- purchase or disposal of equity interests or other major assets or business operations;
- formation of a joint venture;

- restructurings, reorganizations and spin-offs that have an effect on the corporation's assets, liabilities, financial position or profits and losses;
- legal disputes and proceedings;
- revocation or cancellation of credit lines by one or more banks;
- changes in value of assets;
- insolvency of relevant debtors;
- physical destruction of uninsured goods;
- decrease or increase in value of financial instruments in portfolio which include financial assets or liabilities arising from futures contracts, derivatives, warrants, swaps protective hedges, credit default swaps;
- decrease in value of patents or rights or intangible assets due to market innovation;
- receiving acquisition bids for relevant assets;
- innovative products or processes;
- new licenses, patents, registered trademarks;
- orders received from customers, their cancellation or important changes;
- withdrawal from or entry into new core business areas;
- pledge of the corporation's shares by controlling shareholders; and
- changes in a matter which was the subject of a previous announcement.

► *When and how should inside information be disclosed*

The listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public. The disclosure should be made by way of a formal announcement. Before the information is fully disclosed to the public, the information must be kept strictly confidential. But if the corporation believes that confidentiality cannot be maintained or that confidentiality may have been breached, it should immediately disclose the information to the public.

If a corporation needs time to clarify the details of, and the impact arising from, an event or a set of circumstances before it is able to issue a full announcement, it should consider issuing a "holding announcement" to set out as much detail as possible of the subject matter and the reasons why a fuller announcement cannot be made. The full announcement should be made as soon as reasonably practicable.

► *Safe harbours that allow non-disclosure of inside information*

A listed corporation is not required to disclose any inside information under the following circumstances:

- (i) if and so long as the disclosure is prohibited by an order made by a Hong Kong court or any provisions of other Hong Kong statutes; or
- (ii) if the corporation takes reasonable precautions for preserving the confidentiality of the information, such confidentiality is preserved; and
 - the information concerns an incomplete proposal or negotiation;
 - the information is a trade secret;
 - the information concerns the provision of liquidity support from the Exchange Fund of Hong

Kong or from an institution which performs the functions of a central bank (including such an institution of a place outside Hong Kong) to the corporation or, if the corporation is a member of a group of companies, to any other member of the group; or

- the disclosure is waived by the SFC.

► *Responsibility for compliance and management controls*

The SFO provides that every officer of a listed corporation must take all reasonable measures from time to time to ensure that proper safeguards exist to prevent a breach of a disclosure requirement in relation to the corporation. If a listed corporation is in breach of a disclosure requirement, an officer of the corporation is also in breach of the disclosure requirement if:

- (i) his intentional, reckless or negligent conduct has resulted in the breach; or
- (ii) he has not taken all reasonable measures from time to time to ensure that proper safeguards exist to prevent the breach,

Therefore, the listed corporation should establish and maintain appropriate and effective systems and procedures to ensure any material information which comes to the knowledge of its officers be promptly identified, assessed and escalated for the attention of the board of directors to decide about the need for disclosure. This would require a timely and structured flow to the board of information arising from the development or occurrence of events and circumstances.

► *Listing Rules requirements*

As a result of the amendments to the SFO as highlighted above, some amendments were made to the Listing Rules, which also took effect on 1 January 2013, which clarified that the statutory disclosure relating to inside information is to be enforced by the SFC. The HKEx has a duty under the SFO to ensure an orderly, informed and fair market. Therefore, the Listing Rules provide that where in the HKEx's view there is or there is likely to be a false market in an issuer's securities, the issuer must, as soon as reasonably practicable after consultation with the HKEx, announce the information necessary to avoid a false market in its securities. Such obligation, nevertheless, exists whether or not the HKEx makes enquiries.

Notifiable Transactions

To enhance shareholders' involvement in significant transactions of a listed company, Chapter 14 of the Listing Rules sets out comprehensive rules on certain transactions, principally acquisitions and disposals, which must be publicly disclosed by a listed company. These obligations include the requirements to disclose the transactions to the public and/or to obtain prior shareholders' approval depending on the size of such transactions.

Notifiable transactions generally involve acquisitions or disposal of capital assets, formation of joint ventures, etc. and so on, and are at least 5% in size calculated based on the "5 tests". The Listing Rules have established the "5 tests" to determine the classification of a transaction and the level of disclosure required. By using

reliable information, the relevant tests would provide a meaningful measure of the relative level of activities and the value of the target assets against that of the listed company.

► *5 tests and percentage ratio*

The percentage ratios obtained by the application of the “5 tests” are the percentage figures resulting from the following calculations:

- (i) Assets ratio - the total assets which are the subject of the transaction divided by the total assets of the listed company. The listed company must refer to the total assets shown in its latest published audited accounts or half-year, quarterly or other interim report (whichever is more recent) for the purpose of calculating the assets ratio.
- (ii) Profit ratio - the profits attributable to the assets which are the subject of the transaction divided by the profits of the listed company. The listed company must refer to the profits shown in its latest published annual accounts subject to adjustments. For example, if the listed company has discontinued one of its operating activities during the previous financial year and has separately disclosed the profits from the discontinued operations in its accounts, the HKEx may be prepared to accept the exclusion of such profits for the purpose of calculating the profit ratio.
- (iii) Revenue ratio - the revenue attributable to the assets which are the subject of the transaction divided by the revenue of the listed company. The listed company must refer to the revenue shown in its latest published annual accounts subject to adjustments. For example, if the listed company has discontinued one of its operating activities during the previous financial year and has separately disclosed the revenue from the discontinued operations in its accounts, the HKEx may be prepared to accept the exclusion of such revenue for the purpose of calculating the revenue ratio.
- (iv) Consideration ratio - the consideration divided by the total market capitalisation of the listed company. The total market capitalisation is the average closing price of the listed company’s securities as stated in the HKEx’s daily quotation sheets for the five business days immediately preceding the date of the transaction. Please note that where the listed company pays/receives consideration in the future, the numerator shall be the maximum consideration payable/receivable under the agreement. If the total consideration is not subject to a maximum or such maximum value cannot be determined, the proposed transaction may be classified as a very substantial acquisition, notwithstanding the transaction class into which it otherwise falls.
- (v) Equity ratio - the nominal value of the listed company’s equity capital issued as consideration divided by the nominal value of the listed company’s issued equity capital immediately before the transaction. This test is only applicable for acquisitions (and not disposals) by the listed company issuing new equity capital as consideration.

► *Classification of Transactions and disclosure requirements*

After the application of the “5 tests”, the relevant percentage ratios will be used to classify the type of the transactions. Different requirements will apply to each category of notifiable transactions.

The following table summarises classification of transactions based on the percentage figures resulting from the “5 tests”:

Share transaction	All the ratios are less than 5% but consideration includes securities for which listing is sought
Discloseable transaction	Any ratio is 5% or more but all ratios are less than 25%
Major transaction	Acquisition: any ratio is 25% or more but all ratios are less than 100% Disposal: any ratio is 25% or more but all ratios are less than 75%
Very substantial disposal	Any ratio is 75% or more
Very substantial acquisition	Any ratio is 100% or more
Reverse takeover	Attempt to achieve a listing of assets to circumvent the listing requirements (change of control)

The following table summarises the notification, publication and shareholder approval requirements for each type of transactions:

	Notification to HKEx	Publication of announcement	Circular to shareholders	Shareholders' approval	Accountants' report
Share transaction	Yes	Yes	No	No	No
Discloseable transaction	Yes	Yes	No	No	No
Major transaction	Yes	Yes	Yes	Yes	Yes [#]
Very substantial disposal	Yes	Yes	Yes	Yes	No*
Very substantial acquisition	Yes	Yes	Yes	Yes	Yes [#]
Reverse takeover	Yes	Yes	Yes	Yes	Yes [#]

[#] Only for the acquisition of businesses and /or companies

* A listed issuer may at its option include an accountants' report

► *Aggregation rule*

To prevent circumvention of the Listing Rules by splitting a transaction, the HKEx may require the listed company to aggregate a series of transactions and treat them as if they are one transaction if they are all completed within a 12-month period or otherwise related. Such a rule of aggregation applies to both notifiable

transactions and connected transactions (to be further discussed below). The factors taken into account by the HKEx in determining aggregation include whether the transactions:

- (i) are entered into by the listed company with the same party or with parties connected or otherwise associated with one another;
- (ii) involve the acquisition or disposal of securities or an interest in one particular company or group of companies;
- (iii) involve the acquisition or disposal of parts of one asset; or
- (iv) together lead to substantial involvement by the listed company in a new business.

Connected Transactions

Connected transactions are governed by the rules set out in Chapter 14A of the Listing Rules, which are complex and highly technical. The intention of having such rules is to ensure that the interests of shareholders as a whole are taken into account by a listed company when the listed company enters into connected transactions. Of course, such rules will also provide certain safeguards against listed companies' directors, chief executives or substantial shareholders (or their associates) taking advantage of their positions in the relevant company.

The most common connected transactions are transactions entered into between the listed company or its subsidiaries on one side, and the connected persons or their associates on the other side. Save in certain cases where exemptions apply, connected transactions are generally subject to disclosure and reporting, or in addition, prior independent shareholders' approval. The definition of "transactions" for "connected transactions" is broader than that of "notifiable transactions", as it includes transactions such as issuing new securities, provision of or receipt of services and sharing of services, and so on.

► Definition of "connected persons" and "associates"

1. Connected persons

Under Rule 14A.11 of the Listing Rules, connected persons include:

- (i) director, chief executive, substantial shareholder (holding at least 10% of issued share capital of the company) or supervisor (in case of a PRC issuer) of the listed issuer (which, for the purpose of Chapter 14A, also includes its subsidiaries);
- (ii) any person who was a director of the listed issuer within the preceding 12 months;
- (iii) any "associate" of any person referred to in (i) and (ii);
- (iv) any non-wholly-owned subsidiary of the listed issuer where any connected person of the listed company itself (i.e. other than at the level of its subsidiaries) as defined in (i) to (iii) above is/are (individually or together) entitled to exercise or control the exercise of 10% or more of the voting power at any general meeting of such non wholly-owned subsidiary; and
- (v) any subsidiary of such non-wholly-owned subsidiary.

Having said that, a “connected person” does not include a wholly-owned subsidiary of a listed issuer, or a non-wholly-owned subsidiary by virtue of it being (a) a substantial shareholder of another subsidiary of the listed issuer; or (b) an “associate” of a director (or a person who was a director of the listed issuer within the preceding 12 months), chief executive, substantial shareholder or a supervisor (in case of a PRC issuer) of any subsidiary of the listed issuer.

2. Associates

“Associate” is broadly defined under Rule 1.01 of the Listing Rules and is supplemented by Rule 14A.11 of the Listing Rules. “Associates” are divided into two categories:

- (i) *associate in relation to a connected individual* – including a spouse, a person cohabiting as a spouse, any child or step-child, parent, step-parent, sibling and other relatives of a connected individual (family interest), and any company under a certain level of control of a connected person and/or that connected person’s family interests and/or trustee interests;
- (ii) *associate in relation to a connected company* – including holding company, subsidiary and sister company of a connected company, and any company which the connected entity may (1) exercise or control the exercise of 30% or more of the voting power at general meetings of such company, or (2) control the composition of a majority of the board of directors of such a company, and any other company which is a subsidiary of such a company.

► Disclosure requirements

There are two main types of connected transactions: namely, one-off connected transactions and continuing connected transactions. So far as disclosure requirements are concerned, they can be divided into three main categories:

(i) Fully exempted transactions

Connected transactions in this category are exempted from all disclosure, reporting and independent shareholders’ approval requirements if:

- the transaction is on normal commercial terms where each or all of the percentage ratios (except for the profits ratio) is/are:
 - less than 0.1% (less than 1% for the transaction with persons who are connected at the level of the listed company’s subsidiaries); or
 - less than 5% and the consideration is less than HK\$1 million; or
- the transaction is otherwise exempted under Rule 14A.31 and 14A.33 of the Listing Rules.

(ii) Partially exempted transactions

Connected transactions in this category are not subject to prior independent shareholders’ approval but are subject to reporting requirements if:

- the transaction is on normal commercial terms where each or all of the percentage ratios (except

for the profits ratio) is/are:

- less than 5%; or
- less than 25% and the consideration is less than HK\$10 million.

(iii) Non-exempted transactions

For other connected transactions, the relevant listed companies are required to comply with disclosure requirements and obtain the prior approval from the independent shareholders. In addition, an opinion from an independent financial adviser on the fairness and reasonableness of the terms of the transaction and a recommendation from an independent board committee are also required for each of these transactions.

► *Connected transaction compliance recommendations*

Having a good connected transaction compliance system will help reduce the risk of breaching the Listing Rules and promote investors' trust in a listed company. Although there is no single internationally-accepted form of such a system, the following recommendations may provide some useful ideas:

- Set up an internal connected transactions committee or working team – members should include staff from legal, business and/or financial divisions;
- Enforce timely internal reporting to the listed company – each company or division within the group should collate and report information on connected transactions promptly;
- Regularly supervise the status of, and review, connected transactions;
- Actively investigate any unusual increases in the volume of connected transactions or changes in the transaction terms;
- Regularly update the list of connected persons;
- Comply with the necessary Listing Rules requirements as soon as possible if the listed company estimates, through supervision and periodic reports, that the transaction value is likely to exceed the annual cap;
- Determine whether a deal is a connected transaction before signing; and
- Collect information on connected transactions in advance and review the coordination work on connected transactions for the year before publication of its annual report.

Conclusion

Disclosure by listed companies should be aimed at providing shareholders and the public with appropriate data and information on a timely and even basis, and not merely to meet the minimum regulatory requirements. Given that nowadays effective internal control and transparent disclosure practices are increasingly important selection criteria for investors, one can foresee that the timely disclosure of accurate and quality information would be in the listed companies' interests, since investors often give premium ratings to the most transparent companies.



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Appendix I - Sample Contents of a Hong Kong IPO Prospectus

The prospectus for a Hong Kong IPO on the Main Board of the Hong Kong Stock Exchange (HKEx) will generally include all or most of the following sections. Please note that the following is simply an outline of the most common prospectus sections. Some of these sections may not be applicable for some companies, while other companies may include sections which are in addition to those below in order to tailor to their own circumstances and meet the relevant disclosure requirements. The precise names of these sections and the order in which they appear may also differ from one prospectus to another.

- Expected Timetable
- Contents
- Summary and Highlights
- Definitions
- Glossary
- Risk Factors
- Waivers from Compliance with the Listing Rules and Exemptions from the Hong Kong Companies Ordinance
- Forward Looking Statements
- Information About this Prospectus and the Global Offering
- Corporate Information
- Industry Overview
- History and Development
- Business
- Directors, Senior Management and Staff
- Financial Information
- Controlling Shareholders
- Connected Transactions
- Future Plans and Use of Proceeds
- Underwriting
- How to Apply for Hong Kong Offer Shares
- Accountants' Report
- Unaudited Pro Forma Financial Information
- Property Valuation
- Summary of the Constitution of the Company
- Statutory and General Information
- Documents Delivered to the Registrar of Companies and Available for Inspection

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iOne Financial has produced the above IPO Prospectus, including but not limited to:



MANAGING THE RISKS OF AN IPO

In today's environment, it is critical to manage the IPO risk exposures for stakeholders such as directors, officers and the company itself. Marsh has been actively creating and delivering solutions for clients to manage their risks arising out of an IPO, including:

- REGULATORY RISKS
- SHAREHOLDER-RELATED RISKS
- COUNTERPARTY RISKS
- EMPLOYEE RISKS

Marsh has a dedicated team of more than 1,100 professionals focusing on client's risks and insurance needs and negotiates over US \$6 billion in premiums annually including for 63% of the Fortune 100. With this background, Marsh is best placed to deliver a solution to meet your needs.

In Asia, a team of approximately 90 professionals provide clients with local knowledge backed by a vast global network of resources. Marsh has experience advising clients from all sectors.

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